Asset Protection (High-Level Strategies and Problems)

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A PRACTICAL CASE FOR
OFFSHORE TRUST PLANNING
FOR ENHANCED ASSET PROTECTION

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Effective wealth and asset protection planning is accomplished by the use of the most favorable entities, drafted agreements, and incorporation of the most favorable systems of laws found in select jurisdictions. The concept is to establish the most impenetrable barrier or barriers possible to prevent a creditor from reaching the wealth and assets of an asset protection client in satisfaction of a judgment against that client. With a world to choose from, there are a wide variety of available jurisdictions. Why not choose the most effective available?

Very simply put, the core of collection efforts launched by creditors, and which must be understood by debtors, is founded on the premise that "if the debtor owns it, the creditor can take it." If a judgment debtor maintains title to his or her wealth in his or her personal name, the judgment debtor, armed with a judgment and with the authority of the courts, can seize that wealth. However, understanding that premise reveals that the converse is also true: "If the judgment debtor does not own the asset, the judgment creditor cannot take the asset away from the debtor." How then can we hold wealth without fear of seizure?

The success of any asset protection planning endeavor is founded upon the assembly of a structure consisting of, among other elements, trusts and entities utilizing the most favorable systems of laws found in select jurisdictions into which title can be nested to realize the separation of ownership desired. Certainly, the drafting of the underlying documents, operating agreements and trusts must be done carefully such that full advantage is taken of the available protections capable of incorporation applying the available and legal techniques. For clients residing in the US his or her domicile may represent a convenient and readily available choice for jurisdiction, which may translate into cost savings, a laudable endeavor, but may not present the most effective legal environment. And somewhat naturally clients who have selected professionals for previous legal and financial efforts, outside the scope of asset protection planning typically return to that professional and seek services reflecting that particular professional's level of experience.

However, asset protection planning is not an area in which to trust your professionals to become educated on your particular circumstance. Asset protection planning is a rapidly developing area of law requiring not only a good understanding of creditor/debtor law, but a thorough understanding, endorsement and capacity to apply a variety of asset protection concepts. This aspect cannot be enough stressed. There are certain approaches to protecting wealth and assets that run contrary to accepted standards and norms, sometimes oppressively so, that are required to fully protect certain assets, such as the selection of the most favorable jurisdiction upon which to base the planning undertaken.

The questions are these: Has the selected practitioner done all that can be done? Has that client availed themselves of the most effective planning? If the creditor aggressively pursues collection of wealth, where will the final fight for that client's wealth take place? Will it be in a traditionally creditor friendly or debtor friendly jurisdiction? Will the location itself of the selected jurisdiction the laws of which are governing the planning represent a location sufficiently difficult to access so as to motivate the creditor to discuss settlement more readily? This article will explore and contrast the distinctions between onshore and offshore jurisdictional offerings available, and go on to defend, on a practical level, the decision to seek the most effective jurisdiction or jurisdictions available. and argue specifically that the most effective jurisdiction or jurisdictions in which to settle such a trust for a United States person is outside the United States, or offshore.

Let's start simply. The cornerstone of any effective protection strategy is a trust and a fairly common misconception is that a trust is an entity. While a trust may be considered an entity in the context of commercial dealings[1], or as a separate entity for tax purposes[2], when used in planning the disposition of wealth for a Settlor, it is not. A trust is recognized as an agreement, both in the United States[3] and abroad,[4] between the Trustee and the Settlor, that the Trustee will hold the trust property on behalf of the Settlor for the benefit of the named or classified beneficiaries.[5]

Why is that important? As it is an agreement, the drafter has wide latitude to include provisions that will accomplish the goals set out by the Settlor. Often the Settlor himself will be named as a beneficiary (leading to the definition set forth below). If the Settlor is interested in protecting wealth and assets in the process and context of planning, the asset protection features of the trust, if available and capable of incorporation in the drafting process, in the chosen jurisdiction, will become most important. If the Settlor wishes to protect the trust property contributed to the trust from the reach of a creditor, even a creditor of the Settlor, appropriate cautions must be taken in drafting, supported and augmented by the laws of the jurisdiction in which the trust will be settled, that will most effectively accomplish those goals. A trust with

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[1] See e.g. 810 ILCS 5/1-201
[2] See e.g. § 6034A .
[3] See e.g. 760 ILCS 5/2.
[4] "A trust is a private legal arrangement where the ownership of someone's assets (which might include property, shares or cash) is transferred to someone else (usually, in practice, not just one person, but a small group of people or a trust company) to look after and use to benefit a third person (or group of people)". *Trusts Explained*, Society of Trust & Estate Practitioners, 2009.
[5] "One common misconception is that the assets in the trust fund are legally owned by the trust. In fact, a trust, unlike a company, cannot own assets and instead the trustees are the legal owners of the assets". Id.

these characteristics typically used in asset protection planning, asset protection trust or "APT", is called a self-settled, spendthrift trust.

