

It's My Tax Refund and I Want It Now; by Mark Buckley, February 6, 2010

Because so many income tax filers are afraid to owe the IRS, they have more taxes deducted from their paychecks throughout the year than is required. They would rather pay a little extra in taxes each pay period than to find themselves in a jam on April 15.

As soon as the W2 statements and other tax documents arrive, they quickly file their tax return and patiently await the big refund. Statistics show that a whopping 75% of all tax payers receive a refund and that the average amount is \$ 2,300. I've had clients receive refunds of more than \$ 6,500.

This presents an interesting dilemma for those who may need to file bankruptcy, but who also are expecting a tax refund. From January to April, go to any 341 meeting of creditors across the country and you are likely to hear the bankruptcy trustee ask, "Are you expecting a tax refund this year?"

So here is the question: Can you wipe out your creditors in a Chapter 7 bankruptcy and still keep your income tax refund? For most debtors, the answer is yes. Here are three tips to consider.

Adjust your Withholdings

If you typically get a large refund year after year, you should adjust your withholdings so fewer taxes are deducted from your pay. This will accomplish two things. First, you will be downsizing your future refund and make it less attractive to the trustee. Second, by having the correct amount of taxes taken from your pay, you are freeing up your true income. You will then have more of your actual income to cover necessities and be less inclined to rely on credit.

Consider Waiting To File

If there is little time to adjust withholdings, and a large refund is expected, consider filing your bankruptcy petition AFTER the refund arrives. The bankruptcy trustee will know you received a large refund, so be prepared to answer questions as to how it was spent.

Clearly, you should not use any portion of your refund to repay debts to friends or family members. In the eyes of the bankruptcy court, this would be considered playing favorites with your creditors. If the trustee discovers a preferential treatment, he will take steps to get the money back.

There are acceptable ways to spend the money and not get in trouble. You should have no problem spending the refund on necessities like food, clothing, medicine and vehicle repair. If you have any questions, be sure to consult a qualified bankruptcy attorney.

Consider Your Exemptions

Every state has protection laws which allow a debtor to keep property. Some states, like Rhode Island, even allow protection using Federal exemptions. Whether state or federal, exemption laws can be used to protect income tax refunds.

Depending on the size of the refund, and value of other property trying to be protected, most who file bankruptcy can protect their income tax refund. Once again, consult a skilled bankruptcy lawyer to determine when to file your case and how best to protect your refund.