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WHAT IS BANKRUPTCY PRE-PLANNING?

By Diane L. Drain, Arizona Attorney

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 laws 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 not 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 advise 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

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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.



BANKRUPTCY FRAUD

🔍 **HIDING PROPERTY IN BANKRUPTCY CASE BRINGS PRISON TERM** Copyright The Associated Press

(Cedar Rapids-AP) -- A Waterloo woman will spend a year in federal prison for fraudulently concealing property while filing for bankruptcy. Sandra Risse was sentenced today in U-S District Court in Cedar Rapids after she plead guilty in June.

The 40-year-old Risse admitted that after her husband died, she inherited a car and several motorcycles and placed the titles of some of them in other names. When she filed for bankruptcy, she didn't list those vehicles. From 1994 to 2000, Risse received supplemental Social Security income on behalf of her son. She claimed she owned only one car and a motorcycle, which she valued at 500 dollars. Authorities say the vehicles Risse concealed were worth as much as 50-thousand dollars. She was ordered to pay the government 32-thousand dollars in restitution.

🔍 **WISCONSIN MAN FACES BANKRUPTCY FRAUD CHARGE**

Edward DeBoth, 43, is accused of concealing money to protect it from creditors during a bankruptcy action in May 2001, according to a federal indictment.

Edward and his wife Patricia filed a bankruptcy petition with the U.S. Bankruptcy Court in Wisconsin. On the petition, DeBoth stated he had no cash on hand but in fact had at least \$11,500, according to the indictment.

After the discharge, DeBoth and his girlfriend deposited \$19,000 in his girlfriend's bank account in small increments, to keep its existence hidden, and then used it as a down payment on a house in Green Bay, the indictment says. He's charged with bankruptcy fraud and with structuring. Each crime carries a penalty of up to five years in prison.

🔍 **ATTORNEY'S FAILURE TO SCHEDULE ASSETS** Barger v. City of Cartersville, Ga. (11th Cir. 2004)

The failure to comply with the Bankruptcy Code's disclosure duty is "inadvertent" only when a party either lacks knowledge of the undisclosed claim or has no motive for their concealment. A debtor who failed to disclose the existence of her employment

discrimination lawsuit during the pendency of her bankruptcy could not escape the consequences, even if it were her attorney's error.

Although it is undisputed that Barger's attorney failed to list Barger's discrimination suit on the schedule of assets despite the fact that Barger specifically told him about the suit, the attorney's omission is no panacea. As the Supreme Court stated in *Link v. Wabash R.R. Co.*, "[t]here is certainly no merit to the contention that dismissal of petitioner's claim because of his counsel's unexcused conduct imposes an unjust penalty on the client. Petitioner voluntarily chose this attorney as his representative in the action, and he cannot now avoid the consequences of the acts or omissions of this freely selected agent." "[I]f an attorney's conduct falls substantially below what is reasonable under the circumstances, the client's remedy is against the attorney in a suit for malpractice. But keeping this suit alive merely because plaintiff should not be penalized for the omissions of his own attorney would be visiting the sins of plaintiff's lawyer upon the defendant."

MORAL TO THIS STORY - THIS IS YOUR BANKRUPTCY - IT IS ABSOLUTELY YOUR OBLIGATION TO REVIEW ALL YOUR DOCUMENTS AND MAKE SURE YOU HAVE DISCLOSED EVERYTHING.



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