The Difference Between Consumer Proposals and Bankruptcy

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Introduction

Debt is a fact of life that many Canadians are faced with. Using credit to finance the purchase of a home, acquire goods and services, pay for education or cover other expenses is very common. According to Statistics Canada (Q2 2013), the ratio of household debt to personal disposable income surpassed 165% in 2011, a meteoric rise from 66% in 1980. As this increase indicates, it has become the norm for Canadians to use credit as a way of making ends meet.

Generally, people take credit with the expectation that they will be able to pay it back. They take out mortgages on houses, use a variety of credit cards to make purchases, or acquire lines of credit to finance education and other services. But for some, these debts accumulate to the point where they become overwhelming. Whether by misfortunes like job loss, illness or relationship breakdown, or as a result of financial mismanagement, people have built up debt that is beyond their ability to pay.

Once an individual reaches this point of financial insecurity, they pursue one of two options: filing a consumer proposal or declaring bankruptcy. While essentially designed to try and resolve issues of debt, the two options are vastly different from one another. Determining the correct course of action for your particular situation begins with understanding these differences. Our purpose here is to provide a comprehensive comparison between Consumer Proposals and Bankruptcy. For each of these options, we will specifically outline:

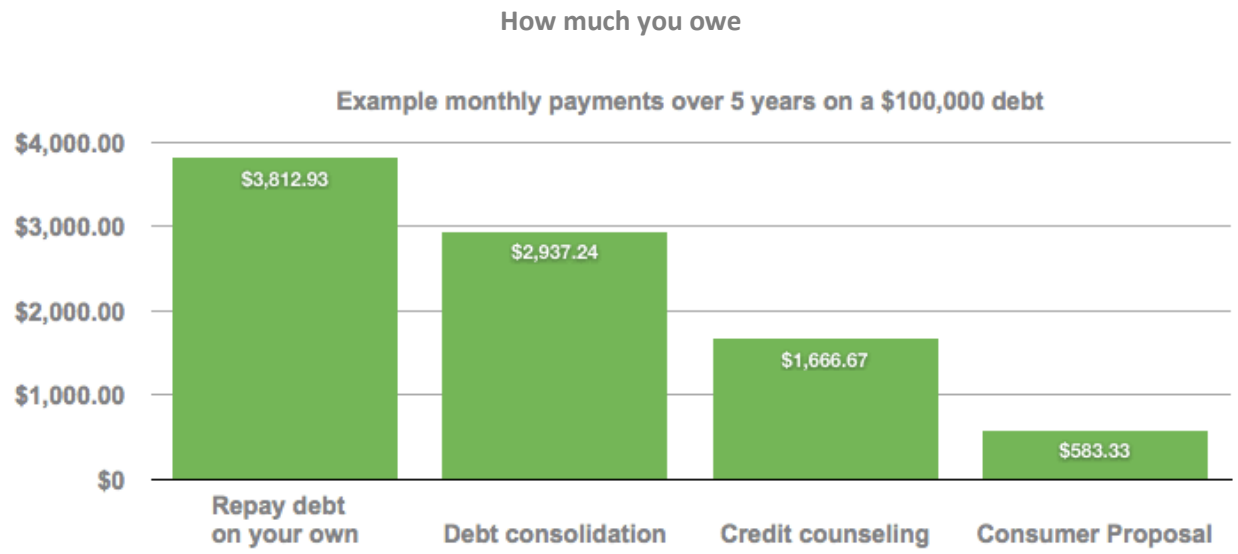
- What it is
- How it works
- Criteria for judging if it is the right option for you
- The end result

Equipped with this information, you will develop a better understanding of the options available to you for resolving your debt issues, and be able to identify the course of action that best suits your particular situation.

Consumer Proposals

What is a Consumer Proposal?

A Consumer Proposal is a proactive solution to dealing with debt problems. Essentially, it involves proposing a settlement with your creditors. It is a legally binding, negotiated settlement that is made between you and the people or institutions that you owe money to. In a typical proposal, you make one monthly payment over a period of no more than 5 years, and these funds are distributed amongst your creditors. Once you have made the final payment, your debts are eliminated. In the majority of cases, a Consumer Proposal will require you to pay less than the full amount you owe and still get discharged from your debts.



