

# Actions to Avoid Before Filing Bankruptcy

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The types of actions a potential bankruptcy debtor should avoid can be organized into three groups. The first group includes actions that are forbidden by Bankruptcy Code and may cause your case to be dismissed. The second group includes transactions are not forbidden by the Bankruptcy Code but can get you in trouble with the Trustee, cause certain debts to not be discharged, or potentially result in having the transaction forcibly reversed. The last group includes actions that are not necessarily stumbling blocks in the bankruptcy process but are unwise and could be handled better with some forethought.

The following is a brief, non-comprehensive discussion of the things you should avoid doing prior to filing bankruptcy to help ensure a successful discharge and get the fresh start you desire.

## **Actions Prior to Filing Bankruptcy Which May Result in Having Your Case Dismissed**

Fraud is the name of the game here. The most common basis for denying a debtor's bankruptcy discharge is because a debtor either hid assets or fraudulently transferred them prior to filing

bankruptcy in an effort to keep them out of the hands of their creditors. In essence, people who do either of these actions are not the type of honest debtors who are entitled to relief under the Bankruptcy Code.

The previously listed bases for denial of discharge should be obvious. What is not quite as obvious, but equally enforceable, is a debtor's conversion of non-exempt assets into an

exempt form prior to filing bankruptcy. For example, when a person takes all of her cash the week before bankruptcy and puts it in her retirement account because she knows it will not be protected otherwise. These types of cases usually revolve around the debtor's intent but when there is no direct evidence of the debtor's intent, the court can look at factors such as how soon bankruptcy was filed after the conversion was made to form its own conclusions.

Another way a debtor's pre-filing actions can result in a denial of his discharge involves the purposeful destruction or hiding of financial records. The bankruptcy trustee and the Court in general require certain documentary evidence of a debtor's financial history in the time leading up to bankruptcy. If those documents are not provided and a sufficient, provable excuse cannot be provided as to why, the Court can deny your discharge altogether for failure to maintain records. This tends to be more of an issue when small businesses are involved or assets cannot be located, but should not be taken lightly in any case.

### **Actions Taken Prior to Filing Bankruptcy Which May Result in a Partial Discharge or Other Issues**

Some debts are nondischargeable due to the unique status granted to them by Congress and the courts. Other debts are nondischargeable because of improper actions taken by a debtor in relation to that particular debt. These types of actions are all rooted in fraud and include, generally:

- Debt incurred through actual fraud – For example, if you get a signature loan with no intent to pay it back or write a check which you know will bounce.
- Luxury goods or services – Includes consumer debts owed to one creditor for amounts higher than \$550 incurred in the 90 days before filing bankruptcy.
- Cash advances – Includes cash advances taken within 70 days before a bankruptcy filing totaling more than \$825.
- False financial statements – For example, if you grossly misstate your income on a car loan application in order ensure approval.

Ordinarily, an adversary proceeding must be successfully brought by the creditor alleging these types of fraud in order for that particular debt to be rendered nondischargeable. While adversary proceedings, in general, are rare, it is best to play it safe and avoid any of the above actions if you want a smooth bankruptcy.

Another problematic issue which does not involve discharge but can have negative consequences is the preference doctrine. The preference doctrine basically states that payments made to general creditors in the 90 days prior to filing bankruptcy or to “insiders” – such as family members – in the year prior to filing bankruptcy can be considered inequitable payments and undone by the bankruptcy trustee as such.

The exact requirements for establishing a preferential payment are complex and beyond the scope of this article, but the bottom line is that if you decide to pay your mother back in the year before filing bankruptcy for money she loaned you and let your other creditor’s debts go unpaid, the trustee may sue your mother to take that money back and distribute it amongst all your creditors – hardly the result you were aiming to achieve. There is nothing wrong with voluntarily repaying a debt after it is discharged so save your mom some grief and hold off on that payment.

### **Actions Taken Prior to Filing Bankruptcy Which Should Be Reconsidered in General**

One of the biggest mistakes people make when it comes to bankruptcy is waiting too long to speak with a bankruptcy attorney about their options. Before you take any of the following actions, you may want to talk with a bankruptcy attorney regarding their effectiveness and possible ramifications on a bankruptcy filing:

- Taking money out of a retirement account – Not only is this money usually exempt from creditors while it stays in the retirement account, you also will have to pay taxes on the disbursement even if you do later file bankruptcy.

- Signing off on a debt consolidation plan – The non-consolidated debt may be dischargeable through bankruptcy and the new loan given for the consolidation may not be.
- Paying off a credit card with the hopes of keeping it through bankruptcy – You may find the payment reclaimed as a preference or the credit card cancelled anyways due to a lowered credit score.
- Taking out a payday loan – These beasts can hit you with an astronomical interest rate and cause criminal complications under the hot check laws if unpaid

## **Conclusion**

While most pre-filing actions which can cause major problems for a bankruptcy debtor are fairly obvious, not all are so and much care should be taken to ensure that one does not fall on the wrong side of the bankruptcy system. The consequences can be harsh when the taint of fraud is sensed in a bankruptcy filing.

The legal scenarios mentioned in this article are subject to exceptions and detailed requirements and the amounts listed change periodically as the law is updated. This article is not intended as a substitution for legal advice and does not create an attorney-client relationship between its reader and the author. Feel free to give us a call at (512) 777-4099 to speak with a bankruptcy attorney regarding the specifics of your case.