

Personal Bankruptcy: A Fresh Start With Lasting Consequences

Bankruptcy can stop creditor actions and give you a path to a fresh start, but it also has important trade-offs. Learn your options and choose the path that's right for your situation.

Chapter 7

Liquidation of nonexempt property; discharge often within months.

Chapter 13

Repayment plan; usually 3–5 years.

Automatic Stay

Most collection activity stops as soon as you file.

Some Debts May Be Discharged

Many unsecured debts, such as credit cards and medical bills, may be eliminated.

Some Property May Be Exempt

Keep certain property, such as your home (up to a limit), car, household goods, and retirement accounts (within limits).

Credit Impact Can Last Years

A bankruptcy remains on your credit report for 7–10 years, depending on the chapter.

Personal Bankruptcy: A Fresh Start With Lasting Consequences

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The good news about filing for personal bankruptcy is that it can provide something a financially overwhelmed person desperately needs: breathing room.

Filing a bankruptcy petition generally creates an **automatic stay** that stops most creditor collection efforts. Collection calls, lawsuits and wage garnishments generally must stop while the stay is in effect. Bankruptcy can also eliminate many debts and provide what federal bankruptcy law describes as a financial “fresh start.”

But bankruptcy is not simply a matter of walking into court, wiping the slate clean, and walking away. It is a serious federal legal proceeding with consequences for your property, credit history, and future borrowing. Some debts survive bankruptcy entirely.

The important question is therefore not simply, “Can I file bankruptcy?” It is **“Is bankruptcy the best solution to my financial problem?”**

Chapter 7 and Chapter 13 Are Very Different

Most individuals considering bankruptcy encounter two names: **Chapter 7 and Chapter 13**.

Chapter 7 is commonly called liquidation bankruptcy. A trustee can sell property that is not protected by bankruptcy exemptions and distribute the proceeds to creditors. In return, qualifying debtors can receive a discharge eliminating personal liability for many debts. Chapter 7 can move relatively quickly. In a typical case without objections or complications, the discharge may be issued only a few months after filing.

Chapter 13 works differently. It is intended for individuals with regular income and allows the debtor to propose a court-approved repayment plan, usually lasting **three to five years**. Instead of liquidating nonexempt property as under Chapter 7, the debtor generally keeps property while making required payments through the plan. Chapter 13 can also provide a way for some homeowners to catch up on overdue mortgage payments and prevent foreclosure.

Bankruptcy Can Stop Collection Activity

One of bankruptcy's most immediate protections is the automatic stay. Once a bankruptcy petition is filed, most creditors generally must stop collection actions. That can halt collection calls, lawsuits and wage garnishments and may temporarily stop foreclosure or repossession proceedings.

There are exceptions, and the stay does not make the underlying debts disappear. Secured creditors can sometimes obtain court permission to proceed against collateral. Still, for someone being overwhelmed by collection activity, the automatic stay can provide valuable time to sort out the financial situation.

You Don't Necessarily Lose Everything

One of the most persistent myths about bankruptcy is that the debtor loses every possession. Bankruptcy law provides **exemptions** that protect certain property from creditors. Depending on applicable federal or state law, exemptions may protect some equity in a home, a vehicle, household furnishings, clothing, retirement accounts, and other property.

The details vary considerably because states have different exemption laws, and some states require residents to use state rather than federal bankruptcy exemptions. That makes it dangerous to assume either that “bankruptcy takes everything” or that “I can keep everything.” What you can protect depends on what you own, how much it is worth, what you owe on it, where you live, and which exemptions apply.

Chapter 7 Has an Income Test

Chapter 7 is not automatically available to everyone who has debts. Consumer debtors may have to complete a **means test** comparing income and allowed expenses under formulas established

by federal bankruptcy law. If the calculation shows sufficient disposable income, a Chapter 7 filing can be presumed abusive, and Chapter 13 may be the more appropriate route.

The calculation is considerably more complicated than simply deciding whether your salary seems high or low. Current income thresholds and allowable expenses also change periodically.

Credit Counseling Comes Before Filing

Bankruptcy now includes education requirements that deserve more attention than they received in the original version of this article.

With limited exceptions, an individual must complete **credit counseling from an approved agency before filing bankruptcy**. After filing, a separate debtor-education or financial-management course generally must be completed before receiving a discharge. These requirements are intended in part to make sure debtors understand both the bankruptcy process and possible alternatives.

Bankruptcy Does Affect Your Credit

Bankruptcy is a major negative event on a credit history, but the old statement that it remains for “at least six years” is inaccurate. According to the Consumer Financial Protection Bureau, a **Chapter 7 bankruptcy generally can remain on a credit report for 10 years**, while Chapter 13 is generally reported for **seven years**.

That does not mean you are prohibited from obtaining credit throughout that entire period. Lenders make their own underwriting decisions, and the effect of negative credit information generally diminishes as it gets older.

Rebuilding credit after bankruptcy takes time and responsible financial management, but bankruptcy does not create a permanent ban on mortgages, car loans, or credit cards.

