A Collision Between Two Worlds: Estate Planning vs. Bankruptcy

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2016

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American Bankruptcy Institute

Northeast Bankruptcy Conference

July 2016

Life Estates - Spendthrift Trust Provisions, Property of Self-Settled Trust and 548(e), What is the Estate's Property, Res V. Beneficial Interest, and Inherited IRA

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Life Estates

The Trustee in a bankruptcy matter has the ability to sell the estate's interest and the interest of a co-owner pursuant to 11 U.S.C. 363(h), which states as follows:

> "(h) Notwithstanding subsection (f) of this section, the Trustee may sell both the estate's interest, under subsection (b) or (c) of this section, and the interest of any co-owner in property in which the Debtor had, at the time of commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety, only if—
>
> (1) partition in kind of such property among the estate and such co-owners is impractical;
>
> (2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interest of such co-owners;
>
> (3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and
>
> (4) such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light or power."

So what happens if, for example, the parent of the Debtor has transferred title to a property to the Debtor reserving a life estate to themselves and the Debtor files bankruptcy? Can the Trustee sell the property? It appears not, as the interest owned by the parent is nor held as an undivided interest as a tenant in common, joint tenant or tenant by the entirety. However, the Trustee can sell, if he can find a buyer and if applicable, the Debtor's remainder interest in the property. See Kovacs v Sargent (In re Sargent), 337 B.R. 661 (Bankr. N.D. Ohio, 2006).

First, so what is a life estate? It is an estate or interest in property whose duration is limited to the life of an individual whereby the individual can live in the property generally subject to that person maintaining the property. "Property interests are created and defined by state law unless some federal interest requires a different result, there is no reason why such interest should be analyzed any differently simply because an interested property is involved in a bankruptcy proceeding". Butner v. United States, 440 U.S. 48, 99 S. Ct. 914, 59 L. Ed. 2d 136, 1979 U.S. LEXIS 58, 19 Collier Bankr. Cas. (MB) 481, Bankr. L. Rep. (CCH) P67,046, 4 Bankr. Ct. Dec. 1259 (U.S. 1979). Also "deeds should be 'construed as to give effect to the intent of the parties unless inconsistent with some law on or repugnant to the terms of the grant.'" Commercial Wharf East Condominium Ass'n v Waterfront Parking Corp., 407 MASS 123, 131 (1990) (quoting Harrison v Marcus, 396 MASS 424, 429 (1985)). See also Appletree Mall Associates, LLC v Ravenna Inv. Associates, 33 A.3d 1097, 162 N.H. 344 (N.H. 2011) where a New Hampshire Supreme Court stated "In interpreting a deed, we give it the meaning intended by the parties at the time they wrote it, taking into account the surrounding circumstances at that time."

In the case of Braunstein v Hajjar (In re Hajjar), 385 B.R. 482 (Bankr. D. Mass 2008), the Court dealt with a deed that stated in the granting clause that the Debtor conveyed the property to

himself and his sisters. After the metes and bounds description the deed stated "The grantor hereby grants to Barbara A. Niles the right to the use and enjoyment of the above-described premises for and during her lifetime or as long as she so desires with the provision that said life tenant shall be responsible for the payment of taxes and maintenance of said premises using the period of said occupancy, specifically denying any rights by the grantor to partition." The Trustee took the position that the Debtor created a tenancy in common for the entire property. The Court held that the Debtor intended to give his sister, Barbara A. Niles, a life estate. Id. at 487.

The Court in Hajjar then turned to the issues created by 11 U.S.C. 363(h), citing Sargent v Kovacs, 337 B.R. at 666, the Court stated that the Trustee has the burden of establishing all four elements under 363(h). That section of the code identifies three forms of co-ownership: tenancies in common, joint tenancies and tenancies by the entirety. "This plain language forces the conclusion that the three co-tenancies are the only three in which the co-owners interest may be sold without his consent." Geddes v Livingston (In re Livingston), 804 F.2d 1219, 1223 (11th Cir. 1986). "Because a life tenancy is outside the scope of §363(h), the Trustee has failed in his burden and may not sell the property." Hajjar 385 B.R. at 488. See also Madoff v Amaral (In re Amaral), 2016 Bankr. LEXIS 1778 (Bankr. D. Mass. April 20, 2016).

The Court in Hajjar then went on to state that "Although the Debtor does not have a present possessory interest, and the Trustee may not sell the property under §363(h) the Debtor owns a one-third remainder interest in the property which is property of the estate. Id. at 488.

Formulas exist to determine the value of the remainder interest by subtracting from the equity value of the property, the value of the life estate based on that party's life expectancy. If there is more than one remainderman, the value of Debtor's interest would generally be equal to

Debtor's percentage of total remainderman's interest. However, the Trustee's ability to be able to actually sell Debtor's interest for the value determined by the formula is questionable. While the valuation is based on actuarial tables, a purchaser would only receive its interest upon the actual death of the life tenant. Because of the uncertainty as to when a buyer will actually receive its interest, the actual price a buyer will pay has to take that into account. Although Trustees tell me that they get solicitations from companies who will buy remainder interest, my suspicion is that amount is highly discounted.