A careful definition is in order. It is a trust that is settled by a person (here person is defined as an individual or an entity), that is to say that it is the person expecting benefit from the trust (although in most cases but not necessarily a named beneficiary) that settles or creates a trust (hereinafter the "Settlor" or "Grantor"), contributes assets to it for safekeeping by the Trustee, which contains a clause (commonly called a spendthrift clause or provision) providing that the Settlor or any other named or classified beneficiary, entitled to benefit from the trust estate in distributions of income and/or principal, cannot force that Settlor or beneficiary to demand an assignment of principal or income or a distribution from the Trustee of the trust on account of the Settlor or beneficiary that will be used to benefit that Settlor's or beneficiary's creditor. It's a lot, but it's all there.

As an aside, the trust created is typically, but need not be, a grantor trust complying with the provisions of Sections 671 to 679 of the Internal Revenue Code.[6] As a grantor trust, any income earned by the trust on investment of the trust property is taxed to the Settlor. Further exploration of the nuances of such a classification, or lack thereof, is beyond the scope of this article.[7]

Several states in the United States have traditionally either judicially resisted, instilled or enacted an outright prohibition against the use of a self-settled, spendthrift trust either through statutory prohibitions,[8] scholarly analysis,[9] often used as authority for decisions upholding the

[6] See IRC § 671 - § 679.
[7] A quite complete reference on all aspects of grantor trusts is Howard M. Zaritsky, 858-2nd T.M., *Grantor Trusts: Section 671 – 679* (BNA) and see *Fundamentals of Grantor Trusts,* Samuel A. Donaldson, Associate Professor, University of Washington School of Law.
[8] See *e.g*. 735 ILCS 5/2-1403; Idaho Code § 55-905; Wash. Rev. Code § 19.36.020.
[9] Restatement (Third) of Trusts § 60 cmt. f; UTC § 505(a)(2)(2005)

prohibition, or judicial declaration citing public policy arguments, a posture that continues in most states today.[10] However, with the rabidly increasing interest in asset protection planning generally and a rapid exodus of clients using offshore vehicles, the demonstrated effectiveness and, albeit colored, successes of asset protection planning outside the United States, and on the heels of a moderately beneficial settlement in one high profile case,[11] several states have found it expedient to enact comprehensive legislation allowing the use of properly drafted self-settled, spendthrift trusts for protection from creditors, even creditors of the Settlor. This legislation empowered domestic trust companies located in the few states enacting such legislation, and U.S. planners across the country, to solicit clients and customers seeking asset and wealth protection.

Next, let's define what is onshore and offshore for trust purposes. It's quite simple: anything outside your home, national boundaries is offshore. The term "offshore" originates from the use of trusts settled in the Channel Islands by English taxpayers to avoid (no judgment here) taxes or loss of control whilst off fighting the Crusades. Trustees located in the Channel Islands were not in the same jurisdiction, and in fact off the shore of the United Kingdom. Indeed, most offshore banks offering Trustee services are located in island nations to this day. However, the term is now used more figuratively to refer to such banks or trust companies regardless of location, such as Swiss banks and those of other nations, and not surrounded by water such as Luxembourg and Andorra.

A more appropriate and inclusive answer is that an offshore trust is a trust relationship established with a Trustee outside the geographical boundaries of the Settlor's home jurisdiction.

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[10] "This rule promotes a valid public policy that a person ought not to be able to shelter his or her assets from creditors in a discretionary trust of which he or she is the beneficiary and thus be able to enjoy all the benefits of ownership of the property without any of the burdens." Commerce Bank, N.A. v. Bolander, 44 Kan. App. 2d 1 (2010) 239 P.3d 83; See also In re Johannes Trust, 199 Mich. App. at 518.

