

MELISSA R. LANIER
CONSUMER BANKRUPTCY LAW

PRE-BANKRUPTCY PLANNING

In a Chapter 7 bankruptcy, the trustee will take any non-exempt property that he can sell to make money. He then distributes this money to your creditors. That is the whole idea behind a Chapter 7 “liquidation” bankruptcy. However, you can arrange your property and debt in order to maximize your exemptions. This is called “prebankruptcy planning”. Prebankruptcy planning generally consists of selling or borrowing against non-exempt property, then buying exempt property. You do not have an unlimited right to maximize your exemptions through prebankruptcy planning. The purpose of this handout is to outline some general principles, but you must consult with your lawyer regarding your specific situation.

You Can’t Give Away or Hide Property

You can’t simply give away your property or transfer it into someone else’s name. That is a fraudulent transfer that will be avoided by the bankruptcy trustee. You can’t hide property or fail to list it on your schedules. That is a bankruptcy crime punishable by five (5) years in jail and a \$500,000.00 fine. It is particularly foolish to think about committing a crime when your lawyer can advise you on intelligent prebankruptcy planning that allows you to protect your assets in a legal and honest manner.

Sell or Borrow Against Property

You can sell exempt property for fair value. This must be an honest sale for an honest value. If you sell to a friend for a cheap price, the trustee can void the sale as a fraudulent transfer. You can sell the property to anyone you want, including friends and relatives, as long as it is a fair sale and a fair price.

You can borrow money and use exempt property as collateral. Property subject to a valid security interest is not exempt, but the trustee can’t sell the property without paying the secured debt. For example, you could borrow money from a bank using non-exempt land as collateral. The trustee might still decide to try to sell the land, but he must also pay the secured loan. The trustee may sell the land if he believes he can sell it for enough to pay the loan and have at least \$3,000.00 to \$4,000.00 left over. You can borrow the money from anyone, including friends and relatives, but you must make certain that the security interest is correctly prepared by a lawyer and perfected by filing or other appropriate method.

Some of your property may already be subject to a security interest or bank setoff. Discuss this with your lawyer.

Purchase Non-Exempt Property

You can take the money that you get from selling or borrowing against exempt property and put it into exempt property. You can't just give the money away because that would be a fraudulent transfer.

You need to be particularly careful to consult with your lawyer before any prebankruptcy planning. You must choose between the Texas and Federal exemptions, so your lawyer must give you specific advice on the best option for you. However, some types of property that are usually exempt (with limits and restrictions are as follows:

1. Retirement Account. You can put money into a qualified retirement account such as an IRA account or annuity.
2. Personal Property. You may buy personal property such as cars, household goods, furniture, clothes or other items that you need. There are different limits on the amount of personal property you may purchase, depending on whether you use the state or federal exemptions.
3. Home. You may be able to purchase a home or make advance payments on your homestead, depending on whether you use the state or federal exemptions.
4. Texas Tomorrow Fund. Investment in the Texas Tomorrow Fund for the college education of children may be exempt if you use the Texas exemptions, but not the Federal exemptions.

Spend Money

In addition to buying exempt property, you may spend money before filing bankruptcy. It would be an abuse of the bankruptcy process if you and your family went on a two-week vacation to Hawaii immediately before filing bankruptcy. However, it may be perfectly acceptable to spend money on other expenses immediately before filing bankruptcy. Your lawyer can advise you.

Pay debts

You can't pay debts to friends and relatives immediately before filing bankruptcy. That is called a "preference" in bankruptcy. The trustee would then sue your friend or relative to get the money back. The trustee can sue friends for any money you pay them for three months before bankruptcy was filed. The trustee can sue relatives for any money you pay them for one year before bankruptcy was filed. If you pay debts to friends and relatives, you should wait to file bankruptcy, so the trustee cannot sue them to get the money back (three months for friends, one year for relatives).

If you owe them a legitimate debt, you could give a friend or relative a security interest in nonexempt property. This security interest would mean that the trustee could not sell the property without paying your friend or relative on the secured debt. However, the security interest can be a preference, just like paying a debt. If you give a security interest to friends or relatives, you must wait to file bankruptcy (three months for friends, one year for relatives) or the trustee can sue them to cancel the security interest.

You can pay the IRS, property tax or other nondischargeable debt. Discuss this option with your lawyer.

Summary

You must consult your lawyer about the specifics of any pre-bankruptcy planning. Your lawyer will be able to advise you on the types of pre-bankruptcy planning that are honest, ethical and will withstand the inspection of the Chapter 7 bankruptcy trustee. The Texas Legislature and the U.S. Congress created exemptions with the intent that they would be used. Therefore, you are allowed to arrange your property and debt so that you can maximize your exemptions. Your lawyer will advise you how to do this correctly.