Spendthrift Trusts and Discretionary Trusts

Issues arise if a debtor's interest in a trust is subject to spendthrift trust provisions. Section 541(c)(2) of the code excludes from property of the estate so called spendthrift trusts. Section 541(c) of the code states as follows:

> (c)(1) Except as provided in Paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2) or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable non-bankruptcy law.
>
> …
>
> (2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law is enforceable in a case under this title.

A spendthrift trust is generally defined as a particular kind of an express trust that restrains both voluntary and involuntary transfer of a beneficiary's interest. See for example NH RSA 564-B:1-103(17) and Restatement (Third) Trust §58. According to the Restatement, "if the terms of a trust provide that beneficial interest shall not be transferable by the beneficiary or subject to claims of the beneficiary's creditors, the restraint on voluntary and involuntary alienation of the interest is valid."

New Hampshire adopted, with some minor revisions, the Uniform Trust Code in 2004 as codified in NH RSA 564-B including a spendthrift trust provision. Prior to that time, "New Hampshire did restrict the power of creditors to subject a beneficiary's interest to payments of claims if the beneficiary's power to alienate such interests was restricted under the terms of a trust, NH RSA 564:23(I) (repealed effective October 1, 2004), but otherwise did not have a spendthrift trust provision. This provision of prior law became effective on June 3, 1996. In re Chappell, 2006 BNH 001, 9-10.

Under state statutes that have adopted the Uniform Trust Code, certain creditors are sometimes excluded from the prohibitions of reaching the debtor's interest in a spendthrift trust. For example, in New Hampshire, a child support creditor, a creditor seeking alimony to the extent the Court order expressly specifies the alimony amount attributable to the most basic food, shelter and medical needs, a judgment creditor who has provided service for the protection of a beneficiary's interest in the trust, and claim of the State of New Hampshire or United States to the extent a statute of this state or federal law so provides. See NH RSA 564-B:5-503(b). Further subsection 503(d) states that "nothing in this section or RSA 564-B:5-502 shall be construed to prevent the application of RSA 545-A, the Uniform Fraudulent Transfer Act, or similar law of another state having jurisdiction over a transfer of property."

The opinion of the United States Bankruptcy Appellate Panel for the First Circuit in the case of Massillon v Riley (In re Massillon), 2011 Bankr. LEXIS 83 (Bankr. D. Mass. 2011) in overruling the Bankruptcy Court for the District of Massachusetts focused on sections 541(a)(5) and 541(c)(2) of the code. The BAP, in discussing how a debtor may extract assets, stated that there are two ways. First, a debtor can exempt assets and second assets may not become property of the estate under Section 541 of the code. These are two different legal issues. Under

section 541(c)(2), a debtor can exclude from property of the estate an interest in a valid spendthrift trust. The BAP held, based on the facts, that the parties had agreed and the Bankruptcy Court had held that the trust was a valid spendthrift trust and therefore the debtor's interest did not come into the estate. Further, however, since the debtor actually received a distribution under the trust within 180 days after the filing, those payments pursuant to 541(a)(5) did become property of the estate, but any distribution to the Debtor beyond the 180 days were not property of the estate.

Other cases from the region to uphold a spendthrift trust asset not to be property of the estate include Treadway v United Bank Trust Co., 1988 Bankr. LEXIS 2359 (Bankr. D. Vt. Oct. 19, 1989).

A discretionary trust is a trust where the beneficiaries do not have a fixed interest in the trust funds or a fixed entitlement to the trust funds. The terms of the trust set out in the trust document leave it up to the Trustee's discretion as to which of the beneficiaries receive how much. The Trustee cannot be compelled to pay any amount to any one of the beneficiary(s).

If a discretionary trust complies with a state's statutes and common law, pursuant to 11 U.S.C. 541(c)(2), the Trustee in bankruptcy should not be able to compel a distribution to a debtor beneficiary.

New Hampshire has enacted RSA 564-B:5-504 to deal with discretionary trusts. A Court may be able to compel a distribution for support of a beneficiary's child or for alimony if the Trustee has not complied with a standard put forth in a trust document or has abused his discretion pursuant to subsection 504(c). However, if a beneficiary is also a Trustee, the beneficiary-trustee cannot play a role in making a distribution to himself (see 504(c)).

Self-Settled Trusts and 11 U.S.C. 548(e)

A self-settled trust is a trust where the settlor is also the beneficiary. A settlor is the person who creates or contributes property to the trust. Settlor then sometimes attempts to add spendthrift trust provisions in an attempt to protect their assets from their own creditors.

