**What Is Bankruptcy?**

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**Chapter 7 and Chapter 13 bankruptcy basics.**

Bankruptcy is a process in which consumers and businesses can eliminate or repay some or all of their debts under the protection of the federal bankruptcy court. For the most part, bankruptcies can be divided into two types -- liquidation and reorganization.

Chapter 7 bankruptcy comes under the liquidation category. It's called liquidation because the bankruptcy trustee may take and sell ("liquidate") some of your property to pay back some of your debt. However, you may keep property that is protected (also called "exempt") under state law. There are several types of reorganization bankruptcies, but Chapter 13 is most commonly used by consumers. In Chapter 13 bankruptcy, you keep all of your property, but must make monthly payments over three to five years to repay all or some of your debt.

Both Chapter 7 and Chapter 13 bankruptcy have many rules -- and exceptions to those rules -- regarding which debts are covered, who can file, and what property you can and cannot keep.

**Chapter 7 Bankruptcy**

Chapter 7 bankruptcy can be filed by individuals (called a "consumer" Chapter 7 bankruptcy) or businesses (called a "business" Chapter 7 bankruptcy). A Chapter 7 bankruptcy typically lasts three to six months.

Property liquidation. In Chapter 7 bankruptcy, some of your property may be sold to pay down your debt. In return, most or all of your unsecured debts (that is, debts for which collateral has not been pledged, such as medical debts and most credit card debts) will be erased. You get to keep any property that is classified as exempt under the state or federal laws available to you (such as your clothes, car, and household furnishings). Many debtors who file for Chapter 7 bankruptcy are pleased to learn that all of their property is exempt. To learn more, see Bankruptcy Exemptions in Chapter 7.

Secured debt. If you owe money on a secured debt (for example, a car loan for which the car is pledged as a guarantee of payment), you have a choice of allowing the creditor to repossess the property; continuing your payments on the property under the contract (if the lender agrees); or paying the creditor a lump sum amount equal to the current replacement value of the property. Some types of secured debts can be eliminated in Chapter 7 bankruptcy. Check out Secured Debt & Property in Chapter 7 Bankruptcy to learn more.

Eligibility for Chapter 7. Not everyone can file for Chapter 7 bankruptcy. For example, if your disposable income is sufficient to fund a Chapter 13 repayment plan -- after subtracting certain allowed expenses and monthly payments for certain debts -- you won't be allowed to use Chapter 7 bankruptcy. For more on this and other requirements, see Chapter 7 Bankruptcy -- Who Can File?

Bankruptcy doesn't work on some kinds of debts. Though bankruptcy can eliminate many kinds of debts, such as credit card debt, medical bills, and unsecured loans, there are many types of debts, including child support and spousal support obligations and most tax debts, that cannot be wiped out in bankruptcy. For more information, see What Bankruptcy Can and Cannot Do.

**Chapter 13 Bankruptcy**

Chapter 13 bankruptcy is also known as "wage earner" bankruptcy because, in order to file for Chapter 13, you must have a reliable source of income that you can use to repay some portion of your debt.

Repayment

When you file for Chapter 13 bankruptcy, you must propose a repayment plan that details how you are going to pay back your debts over the next three to five years. The minimum amount you'll have to repay depends on how much you earn, how much you owe, and how much your unsecured creditors would have received if you'd filed for Chapter 7 bankruptcy. See our section on The Chapter 13 Repayment Plan to get in-depth information. If you're thinking about Chapter 13 bankruptcy, the Chapter 13 Plan Payment Calculator can tell you what the minimum monthly payment might be.

Debt limits. Your debts must be within limits set by the federal government: Currently, you may not have more than $1,149,525 in secured debt and $383,175 in unsecured debt.

Secured debts. If you have secured debts, Chapter 13 gives you an option to make up missed payments to avoid repossession or foreclosure. You can include these past due amounts in your repayment plan and make them up over time. To get a better understanding of how Chapter 13 can help with secured debts, see Nolo's sections on Your Home and Mortgage in Chapter 13 Bankruptcy and Reducing Loans and Non-Residential Mortgages in Chapter 13 Bankruptcy.

**Other Types of Reorganization Bankruptcy**

In addition to Chapter 13 bankruptcy, there are two other types of reorganization bankruptcy: Chapter 11 and Chapter 12.

**Chapter 11 bankruptcy**

Chapter 11 is typically used by financially struggling businesses to reorganize their affairs. It is also available to individuals, but because Chapter 11 bankruptcy is expensive and time-consuming, it is generally used only by those whose debts exceed the Chapter 13 bankruptcy limits (rare) or who own substantial nonexempt assets (such as several pieces of real estate). If you are considering Chapter 11 bankruptcy, you'll need to talk to a lawyer.

**Chapter 12 bankruptcy**

Chapter 12 is almost identical to Chapter 13 bankruptcy. But to be eligible for Chapter 12 bankruptcy, at least 80% of your debts must arise from the operation of a family farm of fishery. Chapter 12 bankruptcy has higher debt ceilings to accommodate the large debts that may come with operating a farm, and it offers the debtor more power to eliminate certain types of liens. Very few people use Chapter 12 bankruptcy; if you want to join their ranks, you should consult with a lawyer.

Consequences of Bankruptcy

The overriding principle of bankruptcy is that it wipes away debt — sometimes all debt, many times a portion of it. All the other consequences are negative impact, especially as it concerns your credit score.

Bankruptcy remains on your credit report for 7 to 10 years, depending upon which chapter of bankruptcy you file under. For example, Chapter 7 (the most common) is on your credit report for 10 years, while a Chapter 13 filing (second most common) is there for seven years.

During this time, it could prevent you from obtaining new lines of credit and may even cause problems when you apply for jobs.

If you are considering bankruptcy, your credit report and credit score are probably already considerably damaged. So, your credit report may not endure significantly more damage, especially if you consistently pay your bills after declaring bankruptcy.

Still, because of the long-term effects of bankruptcy, some experts believe it may be beneficial only if you have more than $15,000 in debts.

**In addition to Chapter 7 and Chapter 13 bankruptcies, there are four other types of bankruptcy. They are rarely used, but they are:**

* **Chapter 9**: Chapter 9 may only be applied to municipalities such as cities or towns and allows for their reorganization.
* **Chapter 11**: [Chapter 11](https://www.debt.org/bankruptcy/chapter-11/) is the third most common type of bankruptcy filing, with 1,757 filings in 2011. This chapter is almost always used to reorganize businesses but may be used by individuals as well.
* **Chapter 12**: Chapter 12 is used exclusively to adjust the debts of a family farmer or family fisherman.
* **Chapter 15**: Chapter 15 applies to cross-border cases, in which the debtor has assets and debts both in the United States and elsewhere.