

## **Personal Bankruptcy**

**What it is:** In the U.S. the law allows individuals to relieve all or part of their debts when they find they can no longer meet their obligations to creditors and lenders: this is known as personal bankruptcy. Bankruptcy is a personal decision and is often the result of financial hardships such as unemployment, lack of adequate insurance, or medical expenses. There are two types of personal bankruptcy:

Chapter 7 or liquidation bankruptcy, allows debtors to discharge all or part of their debt.

Chapter 13 or repayment bankruptcy, debtors repay all or part of their debt based on a payment plan.

**How it works:** Currently, all bankruptcy filers are subject to a “means test”. To qualify for Chapter 7, you must prove that your income is less than the median income for your family size in your state. If you fail the means test then you could qualify for Chapter 13 which allows you, if you have a steady income, to keep property, such as a mortgaged house or car, which you might otherwise lose. In Chapter 13, the court approves a repayment plan that allows you to use your future income to pay off your debts during a three-to-five-year period, rather than surrender any property. (Source: Federal Trade commission)

**Why it matters:** Bankruptcy is an expensive and complicated process and you must get credit counseling from a government-approved organization within six months before you file for any bankruptcy relief. While bankruptcy may be able to help you erase or reduce many debts, there are some debts that generally can't be changed:

- child support and alimony;
- student loans;
- debts you owe from a divorce decree or settlement;
- income taxes from recent years;
- fines and penalties such as traffic tickets, criminal fines, court-ordered repayments, income tax penalties and recent property tax assessments;
- cash advances of more than \$925 from any one creditor within 70 days of filing;

(Source: Consumer Action)

**Who should care?** Although bankruptcy is intended to help individuals create a “fresh start”, many people who file bankruptcy don’t realize the effect it will have on their lives. It can impact your credit history for seven to 10 years, which could cause you trouble with new credit, a mortgage, a job, or insurance. Even if you do obtain credit you’re likely to pay a much higher interest rate than someone with a good credit score.

#### **For more information**

- Consumer Action, *Personal Bankruptcy Your Financial Fresh Start*, [http://www.consumer-action.org/downloads/english/2013\\_Bankruptcy.pdf](http://www.consumer-action.org/downloads/english/2013_Bankruptcy.pdf)
- Consumer Financial Protection Bureau <http://www.consumerfinance.gov/askcfpb/1233/how-does-bankruptcy-affect-my-credit-score.html>
- Federal Trade Commission at <http://www.consumer.ftc.gov/articles/0084-debt-relief-or-bankruptcy>
- Iowa State University Extension and Outreach Money Blogs tips <http://blogs.extension.iastate.edu/moneytips/>
- Iowa State University Extension and Outreach website at [www.extension.iastate.edu/humansciences/](http://www.extension.iastate.edu/humansciences/)