AMERICAN BANKRUPTCY INSTITUTE

2022 Consumer Practice Extravaganza

Advanced Exemption-Planning Issues

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Time	Topic	Speaker
0-5	Q: Is exemption planning ok? • Generally ok • But, pigs get fed and hogs get slaughtered • Conflicting circuit cases one allowed conversion of non-exempt to exempt and a separate denied discharge for doing so	
5-10	Q: So, what works? • Maximizing retirement plan contributions within IRS limits • Maximizing cash value of life insurance or similar exemptions • Possibly paying down mortgage subject to caps referenced below and not if done with fraudulent intent • If debtor owns a business, possibly creating a defined benefit or other plan that permits greater annual contributions • Richard to share war stories • Mike to add any comments from Illinois perspective	
10-15	Q: What are some of the caps on exemptions that limit exemption planning? • Section 522(n) – Caps exemptions in IRAs at $1,512,350 • Section 522(o) – 10 year look back to avoid transfers of non-exempt to exempt property made with actual intent to hinder, delay, or defraud • Section 522(p) – Caps exemptions in residences, burial plots to the extent debtor acquired such interest in the 1215 day (3.33 year) period prior to bankruptcy. Current cap is $189,050 • Section 522(q) – Caps exemptions by felons or if debtor owes a debt arising from a crime, intentional tor, or reckless	

	misconduct that caused serious physical injury or death at $189,050 • Gallian – Debtor held title to residence in LLC and then transferred to herself on the eve of bankruptcy. Court held that cap applied. • Kane – Debtor held title to residence in LLC and court held that debtor could not exempt residence because only asset of the estate was the membership interest •	

15-20	Q: What doesn't work
	• Asset protection schemes
	• Single premium deferred annuity
	  ○ In re Turner
	  ○ Georgia Supreme Court
	• PRPs
	  ○ Allebest – Tell Story
	  ○ Jafroodi – Tell Story
	  ○	

20-25	Q: Exemptions in property recovered by trustee
	• Section 522(g) permits exemptions unless
	• Recovered property voluntarily transferred
	  ○ Glass – no formal action necessary
	  ○ Perez BAP case – but need a clear demand (possibly allows debtors to transfer back)
	  ○ Roach - Deed of trust subordinated per agreement with trustee
	  ○ Not to a foreclosure sale
	• Recovered property concealed
	  ○ 9th Cir BAP case where debtor didn't disclose
	• Section 522(h) permits a debtor to avoid a transfer if can exempt
	  ○ Swintek – debtor avoided preferential judgment lien on	

	cash that was exempt under wildcard exemption ○	
25-27	Burden of Proof • FRBP 4003 – on objecting party • May be different in opt-out states • Per SCOTUS, the burden of proof is an element of a claim • If state law provides the exemption and if state law imposes burden on party claiming the exemption, then bankruptcy courts follow state law	
27-30	Special Assets Joint Tenancy • In community property states, JT still presumed to be CP – Brace • Some states provide that JT or TBE property is exempt • Mike to comment or Illinois law • Right of survivorship ○ Can increase POE if non-debtor JT dies – Brace ○ Can remove property from estate if Debtor dies – Recent Illinois case ○ Practice Tip: Consider whether to sever the JT ○	
30-34	Special Assets Revocable Living Trusts Q: Debtor has an interest in a revocable living trust, is it exempt? • Trick question because it's not POE • If debtor's status as beneficiary is subject to a right of revocation, then such an interest does not constitute property. • Thus, it will not be property of the estate • This type of revocable interest is generally referred to as an expectancy Q: What if Debtor's status as a revocable beneficiary terminated on eve of petition date?	

	• Steinmann - parents removed debtor as a beneficiary. They did this with actual intent to keep creditors from getting any money. • Trustee sued to avoid and recover trustors' termination of debtor's revocable interest • But, Sections 544 and 548 only permit a trustee to avoid a debtor's transfer of an interest in property and also sought to impose a constructive trust • In this case, there was never a property interest. As such, there is nothing to avoid and recover. • A trustee, however, filed such a lawsuit against the parents and against Debtor's nine other siblings alleging that their increased percentage interests in the trust were subject to avoidance • The parents were quite wealthy and Trustee then started extensive discovery into the parents' assets • I was retained to defend trustee's action • We obtained judgment on the pleadings and the court wrote a 35 page unpublished decision • Side note: Defendants then retained counsel to pursue sanctions and court imposed massive sanctions	
34-38	Special Assets Bequest, Devise, or Inheritance Q: If debtor's revocable interest as of the petition date isn't property, what if their parents pass away in the first 180 days post-petition? Does that trust interest become property of the estate under Section 541(a)(5)? • No. Section 541(a)(5) applies to a bequest, devise, or inheritance • An inter vivos trust does not constitute a testamentary disposition	

