

WHAT IS BANKRUPTCY PRE-PLANNING?

Pre-bankruptcy planning is the transferring of non-exempt assets into [exempt](#) assets. This practice is not in and of itself illegal or improper. The Bankruptcy Code legislative notes specifically permit this type of activity. But, this is not to say that the procedure is without risk. The 2005 changes in the bankruptcy law challenge the constitutional right of every person to receive adequate legal advice from their attorney regarding pre-bankruptcy transfers or incurring new debt.

Under the old bankruptcy law our Arizona Bankruptcy judges declared that they "would know pre-bankruptcy planning that had crossed the line when they saw it." Some Bankruptcy courts in other states have been very outspoken about such planning prior to filing a bankruptcy. At this time there is no single test which has been universally accepted by all the Bankruptcy Courts in determining how much pre-bankruptcy planning is too much. Generally, a number of criteria appear to have been considered in several cases:

- a. What is the amount of the transfer to [exempt](#) property?
- b. What is the proximity to the bankruptcy filing?
- c. Did the conversion to exempt property involve new funds or previously secured property?
- d. Did the conversion benefit insiders of the debtor?
- e. Did the debtor mislead creditors during the conversion?

Other courts have considered additional circumstances in determining whether or not the pre-bankruptcy planning is acceptable. The best way to summarize whether or not pre-bankruptcy planning will succeed is to consider the old maxim, "pigs get fat and hogs get slaughtered". Obviously, it will take years to determine how the new bankruptcy laws will change this pre-bankruptcy planning process.

Any attorney participating in pre-bankruptcy planning is incurring some risk if the planning progresses to a stage where it could be interpreted as fraud upon creditors. Though normally the Bankruptcy Courts do condemn the attorney for the planning, but rather punish the debtor, in past non-bankruptcy settings, the Arizona courts have sanctioned attorneys for overly zealous asset protection tactics. Of course, this may change under the new bankruptcy laws.

For instance: the new bankruptcy laws 11 USC Section 526(a)(4) prohibit anyone helping a consumer in filing for bankruptcy from advising that person to incur more debt or to pay an attorney, or anyone else, for help in the a bankruptcy. Obviously, this is just ridiculous. Did Congress really intend on making it illegal to pay an attorney, or anyone else, for help in filing for bankruptcy? Did Congress intend on the attorney not be able to advice the client to get rid of an old clunker car and buy a new one before filing for bankruptcy? The client fully intends on keeping the payments current on the new car, they just need dependable transportation. I think not. This is just another example of how poorly the new law is written.

Debtors whose pre-bankruptcy planning has been successfully challenged face a variety of repercussions. Oftentimes, the courts order that transfers shall be undone and the asset brought back into the bankruptcy estate. For example, a debtor pays \$25,000 toward the debt secured by his residence, so as to maximize his allowed homestead exemption. The Court could second guess this payment and order the funds to be brought back into the bankruptcy estate. At times it is a gamble whether or not the Bankruptcy Court will find this type of pre-planning to be "piggish or hoggish". Under the new law 11 USC Section 522(o) and (p) may expose any transfers made within 10 years or 3 years 4 months, respectively, into exempt property. This law does not specifically refer to homestead property and requires that the property be disposed of with the intent to hinder, delay or defraud a creditor and that the property disposed of was not already exempt.

In some situations, courts found the pre-bankruptcy planning to be so egregious that it justified the debtor losing his or her discharge and/or sanctioning of the debtor's attorney. Under the prior law this result was rare, being deprived of a discharge defeats the entire reason behind bankruptcy and is disastrous for the debtor. Given the uncertainty in this area it would be advisable for debtors and their counsel to tread very carefully. The new law is so confusing that no one, judges included, really understand how to deal with issues. My recommendation: do not be the first one to try aggressive pre-bankruptcy planning.

To lawyers: you need to make a decision whether your constitutional right and ethical duty to give your clients competent advice, is controlled by this poorly drafted attempt of the credit card industry to scare everyone, lawyers included, away from bankruptcy protection.