Example payments for illustrative purposes only. The actual amount you pay may be higher or lower, and depends on how much owe and what you can afford to pay each month.

How does a Consumer Proposal Work?

Filing a Consumer Proposal

The process for filing a Consumer Proposal begins by seeking out the help of a Consumer Proposal Administrator (a Trustee that can assist you with filing). The Trustee will examine your particular financial situation and provide advice on the specific type of proposal that is the best course of action. When this has been decided, the Trustee will prepare the necessary paperwork for you to sign, and the proposal will be filed with the federal government in order to make it legally binding. The Trustee will then contact your creditors to inform them of your proposal.

Acceptance or Rejection

Under Canadian federal law, creditors have a total of 45 days to either accept or reject the Consumer Proposal. In order for your proposal to be accepted, creditors representing a majority of the dollar value

of your debt must agree to the proposal. If the initial proposal is rejected, your Trustee can contact your creditors and determine if they will accept alternate terms. Generally, a reasonable Consumer Proposal will be accepted.

Costs

Once an agreement has been reached between you and your creditors on a proposal amount, the monthly payment remains fixed for the duration of your proposal through its completion. The cost of your Trustee is also included within your monthly payment, meaning that your creditors are essentially absorbing the cost of the proposal. For example, if your proposal dictates that you will pay $400 per month over 3 years, the fees for hiring a Trustee will be taken from that amount and will not require any additional payment on your part.

Debts Included

In a Consumer Proposal, most unsecured debts can be included. An unsecured debt is one that has no security against it (you have not used assets as collateral for the loan). The most common types of unsecured debt include credit cards, lines of credit, personal loans and payday loans.

With a Consumer Proposal, you will not lose any assets and are not required to surrender anything.

A Consumer Proposal cannot include secured debts, as these are guaranteed by an asset and as such secured creditors do not receive any of the money from the proposal. Therefore, for secured debts such as home mortgages or car loans, you must continue paying your secured creditors, or the asset may be seized by your creditor.

How It Affects Credit

A Consumer Proposal will remain on your credit file for three years after you have completed making all the associated payments.

Is a Consumer Proposal Right for Me?

Who Can Claim

A Consumer Proposal is not the appropriate debt management solution for everyone, as there are limitations. In order to file a proposal, your total debt cannot exceed $250,000 (excluding a mortgage), and you must be unable to fully repay your debts. If you are eligible, remember that filing a Consumer Proposal does not guarantee that it will be accepted by your creditors.

The End Result

If the Consumer Proposal has been successfully filed, accepted by your creditors, and then paid through completion, a certificate is given indicating the full performance of the proposal to you and the Official Receiver. You will then be relieved of all the debts that were included in the proposal.

Bankruptcy

What is Bankruptcy?

Bankruptcy is a legal procedure through which you may be discharged of your debts. Your Trustee distributes your assets to your creditors, and your debts are eliminated. After you file for Bankruptcy, the people or institutions that you owe money to are not permitted to take you to court, sue you or garnish your wages. Once your bankruptcy is finished, your unsecured debts are discharged. Personal Bankruptcy is a last resort debt management solution, and it is recommended only if all other options have been exhausted.

How Does Bankruptcy Work?

Filing for Bankruptcy

The Bankruptcy process begins with consulting a Bankruptcy Trustee. The Trustee will assess your financial situation with you and explain the debt management options that are available. As mentioned above, Bankruptcy is generally regarded as a last resort, and your Trustee may discuss alternative options (such as a Consumer Proposal). Once a decision to declare Bankruptcy has been reached, the Trustee will prepare the necessary paperwork for you to sign. You are considered a bankrupt only once the Trustee files these forms with the Official Receiver.

In Ontario, you will need to sign at least two forms when filing Bankruptcy. The “Assignment” form states that you are handing over your property to the Trustee, who will distribute said property amongst your creditors. The “Statement of Affairs” form is a list of your assets, liabilities, income and expenses. Once these have been filed with the Official Receiver, you are legally bankrupt.

