

REPRESENTING THE HIGH INCOME DEBTOR.

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Various musings on high income cases. Your case will be subject to additional scrutiny. Therefore, it will require a lot of extra work.

1. Listing Debts in Schedules. If there is a business, then you need to work with the client to try to identify all business debts and list them in the schedules. The client will often be able to print out an AP list. However, that will miss a lot of potential creditors.
 - a. Guaranties.
 - b. All business debt.
 - c. Other guarantors of business debt who may have subrogation or contribution claims.
 - d. Warranty claims.
 - e. Landlords.
 - f. Personal property leases.
 - g. List the business as a creditor. This will help with potential derivative claims. It may further help with discharge of officer loans and deemed income issues.
 - h. List the SBA if there are SBA loans.
 - i. Potential personal property taxes.
 - j. Find out if you need to list the Wisconsin DWD for unemployment or workers comp.
 - k. List other states if there is a potential for debt in another state. (Many businesses owe Illinois sales taxes, they just do not know it yet.)
 - l. Make sure to check disputed, contingent, and co-debtor boxes as appropriate.
 - m. If you are listing the business debt, then you will likely want to list the business as a co-debtor, and list other guarantors as co-debtors. That will also help you to identify consumer/ non-consumer obligations.
 - n. List student loans.
 - o. There is no such thing as “not including a debt in a bankruptcy.”

2. Tax claims. List all tax claims, regardless as to whether they are dischargeable and regardless as to whether the tax has actually been assessed.
 - a. If a lien has been filed, then at least a portion of the claim should be listed as secured.

- b. List tax claims even if they have not been assessed. E.g. xyz corp. owes withholding taxes for the last three years. Debtor was an officer. Debtor can probably be assessed as a responsible person. Therefore, you should list the debt. If the debtor was not a responsible person (which is not necessarily the same thing as being irresponsible) list the debt as disputed.
 - c. If the tax obligation is entitled to be treated as a priority claim, then it should be listed on Schedule E. This may also assist with preparing the means test.
 - d. If the debtor was recently audited and assessed a tax by the IRS, then you will likely want to list the Wisconsin Department of Revenue as a creditor as well. You may also wish to advise the debtor to file an amended return with the State of Wisconsin.
 - e. Have the debtor consult with a tax professional regarding net operating loss carry backs.
3. SOFA. Be consistent.
- a. If you have a business on Schedule B, then you will likely need to list the business on SOFA 18.
 - b. You need to help debtors to list transfers of properties and repayment of debts. Debtors often “forget” to list transfers they do not want people to know about. An attorney can assist the debtor by asking the right questions and pointing out the ramifications for not carefully reviewing the information to make sure that it is accurate and complete. Debtors will frequently “remember” at the 341 meeting that they no longer have a valuable asset because they sold it or gave it away. If their statement is inconsistent with the transfer section, they may have a problem. Debtors will universally state under oath at a 341 meeting that they told their attorney all about the transfers that they forgot to list in their schedules. If the debtor has sold a valuable asset, the trustee will ask at the section 341 meeting what happened to the proceeds. Your debtor should be prepared to answer that question. If the debtor is “taken by surprise,” he will answer “I paid bills.” That will in turn lead to a lot of other questions about preferential payments. It is better to know the answer to these questions prior to the section 341 meeting.
 - c. If the debtor has not had any income in the last several years, it pays to inquire as to how they have been living. Often you will find that the “business” has been making the house, car, and credit card payments and etc. This income may need to be disclosed if it was income, or it should be treated as a loan if it was a loan.
 - d. Inquire about payments made to or for the benefit of family members.

- e. If there is interest from a bank account on a tax return, and the bank account is not listed in Schedule B, then it is likely that the closed account information should be listed on the SOFA.
 - f. Ask about property held for another person. Ask whether somebody else parks any boats, cars, or trailers at their house. Also ask about jewelry that may belong to somebody else. You should do this because when a creditor asks about the large boat that is sitting in the back yard, and the debtor then testifies that it belongs to his brother, it is better to have a similar answer on the SOFA.
 - g. I also ask about jewelry that the debtor is wearing at the meeting. E.g. schedules list “None” under jewelry, but there is a large Rolex on the debtor’s wrist.
4. The Fourth Dimension: Special Relativity Theory and Time Dilation. Time slows at higher speeds in the reference frame relative to other reference frames, and it is not a fixed rate in all reference frames.

The timing for filing a case for higher income debtors can be very important.

- a. The consumer/non-consumer calculation will change periodically.