	• This was the holding in In re Spencer which is a bankruptcy case from the Central District of California • In Spencer, debtor was a revocable beneficiary of her parents' trust • The Trust provided that it was revocable at any point during the lifetime of either parent. • Mom died prior to bankruptcy • Dad died within 180 days after bankruptcy • Trustee filed an action for declaratory relief and turnover • Court granted debtor judgment on the pleadings in a published decision • The 9th Cir. BAP reached the same conclusion in an unpublished decision called In re Cook. • NOTE: The result would different for a testamentary trust which is a trust created after the death of the settlor pursuant to a will • But, if Debtor actually inherits property by will, then it will be POE • Practice Pointer: Be sure to ask your clients if they are likely to inherit and plan the filing accordingly • ALSO, if Debtor in a Ch 11 or 13, then there are cases that hold that property acquired beyond the 180 days is still POE because all post-petition property becomes POE. Seek to convert or dismiss if in a reorganization beyond the 180 days •	
38-42	Special Assets Spendthrift Trusts Q: If a debtor's interest in a trust vested prior to bankruptcy because a settlor died, can a trustee reach assets in a Spendthrift trust? • Spendthrift provisions are common in trusts	

	• Whether such a provision is enforceable to exclude debtor's interest from property of the estate is depend upon state law. • Most states do enforce spendthrift provions to some extent • But, State laws vary • In Illinois, no limits on extent of spendthrift provision • But, in California, the law refers to 75% • California Supreme Court decided the Reynolds case in 2017 • In Reynolds, Debtor filed bankruptcy one day after his father died. Under the terms of his father's trust, his interest in the trust vested subject to a condition that he outlive his father by 30 days. • Debtor was immediately entitled to $250k plus also $100k per year for 10 years • California Supreme Court held that once the $250k payment became payable, then no spendthrift protection • With regard to the 10-year stream of payments, creditors could get an order now to intercept 25% of the future payments • The BIG unanswered question in Reynolds is whether a trustee can leave the bankruptcy case open for 10 years waiting for each payment to become payable and lose all protection • Trustees will argue that the exclusion from estate property is only for as long as the restriction is enforceable • Example: Pittman – Debtor's rights in spendthrift trust vested prior to bankruptcy. No payments were due and payable to her as of the petition date. Right to intercept 25% of future payments. Settled case threatening to leave it open until all her payments became due.	

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42-46	Q: If spendthrift provisions are enforceable, can a debtor create a trust with a spendthrift provision and name himself as beneficiary? • This is called a self-settled trust • Many states' laws do not enforce self-settled trusts • Approximately 10-15 states, however, do enforce self-settled trusts • Delaware, Mississippi, South Dakota, Wyoming, Tennessee, Utah, Oklahoma, Colorado, Missouri, Rhode Island, New Hampshire, Nevada, Alaska, and Hawaii • Even if state law enforces a self-settled trust, debtor's transfer of property to such trust remains subject to fraudulent transfer statutes • Most state laws have 2-4 year reach-backs • But, Section 548(e) extends avoidance of self-settled trusts to 10 years • Section 548(e) applies even if state law would enforce a self-settled spendthrift provision • One Section 548(e) case is In re Huber out of Washington. In Huber, debtor created a self-settled trust and transferred his residence and other assets to an Alaskan LLC owned 99% by the trust and 1% by debtor who was the LLC's manager • The LLC then leased debtor his residence back • So, in effect, nothing changed with debtor continuing to live in and control his home • Debtor then filed bankruptcy and trustee successfully avoided the transfers under Section 548(e) • PRPs would be self-settled because debtor creates phony retirement plan and names himself beneficiary	

46-50	Q: If a debtor transfers to an irrevocable or self-settled trust outside of a state's fraudulent conveyance reach-back, is the Debtor now able to safely file bankruptcy? • Not necessarily • With any luck, the US government will be a creditor • Under the Federal Debt Collections Procedure Act "FDCPA" not to be confused with the Fair Debt Collection Practices Act • Title 28 vs. Title 15 • 28 U.S.C. § 3304(a) provides that • a transfer made or obligation incurred by a debtor is fraudulent as to a debt to the United States which arises before the transfer is made or the obligation is incurred if— • (1)(A) the debtor makes the transfer or incurs the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation; and • (B) the debtor is insolvent at that time or the debtor becomes insolvent as a result of the transfer or obligation[.] • Bensal was a 9th Circuit case • In Bensal, debtor owed money to the SBA • Debtor's father died vesting debtor's interest in a trust • Debtor's interest worth at least $400k • Four months later, Debtor disclaimed his interest in the trust • A disclaimer is generally a debtor saying no thanks to an inheritance • Most state laws provide that disclaimers are not subject to avoidance as fraudulent transfers • Bensal lived in California and California law follows the general rule that disclaimers are not fraudulent transfers	

	• But, federal law including the FDCPA does not have a similar disclaimer statute • The 9th Circuit held that when debtor's interest in the trust vested, he acquired property rights. This issue was decided by reference to state law. • The FDCPA's fraudulent transfer provision the permitted its avoidance with the state law to the contrary being preempted • The reason why the FDCPA is exciting for trustees is that it has 10-year reach back • Many bankruptcy courts allow a trustee to step into the shoes of such governmental creditor to avoid transfers otherwise outside the statutes of limitations under Section 548 and state law • Only Circuit to address is the 5th Circuit which said a trustee couldn't • But, this is the minority position	
50-54	Q: Are transfers to an offshore trust safe? • Olson • Debtor transfers money to Cook Islands • Debtor ordered to repatriate the money • Instead, she sends poison pill • Debtor found in civil contempt and incarcerated for 15 months • Because the Cook Islands exist to thumb their nose at US laws, the offshore trustee will never return the money • So, we sued the local asset protection attorney for aiding and abetting and conspiring to commit a fraudulent transfer • No damages if funds repatriated • Cut settlement with asset protection attorney for him to be a liaison • Debtor signed • $4 million back	