In relatively recent history, certain states enacted what are often referred to Domestic Asset Protection Trusts in what appears to have been a strategic move to entice people to their state. These trusts are generally self-settled trusts with spendthrift trust provisions thus protecting one's own assets from one's own creditors. However, they appear to be generally irrevocable trusts. New Hampshire is actually one of those states. See NH RSA 564-D. The analysis of these trusts is beyond the scope of this paper.

In general, outside of those states that have enacted Domestic Asset Protection Trusts, the Courts have not upheld the spendthrift trust provisions in self-settled trusts. See Murphy v Felice (In re Felice), 494 B.R. 160 (Bankr. D. Mass. 2013). In response to five states, Alaska, Delaware, Nevada, Rhode Island and Utah, having enacted laws that permit their citizens to establish self-settled trusts where they can place their assets outside the reach of their creditors, Congress passed 11 U.S.C. 548(e) which states as follows in relevant parts:

> 548(e)(1) "…the Trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition if-
>
> (A) Such transfer was made to a self-settled trust or similar device;
>
> (B) Such transfer was by the debtor;
>
> (C) The debtor is a beneficiary of such trust or similar device; and

(D) the debtor made such transfer with actual intent to hinder, delay or defraud any entity to which the debtor was or became on or after the date that such transfer was made, indebted."

The New Hampshire Bankruptcy Court in the case of Smith v Pollack (In re Pollack), 2016 Bankr. LEXIS 190 (Bankr. D.N.H. Jan 20, 2016), found that the Trustee did not produce evidence that allowed the Court to make a finding that the Debtor made a transfer to the trust which in this case was a revocable trust. It went on to say that even if he could find it was a transfer to a revocable trust, the record did not show that the trust was a self-settled trust or similar device as required by § 548(e)(1). Most cases dealing with §548(e) deal with subsection D, which requires a finding that the Debtor transferred the property with the actual intent to hinder, delay or defraud a creditor. Fraudulent transfers are a part of another presentation at this meeting and therefore will not be discussed further.

For some other cases that deal with 548(e)(1), see Roeder v Priscilla Avers Family Trust (In re Avers), 2015 Bankr. LEXIS 1623 (Bankr. W.D. Pa. May 13, 2015), Quality Meat Prod., LLC v PorCo, Inc., (In re PorCo, Inc. 447 B.R. 590 (Bankr. S.D. Ill. 2011) and Safanda v Castellano (In re Castellano), 514 B.R. 555 (Bankr. N.D. Ill. 2014).

What Becomes Property of the Estate – The Trust Res or the Debtor's Beneficial Interest

In the case of In re Nichols, 434 B.R. 906 (Bankr. M.D. Fl. 2010), the Court held that where the Debtor established a revocable, self-settled trust solely for her own benefit and under which the Debtor is the Grantor, Trustee and sole beneficiary, the law is well settled that property held in such a trust is property of the estate when the Debtor files a bankruptcy case, Id. at 907. In this case, the Trust contained spendthrift provisions that attempted to make the

Debtor's interest in the trust assets not subject to the claims of any creditors, but was unsuccessful in keeping the assets out of the hands of the bankruptcy Trustee. As the Court states, the Debtor retained complete dominion and control over the trust's assets.

In the case of Riley v Tougas (In re Tougas), 338 B.R. 164, 173 (Bankr. D. Mass., 2006), the Court focused in on the terms of the Trust which in places appeared to be contradictory. The Court determined that since the Debtor had the right to revoke or terminate the trust, that the trust res must be considered property of the estate. It further states that "The outcome of these cases sometimes turns on whether the settlor or trustee is also a beneficiary of the trust or whether the debtor treated the trust res as if it were his own." See also Marrama v DeGiacomo (In re Marrama), 316 B.R. 418 (B.A.P. 1st Cir. 2004); Beatrice v Braunstein (In re Beatrice), 296 B.R. 576 (B.A.P. 1st Cir. 2003); and Aylward v Landry (In re Landry), 226 B.R. 507 (Bankr. D. Mass. 1998).

In the New Hampshire case of Gordon v White (In re Morgenstern), 542 B.R. 650. (Bankr. D.N.H. 2015) where the Court found that absent the bankruptcy filing, the Debtor's creditors would have been able to reach the property to settle their claims against the trustee, the trustee in bankruptcy could reach the assets. Therefore, even though the Debtor was only a 25% beneficiary of his self-settled revocable trust, the entire property held by the Trust was property of the Debtor's estate not, just the 25% interest.

Property of Estate in Chapter 13 Under § 1306(a)(1) and 541(a)(5)(A)

Under 11 U.S.C. 541(a)(5)(A), property of the estate also includes any interest in property that would have been property of the estate had it been an interest of the debtor on the date of filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after the date of filing by bequest, device or inheritance.

