

Bankruptcy And Car Loans

I often get asked what happens to car loans in bankruptcy. Here is a rundown of some of the tools and approaches available in bankruptcy.

Chapter 13 Bankruptcy Cram Down

Chapter 13 bankruptcy allows us to cram down your car loan and convert the unsecured portion of the loan into general unsecured debt. This can be huge. For example, if you have a \$20,000 loan on a vehicle that's only worth \$5,000, you can cram down the loan to the car's true value (\$5,000). In that case, the \$5,000 debt would be paid with a modest interest rate over the course of the Chapter 13 bankruptcy plan and the balance of the loan would be given the same treatment as your credit card debt.

Chapter 13 Bankruptcy 910 Day Rule

You can only do a Chapter 13 bankruptcy cram down on your vehicle loan if the loan is old enough. The car loan must have originated more than 910 days of filing bankruptcy. If you got your car loan less than two and a half years before filing bankruptcy you won't be allowed to cram down the car loan in Chapter 13 bankruptcy.

Surrender Car

If you don't want to keep paying on the car—because it is a piece of junk or just too expensive—you can surrender the car with no strings attached. You can surrender the car in a Chapter 13 or a Chapter 7 bankruptcy. And yes, that means you will have to give the car back to the lender. Once you surrender the car in bankruptcy, you will no longer be on the hook for making payments.

Redeem The Loan

In Chapter 7 bankruptcy you also have the option of “redemption.” Redemption allows you to pay the lender the fair market value of the car and to discharge the loan balance. The difficulty with this option, though, is that you will likely need to find a new lender to give you a loan to make the redemption payment to the prior lender.

Reaffirm The Loan

Reaffirmation is another option for Chapter 7 bankruptcy filers, but it's risky. When you reaffirm a debt you are legally bound to pay the debt after bankruptcy. It's as if you never filed bankruptcy on that loan. That means you are still on the hook if your car ever breaks down, you are in an accident where insurance doesn't cover all the damage, or you lose a job or otherwise lose the ability to make car payments. In these situations, if you have reaffirmed the car loan the lender can sue you even after repossessing the car.

Retain and Pay

The option most preferred by my clients is to keep the car and continue making payments to the lender. Most car lenders simply want to continue taking your car payment. That is how they make money. They do not want to be in the car repossession business. Repossession is how they lose money. That is why even without a reaffirmation agreement car lenders almost universally continue to accept your car

payments without repossessing your car. For clients who choose this option, I recommend that they call their car lender and personally inform them of their intent to continue making payments.

Talk With An Experienced Bankruptcy Attorney

Whichever approach you decide, it is very wise to talk to an experienced bankruptcy attorney to guide you through the process.