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54-58	Q: What if the debtor has a vested interest in a trust and the trust owns the property in which debtor resides? • Clarkson's In re Nolan case	
58-End	Questions	

Advanced Exemption Planning and Treatment of Trusts in Bankruptcy

CPEX – 2022

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1. Exemption Planning

    a. Legislative history indicates planning is proper. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 361 (1977), reprinted in App. Pt. 4(d)(i) infra (the conversion of nonexempt property into exempt property is not per se fraudulent).

    b. Conflicting cases. Eighth Circuit cases.

        i. *Hanson v. First National Bank Hanson v. First Nat'l Bank*, 848 F.2d 866 (8th Cir. 1988) and *Norwest Bank Neb., N.A. v. Tveten*, 848 F.2d 871 (8th Cir. 1988) were decided on the same day by the same panel of judges.

        ii. In *Hanson*, the debtors were farmers who converted $35,000 of non-exempt property into exempt property. The Eighth Circuit affirmed the lower courts' decisions overruling the objection to the exemption based on the finding that the debtors had no fraudulent intent in making the transfers.

        iii. In *Tveten*, the debtor was a physician who liquidated his nonexempt property and purchased approximately $700,000 worth of exempt annuities and life insurance policies. The Eighth Circuit affirmed the lower courts' denial of discharge because the transfers were made with fraudulent intent.

2. What works

    a. Maximizing retirement plan contributions within IRS limits especially if debtors have a history of doing so

    b. Maximizing cash value in life insurance or similar exemptions

    c. Possibly paying down mortgage subject to Section 522 caps and if not done with fraudulent intent

    d. If debtor owns a business, possibly creating a defined benefit or other plan that permits greater annual contributions

3. What doesn't work

    a. Asset protection schemes rarely, if ever, work. Great risk for denial of discharge

    b. Single premium deferred annuities.

        i. Most courts hold that they are not exempt under state or Section 522(d). *In re Turner*, 186 B.R. 108 (9th Cir. BAP 1995)

ii. But, see *Silliman v. Cassell*, 292 Ga. 464 (2013).

4. Section 522 Caps

   a. Section 522(n) – Caps exemptions in IRAs at $1,512,350

   b. Section 522(o) – 10 year look back to avoid transfers of non-exempt to exempt property made with actual intent to hinder, delay, or defraud

   c. Section 522(p) – Caps exemptions in residences, burial plots to the extent debtor acquired such interest in the 1215 day (3.33 year) period prior to bankruptcy. Current cap is $189,050

   d. Section 522(q) – Caps exemptions by felons or if debtor owes a debt arising from a crime, intentional tor, or reckless misconduct that caused serious physical injury or death at $189,050

5. Exclusions from Property of the Estate – Is the Debtor's Interest in a Trust Excluded?

   a. A debtor's interest in a trust that contains a restriction on transfer (spendthrift provision) that is enforceable under applicable non-bankruptcy law is excluded from the Estate. 11 U.S.C. § 541(c)(2). *See also, Patterson v. Shumate,* 504 U.S. 753 (1992); *United States Internal Revenue Service v. Snyder*, 343 F.3d 1171 (9th Cir. 2003).

   b. A debtor's powers as the trustee of a trust *of which the debtor is not a beneficiary* may not be property of the estate. 11 U.S.C. § 541(b)(1); *see, e.g., In re Simon*, 179 B.R. 1, 5-6 (Bankr. D. Mass. 1995); *In re Poffenbarger*, 281 B.R. 379, 391-92 (Bankr. S.D. Ala. 2002) (collecting cases, and ruling that when the debtor held funds in trust for a child, but was not the beneficiary, such funds did not come into the estate); *cf.* 11 U.S.C. § 541(b)(6) (excepting certain funds placed in a Section 529 education fund from property of the estate).

   c. Bodies of applicable non-bankruptcy law

      i. ERISA - Title 29 of the United States Code.

         1. 29 U.S.C. § 1056(d)(1) provides that ""[e]ach pension plan shall provide that benefits provided under the plan may not be assigned or alienated."
         2. ERISA is applicable non-bankruptcy law sufficient to exclude retirement plans subject to and qualified under ERISA from property of the estate. *See, Patterson v. Shumate, supra*.

a. Control. A debtor's interest in an ERISA qualified plan is not subject to alienation and is not property of the bankruptcy estate, even though the debtor holds substantial control over the timing and manner of plan distributions. *In re Connor*, 73 F.3d 258 (9th Cir. 1996).