So what happens in a Chapter 13 case where the Debtor becomes entitled to an inheritance, say 2 years after his Chapter 13 case was filed? The majority of Courts hold that the inheritance becomes property of the 13 estate because of Section 1306(a)(1), which states:

> "Property of the estate includes, in addition to the property specified in section 541 of this title – (1) all property of the kind specified in such section that the Debtor acquires after the commencement of the case, but before the case is closed, dismissed or converted to a case under Chapter 7, 11 or 12 of this title, whichever occurs first."

Relying on Barbosa v Solomon, 235 F.3d 31, 36-37 (1st Cir. 2000), the New Hampshire Bankruptcy Court in the case of In re Mizula, 525 B.R. 569 (Bankr. D.N.H. 2015) found last year that where Debtor's mother died about 2 years after the case was filed and the plan had been confirmed that the inheritance became property of the estate. In Barbosa v Solomon, the first circuit held that even though Section 1327(b) states that "the confirmation of a plan vests all of the property of the estate in the debtor," the bankruptcy estate continues to exist post-confirmation and continues to be funded by post-petition assets.

Resulting Trust

It is not uncommon for a Debtor, for example, to be on her mother's checking account for estate planning purposes. At least my experience has been that the Bankruptcy Trustees treat the funds as being held by the daughter in a "resulting trust" for the benefit of the mother and not reachable by the bankruptcy estate's Trustee. Property of the bankruptcy estate specifically excludes "[p]roperty in which the debtor holds, as of the commencement of the case, only legal

title and not an equitable interest…" 11 U.S.C. § 541(d). This was written into the Bankruptcy Code to make sure the Trustee did not have greater rights in property that the Debtor had prior to filing.

Whether a resulting or implied trust will protect the asset from the Trustee's turnover action is determined by the applicable state law. In the case of Askenaizer v May (In re Jewett), 2007 Bankr. LEXIS 18 (Bankr. D.N.H. 2007), Judge Deasy laid out New Hampshire law regarding the creation of a resulting trust. "Under New Hampshire law, a traditional resulting trust occurs when a Party ("Party A") provides the consideration for a conveyance of land and instructs that title be taken in the name of a third party ("Party B")." "A resulting trust may also arise when "Party A" borrows money from "Party B" for the purchase of land and title to the land goes into "Party B". As a note, NH RSA 477:17 states that "no trust concerning lands, except as may arise or result by implicating law, shall be created or declared unless by an instrument signed by the party creating the same or by his attorney (emphasis added.)

Likewise, when Mom has a bank account or even a piece of real estate and puts daughter on the account or even on a deed, it can be argued that the daughter holds the property in a resulting trust for mom and/or that the daughter only holds legal title and not an equitable interest in the property. However, if daughter deposits money to that bank account or uses the money for her own purposes, the trustee may be able to recover the property. Likewise, problems can result regarding the involvement of the Debtor related to deeded property.

Clark v Rameker

On March 24, 2014, the US Supreme Court in the case of Clark v. Rameker, 134 S. Ct. 2242, 189 L. Ed. 2d 157, 2014 U.S. LEXIS 4166, 82 U.S.L.W. 4481, 2014-1 U.S. Tax Cas.

(CCH) P50,317, 71 Collier Bankr. Cas. 2d (MB) 865, 59 Bankr. Ct. Dec. 159, Bankr. L. Rep. (CCH) P82,641, 24 Fla. L. Weekly Fed. S 843 (U.S. 2014) had to deal with the issue of whether a debtor, who inherited a retirement account from her mother, could use 11 U.S.C. 522(b)(3)(C) to exempt the funds. The holding does not appear to apply to funds from a spouse's retirement account. However, it may be wise if counseled by a recipient, to have a spouse roll over his or her deceased spouses' IRA as opposed to leaving it in an inherited IRA account because of lengthy discussions about an inherited IRA.

Heidi Heffron-Clark, Debtor, was the sole beneficiary of an IRA established by her mother who passed away prior to debtor's filing. The Debtor claimed, pursuant to 11 U.S.C. 522(b)(3)(C), she was allowed to exempt the funds held at the time of the filing in an inherited IRA, but the Supreme Court held otherwise. In assisting it in making its decision, the Court examined the IRS's statutes regarding, in this case, an IRA. Since Debtor was not the former spouse of the decedent, she either had to cash it out upon her mother's death or keep it in an inherited IRA. The Debtor kept the funds in the inherited IRA account and was required to take distributions over a period of 5 years or take what are referred to as a minimum annual distribution. "That the tax rules governing inherited IRAs routinely lead to their diminution over time, regardless of their holder's proximity to retirement, is hardly a feature one would expect of an account set aside for retirement." Id. at 2247. Also, the Court noted that withdrawals of inherited IRAs do not have the 10% early withdrawal penalty, and thus don't have the incentive to keep the money in the account until the owner is approaching retirement. Finally, the Court noted the Debtor could not contribute any funds to that IRA. For all those reasons the court held the account didn't have the characteristics of being used for retirement. The Court remarked that the exemptions a debtor is entitled to in bankruptcy generally relate to essential needs like a

house, a car, tools of the trade, possibly some cash, and while having money for retirement may be considered an essential need, these account really do not help that purpose.