[11] Federal Trade Commission v. Affordable Media, LLC, 179 F.3d 1228 (9th Cir. 1999) (a/k/a Anderson).

For example, United States citizens might consider establishing a trust relationship with a Canadian Trustee to accomplish specific goals. This trust would be considered offshore. In point of fact, citizens of other countries, again using Canada as an example, might establish a trust relationship with a U.S. based trust company to accomplish a planning goal and that trust is considered offshore to the Canadian Settlor.

This often starts a client discussion of a trust relationship with an unknown and perhaps exotic foreign Trustee nestled in a place most would consider only for a winter vacation getaway. Included are visions of palm trees and sandy beaches. While there are certainly those, there are others as well. The offshore banking and trust industry has grown to be a sophisticated, well managed and trustworthy sector of the worldwide economy. Whatever the planning goals sought to be accomplished by using a trust relationship offshore to the Settlor, it must be apparent that the use of legal attributes of the jurisdiction chosen is the driving force.

An additional impetus to the use of domestic U.S. vehicles, and greater resistance to extra-jurisdictional planning, was the general distrust of extra-jurisdictional trust companies and planners. The typical view was that planners, attorneys and trust companies outside the U.S. were not bound or constricted by the same professional ethics, regulations and morays as a planner or trust company in the United States. As has been expressed to this author on more than one occasion: "I do not trust a trust company that works from a desk under a palm tree on a beach somewhere," and "Isn't this type of planning un-American?" And those views were, in some circumstances, justified by cases in which truly bad guy Trustees attempted to abscond with the Settlor's wealth.[12] And now with domestic alternatives available, why not use a trust vehicle established in one of the new U.S. based jurisdictions? Good idea? Is it the most

[12] See the trilogy of: Sheldon v. The Trust Co. of the Virgin Islands, 535 F.Supp. 667 (1982); National Bank of Detroit v. Sheldon, 730 F.2d 421 (6th Cir. 1984); Detroit Bank & Trust Co. v. The Trust Co. of the Virgin Islands, 644 F.Supp. 444 (1985) (hereinafter "Sheldon")

effective? Let's review the general, practical differences between applying domestic and offshore asset protection trust legislation.

At last count, there were fifteen states which offered legislation permitting self-settled, spendthrift trusts [13] and several that were considering it.[14] However, despite that the first legislative authorization, and presumably the first planning done thereunder, occurred in 1997, some eighteen years ago, there have been no serious tests of domestic APT efficacy, [15] though there are cases refining the application and beginning to settle some underlying.[16] In contrast, the Cook Islands International Trust Ordinance was enacted there in 1984. It took only two short years for the first serious challenge to arise.[17] The legislative response: amend the Ordinance to prevent the same result in the future.[18] Nonetheless, domestic practitioners and trust companies continue the cause basing the efficacy of domestic planning on conjecture, albeit well-reasoned and argued, [19] that the planning will succeed in preventing an aggressive creditor from seizing the wealth and assets nestled therein. They argue that: several constitutional arguments *<u>might</u>*[20] favor domestic planning; there is less risk for Settlors and beneficiaries; tax treatment is more favorable; it is less expensive; less risk of fine or imprisonment; less risk of professional discipline.[21]

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[13] See e.g.: Alaska Stat. § 34.40.110; Del. Code Ann. tit.12,§§ 3570–3576; R.I. Gen. Laws §§ 18-9.2-1– 18-9.2-7; Nev. Stat. §§166.01066.170; Utah Code Ann. § 25-6-14; S. D. Codified Laws §§ 55-16-1–55-16-17; Wyo. Stat. Ann. §§ 4-10-510–4-10-523; Tenn. Code Ann. §§ 35-16-101–35-16-112; Okla. Stat. tit. 31, §§ 10–18; RSMo § 456.5-505.3; Colo. Rev. Stat. § 38-10-111; N.H. Rev Stat. § 564-D:1 et. seq.;Hawaii Act 182 (10); Ohio Legacy Trust Act §5816.01 et. seq.

[14] Florida and Illinois

[15] This in and of itself should be a concern. No tests, no results, no measure of effectiveness. Query: Could it be that the cases which have been brought have been settled prior to there being a reported, thus publicized, failure?