3. Single Participant Plans Not Subject to ERISA. Plans in which the employer is the only participant are not subject to ERISA. *In re Witwer*, 148 B.R. 930 (Bankr. C.D. Cal. 1992).
    a. A former spouse with an interest in the plan may qualify as the non-owner employee subjecting the plan to ERISA. *In re Metz*, 225 B.R. 173 (9th Cir. BAP 1998).
4. Do protections expires when benefits become payable – The Circuits are Split. Once a benefit from an ERISA plan becomes payable to the participant, the restriction on transfer is no longer enforceable. *N.L.R.B. v. HH3 Trucking, Inc.,* 755 F.3d 468 (7th Cir. 2014); *Hoult v. Hoult,* 373 F.3d 47, 53-55 (1st Cir. 2004); *Central States Pension Fund v. Howell,* 227 F.3d 672, 678-79 (6th Cir. 2000); *Wright v. Riveland,* 219 F.3d 905, 919-21 (9th Cir. 2000); *Robbins v. DeBuono,* 218 F.3d 197, 203 (2d Cir. 2000); *Trucking Employees of North Jersey Welfare Fund, Inc. v. Colville,*16 F.3d 52, 54-56 (3d Cir.1994).
    a. Minority Position. See, *United States v. Smith,* 47 F.3d 681 (4th Cir.1995); *Herberger v. Shanbaum*, 897 F.2d 801, 803-04 (5th Cir. 1990).

ii. State spendthrift trust laws. In California, Probate Code §§ 15300 *et seq.* California law generally enforces anti-alienation provisions on Income (Probate Code § 15300) and Principal (Probate Code § 15301).

1. From 1990 to 2017, the leading bankruptcy case interpreting California spendthrift trust laws had been *Neuton v. Danning (In re Neuton)*, 922 F.2d 1379, 1383 (9th Cir. 1990). In *Neuton*, the debtors filed bankruptcy in November 1987. On the petition date, the debtor held a contingent interest in an *inter vivos* spendthrift trust. The trust provided that debtor was to receive a share of trust income during life and that, if living at the time of the trustor's death, a greater share of the trust. One month later, the trustor died. The 9th Circuit held that 75% of the trust was excluded from the bankruptcy estate as a valid spendthrift trust. The court further recognized that CCP § 709.010 could potentially protect some or all of the remaining 25% that was not necessary for the support of the debtor.

2. *In re Reynolds*, 479 B.R. 67, 71 (B.A.P. 9th Cir. 2012) In *Reynolds*, the debtor was a named beneficiary in three family trusts, the Bypass Trust, the Marital Trust (collectively, the "Family Trust") and the Survivor's Trust ("Survivor's Trust"). Once the debtor survived his father by thirty days, he was entitled to receive distributions from both the Family Trust and the Survivor's Trust. From the Family Trust, debtor was entitled to $250,000. Additionally, as a one-third beneficiary of the Survivor's Trust, debtor was entitled to receive $100,000 per year for ten years. Both the Family Trust and the Survivor's Trust included spendthrift trust provisions. The assets in the Survivor's trust were interests in undeveloped real property that did not generate any income. No income distributions were expected from the trusts.

   Debtor filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code one day after the death of his father. Debtor's interests in the trusts were vested on the petition date subject to the contingency that he outlived his father by 30 days.

3. The California Supreme Court ruled that a creditor or bankruptcy trustee can reach 100% of principal payments that are "due and payable" to a beneficiary as of the petition date even if the funds were still in the hands of the trust and 25% of future payments that have not yet become due and payable. While the decision discusses payments of principal, the result for payments of income would appear to be the same.
   a. Open Issue: Can the bankruptcy trustee leave the case open until the future payments become due and payable and therefore intercept all payments? Section 541(c)(2) provides that a restriction on transfer is enforceable against a bankruptcy trustee. When that restriction ceases to be enforceable, however, due to the passage of time, a good argument can be made that it is no longer enforceable. The contrary argument would be that the estate's interest is fixed as of the petition date. This position, however, ignores that creditors outside of bankruptcy would be able to enforce judgments against such payments when they became due and payable.

4. Needs-based Exceptions under State Law: A beneficiary, however, may be able to reduce the amount that a creditor can reach to the extent that the trust provides protections for a beneficiary's support

or education and the beneficiary needs the money for those purposes. *Carmack v. Reynolds*, 2 Cal.5th 844 (2017).

d. Debtor's Interest in Trust Determined as of the Petition Date. The nature of a debtor's interest as a beneficiary of an *inter vivos* trust is generally determined on date that bankruptcy petition is filed and a trustor's post-petition death likely does not enlarge a bankruptcy trustee's rights. *In re Kim,* 257 B.R. 680 (9th Cir. BAP 2000) [On petition date, debtor had an interest in a fully exempt public employment retirement plan. Within weeks of the petition date, debtor rolled the funds to an individual retirement account. Court held that the exemption was determined by the nature of the interest in property on the petition date and that the account was a fully exempt public employment plan].

e. Revocable Trusts. If Debtor's interest is as a beneficiary of a revocable trust, then the interest in the trust is not property of the estate. Instead, it's a mere expectancy. *In re Spencer*, 306 B.R. 328 (Bankr. C.D.Cal. 2004).

f. Section 541(a)(5) Does Not Apply. The post-petition death of the trustor causing debtor's interest in the trust to vest did not render such interest property of the estate. Furthermore, acquiring property by trust was not a bequest, devise or inheritance bringing the property into the estate under Section 541(a)(5)].

g. Self-Settled Trusts may not be enforceable under State Law or Section 548(e).

   i. California law does not enforce spendthrift provisions in self-settled trusts. California Probate Code § 15304(a). *In re Salkin* 526 B.R. 31 (Bankr. C.D.Cal. 2015), and *In re Nielson*, 526 B.R. 351 (Bankr. D.Hi. 2015).

