

# Bankruptcy Filing on Your Horizon?

## Take Some Simple Steps to Protect Potential Future Inheritances

By SPENCER A. STONE, Esq.

**B**ankruptcy can help you make a fresh start and provide tremendous emotional relief, but it may also negatively impact any potential future inheritances that you may be entitled to receive.

In general, when you file a chapter 7 bankruptcy, a snapshot is taken of your finances. Any debts that you owe as of the moment you file the case can be discharged, (with some exceptions,) and all of your assets as of the moment you file the bankruptcy case become part of the chapter 7 estate.

The assets in the estate may be liquidated by an official called a bankruptcy trustee to pay your creditors. (Note, however, that an experienced attorney can usually assist you in exempting most personal assets from the estate, such as a car, a house, some money in the bank, retirement accounts, personal effects, etc.). Any assets you acquire after the filing of the case are yours to keep, free from any debts.

There is a big exception to this general snapshot rule, however; any property that you become entitled to as a result of someone's death within six months after the bankruptcy filing may also become property of the bankruptcy estate.

Now, consider the following hypothetical situation that is typical of many Americans today:

Suppose that you and your spouse earn a combined gross annual income of \$65,000. You have two kids in middle school. You own your home that is worth about \$170,000 and subject to a \$150,000 mortgage. You have \$55,000 in credit card debt. You also have two cars, each worth about \$7,000, about \$5,000 in the checking account, \$25,000 in a 401(k) account, a snowmobile, and typical personal effects.

The problem you face is that you simply cannot make your minimum credit card payments while staying current on your mortgage and taxes, as well as paying for food and other regular living expenses for your family. So, you decide to file a chapter 7 bankruptcy. Your attorney is able to assist you in protecting your assets, including the cars,

the equity in your house, the snowmobile, and the 401(k). So, your bankruptcy trustee determines that there are no assets in your estate, and about three months after you file your bankruptcy case, you get a discharge and the case is closed. You just walked away with all of your assets and none of the credit card

condo. The bankruptcy trustee could sell the whole condo, pay each of your cousins one-quarter of the proceeds, and keep your quarter to pay your creditors. Now you've lost your inheritance, and your cousins, (who are no longer speaking to you, by the way,) have lost their vacation home.

This could have been prevented.

You knew that your aunt was in poor health, and you knew there was a possibility that she would remember you in her will. A very simple modification to her estate plan could have prevented this whole scenario. She could have left the funds in an education savings account for your children; she could have left the money for your benefit in a "spend-thrift trust"; she could have even directed that the money be used to help pay off the mortgage on your home. Any of these options, if properly executed by an appropriately experienced attorney, would have

protected the money from the bankruptcy estate, while still allowing you to use it for the intended purpose.

So what is the moral of this story?

There are two: First, it is important to have the right attorney assisting you with your bankruptcy filing. A qualified attorney can recognize these types of potential issues and recommend the best ways to avoid them. Second, it is important to tell your attorney everything that might be relevant to your case, including any information about elderly relatives or relatives in poor health. Your attorney could have referred your aunt to an estate planner or simply re-drafted her will before the bankruptcy filing, which would have prevented any issue at all.

Bankruptcy has strict regulations that must be followed, but there are ways to safeguard things like potential future inheritances. Make sure you hire the right advisor to help you through the process. ■

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debt. Whew...

About a month later, your aunt passes away. You always knew she had some money, and it turns out she named you in her will. A check for \$75,000 is coming your way. You think, "Now we can start a college fund, pay off some of the mortgage, go to Aruba," or whatever dream your \$75,000.00 can buy."

Wrong. Since any property or money you become entitled to as a result of someone's death within six months after filing bankruptcy becomes property of the bankruptcy estate, you stand to lose your inheritance. So, the bankruptcy trustee files a motion to re-open your bankruptcy case, which the judge allows. The inheritance check goes to the trustee and he uses the first \$20,000 to pay his fees and commission, leaving about \$55,000 to pay your creditors.

Now, you are in a worse position than if you hadn't filed bankruptcy at all — you could have paid off your credit cards and still kept \$20,000 from your aunt's gift. Now you get nothing.

This scenario could be even worse. What if instead of cash, your aunt had left her Florida condo to each of her nieces and nephews; you and your three cousins? Now the bankruptcy estate would have one-quarter of a Florida