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Chapter 13 vs. Chapter 7 Bankruptcy

In general, most debtors prefer to file for Chapter 7 because it eliminates most unsecured debt and is easier. However, not every debtor qualifies for Chapter 7. In some cases, repaying debt over time in a court-approved Chapter 13 repayment plan provides benefits that are unavailable in Chapter 7. The following is a comparison of Chapter 13 vs Chapter 7 bankruptcy.

Reasons to File for Chapter 13

When comparing Chapter 13 vs Chapter 7 bankruptcy, it may be more appropriate for a debtor to choose Chapter 13 when the following circumstances apply:

You do not qualify for Chapter 7. Under current bankruptcy law, a debtor must qualify under the "means test" to file for Chapter 7. If a debtor's average monthly income for six months prior to filing for bankruptcy is equal to or less than the median income in their state, they may be eligible for Chapter 7. However, if the debtor's income exceeds the median income in their state and the debtor has a certain amount of disposable income to repay some portion of unsecured debt in a Chapter 13 repayment plan, then the debtor does not qualify for Chapter 7.

You want to repay debt. Some debtors would prefer to fulfill repayment obligations to creditors. In Chapter 13, the debtor will make monthly payments in a three or five year plan to the bankruptcy trustee for the distribution to creditors. The debtor must have enough disposable income to pay all priority and secured debt in full and to pay unsecured creditors in an amount at least equal to the value of the debtor's nonexempt property.

You want to save your home from foreclosure. In many cases, filing for Chapter 13 will permanently stop a foreclosure. An automatic stay will temporarily prevent a foreclosure until the court confirms the debtor's repayment plan. Once confirmed, the debtor will pay back the missed payments over the life of the plan and the terms and conditions of the original agreement will govern the debtor and the lender's relationship. Chapter 13, however, will not prevent foreclosure if the debtor filed for bankruptcy within the past two years and the bankruptcy court lifted the automatic stay to allow the creditor to proceed with foreclosure.

In Chapter 7, it is less likely that a debtor can keep their home if they are behind on their mortgage payments. The court will usually grant a lender's request to lift an automatic stay in order to continue foreclosure proceedings on the home.

You want to stop the repossession of your car. A debtor can stop the repossession of a car by filing for Chapter 13 and by repaying the debt and the arrearage in the plan. If the debtor bought the car at least 2 years before filing for bankruptcy, the amount owed on the loan may be eligible for reduction under the "cramdown" option. This option allows the debtor to pay the amount the car is actually worth, plus interest, in equal installments over the entire term of the repayment plan. This is beneficial when the loan is upside down -- the debtor owes more on the loan than the property is worth.

You want to keep nonexempt property. A debtor can keep nonexempt property under Chapter 13. Under Chapter 7, a trustee will sell a debtor's nonexempt property to pay creditors with the proceeds. Chapter 13 allows the debtor to keep nonexempt property in exchange for repayment to unsecured creditors in an amount that is at least equal to the value of the nonexempt property that the trustee would have sold in a Chapter 7 bankruptcy.

You have debts that are not dischargeable under Chapter 7. Certain debts will survive a Chapter 7 bankruptcy, but are eligible for discharge in Chapter 13. Debts included in this category are:

- Debts incurred to pay nondischargeable taxes
- Fees from a condominium, a cooperative, or a homeowners' association
- Court fees
- Marital debts agreed to in a settlement agreement (excludes orders of support)

You have a nondischargeable debt that you want to repay over time. Some debts, like student loans (unless discharged by the court because of undue hardship) and certain tax debts, survive Chapter 7 and Chapter 13 bankruptcy. However, in Chapter 13 the debtor can pay off the debt in a repayment plan.

You have a codebtor. Chapter 13 will protect codebtors from liability for a joint debt if the creditor receives payment through the repayment plan. If debt remains after the plan ends, the creditor may collect the amount still owed from the codebtor. Conversely, Chapter 7 will eliminate the filer's personal liability for a debt, but the codebtor will remain responsible.

Reasons to File for Chapter 7

Chapter 7 bankruptcy is appropriate when the following circumstances apply:

You are unable to repay debt in a repayment plan. If a debtor cannot afford to repay creditors for three or five years in a Chapter 13 plan, it may be best to file for Chapter 7 (if qualified).

You need quick relief from creditors. It takes as little as three months for a bankruptcy court to issue a discharge order. After discharge, the debtor no longer has personal liability for the discharged debt.

Most debt is dischargeable. If most of a filer's debt is dischargeable, Chapter 7 will free the debtor from personal liability for this debt. Dischargeable debt includes credit card debt, medical bills, and personal loans.

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