      1. California law will not enforce a purported spendthrift provision in a revocable trust because assets held in a revocable trust remain subject to creditor claims. California Probate Code § 18200.

      2. Florida also has a strong public policy against the enforcement of self-settled spendthrift trusts which are designed to put assets out of the reach of creditors. *Mehdipour v. Rensin (In re Rensin)*, 600 B.R. 870, 880 (Bankr. S.D. Fla. 2019); *Menotte v. Brown (In re Brown)*, 303 F.3d 1261, 1266-70 (11th Cir. 2002).

      3. Texas law also voids self-settled spendthrift trusts. *Shurley v. Texas Commerce Bank-Austin, N.A. (In re Shurley)*, 115 F.3d 333, 338-39 (5th Cir. 1997).

   ii. Domestic Asset Protection Trusts. Many states now have laws permit spendthrift provisions in self-settled trusts.

1. In most states, a spendthrift provision in a self-settled trust is invalid against creditors. There are approximately 17 states that have enacted statutes specifically authorizing self-settled spendthrift trusts including Alaska, Colorado, Delaware, Hawaii, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming.

2. Typical features: Must contain a spendthrift provision, be irrevocable, and not ***require*** distributions of principal or income.

3. Example: Nevada permits self-settled spendthrift trusts so long as the following requirements are met: (1) the trust is irrevocable; (2) the trust does not require that any part of principal or income be distributed to the settlor; (3) the trust is not intended to hinder, delay, or defraud known creditors; and (4) the trustee is an individual, trust company, or bank with a residence/office in Nevada. Nevada Revised Statutes **§§** 166.015 and 166.040.

4. Many states also require that the majority of assets be located in the state in order for the choice of law provision to be enforceable.

5. Some states also require that at least one of the trustees be domiciled in the state and that tax returns be filed in such state.

6. Fraudulent Transfer Laws. Most states' laws allow creditors or bankruptcy trustees to avoid transfers made with actual intent to hinder, delay, or defraud creditors.

iii. Choice of Law Provisions. Courts in states that do not recognize self-settled spendthrift trusts may be unwilling to recognize a choice of law provision in a trust specifying state law that does enforce self-settled spendthrift trusts. *See e.g.*, *In re Portnoy*, 201 B.R. 685 (Bankr. S.D.N.Y. 1996) [law of state with greatest interest in litigation will prevail over choice of law provision in trust]; *In re Brooks*, 217 B.R. 98 (Bankr. D. Conn. 1998) [law of settlor's state of residence determines validity as to creation of trust notwithstanding choice of law provision which would apply if trust validly created]; *In re Lawrence*, 227 B.R. 907 (Bankr. S.D. Fla. 1998) [bankruptcy court refused to recognize debtor's unilateral specification in offshore asset protection trust that laws of the Republic of Mauritius will apply in determining extent of debtor's rights in property and whether such rights became property of bankruptcy estate]; *Dexia Credit Local v. Rogan*, 624 F.Supp.2d 970 (N.D. Ill. 2009) [court refused to honor laws of another

jurisdiction specified in a trust where doing so would violate the public policy of the State of Illinois]. *See also*, *In re Huber*, 493 B.R. 798 (Bankr. W.D. Wash. 2013) [Trust had a choice of law provision which stated Alaska law would control. Debtor filed bankruptcy in Washington. The Chapter 7 trustee sought assets of the trust under the laws of the state of Washington, but debtor contended that the choice of law provision in the trust was controlling. Debtor's choice of Alaska law designated in a trust would not be upheld as Alaska did not have a substantial relation to the trust; at the time the trust was created, the settlor and beneficiaries were domiciled in Washington, the assets and all of debtor's creditors were located in Washington. The only relation to Alaska was that it was the location in which the trust was to be administered and the location of one of the trustees. Additionally, Washington State has a strong public policy against self-settled asset protection trusts; a debtor should not be able to escape the claims of his creditors by utilizing a spendthrift trust, and a debtor's transfers made to self-settled trusts are void as against existing or future creditors.]

h. Laws Attacking Domestic Asset Protection Trusts ("DAPT").

1. State laws refusing to recognize self-settled spendthrift trusts (California Probate Code § 15304(a), Fla. Stat. § 736.0107)

2. State fraudulent transfer laws (11 U.S.C. § 544; California Civil Code §§ 3439 *et seq.*)

3. Federal fraudulent transfer laws (11 U.S.C. § 548(a) and (e))

4. FDCPA – Fair Debt Collection Procedure Act (28 U.S.C. § 3001 *et seq.)*

   a. Majority Position - Bankruptcy Trustees ***may*** use FDCPA where government is a creditor. *Vieira v. Gaither (In re Gaither)*, 595 B.R. 201, 212 (Bankr. D.S.C. 2018); *Hillen v. City of Many Trees, LLC (In re CVAH, Inc.)*, 570 B.R. 816, 824 (Bankr. D. Idaho 2017); *Gordon v. Harrison (In re Alpha Protective Services, Inc.)*, 531 B.R. 889, 906 (Bankr. M.D. Ga. 2015); *Tronox Inc. v. Kerr McGee Corp. (In re Tronox Inc.)*, 503 B.R. 239, 273-74 (Bankr. S.D.N.Y. 2013).
   b. Minority Position - Bankruptcy Trustees ***may not*** use FDCPA. *See, MC Asset Recovery LLC v. Commerzbank A.G. (In re Mirant Corp.)*, 675 F.3d 530 (5th Cir. 2012).