[16] See e.g.: Dahl v. Dahl, 2015 UT 23 (January 2015)

[17] <u>515 S. Orange Grove Owners Ass'n v. Orange Grove Partners</u>, Pliant No. 208/94 (High Court Rarotonga) Civil Division (1995)

[18] Cook Islands: *Orange Grove Decision Boosts Cooks' Credibility*, Adrian L. Taylor (1998)

[19] <u>*Planning and Defending Domestic Asset-Protection Trusts*, Richard W. Nenno and John E. Sullivan, III, 2008, hereinafter Nenno and</u> Sullivan.

[20] Emphasis added.

[21] <u>Id</u>. At 130-141

A seriatim and full analysis of these arguments supporting U.S. domestic planning is beyond the scope of this paper. However, briefly in contrast, these arguments for domestic planning pale when compared to the attributes which favor planning outside the United States.

First, the constitutional argument states that the several cases which have applied the full faith and credit clause[22] *might* [23]also be extended to support the use of domestic APT planning legislation, that a trust settled in Delaware, for example, applying the Delaware APT trust statute[24] *might*[25] be as protective. When planning outside the U.S., applying an APT statute to settle a trust in such a jurisdiction,[26] no concern need be considered or conjecture applied as the full faith and credit provisions do not apply. On the contrary, a very strong attribute of most APT statues outside the U.S. specifically state that no foreign judgments are enforceable.[27]

Second, they argue that there might be less risk for Settlors and beneficiaries. While it is true that the Settlors and/or beneficiaries in these cases suffered in several respects as a consequence of the planning undertaken, in each case the adage "bad facts make bad law" is fully underscored. However, the argument relies on the results in several high profile cases.[28] In each case that adage can be extended to state that "bad or poor planning makes bad outcomes" for all involved. One need look no further than the "Background" headnote in the Lawrence case as an example to discover that the planners there were throwing darts at the expense of Mr. Lawrence. The trust upon which Mr. Lawrence was relying upon was amended no fewer than four times within several short years following settlement, one of which was to add a

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[22] "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State." U.S. Const. art. IV, § 1
[23] Emphasis added.
[24] Del. Code Ann. tit.12,§§ 3570–3576
[25] Emphasis added.
[26] Cook Islands International Trust Act (1984), as amended,.
[27] See Id. at 13D.
[28] See, e.g., Federal Trade Commission v. Affordable Media, LLC, 179 F.3d 1228 (9th Cir. 1999) ; S.E.C. v. Bilzerian, 112 F. Supp. 2d 12 (D.D.C. 2000); S.E.C. v. Bilzerian, 131 F. Supp. 2d 10 (D.D.C. 2001); In re Lawrence, 279 F.3d 1294 (11th Cir. 2002); Beaubien v. Cambridge, 652 So. 2d 936 (Fla. Dist. Ct. App. 1995).

fundamental spendthrift provision, a provision which is considered hornbook basic. As for the results in both Anderson and Bilzerian, it could certainly be argued just as successfully that the outcomes in those cases point to a success in planning, i.e. the assets remained protected, and not a failure despite the poor planning and execution. Furthermore, the result in Beaubien could have been widely circumvented with the inclusion of a trust position now considered elemental and basic in any asset protection planning, domestic or offshore, that of a trust protector placed and authorized exactly to prevent the outcome there.[29]

Not to belabor the point, but the suffering of each defendant party results in each case presented in favor of domestic planning by the detractors of offshore planning point to a specific failure of careful planning, and consequent weakness, to which any new area of legal practice is in due course subject. Furthermore, in each case presented, the ultimate goal was accomplished: that of preserving and protecting the wealth of the Settlors from the creditors present. And just a word about the creditors in Lawrence, Anderson and Bilzerian, each case was brought by what could be considered ultimate deep pocket plaintiffs if ever there were: agencies of the U.S. government, considered "super-creditors" in today's practice. It would be difficult to imagine that domestic, or any, APTs would survive such attacks in light of the circumstances.

