The Bankruptcy Process: Preferences – How to Avoid Them

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An important reason to meet with an attorney prior to filing bankruptcy is the possibility of prebankruptcy transfers and the possible negative effects on your bankruptcy case. These prebankruptcy transfers can be broken down into two categories: preferences and fraudulent conveyances.

Preferences

A preference that is avoidable (meaning it can be undone by the bankruptcy trustee) is a transfer of property that is worth more than $600 from a person filing for bankruptcy to a creditor for payment of a debt that was owing at the time the payment was made. Further, in order for it to be a preference, it must be for more money than the creditor would receive in your Chapter 7 bankruptcy case. And finally, this transfer or payment must have occurred within 90 days prior to the filing of your bankruptcy (if the person who received the money is a family member this rule applies to transactions that have occurred within the last year).

So what is an example of an avoidable preference? Let's say you paid off a credit card that you owed $5,000 within 90 days prior to your bankruptcy (it happens more than you would think). In a typical chapter 7 bankruptcy this creditor would likely receive nothing. This payment could be undone by the bankruptcy trustee, the $5,000 brought back into the bankruptcy, and the funds distributed evenly amongst all of your creditors.

Or, a more common scenario is your brother loans you $3,000 to fly you and your wife out for a funeral/wedding/graduation. Within a year prior to your bankruptcy filing you pay your brother back in full. Because this payment is more than your brother would receive in a typical chapter 7 bankruptcy, he is related, and the payment was made within a year prior to your bankruptcy, the trustee can go after your brother to get this money back. Often, if such is the case, the person filing for bankruptcy will either pay the money to the court on behalf of the family member or set a up payment plan so that the family member doesn't have to pay it all back to the court (otherwise family reunions get very uncomfortable!).

Fraudulent Conveyances

As second type of transfer that can be set aside by the trustee in your bankruptcy case is a fraudulent conveyance. Essentially, a trustee can set aside any transfer made within two years prior to the filing of your bankruptcy case if (1) the purpose of the transfer was to hinder, defraud, or delay your creditors, or (2) if you did not receive reasonably equivalent value at a time when you were insolvent. The more common is the second part – selling an asset for less than it was worth. Once I had a client who needed some money and had a parcel of vacant land.

She decided to sell this land to her father to get some quick cash. The lot was worth approximately $20,000, however she sold it to her father for $10,000. There was no bad intent on the part of my client, however, the mere fact that she sold the lot for less than what it was worth, and then filed bankruptcy within a year of that sale, the trustee in the client's bankruptcy case was able to go back and try and undo that transaction.

The point of this blog is to not only provide information on possible difficulties in a bankrutpcy case, but to encourage you to visit with a lawyer if you are considering bankruptcy. I offer free bankruptcy consultations and you can learn if bankruptcy is a good option — and importantly — you can learn if it is a good option to do right now or whether you should wait.

Attorney John Skiba offers a free bankruptcy consultation to discuss your specific situation. He can be reached at (480) 559-8131 or via email at jskiba@jacksonwhitelaw.com .