5. State remedies including theories of alter ego or reverse piercing or state laws that void trusts created for illegal or improper purpose (*See e.g., In re Schwarzkopf, infra*.; *Dean v. United States*, 987 F.Supp. 1160 (W.D. Mo. 1997)).

i. Shifting Trusts. Shifting Trusts that provide for forfeiture of a beneficiary's interest upon a creditor's attempted attachment or alienation may be enforceable. *In re Fitzsimmons*, 896 F.2d 373 (9th Cir. 1990).

1. Restriction on transfer in purported trust created by settlement of a personal injury action not enforceable under California law. *In re Jordan*, 914 F.2d 197 (9th Cir. 1990).

2. Spendthrift provisions may not be enforceable against the IRS pursuant to 26 U.S.C. § 6321.

6. Fraudulent Transfer Laws - Can Assets Transferred to a Trust be Avoided

a. A bankruptcy trustee can avoid prepetition transfers of assets by a debtor including transfers to a trust.

b. Bodies of Fraudulent Transfer Laws. The Bankruptcy Code contains fraudulent transfer laws in 11 U.S.C. § 548. The Bankruptcy Code further allows a trustee to use applicable non-bankruptcy fraudulent transfer laws pursuant to 11 U.S.C. § 544 which makes California's version of the Uniform Fraudulent Transfer Act set forth in Civil Code §§ 3439 *et seq.* The FDCPA may also be applicable if the government is a creditor. See above.

c. Fraudulent Transfer Law Under 11 U.S.C. § 548

i. Actual Fraud: A trustee may avoid a transfer if the debtor "made such transfer or incurred such obligation 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 or such obligation was incurred, indebted." 11 U.S.C. § 548(a)(1)(A).

ii. Constructive Fraud: A trustee may avoid a transfer if the debtor "received less than a reasonably equivalent value in exchange for such transfer or obligation" and the debtor meets one of the insolvency definitions. 11 U.S.C. § 548(a)(1)(B).

d. Fraudulent Transfer Law Under 11 U.S.C. § 544 and state law (for example, California Civil Code Section 3429, *et seq*.)

i. Actual Fraud: Pursuant to 11 U.S.C. § 544, a trustee may invoke provisions of state law, standing in the shoes of a creditor, to avoid a transfer of property. To recover on a transfer under Cal. Civ. Code §3439.04(a)(1), a trustee must establish that the transfer of property that was made with actual intent to hinder, delay, or defraud any creditor. An action under Cal. Civ. Code §3439.04(a)(1) must be brought within four (4) years of the transfer. Cal. Civ. Code §3439.09(a). There is not a significant difference between a claim under §548(a)(1)(A) and a claim under Cal. Civ. Code §3439.04(a)(1). But, California Civil Code § 3439.08(a) states that "[a] transfer or obligation is not voidable under paragraph (1) of subdivision (a) of Section 3439.04, against a person that took in good faith and for a reasonably equivalent value given the debtor or against any subsequent transferee or obligee." In turn, the plain language of California Civil Code § 3439.03 provides that "[v]alue is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied. . ."

ii. Constructive Fraud: Under California law, a transfer is constructively fraudulent in two situations. First, as to a creditor whose claim arose before or after the transfer was made or the obligation was incurred, a transfer is constructively fraudulent if the debtor made the transfer: (2) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor either: (A) Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction. (B) Intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due. Cal. Civ. Code § 3439.04(a)(2). Alternatively, under Cal. Civ. Code § 3439.05, a transfer is constructively fraudulent "as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at the time or the debtor became insolvent as a result of the transfer or obligation." See, Cal. Civ. Code § 3439.05

e. Reach-back Period

i. Under Bankruptcy Code Section 548, the reach back period is two years prepetition.

ii. Under Bankruptcy Code Section 544 which makes California Civil Code Sections 3439 *et seq.* applicable, the reach back period is four years or one year after discovery not to exceed seven years.

iii. 10-Year Reach Back – Section 548(e)(1) extends the reach back period for a trustee to 10 years to avoid a debtor's transfer of an interest in property to a self-settled trust.

> "In addition to any transfer that the trustee may otherwise avoid, 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."

iv. *In re Kipnis*, 555 B.R. 877 (Bankr. S.D.Fla. 2016) [chapter 7 trustee permitted to use IRS 10-year reach-back to avoid fraudulent transfer]; *In re CVAH*, 570 B.R. 816, 834-36 (Bankr. D. Ida. 2017) [chapter 7 trustee permitted to use IRS 10-year reach-back].