Third, it is argued that the domestic APTs will receive a more favorable tax treatment. There is no foreign trust account reporting required for a domestic APT as all the prerequisites of the Internal Revenue Code, and Regulations thereunder, are satisfied and the trust continues to be treated as a "U.S. Person"[30] for tax purposes. Also, they argue, that if the trust is considered foreign at the death of the Settlor, the assets held therein will not receive a step-up in basis

[29] See Sheldon Footnote 12.
[30] IRC § 7701 See Reg. 301.7701 (30) and (31)

permitted by IRC § 1014(a).[31] Again, the careful planner can circumvent these negative factors by inclusion of appropriate provisions. By carefully satisfying the definitional requirements of IRC § 7701 (30) and (31), the APT can be classified as a U.S. Person, obviating the onerous reporting complained of, until the truly protective measures authorized by the APT are required. In point of fact, the Regulations allow for concurrent jurisdiction, thus allow shared jurisdictional coverage during the period when no protection is necessary.[32] To include the assets in the federal taxable estate of the Settlor, the carefully planned trust utilizing an offshore jurisdiction might, or should, include a limited power of appointment, as provided under the Internal Revenue Code,[33] which dictates that the trust assets would be included in the estate of the Settlor at death thereby providing a basis step-up for those assets. Nonetheless, the wealth and assets of the asset protection client will remain protected.

Fourth, it is argued that domestic APT planning is less expensive. While that may be true at the outset, as the requisite drafting of a domestic APT based asset protection plan may not be as complex. However, in this author’s experience the long term costs may indeed be more for a domestic APT with a domestic corporate Trustee as the annual fees charged are, in some cases, double those charged by offshore trust companies.

Fifth, domestic APT proponents argue that there is less risk of fine or imprisonment. The basis for this argument comes from the imprisonment of the Andersons and Messrs. Lawrence and Bilzerian. In those cases, each defendant attempted to sidestep a court order to account for or repatriate assets held in offshore trusts by stating that it was impossible to comply with the order.

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[31] IRC § 1014(a)
[32] See Reg. 301.7701
[33] IRC § 2041 and IRC § 2514

It is fairly well settled case law that impossibility of performance is an absolute defense to a finding of contempt for failure to comply with an order of court.[34] It must be stated at the outset that any litigant must be made aware, verbally by counsel or with due discomfort by the court, that the failure to comply with an order of the court they are before, whether from impossibility to perform or from blatant actual contempt (read "stupidity") will not bode well with the sitting judge or magistrate.

However, superimposing a domestic APT in the place of the offshore APT in these cases would not yield a different result given the circumstances. If the Andersons or Messrs. Lawrence and Bilzerian had pled impossibility to perform the mandates of the respective court orders, the result would not have been different had the Trustees similarly refused to comply. Each would have been treated to the same imprisonment for contempt as occurred in the existing cases. If any difference could have resulted, it might surely have been an order of court to the responsible domestic Trustees to release the assets, thus forcing the question of domestic effectiveness to final determination. At this point in time, such is not to be.

Furthermore, it could easily be argued here that the reason these defendants were imprisoned was that the structure in place was impenetrable and completely effective. What follows from that argument is that clients utilizing domestic APT planning would not be in danger of imprisonment. Why? Because the planning structure would ultimately fail allowing the creditor to realize satisfaction of its judgment, obviously not the desired asset protection planning result.

Finally, the proponents of domestic APTs argue that there is less risk of professional discipline when the use of a domestic APT is employed. Just as any professional engaged in

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[34] See *e.g.* In Re Estate of Shlensky, 364 N.E.2d 430; 49 Ill. App.3d 885 (1977), at 895.

aggressive planning, there comes a point beyond which the seasoned professional will not venture. Professional advisors and attorneys are well cautioned to represent their respective clients within the bounds of the law. The Rules of Professional Conduct demand at least that much, if not more.[35]

Here the professionalism, ethics and philosophy of the particular practitioner come into play. An ethical practitioner will consider all the possible methods of protecting wealth and assets and weigh them carefully within the context of the case presented for a particular client's set of circumstances. Some strategies will be permitted, as authorized by available case and statutory law, and others may not be viable or present lines which should not be crossed in planning. Certainly the professional who goes beyond those constraints runs the risk of censure, or more.

