

## Don't Be Afraid of Bankruptcy

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Nobody likes to talk about personal bankruptcy. It's the atomic bomb of personal finance: We all know it's out there, but it's really scary, and most of us hope it never affects our lives in any way.

But as we all know, stuff happens. Whether it's a [difficult divorce](#), [huge medical bills](#), an extended period of unemployment, or a wrongheaded investment, [financial reversals](#) can hit just about anyone. In fact, although bankruptcy's reputation is as a refuge for deadbeats, most of those who end up filing are regular folks who have gone through a life-changing (and finances-changing) experience like the ones I just mentioned.

And like everything else, bankruptcy gets less scary when you understand how it works and what to expect. If there should come a time when you're swamped with debts and falling further behind every month, it's worth knowing that bankruptcy isn't the end of the world. Of course, there are some major downsides, and it's worth knowing the truth about those as well.

### The basics

As you probably know, personal bankruptcy is a process in which a person with debts applies to a special court for protection from creditors while the person's finances are reworked. While your case is in court - generally a period of several months - the court has control of your financial problems. Creditors can't foreclose on your house, repossess your car, garnish your wages, or take other action against you while you're under the protection of the bankruptcy court. Instead, a court-appointed person called a *bankruptcy trustee* works with your creditors to see that they get paid as much as possible.

Whether your debts get wiped out or repaid over time depends on which flavor of bankruptcy you declare. Chapter 13, or "reorganization bankruptcy," involves working with a court-appointed trustee to create a plan to pay back what you owe, usually over three to five years. The plan is often quite strict, and you won't have a whole lot of discretionary income for a while, but when you're done, you're *done* - and with some exceptions, your debts will be gone, whether or not you paid them back in full.

Chapter 7, in which most of your debts are just wiped out, is what most people think of when they think of "bankruptcy." Under Chapter 7, the court reviews your debts and your assets and (theoretically) sells off much of the latter to satisfy the former. In practice, people generally end up keeping most or all of their property - your house, your car (in most cases), and most of your "personal effects" are exempt from liquidation. Although this may sound like a better deal than three to five years of paying back your creditors, [recent changes in the bankruptcy laws](#) mean that many filers can't use Chapter 7.

## The big myths

Many of the “[atomic bomb](#)” aspects of personal bankruptcy turn out to be myths, or at least overblown. For instance, although a bankruptcy is about the worst black mark you can have on your credit record (and it stays there for 10 years), you *will* get credit again. In fact, you’ll start getting credit card offers pretty quickly, though they’ll be [high-interest subprime offers](#) at first. Still, if you really need a car loan, say, you’ll be able to get one - just at a high rate.

Another big myth is that “everyone will know” because it’s a public proceeding. Don’t sweat it. Unless you’re famous, it’ll probably never appear in your local paper - not all bankruptcy proceedings require published notice, and there are just too many bankruptcy proceedings for any newspaper to run them all. Unless you bought a garage full of expensive luxury cars right before filing and have to forfeit them, or unless you live in a slow-news area and one of your neighbors is a stickler for reading the fine-print legal notices, odds are the neighbors won’t ever find out - or notice anything different at all.

## Before you file

If you’re considering bankruptcy, start with these steps:

Your bankruptcy attorney will advise you on the details of the filing process in your state. Before filing, you will be required (by federal law) to meet with a credit counselor, who will review your debts, income, and assets and work with you to see whether there’s any realistic way to repay your debts without a bankruptcy filing.

## The big conclusion

Bankruptcy is a tool, plain and simple. It’s something of a drastic one, with a scary reputation, but if you ever need it, you’ll probably be grateful for its existence. The process isn’t that complicated, and assuming that you’ve been sincere and forthcoming, it’s not particularly awful. Most importantly, assuming you take the opportunity to *really* get your financial house in order, you will recover - and after 10 years, all will be forgotten.

*Do you have questions on bankruptcy? Experience to share? Hop on over to the Fool’s friendly [Credit Cards and Consumer Debt](#) discussion board, open 24 hours a day.*

*Fool contributor [John Rosevear](#) welcomes your questions and comments. The Motley Fool has a [disclosure policy](#).*

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