f. Cases interpreting Section 548(e)

i. *In re Mastro*, 2011 WL 4498834 (Bankr. W.D. Wa. September 27, 2011) [properties transferred to self-settled spendthrift trusts including an offshore asset protection trust avoided in bankruptcy commenced by creditors through filing of involuntary petition to utilize Bankruptcy Code Section 548(e)]

ii. *In re Mortensen*, 2011 WL 5025249 (Bankr. D. Alaska., May 26, 2011) [Property transferred by debtor to asset protection trust more than four years prior to bankruptcy avoided pursuant to Section 548(e). In finding actual fraudulent intent in making the transfer, the bankruptcy court relied on statements in the trust that the purpose of the trust was to preserve assets for the settlor's children. The bankruptcy court refused to apply Alaska law that specifically holds that statements of intent in a trust cannot be used to

establish fraudulent intent finding that state law did not apply to Section 548(e)]

iii. *In re Porco*, 447 B.R. 590 (Bankr. S.D. Ill. 2011) [bankruptcy court refused to apply Section 548(e) to a transfer by debtor to related entity which was attacked as a constructive or resulting trust finding that Section 548(e) applied only to express and not implied trusts]

iv. *In re Potter*, 2008 WL 5157877 (Bankr. D.N.M. 2008) [bankruptcy court found actual fraudulent intent where debtor transferred all assets to trust rendering him insolvent where trust formed after entry of a large judgment and debtor continued to reside in residence]

v. *In re Castellano*, 514 B.R. 555 (Bankr. N.D.Ill. 2014) [debtor's transfer to self-settled spendthrift trust avoidable fraudulent transfer]

vi. Note: Section 548(e) is not dependent on state law. As such, a choice of law provision specifying the law of a state with liberal laws permitting self-settled trusts may not be applicable.

(A) In 2012, the 9th Circuit BAP held that a settlor's choice of law provision can determine the bankruptcy estate's interest in a spendthrift trust. *Zukerkorn v. Zukerkorn*, 484 B.R. 182 (9th Cir. BAP 2012). In *Zukerkorn*, the court concluded that the settlor's choice of Hawaii law in a spendthrift trust was valid because Hawaii had a substantial relation to the trust. The Court also concluded that the choice of law was not a violation of fundamental policy for California. Because Hawaii offered complete creditor protection, the bankruptcy trustee was unable to reach any distributions to the beneficiary who was the son of the deceased settlor. While the Court declined to consider whether post-petition distributions of income from the trust were property of the estate under 11 U.S.C. §§ 541(a)(6) and (7) because they were raised for the first time on appeal, the Court confirmed that such distributions of income were not property of the estate under 11 U.S.C. § 541(a)(5) because distributions from an *inter vivos* trust do not constitute a bequest, devise, or inheritance.

vii. Practice Pointers.

1. Post-claim asset protection rarely avoids scrutiny as an actually fraudulent transfer

2. Post-claim asset protection may subject debtor and estate planning professional to liability including application of RICO laws

3. Alter ego and/or laws voiding trusts created for improper purposes can render asset protection trusts void long after expiration of statutes of limitations

4. Choice of law provisions will not control in all situations especially with regard to the question of whether the trust was created for a proper purpose

7. Disclaimers of Interests in Trusts

   a. California Probate Code § 283 provides "A disclaimer is not a voidable transfer by the beneficiary under the Uniform Voidable Transactions Act."

   b. *Drye v. United States*, 528 U.S. 49 (1999) [taxpayer's disclaimer occurring after debt arose ineffective as to the IRS under FDCPA].

   c. *In re Costas*, 555 F.3d 790 (9th Cir. 2009) [debtor defeated chapter 7 trustee's fraudulent transfer action establishing that prepetition disclaimer not a fraudulent transfer under Arizona law where FDCPA inapplicable].

   d. *United States SBA v. Bensal*, 853 F.3d 992 (9th Cir. April 2017) [FDCPA preempted California law that a disclaimer occurring after debt arose is not a transfer and government successfully avoided disclaimer as a fraudulent transfer].

   e. *In re Kipnis*, 555 B.R. 877 (Bankr. S.D.Fla. 2016) [chapter 7 trustee permitted to use IRS 10-year reach-back to avoid fraudulent transfer].

   f. *In re CVAH*, 570 B.R. 816, 834-36 (Bankr. D. Ida. 2017) [chapter 7 trustee permitted to use IRS 10-year reach-back].

8. Voluntary transfers result in loss of exemptions upon avoidance

   a. If a debtor makes a voluntary transfer to a trust that is later avoided by a bankruptcy trustee, the debtor loses his or her exemption in the recovered asset(s). 11 U.S.C. § 522(g). *See also*, *In re Glass*, 60 F.3d 565 (9th Cir. 1995).

   b. For example, a debtor transfers his home to an irrevocable trust for no consideration. A bankruptcy is later filed by or against the debtor. The Trustee

successfully avoids the transfer as fraudulent. The debtor is denied any homestead exemption in the recovered asset. Under California law (generally), the exemption is $75,000 for a single person; $100,000 for a family unit; and $175,000 for an elderly person.

