CONSUMER BANKRUPTCY

Court Allows Transfer to IRA on Eve of Filing

By Craig D. Robins

Let's get right to the facts: Less than two weeks before filing for Chapter 7 relief, a consumer debtor empties his $44,000 bank account that he jointly holds with his wife.

He uses $13,000 of the proceeds to supplement his Individual Retirement Account; he transfers $22,000 into his wife's bank account, and he pays his attorney $4,585 as a retainer. The debtor does not disclose the transfer to the IRA in his Statement of Financial Affairs, nor does he disclose it at the meeting of creditors, although he does exempt the IRA, which now contains $30,000.

The debtor, who was a stockbroker charged with numerous FINRA violations, filed a bankruptcy petition that was over 300 pages long, including a Schedule F of 176 pages, which listed unsecured claims exceeding two million dollars.

Several months later, after Trustee Marc Pergament discovered the transfer, he objected to the debtor's IRA exemption, indirectly claiming that the debtor engaged in a fraudulent transfer while he was insolvent, and did so in bad faith by converting $13,000 of non-exempt cash into an exempt IRA on the eve of filing. The trustee did not object to the debtor's discharge.

The debtor, who was represented by Garden City attorney Stuart P. Gelberg, defended with three arguments. First, moving money from a checking account to an IRA is not a "transfer" under the Bankruptcy Code. Second, even if the trustee were to recover the $13,000, it would only generate a *de minimis* distribution to creditors; and third, debtor's pre-bankruptcy planning, even if orchestrated with the aid of counsel, may not be used to deny the debtor's exemption claim under the Supreme Court's 2014 decision in *Law v. Siegel*.

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In a decision that left some questions, Judge Alan S. Trust, sitting in the Central Islip Courthouse, held for the debtor and dismissed the trustee's objection, stating, "While Debtor is not to be applauded for his conduct, the Exemption Objection will be denied." *In re: Joseph Louis Castellano* (E.D.N.Y. Case No. 15-71661-ast, April 25, 2016).

However, it was perplexing that the judge did not elaborate on what conduct he found troubling. Judge Trust also addressed the debtor's first two arguments with dicta commentary in the form of footnotes, which may create some concern for practitioners regarding certain disclosures.

In his analysis, Judge Trust noted that the trustee, as the objecting party, carries the burden of demonstrating that the debtor's exemption was improperly claimed. A trustee can object to any objection on the basis that it was fraudulently asserted, and he can do so up to one year after the case is closed.

However, the trustee was not asserting that the exemption claim itself was fraudulently claimed; instead, the trustee argued that "stuffing the IRA was done in fraud of creditors." Judge Trust stated that recent decisions have noted that *Law v. Siegel* prohibits the bankruptcy court from disallowing exemptions or amendments to exemptions due to bad faith or fraud.

The judge held that *Law v. Siegel* requires the court to deny the exemption objection. In that High Court case, the California debtor engaged in fraudulent conduct in an attempt to insulate his homestead exemption. The Chapter 7 trustee in that case incurred substantial legal fees to uncover this fraudulent conduct and sought attorney's fees as a surcharge against the debtor's exemption. However, the Supreme Court prevented the Chapter 7 trustee from disturbing the homestead exemption as doing so contravened the provision of the Bankruptcy Code that permitted debtors to exempt assets.

Judge Trust did not elaborate on what conduct the debtor in *Castellano* engaged in that was problematic. Was it his pre-bankruptcy planning or was it his failure to list the transfer of funds in the petition and testify about it at the meeting of creditors? In a footnote, Judge Trust states: "Debtor challenges whether the transaction at issue here constitutes a transfer. See 11 U.S.C. sec 101(54). Although it is not material to the outcome of this ruling, the court rejects that contention and will use the phrase transfers."

One can only wonder how significant this dicta is. If a debtor removes funds from one account and deposits them in another account, is that a "transfer" that must be reported on the Statement of Financial Affairs?

It seems that based on past local practice and procedure, consumer bankruptcy practitioners do not believe so. Yet, one can only wonder whether the court is sending a message to the bar that debtors have to disclose the pre-petition movement of funds from one account to another. In reviewing the decision with Mr. Gelberg, he queried, "Do we have a whole new definition as to what has to be disclosed in the SFA?"

In Judge Trust's second footnote, which addressed the debtor's argument that a $13,000 gross estate in which unsecured claims exceed $2,000,000 would result in *a de minimis* distribution, the judge stated, "There is simply no viability to Debtor's argument that because he owes so much money, the Trustee should not bother himself with complying with his statutory obligation to recover assets for the benefit of creditors." Although that may be true, the judge does not mention anything of the generally accepted notion that a trustee should only administer an estate if there is a reasonable distribution to creditors that makes the process cost efficient for all concerned.

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