While on the subject of retirement accounts, just one last note in case it has never come to your attention, in 2005, Section 522(n) was added to the code, limiting the amount that one can exempt in all of the debtor's IRAs to now $1,283,025 with the added proviso that the limit may be increased if the interests of justice so requires. The maximum amount automatically increases every three years.

The Interplay of Bankruptcy Code Sections 541 and 522 Powers of Appointment and Remainder Interests

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This article discusses the intersection of bankruptcy law and estate planning, with a focus on powers of appointment and remainder interests. Where the bankruptcy practitioner knows that the potential bankruptcy debtor created these or other estate planning devices, it is for the practitioner to assess their impact on the contemplated bankruptcy filing. The interplay between specific provisions of the Bankruptcy Code, namely §§541 and 522, is central to this determination. The client's decision to file for bankruptcy may depend on the extent to which assets of their estate planning arrangement could also comprise the pool of assets from which their creditors would be paid in a bankruptcy proceeding, also known as the bankruptcy estate. There may be limited, if any, choice in the matter, however, if their estate planning arrangement does not comport with Bankruptcy Code provisions protecting certain interests, as well as with relevant state laws looked to by the bankruptcy courts in applying the Code.

Two factors are key in prebankruptcy assessment for such compliance: (1) the ownership control the client retains over the assets of their estate planning arrangement; and (2) the timing of their estate planning efforts relative to the contemplated bankruptcy. Of particular concern is whether the estate planning arrangement could be challenged as manifesting the "intent to hinder, delay or defraud" the client's creditor.

Sections 548 and 544 of the Bankruptcy Code authorize the bankruptcy trustee to avoid the prebankruptcy estate planning of a bankruptcy debtor as "transfers" if the bankruptcy court determines the estate planning is the result of fraudulent conduct, actual or constructive. A court's finding to that effect places the challenged estate planning assets in the bankruptcy estate. Additionally, estate planning assets the bankruptcy debtor is unable to exempt will also constitute property of the bankruptcy estate. The bankruptcy practitioner, ideally, will know the extent of the client's estate planning efforts to determine exemptions to be claimed before filing for bankruptcy.

Client intake discussions on alternatives to bankruptcy can help identify the scope of the client's estate planning affairs, as implicated by a potential bankruptcy. Inquiries into bankruptcy alternatives may, for example, reveal family members of the client with the means to help resolve their financial difficulties outside of bankruptcy. Occasionally, these same relatives have estate plans in place that devise an ownership interest in the client. Here, too, the practitioner ideally is able to review the correlating estate planning document(s), pre-bankruptcy,[1] even if ultimately to advise the client to retain the services of an estate planning specialist.

Some familiarity with estate planning instrumentalities and an individual's possible designations within them can facilitate these pre-bankruptcy consultations. Attached for reference is a non-exhaustive list of traditional estate planning instruments, the beneficial

[1] Under Massachusetts General Laws ("M.G.L") Chapter 190, §2-516, any person having the custody of a will must deliver the will for probate within thirty days of acquiring knowledge of the death of the testator. Delivery is usually made to the probate court in the county of the decedent-testator's primary resident. Accordingly, one may be able to obtain a copy of estate planning documents of a testator at the appropriate probate court.

and legal interests they can devise, as well as statutory estate planning designations under the Massachusetts Probate Uniform Code (MPUC).

This article references the following Bankruptcy Code sections: 11 U.S.C, §541, *Property of the estate* and 11. U.S.C., §522, *Exemptions.* Reference is also made to Massachusetts General Laws, Chapter 188, *Homesteads.*

11 U.S.C. § 541 – PROPERTY OF THE ESTATE

Section 541 of the Code sets forth the nature and extent to which the corpus of any interest of a bankruptcy debtor may become property of the bankruptcy estate at the time of the bankruptcy filing.

The equitable interest common to estate planning arrangements may become property of a bankruptcy estate pursuant to § 541(a) of the Bankruptcy Code.

That provision reads:

> (a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all of the following property, wherever located and by whomever held:
>
> (1) Except as provided in subsections (b) and (c)(2) of this section, all legal or equitable interests of the debtor in property as of the commencement of the case.
> §541(a)(1)

Section §541(a)(7), the final subsection, further notes that the bankruptcy estate includes "Any interest in property that the [bankruptcy] estate acquires **after** the commencement of the case." §541(a)(7) (emphasis added) Due to §541(a)(5), as discussed below, section 541(a)(7) is subject to limited applicability in a chapter 7 bankruptcy case.

