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New Bankruptcy Law Moving Quickly Through Congress.

Republicans close to passing special-interest legislation for credit card industry that will harm middle-class debtors.

Updated 3/2/05

Three times in the last eight years, pro-business bankruptcy "reform" legislation has been on the brink of becoming law, only to be defeated at the last minute by the Senate. It is at the brink again. Senate Bill 256 (this year's model) is virtually identical to the defeated bankruptcy legislation of 2002 and 2004. Given the results of the 2004 elections, many observers believe it has a good chance of passing this time.

The legislation, which has been heavily backed by the credit card and banking industries, is unfriendly to debtors. It prohibits some people from filing for bankruptcy altogether and makes it harder for those who can file to come up with manageable repayment plans. It also limits protection from collection efforts for those who manage to qualify for bankruptcy.

The credit industry says changes are needed because the increasing number of personal bankruptcies -- around 1.5 million in 2003, up from about 700,000 in 1990 -- is costing them too much money. Meanwhile the credit card industry continues to post record profits -- more than \$300 billion in 2003. Opponents say the credit card companies bring their problems on themselves by sending out billions of solicitations each year for high-interest credit cards and encouraging consumers to run up high debts.



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Who Files for Bankruptcy?

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The vast majority of bankruptcy filers are not wealthy individuals trying to cheat the system. According to a 1999 study by federal bankruptcy judges, the average person filing for bankruptcy earns just \$22,000 per year. Most have suffered a significant period of unemployment before filing. According to [a report by Consumers Union](#), 85% of elderly debtors cite medical or job problems as the reason for bankruptcy. Consumers Union also says that single moms trying to make ends meet make up a large portion of bankruptcy filers. They note that "a divorced women is 300% more likely to find herself in bankruptcy than a married or single woman, and a divorced woman raising children and trying to collect child support is 500% more likely to end up in bankruptcy."

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In addition, [a recent Harvard study](#) reported that half of all bankruptcies are triggered by sudden uninsured medical expenses. (Information is also available from the author's [appearance](#) before the Senate Judiciary committee.)

If the new legislation is passed by this Congress, the changes will be devastating to many people who find themselves out of work, ill, or injured, and over their head in debt.

Following is a summary of the bankruptcy law changes that proposed in Senate Bill 256.

Fewer People Eligible for Chapter 7 Bankruptcy

Losers: Those who want to file for Chapter 7 bankruptcy but have an above-average income and could pay a little each month, according to the IRS.

Traditionally, bankruptcy's fresh start has been available to almost everybody. The proposed law, however, prohibits some people from filing for Chapter 7 bankruptcy altogether -- those whose incomes are above the state median (quite low in some states) and who can pay as little as \$100 per month to creditors. Whether or not a debtor can afford to pay \$100 or more a month would be determined not by the person's actual income and expenses, but by IRS rules that state what "reasonable" expenses are.

People denied a Chapter 7 bankruptcy either have to file for Chapter 13 bankruptcy and come up with a three- to five-year repayment plan or keep slipping further behind on their debts.

This restriction is one reason many women's groups oppose the bankruptcy legislation. People who can't file for Chapter 7 bankruptcy and wipe out their credit card balances, they fear, will have less money available to pay other debts -- child support, for example.

Fewer People Able to Stick to Chapter 13 Repayment Plans

Losers: Those who want to file for Chapter 13 bankruptcy but reside where the cost of living is high.

Debtors forced into Chapter 13 bankruptcy because Chapter 7 is no longer available to them will find that the proposed law makes Chapter 13 bankruptcy more difficult. In Chapter 13 bankruptcy, debtors must put together a repayment plan, basing their payments on their income and expenses. Under the proposed law, actual expenses for many things don't matter -- debtors are allowed to claim only certain amounts for certain expenses (housing, for example), even if the actual cost is higher. Some people, especially those living in areas where the cost of living is high, will be unable to follow through with a repayment plan.

Less Protection From Creditors' Collection Efforts

Losers: People in the throes of an eviction, a state license suspension proceeding, or a family law proceeding.

One of the most powerful aspects of current bankruptcy law is called the "automatic stay." This jargon refers to rules that immediately halt almost all collection actions and lawsuits against someone who files for bankruptcy. (For an explanation, including a list of common actions stopped by a bankruptcy filing under current law, see [How Bankruptcy Stops Your Creditors: The Automatic Stay](#).)

The proposed law places limits on the automatic stay. Among other things, the automatic stay no longer stops or postpones:

- evictions
- actions to withhold, suspend, or restrict a driver's license
- actions to withhold, suspend, or restrict a professional or occupational license
- lawsuits to establish paternity, child custody, or child support
- divorce proceedings, or
- lawsuits related to domestic violence.

Fewer Debts Wiped Out

Losers: People who recently bought luxury goods or received cash advances, as well as those who owe child support or those who incurred debts through fraud.

Some types of debts can never be wiped out in bankruptcy, and the proposed law expands this list.

Delays in Filing

The proposed law requires most people to get credit counseling from a

nonprofit agency before filing for bankruptcy. In addition, debtors have to complete a course on personal financial management before completing either Chapter 7 or Chapter 13 bankruptcy.

Another roadblock delays people who had not yet filed a tax return for a recent year. Anyone filing for Chapter 7 bankruptcy has to provide a federal tax return for the most recent tax year; those filing for Chapter 13 have to be current on tax returns for the previous four years.

Keeping Up to Date

To track major developments in bankruptcy reform legislation, visit Nolo's website. You can also get frequent updates on the websites of the American Bankruptcy Institute (www.abiworld.org), the Commercial Law League of America (www.clla.org) and www.BankruptcyReformNews.com.

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