12 myths about bankruptcy

By Pat Curry • Bankrate.com

Like most big, bad scary things, bankruptcy has a reputation based on a few tidbits of truth and lots of embellishment. And like most creepy crawlies, it's not nearly as frightening once you know the truth. With a mind toward declawing the monster, here are a dozen misconceptions about bankruptcy:

1. Everyone will know I've filed for bankruptcy. Unless you're a prominent person or a major corporation and the filing is picked up by the media, the chances are very good that the only people who will know about a filing are your creditors. While it's true that bankruptcy is a public legal proceeding, the numbers of people filing are so massive, very few publications have the space, the manpower or the inclination to run all of them.

2. All debts are wiped out in Chapter 7 bankruptcy. You wish. Certain types of debts cannot be discharged, or erased. They include child support and alimony, student loans and debts incurred as the result of fraud. It's also very unlikely that a judge will discharge legal settlements you've been assessed, such as money you've been ordered to pay to someone who sued you.

3. I'll lose everything I have. This is the misconception that keeps people who really should file for bankruptcy from doing it, says Chris Viale, chief operating officer of Massachusetts-based Cambridge Credit Counseling Corp. "They think the government will sell everything they have and they'll have to start over in a cardboard box," Viale says.

While the bankruptcy laws vary from state to state, every state has exemptions that protect certain kinds of assets, such as your house, your car (up to a certain value), money in qualified retirement plans, household goods and clothing.

"For most people, they'll pass through a bankruptcy case and keep everything they have," says John Hargrave, a bankruptcy trustee in New Jersey. If you have a mortgage or a car loan, you can keep those as long as you keep making the payments (like the rest of us).

4. I'll never get credit again. Quite the contrary. It won't be long before you're getting credit card offers again. They'll just be from subprime lenders that will charge very high interest rates. "There are innumerable companies that will provide credit to you," says California bankruptcy attorney and trustee Howard Ehrenberg. "I don't advise any of my clients to run out and run up the bills again, but if someone does need an automobile, they can go and will be able to get credit. You don't have to go underground or something to get money."

However, if you're planning to buy a house or a car, you might want to do that before you file. Those loans will be tough to get and the higher interest rate on such a large purchase would make a significant impact on your payments. Also, if you have a credit card with a zero balance on the day you file for bankruptcy, you don't have to list it as a creditor since you don't owe any money on it. That means, you might be able to keep that card even after the bankruptcy.

5. If you're married, both spouses have to file for bankruptcy. Not necessarily. "It's not uncommon for one spouse to have a significant amount of debt in their name only," Hargrave says. However, if spouses have debts they want to discharge that they're both liable for, they should file together. Otherwise, the creditor will simply demand payment for the entire amount from the spouse who didn't file.

6. It's really hard to file for bankruptcy. It's really not. While you don't technically need an attorney to file, it's not recommended to go through the procedure without one.

7. Only deadbeats file for bankruptcy. Most people file for bankruptcy after a life-changing experience, such as a divorce, the loss of a job or a serious illness. They've struggled to pay their bills for months and just keep falling further behind.

8. I don't want to include certain creditors in my filing because it's important to me to pay them back someday and if the debt is discharged, I can't ever repay them. Bless you for even thinking about such a thing. You're no longer obligated to repay them, but you always have that opportunity. If your conscience won't let you sleep nights because you didn't pay your debts, there's nothing in the bankruptcy code that prevents you from doing that once you're back on your feet. But bankruptcy is an all-or-nothing deal, so you have to include all your creditors in the petition.

9. Filing for bankruptcy will improve my credit rating because all those debts will be gone. That sounds like an ad for a bankruptcy lawyer trolling for clients. Filing for bankruptcy is the worst 'negative' you can have on your credit report. Unlike other negatives, which stay on your report for seven years, bankruptcy can be there for 10 years.

10. You can't get rid of back taxes through bankruptcy. Generally speaking, this is true. However, there is such a thing as tax bankruptcy, says tax educator Eva Rosenberg, known on the Web as Tax Mama. To get a shot at it, you have to file all your returns and the taxes owed need to be at least three years old.

11. You can only file for bankruptcy once. The truth is, you can only file for Chapter 7 bankruptcy once every six years, Hargrave says. For Chapter 13 reorganization, you can file more often than that, but you can't have more than one case open at the same time, he says. Of course, that doesn't make it a good idea. "Multiple bankruptcies are really bad," Rosenberg says. "Many people get into the habit of once they've done it, it becomes a way of life. This is not good for your karma." Or your credit rating.

12. I can max out all my credit cards, file for bankruptcy, and never pay for the things I bought. That's called fraud and bankruptcy judges can get really cranky about it. The trustee in your case will review all your purchases right before your filing. He knows what to look for.