Credit Cards May Disappear—but Not Forever

Credit-card accounts included in bankruptcy will ordinarily be closed or otherwise affected, and obtaining inexpensive unsecured credit immediately afterward can be difficult. That is not the same thing as saying you can never have a credit card again.

Credit may become available after bankruptcy, although initial offers can carry high interest rates or fees. Secured credit cards and carefully managed new accounts can sometimes become part of rebuilding a credit history.

The objective after bankruptcy should not be to acquire new debt as quickly as possible. It should be to demonstrate that new obligations can be managed responsibly.

Bankruptcy Does Not Automatically Cost You Your Job

The original version of this article warned that an employer might “take a dim view” of bankruptcy. That is too broad.

Federal bankruptcy law contains protections against certain forms of employment discrimination based solely on bankruptcy. Government employers cannot discriminate against someone solely because that person filed bankruptcy or failed to pay a dischargeable debt. The rules involving private employers and hiring are more complicated.

Certain jobs involving money, financial responsibility, bonding, professional licensing, or security clearances may involve financial background reviews. But bankruptcy by itself does not automatically make someone unemployable.

Tax Refunds Require Individual Analysis

The old claim that bankruptcy means you can be “denied tax refunds” is also too sweeping.

A tax refund can sometimes become property of the bankruptcy estate, depending on when it was earned, when the bankruptcy was filed, applicable exemptions, and the chapter involved. Other refunds may be protected or remain with the debtor.

This is exactly the kind of issue that should be discussed with a bankruptcy attorney **before filing**, particularly when a substantial refund is expected.

Bankruptcy Does Not Eliminate Every Debt

This remains one of the most important points from the original article. A bankruptcy discharge eliminates personal liability for many debts, but **not all debts are dischargeable**.

Common exceptions can include child support and alimony, certain taxes, many government fines and penalties, debts arising from death or personal injury caused by intoxicated driving, and certain debts involving fraud or other misconduct.

A valid lien may also survive bankruptcy even when personal liability for the underlying debt has been discharged.

Student Loans Require Special Attention

Student loans deserve their own discussion because the rules are more complicated than the old statement that they survive bankruptcy “except in unusual circumstances.”

Many student-loan debts are not discharged through the ordinary bankruptcy discharge. A borrower generally must bring a separate proceeding asking the bankruptcy court to determine whether repayment would impose an **undue hardship**.

That makes student-loan discharge different from ordinary credit-card or medical debt. Someone considering bankruptcy primarily because of student loans should obtain advice specifically addressing those loans rather than assuming bankruptcy will—or will not—eliminate them.

Chapter 13 May Protect Property

Someone who has regular income but is behind on debts may find Chapter 13 more appropriate than Chapter 7.

Chapter 13 allows a debtor to propose a repayment plan lasting three to five years. During the plan, creditors generally cannot continue ordinary collection efforts, and the debtor usually keeps property while making the required payments.

For homeowners, one particularly important feature is the possibility of stopping a foreclosure and catching up on past-due mortgage payments through the plan—provided the foreclosure sale has not already been completed under applicable state law and the debtor can continue meeting the required obligations.

Consider the Alternatives First

Bankruptcy is not the only response to serious debt.

Depending on the situation, alternatives can include negotiating directly with creditors, entering a legitimate debt-management plan through a nonprofit credit-counseling organization, refinancing or restructuring certain debts, selling assets, or negotiating settlements.

Debt settlement deserves particular caution. A creditor is not required to accept a settlement, forgiven debt can sometimes have tax consequences, fees may be substantial, and stopping payments while attempting to negotiate can further damage credit and expose the borrower to collection or lawsuits.

An alternative is useful only if it actually solves the underlying financial problem.

Don't Let Embarrassment Make the Decision

The original article listed the “embarrassment of having declared bankruptcy” as one of its disadvantages. That does not really belong in a financial analysis.

Bankruptcy is a public legal proceeding and should never be taken lightly. But whether someone should file should depend on debts, assets, income, family obligations, available alternatives, and the long-term financial consequences—not embarrassment.

Federal bankruptcy law exists specifically to provide qualifying debtors with an orderly way of resolving debts they cannot reasonably manage.

The Fresh Start Has Conditions

Bankruptcy can be enormously valuable when debt has become impossible to manage. The automatic stay can stop most collection activity, many unsecured debts can be discharged, and exemptions can protect important property.

The price of that fresh start can include damage to your credit record, loss of nonexempt assets under Chapter 7, several years of repayment obligations under Chapter 13, legal and filing costs, and the fact that certain debts will remain after the case ends.

Bankruptcy should therefore be neither feared automatically nor treated casually.

If debt has reached the point where minimum payments, collections, lawsuits, foreclosure, or garnishment are overwhelming your ability to recover, consulting a qualified bankruptcy attorney can help determine whether Chapter 7, Chapter 13, or a non-bankruptcy alternative offers the most realistic route forward.

Sometimes bankruptcy really is the last resort. But when other realistic solutions have been exhausted, that “last resort” can also be exactly what bankruptcy law was designed to provide: **a chance to start over.**

This article provides general information about U.S. bankruptcy law and is not individualized legal, tax, or financial advice. Bankruptcy exemptions, procedures, and outcomes depend on individual circumstances and applicable federal and state law.