Example. Debtor had a \$1.0 million dollar homestead with a \$1.2 million dollar mortgage. The foreclosure was going to be started in the near future, and the debtor did not intend to keep the house, and the debtor had already moved out of the house. Debtor also had non-consumer business debt of approximately \$1.0 million. Debtor went to a bankruptcy attorney and was told he would need to file a Chapter 11 because he could not qualify for either a 7 or a 13. Debtor did not like this answer, so he went to attorney 2, who confirmed that attorney 1 was absolutely correct. Even if the debtor tried to use the large deduction for the mortgage payment, the debtor could not pass the means test, and the debts were primarily consumer obligations. Attorney 2 referred the case out for a Chapter 11. Chapter 11 attorney advised debtor to sell house on a short sale. The house was sold shortly thereafter. The high income debtor then filed a chapter 7 as a non-consumer case with unsecured consumer debt of approximately \$500,000 and business debt of approximately \$1.0 million. Debtor possibly could have waited until the foreclosure was concluded, but his wages would have been garnished for the full duration of the foreclosure.
- b. means test income can change substantially from month to month. Just because a debtor does not pass the means test this month does not mean that the debtor cannot pass it next month.

- c. Try to wait at least one year after any questionable transfers.

11 U.S.C. § 727(a) provides as follows:

The court shall grant the debtor a discharge, unless —

- (2). the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed —

(A) property of the debtor, within one year before the date of the filing of the petition.”

If you have concerns about some of the debtor’s historical financial decisions, waiting for one year, or more, from the date of a transfer may take some leverage away from creditors and the trustee.

- d. Taxes. An attorney should explain the timing issues relative to the dischargeability of taxes. It is ultimately the client’s decision when to file, but the decision should be an informed decision, and the attorney should not be afraid to make a recommendation. I have seen many cases where a debtor could have discharged a significant amount of tax debt if they had merely waited a couple of extra months before filing. Similarly, it may be a good idea to have the debtor file tax returns that were previously not filed. The debt may then either be treated as a priority because the returns generated an assessment, or the debtor could try to wait out a 2 year discharge period. It also is a good idea to review the tax notices. If a tax is based upon a dooamage assessment (it has a lot of round numbers), then the debtor can likely reduce the amount of the tax merely by filing the return or report.
- e. Tax refunds. If electing state exemptions, debtors may be much better off waiting until after they receive their tax refunds before filing. \$5,000 in a depository account may be exempt. A \$5,000 tax refund will likely not be exempt.
- f. Preferential payments. If the debtor has made preferential payments that s/he does not want avoided, then it is important to count past the preference period. On the other hand, filing the case within the preference period may be important if the debtor wants to try to recover garnished funds that the debtor can claim as exempt.

Example. Debtor's wages have been being garnished for an extended period of time. In the last 60 days, the most recent garnishing creditor has received \$594.00. The debtor elected to wait one more pay period prior to filing her case. The preference claim was then listed on Schedule B and claimed as exempt.

- g. Fraudulent transfers. If the debtor has made transfers that could be deemed to be avoidable as fraudulent transfers, then the debtor may be better off in waiting for the fraudulent transfer period to run prior to filing a bankruptcy.
 - h. 529(b) Plans. If the amount of money involved is significant, the debtor may want to wait two years from the date of the last contribution. 11 U.S.C. 541(b)(6). If the debtor can wait 2 banking years (720 days) from the date of the last contribution, then the funds will not be property of the estate, assuming that the other requirements of the statute are met.
 - i. Cash value of Life insurance. The Wisconsin life insurance exemption has a convoluted two year rule on exemptions of cash value in life insurance.
5. Claim Real Estate as Exempt, if possible. Claim real estate as exempt, even if the property is over-encumbered.

26 U.S.C. 1017(c)(1).

(1) Reduction not to be made in exempt property.

- 1. In the case of an amount excluded from gross income under section 108(a)(1)(A), no reduction in basis shall be made under this section in the basis of property which the debtor treats as exempt property under section 522 of title 11 of the United States Code.

Example. IRS audited debtors tax returns two years following a bankruptcy. Auditor contended that the basis in real property should be reduced pursuant to 26 U.S.C. 108(a) for the amount of the debt that was discharged in the bankruptcy. Debtor's accountant tells debtor he has a problem. Debtor called BK attorney to complain. Attorney can then point out that property was exempt under title 11, so basis reduction was not required.

Similarly, to the extent that a debt is disputed, contingent, or a guaranty of a business debt, it will be helpful to the debtor in such an audit situation if accurate designations of the debt are made in the schedules.

6. Review tax returns if possible. There is often information in tax returns that is inconsistent with the information shared by the debtor: interest in undisclosed bank accounts, disposition of stock, listed interests in businesses, and Schedule C income. It is better to address the inconsistencies before filing the case instead of after filing the case.

7. Settlement is an option. High income debtors often have one bad financial event that is causing financial difficulty. If the debtor has access to funds, either from family loans or retirement accounts, a settlement may be a better solution in the long run than filing a bankruptcy. We frequently settle guaranties of investment debt at substantially discounted amounts. Remember to refer the debtor to an accountant for tax implications of debt forgiveness with respect to settlements.