9. QPRT – Qualified Personal Residence Trusts

   a. A QPRT is used to transfer a grantor's residence out of the grantor's estate at a low gift tax value. Once the trust is funded with the grantor's residence, the residence and any future appreciation is excluded from the grantor's estate upon death if the grantor survives the term of the trust. QPRTs purport to be irrevocable split interest trusts. For at least tax purposes, the transfer of the residence to the trust constitutes a completed gift. The grantor retains the right to live in the house for a specified number of years rent free. Then, the remainder beneficiaries of the trust become fully vested. If the grantor did not have the right to live in the house post-transfer, then the value of the gift for tax purposes would be the value of the house at the time of the transfer. However, to minimize gift taxes, the Internal Revenue Code § 7520 provides a formula that takes into account the term of the trust, the life expectancy of the grantor, and a specified rate based on the month and year that the transfer was made. This determines the value of the grantor's retained interest which is applied against the value of the residence to minimize or eliminate the gift tax.

   b. For bankruptcy purposes, when the grantor subsequently files bankruptcy during the period of time that he or she has the right to live in the property, does the residence become property of the bankruptcy estate? Or, does the completed gift aspect of the transfer result in the debtor no longer having fee simple title (subject to a trustee's ability to avoid the entire transfer as a fraudulent transfer)?

   c. *In re Yerushalmi*, 487 B.R. 98 (Bankr. E.D.N.Y. 2012) [QPRT not property of grantor's bankruptcy estate]. See also, In re Earle, 307 B.R. 276 (Bankr. S.D.Al. 2002) [debtor's transfer of property to QPRT not fraudulent conveyance].

   d. *Compare*, *In re Ferrante*, 2015 WL 5064087 (9th Cir. BAP 2015). BAP affirmed Judge Albert's judgment which determined a waterfront home in Newport Beach transferred to a QPRT more than 10 years prior to bankruptcy was an asset of the estate. Decision based on actual language of the trust that provided that the QPRT would terminate if the debtor ceased to use the property as his principal residence prior to the specified term until the beneficiaries' interests vested. Court ordered Debtor to move out causing the trust to fail.

10. Exemptions

    a. Exempt property protected from reach of creditors. 11 U.S.C. § 522.

    b. Exempt property not subject to payment of administrative claims of estate. 11 U.S.C. § 522(k); *Law v. Siegel*, 571 U.S. 415, 427-28 (2014) (Supreme Court held that bankruptcy court improperly surcharged dishonest debtor's homestead exemption to pay administrative expenses).

    c. Bankruptcy Code allows states to "opt out" of federal exemptions and allow debtors to use state law exemptions. 11 U.S.C. § 522(b)(2).

    d. The burden of proof may be governed by state law notwithstanding Rule 4003. *In re Diaz*, 547 B.R. 329 (9th Cir. BAP 2016) (applying the reasoning of *Raleigh v. Illinois Department of Revenue*, 530 U.S. 15, 20-21 (2000) to the burden of proof in state law exemptions: "the burden of proof is an essential element of the claim itself; one who asserts a claim is entitled to the burden of proof that normally comes with it."); *but see In re Weatherspoon*, 605 B.R. 472, 482 (Bankr. S.D. Ohio 2019) (recognizing that the Sixth Circuit follows the plain language of Rule 4003 under *Zingale v. Rabin (In re Zingale)*, 693 F.3d 704, 707 (6th Cir. 2012).

    e. California law contains exemptions for "private retirement plans." California Code of Civil Procedure §§ 703.140(b)(10)(E) and 704.115(a)(3) and (e).

    f. California law does not permit a debtor to purchase a single premium deferred annuity and exempt it under Code of Civil Procedure § 704.100 which provides exemptions for life insurance (including endowment and annuity) policies. *In re Turner*, 186 B.R. 108 (9th Cir. 1995).

    g. Debtor cannot create an exemption out of whole cloth by affixing a title to an agreement or trust (i.e. the retirement plan must be designed and principally used for retirement purposes). *In re Peacock*, 292 B.R. 593, (Bankr. S.D. Ohio 2002).

    h. Pre-bankruptcy planning to maximize exemptions generally permissible; however, 2005 Amendments to Bankruptcy Code placed substantial limits on the practice. For example, 11 U.S.C. § 522(o) provides that a debtor that converts non-exempt property into certain specified assets including an exempt residence if the transfer was made with actual intent to hinder, delay or defraud creditors.

11. "Pigs get fed, hogs get slaughtered:" Denial or Revocation of Discharge

    a. Certain transfers or asset protection strategies may create the risk of loss of bankruptcy discharge

b. Transfers with Intent to Defraud – 11 U.S.C. § 727(a)(2)

i. Debtor transfers property within one year prior to bankruptcy with actual intent to hinder, delay, or defraud creditors

ii. "Continuing Concealment" – Debtor conceals property more than one year prior to bankruptcy and the concealment continues into the one year prior to bankruptcy. *In re Lawson*, 122 F.2d 1237 (9th Cir. 1997).

c. False oaths – 11 U.S.C. § 727(a)(4)

i. Debtor executes Schedules and Statements concealing an asset, an interest in an asset, an interest in a trust, or a pre-bankruptcy transfer of assets.

d. Failure to explain dissipation of assets – 11 U.S.C. § 727(a)(5)

e. In general terms, if a debtor conceals an asset, but the concealment is not discovered until after the debtor's discharge is entered, and the asset is material (for example, failure to disclose an eight-unit apartment complex in Long Beach, California, compared with failure to disclose $50 in debtor's wallet), the trustee may request revocation of the discharge within the time limits specified in 11 U.S.C. § 727(e).

12. Bankruptcy Crimes – 18 U.S.C. §§ 151-158

a. False oaths, concealment of assets. 18 U.S.C. § 152.

b. Bankruptcy fraud including false petition, involuntary petition, or claim. 18 U.S.C. § 157.

Faculty

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