Section 541(c)(2) narrows the composition of the bankruptcy estate, stating that:

> A restriction on the transfer of a beneficial interest of the debtor in trust

> that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title. §541(c)(2).

Ideally, the practitioner and the bankruptcy debtor are fully apprised of the treatment that the debtor's estate planning assets would receive in a bankruptcy case, prebankruptcy. However, litigation of related issues illustrates that these cases can be extremely fact-driven, as well as subject to developing state laws.[2] Independent of such variables, the case *In re McGuire* captures the fundamental dilemma to be reconciled, recognition of a legitimate estate planning purpose – to dispose of one's property as one wishes upon one's death – and implementing the intent of the Code that a bankruptcy estate deal fairly with the debtor's creditors.

In *In re McGuire*,[3] the nondebtor mother executed a codicil to her will, after her Debtor son filed for bankruptcy. The codicil disinherited the Debtor son for a period that effectively eluded the 180-day schedule set forth in §541(a)(5)(A) of the Bankruptcy Code, during which property that a Chapter 7 debtor acquires "…by bequest, devise, or inheritance…" post-petition is property of the bankruptcy estate.[4] The Debtor's mother died during the 180-day timeframe of §541(a)(5)(A). As such, the Debtor's sister was to inherit all of the mother's estate, pursuant to the codicil.[5] The bankruptcy trustee filed an

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[2] As of the date of this article, various states comprising the Northeast region had undertaken some form of revision to their respective probate laws between 2012 and 2016.

[3] *In re McGuire*, 209 B.R. 580 (Bankr. D. Mass. 1997)

[4] Note, however, that in interpreting New York state law, a bankruptcy court held that creditors and the bankruptcy trustee were entitled to distributions of spendthrift trust beyond the 180 day period of §541(a)(5)(A). *See In re Hunger*, 272 B.R. 792 (Bankr. M.D. Fla. 2002) (interpreting New York statue, N.Y.C.P.L.R §5205(d)(1))

[5] The majority view holds that §1306 of the Bankruptcy Code creates an exception to the 180-day time period in a Chapter 13 bankruptcy. Specifically, any inheritance a Chapter 13 debtor receives "after the

adversary complaint asserting, among other grounds, that the codicil violated public policy. In holding for the debtor, the court looked to state law. It found that the facts before it gave the Debtor "…no more than an expectation of inheriting property from his mother at the time of her death.[6] The court also found that the Debtor's mother revoked her gift to the Debtor prior to her death.[7]

A secondary source cites *In re McGuire* in its discussion of the general invalidity of "ipso facto" clauses in the context of a bankruptcy, and also then references §541(c)(2) as the exception to the general unenforceability of "ipso facto" clauses – encapsulating the nature of the competing issues in *In re McGuire*.[8] As provided above, §541(c)(2) establishes that a spendthrift trust, under state law…" effectively "…[functions to] supersede the Bankruptcy Code policy that all non-exempt assets of a debtor under Chapter 7 be distributed to the debtor's creditors."

11 U.S.C. § 522 - EXEMPTIONS

Section 522 of the Bankruptcy Code delineates the debtor's right to exempt certain property that could be recovered by the bankruptcy trustee. Generally, exemptions under

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commencement" of the Chapter 13 case, but before the case is "closed, dismissed or converted," becomes property of the bankruptcy estate, regardless if inherited after the 180 day time period. *See In re Roberts*, 514 B. R. 358, 360 (Bankr. E.D.N.Y 2014) (citing *In re Euerle*, 70 B.R. 72, 73 (Bankr. D.N.H. 1987)). As §11325(b)(4) of the Bankruptcy Code requires an applicable commitment period of approximately three to five years in a Chapter 13 case, it is this period of time during which a Chapter 13 debtor's inheritance may constitute property of the bankruptcy estate.

[6] *In re McGuire,* 209 B.R. 580, 582 (Bankr. D. Mass. 1997); See also, *In re Trautman*, 296 B.R. 651, 655 (Bankr. W.D.N.Y. 2003)(("debtor possessed mere expectancy of payment in the event that her mother might die before exercising her right to change beneficiary.") Journal of the National Association of Bankruptcy Trustees; Fall 2014, Volume 30, Issue 3.

[7] *Id.* 584

[8] William C. Hillman and Margaret M. Crouch, *Bankruptcy Deskbook*, Practising Law Institute, Banking and Commercial Law Library, Fourth Edition, Volume 1, , Section 7:1.2 "Exclusion from Property of the Estate"

§522 are not automatic. The debtor, therefore, must claim the exemptions necessary to protect exemptible property from the bankruptcy estate.[9]

In pertinent part, §522(b)(1) states:

> Notwithstanding section 541 of this title, an individual debtor may exempt from property of the estate the property listed in either paragraph (2) or, in the alternative, paragraph (3) of this subjection. If the parties cannot agree on the alternative to be elected, they shall be deemed to elect paragraph (2), where such election is permitted under the law of the jurisdiction where the case is filed. §522(b)(1)

Pursuant to §§ 522(b)(2) and (3), a debtor may elect to exempt certain property interest from the bankruptcy estate either as delineated under section 522(d) of the Bankruptcy Code, or the debtor may use the state exemption scheme where the debtor can establish domicile under section 522(b)(3). Some states have "opted-out" of the federal exemption system as provided by the Bankruptcy Code and do not allow bankruptcy petitioners to claim federal exemptions.