Costs

While costs associated with Bankruptcy are different in each case, there are costs that are fairly common across the majority of personal bankruptcies. There is a filing fee to be paid to the Superintendent of Bankruptcy; the fees associated with the Trustee’s services; the monthly contribution you must pay for your Bankruptcy; and 50% of your monthly surplus income (if applicable). Once you file for Bankruptcy, you automatically lose any tax refunds or HST refunds, which are forwarded directly to your Trustee.

Assets

In Personal Bankruptcy cases, most things you own – household furniture, clothing, RRSPs and one vehicle worth less than $5,650 – are not seized. However, many items of value are subject to seizure, including houses with equity, valuable investments or vehicles, and contributions to your RRSP within the last year. If you have any of these items, they may have to be surrendered in order to absolve you of your debts.

Debts Included

Personal Bankruptcy will discharge most unsecured debts, such as credit card debts, lines of credit, personal loans and payday loans. However, under Canadian law, certain debts remain even in Bankruptcy: student loans less than seven years old, spousal or child support, alimony, debt arising from fraud, restitution orders and any court imposed fines.

How It Affects Credit

If this is your first bankruptcy, a notice will remain on your credit report for 6 years after you receive your discharge. If you qualify for an automatic discharge in nine months, that means your bankruptcy will remain on your credit report for a little less than seven years.

Is Bankruptcy Right for Me?

Who Can Claim

While Bankruptcy is a last resort, it may be the right choice depending on your particular situation. Any person who owes more than $1,000 in debt is eligible to file a Personal Bankruptcy in Canada. If you meet the following criteria, filing for Bankruptcy may be your most viable option: you need rapid financial relief or protection from your creditors; you have few to no assets; your income is low; or you cannot make an acceptable arrangement with your creditors through a Consumer Proposal.

The End Result

If the Bankruptcy process goes smoothly, you will receive a discharge, legally releasing you from all debts covered under your Bankruptcy. This means that you are no longer liable for payments and you are legally protected from your creditors. The time it takes to receive a discharge depends on your particular situation – for example, surplus income or having other bankruptcies are factors that affect the nature of your Bankruptcy.

Topics	Consumer Proposal	Personal Bankruptcy
Who can claim	Your total debt cannot exceed $250,000 (excluding a mortgage) and you must have the ability to repay a portion of your debts. Your proposal must be accepted by your creditors.	Any person who owes more than $1,000 in debt and is insolvent, meaning you owe more than you own and are unable to pay your debts as they come due. Ideal candidates are those who need rapid financial relief.
Costs	Once you and your creditors agree to a proposal amount, your monthly payment is fixed and it will remain the same until your proposal is completed.	Monthly payments vary as they are based on your income. The more you earn, the more you will be required to pay.
Assets	You will not lose any assets and you are not required to surrender anything.	In order to be absolved of your debts you are required to surrender certain assets.
Credit Rating	A notice of your consumer proposal will remain on your credit report for three years after you complete your payments.	If this is your first bankruptcy, a notice will remain on your credit report for 6 years after you receive your discharge. If you qualify for an automatic discharge in nine months that means your bankruptcy will remain on your credit report for a little less than seven years.
Monthly Reporting	You have no monthly tasks or reporting.	You are required to complete a monthly budget for all income and expenses, as well as supply copies of your pay stubs to your trustee.
Taxes	You are still entitled to all tax refund(s) and/or credits which you are owed.	You will lose all tax refund(s) and/or credits which you are owed.

Conclusion

Both a Consumer Proposal and Bankruptcy are debt management solutions that are meant to resolve debtors' issues. However, they are significantly different from one another, and the best course of action is not always obvious. Every case needs to be examined in order to determine whether bankruptcy, a consumer proposal, or even an alternative avenue, is the most viable option. Aspects such as surplus income, assets owned, total amount of debt and the costs associated all need to be taken into consideration.

The first step to resolving your debt issues begins with contacting a professional who will help you explore the options available to you and determine the best way to move forward. At Hoyes Michalos, we have helped countless Ontarians manage their debts and are well-equipped to support you through consumer proposals, personal bankruptcy and a variety of other solutions. We are available to answer questions over the phone, by e-mail or in person. Contact one of our offices today and start on the path to a new beginning.

For more information or to book a
FREE 30 Minute Consultation with one of our Trustees
Call us at **310-PLAN (7526)**
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