In Massachusetts, where the asset of the estate plan is a principal residence, a homestead exemption of that asset may be available pursuant to M.G.L. Chapter 188. Under this statutory exemption scheme, the debtor homeowner may select only one exemption to protect the value of their home from specific creditors. As of its revision in 2011, Section 1 of the statute provides an automatic homestead in the amount of $125,000,

[9] *In re Wallace*, 453 B.R. 78 (Bankr. W.D.N.Y. 2011) (the court did not allow the debtor to avoid a judicial lien, pursuant to 522(f)(1) of the Code, because the debtor failed to claim a homestead exemption, as required under applicable state law. The court conditioned the debtor's eligibility to avoid the judicial lien on the debtor amending their bankruptcy petition to claim the homestead protection.)

precluding the sale of the debtor's home to satisfy money judgment that is less than $125,000. M.G.L. c. 188, §1. Note the saving grace of this additional statutory provision in some of the cases discussed below.

Section 2 of the provision allocates the automatic homestead exemption in proportion to the ownership interest where the "owners"[10] are tenants in common or trust beneficiaries. As discussed below, this allocation was applied in the bankruptcy *In re Vanburskirk*.

Section 522(c), in relevant part, states:

> Unless the case is dismissed, property exempted under this section is not liable during or after the case for any debt of the debtor that arose, or that is determined under section 502 of this title as if such debt had arisen, before the commencement of the case,…§522(c)

Section 502 of the Bankruptcy Code, as referenced above, sets forth the requirements for allowing creditors' "claims or interests" against a bankruptcy debtor.

As the cases below illustrate, Section 522 provisions of §541 are fundamental to determining whether an estate planning arrangement constitutes property of the bankruptcy estate.

Related Cases

Power of Appointment[11]

[10] In its most recently amended version, effective March, 2011, MGL c. 188 includes homestead exemption for a home owned by a "trustee beneficiary." The statute defines "owner" as "a natural person who is a sole owner, joint tenant, tenant by the entirety, tenant in common, life estate holder or holder of a beneficial interest in a trust." M.G.L. c. 188, §1.

[11] A power or authority conferred by one person by deed or will upon another (called the "donee") to appoint , that is, to select and nominate, the person or persons who are to receive and enjoy and estate or an income therefor or from a fund, after the testator's death, or the donee's death, or after the termination of an existing right or interest." Black's Law Dictionary (5th ed. 2009).

In *Casey v. Schneider (In re Behan),*[12] the Chapter 7 bankruptcy debtor held a prebankruptcy beneficial interest in a trust. The trust contained a spendthrift provision and also granted the debtor a power of appointment. Specifically, the trust authorized the debtor to demand payment from the trust. Consequently, the bankruptcy trustee argued that the debtor's beneficial interest in the trust was property of the bankruptcy estate, pursuant to §541 encompassing a bankruptcy estate to include a debtor's "legal and equitable interest." In further support of the objection, the bankruptcy trustee pointed to the fact that the debtor's power to demand payment was not subject to the discretion of the trustees of the trust, the debtor's sisters. The debtor countered that §541(c)(2) whereby the subject trust would qualify as a spendthrift and not constitute property of the bankruptcy estate. The debtor argued furthermore that he had not exercised the right to demand payment. Still, the debtor attempted to amend his exemption claims to include the interest at issue, to which the bankruptcy trustee objected on the ground of prejudice to the debtor's creditors.

The court held for the bankruptcy trustee, noting that the trust did not comply with state law. Specifically, the court stated that applicable state law invalidated a spendthrift trust where the holder of a beneficial interest under the trust "could appoint to himself or his executor." The subject trust provision granting the debtor the power to demand payment violated this principle of a valid spendthrift trust, held the court. Therefore, §541(c)(2) did not apply and the trust comprised the debtor's bankruptcy estate.

[12] *Casey v. Schneider* (In re Behan) 2014 Bankr. LEXIS 732 (Bankr. D. Mass. February 24, 2014)

Citing other bankruptcy decisions, the court further found precedence holding that bankruptcy trustee could exercise the power of appointment of a bankruptcy debtor, when that power of appointment invalidated the spendthrift of trust.

In re Vanbuskirk[13] presents a multi-faceted set of issues, involving a recently amended state homestead exemption statute and principles of powers of appointment, among other issues. In short, the Chapter 7 joint debtors created two trusts before filing their bankruptcy. At the time of filing, the joint debtors held the right to change the beneficiaries of the first trust, for which they were settlors and trustees the Realty Trust. Upon filing, the joint debtors also still had their ownership interest in one of three-unit condominium held in the second trust, the Family Trust. The Family Trust res also included the debtor couples' three-unit condominium complex and their one-fourth beneficial interest as co-owner occupants of one of the condo units. Eventually, the couple claimed Massachusetts' automatic homestead exemption.

The bankruptcy trustee objected to the couple's homestead exemption on two grounds. First, the bankruptcy trustee argued, the joint debtors were not entitled to a homestead exemption because their beneficial interest in the Realty Trust did not pass from to the Family Trust, which held the Realty Trust. On the other hand, the bankruptcy trustee asserted, if the Family Trust did hold the debtor couple's beneficial interest, it was only as to the proportion of their ownership interest, which was calculated at one-fourth, pursuant to requirements of M.G.L. c. 188, §1. The debtors co-owned the condominium unit with their three sons.

[13] *In re Vanbuskirk*, No. 13-41947-MSH (Bankr. D. Mass. 2014)

The court noted that the bankruptcy trustee's reasons for challenging the couple's homestead exemption were two-fold. As the court stated, the bankruptcy trustee's intentions were to "come to own unit 1 or at least cause it to be sold and retain the net sale proceeds for the benefit of the bankruptcy estate free of…any homestead exemption claim." The court further observed that the revocable power that the debtors had retained for themselves in the Realty Trust effectively established the trust as property of the bankruptcy estate.[14] The bankruptcy trustee could later advance this argument to exercise the rights and powers of appointment of the joint debtors under the Realty Trust, including the power to appoint its beneficiaries. The court also discussed the characteristics of general appointment power in contrast to a special power of appointment. Quoting *Morgan v. Comm'r of Internal Revenue* (citation omitted), that the "distinction" lies in whether the holder of the power of the appointment (the donee) may "appoint anyone…including himself" – a general power – or whether the donee may only appoint a specific or designated group of people, and cannot appoint himself."

The court determined that the debtors were entitled to a one-fourth claim for homestead purposes.[15]

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[14] citing *Marramar v. Degiacomo (In re Marrama,* 316 B. R. 418 (BAP. 1st Cir. 2004); *Beatrice v. Braunstein (In re Beatrice),*296 B.R. 576 (B.A.P. 1st Cir. 2003); *Murphy v. Felice (In re Felice)*, 494 B. R. 160 (Bankr. D. Mass. 2013), among others.

[15] However, see *Boyle v. Weiss*, 461 Mass. 519 (District of Massachusetts Bankruptcy Court certified the following question to the Massachusetts Supreme Judicial Court: "May the holder of a beneficial interest in a trust which holds title to real estate and attendant dwelling in which such beneficiary resides acquire an estate of homestead in said land and building under G.L. C. 188, § 1?" The subject homestead was recorded prior to the Commonwealth's revisions of the homestead statutes, which did not define "owner" for purposes of homestead exemptions to include the holder of a remainder interest.

Life Estates and Remainder Interests

In re Gordon[16] addresses the application of §§541(a)(5) and 522, subject to state law. A Massachusetts case, the Chapter 13 debtor claimed a homestead exemption for her remainder interest in real property, citing M.G.L. c. 188, §1, the Massachusetts homesteads statute . The bankruptcy trustee objected on the ground that the debtor's remainder interest did not constitute an ownership interest as defined in the homestead statute. The debtor differed, asserting the statute's "..expand[ed] definition of 'owner' to include, *inter alia*, the holder of a beneficial interest in a trust, signaled a general expansion of the term 'owner' that encompassed her remainder interest.

In sustaining the bankruptcy trustee's objection, the court observed that it must interpret the statute as it thought the highest court of the state would rule. Citing the Supreme Judicial Court decision in *Boyle v. Weiss*,[17] the bankruptcy court determined that it accordingly was limited in the extent that it could interpret the state's statute in the present case. In *Boyle*, the SJC decided a question certified to it by the District of Massachusetts Bankruptcy Court. That question was as to the eligibility of Chapter 7 debtor who declared and recorded a homestead exemption under the 2004 version of the state's homestead statute could apply homestead exemption found only in the 2011 revised homestead statutes. The SJC declined to apply the 2011 statute retroactively. The bankruptcy court in *In re Gordon* reasoned, therefore, that "while not directly on point", the *Boyle* decision was instructive in how it must rule in interpreting the state's homestead

[16] *In re Gordon*, 487 B.R. 600 (Bankr. D. Mass. 2013)

[17] 461 Mass. 519

statute. As such, the court concluded that the "remainder interest" for which the debtor claimed a homestead exemption did not satisfy the definition of "owner" under the 2011 homestead statute