Remember that the concept of protecting wealth and assets mandates the use of the greatest and most effective barriers to prevent a potential creditor from seizing assets. Certainly a practitioner attempting to do all that is possible for a client will be directed to use the most effective tools at his or her disposal, given the required level of experience and expertise at hand. The primary guidelines are readily ascertainable. In fully and adequately (another requirement of the Rules of Professional Conduct) representing his clients the asset protection practitioner is, or certainly should consider him or herself, constrained by, among other things, the same strictures that would bind his client such that no transfers are implemented, for example, "with actual intent to hinder, delay, or defraud any creditor of the debtor."[36] To completely avoid this concern, clients and practitioners would be well warned to refrain from funding any APT, domestic or offshore, as so doing may materially offend that constraint. Furthermore, even

[35] See generally: Illinois Rules of Professional Conduct (2010) and the ABA Model Rules of Professional Conduct.
[36] Uniform Fraudulent Transfer Act §4, See also Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 1406

offshore Trustees are offended by the use of APTs to actively defraud existing or contemplated creditors.[37]

When presented with a particular set of facts from a client that suggest, or perhaps dictate, the use of a self-settled, spendthrift trust, what would drive a practitioner to use an offshore vehicle as opposed to a domestic APT? Consider these attributes found only offshore.

Courts in the well-recognized offshore jurisdictions will not follow or recognize the judgment of a U.S. court. Domestically, that judgment creditor would merely need to register the judgment in hand in any jurisdiction in the U.S. in which the judgment debtor held assets to collect those assets in satisfaction of the judgment. Offshore, that judgment creditor would be required to begin his or her case and proofs anew in pursuit of the judgment giving the creditor the rights to seize assets of the debtor.[38]

Use of an offshore APT will force the judgment creditor to either press his case in the selected APT jurisdiction or to settle on the most favorable terms available. If pressed to pursue the collection of his or her judgment within the legal system of that foreign jurisdiction, the creditor will be governed by the statutes of that jurisdiction. These statutes raise significantly higher barriers to collection by a judgment creditor than those found domestically. A succinct list of these attributes can be gleaned from the statutes of several favored jurisdictions and is as follows:[39]

a. Significantly narrower definitions of acts which rise to the level of a fraudulent-transfer that, if proven, may defeat the APT.

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[37] See Bank of Am. v. Weese, 2002 WL 33957429 (Md. Cir. Ct. 2002).
[38] Cook Islands International Trust Act (1984), as amended; See also: Nevis International Exempt Trust Ordinance, 1994, as amended.
[39] Nenno and Sullivan.

b. Statute of limitation periods that are far shorter than those found domestically. Why give a potential creditor a longer period in which to file suit?

c. Application of a beyond a reasonable doubt standard of proof in civil cases. This requires proof that the defendant is liable beyond a reasonable doubt, the standard used only in criminal cases domestically. Civil cases in the U.S. apply a far lower "preponderance of the evidence" standard when weighing defendant liability while civil cases elsewhere apply the beyond a reasonable doubt standard.

d. Non-recognition of U.S. judgments. A creditor, even though successful in the U.S. courts, may not levy on trust assets located offshore to enforce a claim, as the judgment carries no weight, but must re-litigate the claim in its entirety in the jurisdiction in which the assets are located.

e. APT provisions, commonly called "flight or flee clauses," that permit the Trustee or protector to change the governing law of the APT or to physically move the trust assets if the creditor attempts to press his case in the selected offshore jurisdiction. Remember that a creditor (much like the FTC in the Anderson Case) did not hesitate to seek redress in the jurisdiction where the Trustee was located.

f. APT provisions, commonly called "duress clauses" that trigger the protective mechanisms of the APT and instruct the Trustee or protector to ignore orders of the Settlor or a U.S. court if creditor problems develop.

g. Creditors attempting to engage counsel in the offshore APT jurisdiction will experience far greater difficulty then in the U.S. Attorneys in the most attractive jurisdictions will not become engaged on the promise of future recovery. Commonly called "contingent fee agreements" readily available in the U.S., such arrangements are specifically outlawed in many offshore jurisdictions.

h. As a consequence of the fact that the Trustees are outside the U.S., U.S. courts will be unable to obtain personal jurisdiction over the Trustee. Offshore Trustees are wise to this issue and will not, under penalty of contempt and imprisonment, come onshore.

i. It is typical to involve the role of a trust protector in APT planning. The protector could be placed in a position to: approve or veto Trustee activities, amend the APT in defined circumstances, and even fire the existing Trustee and position a replacement.

j. Creditors are not classified as exception creditors capable of piercing the APT under specified circumstances. Under some domestic APT statutes, certain creditors are given full access to APT assets.[40] Such is not the case offshore.[41]

k. The necessity to travel, sometimes great distances, to pursue collection. While Nevis, as a certainly superior jurisdiction, lies fairly close to the U.S. in the British West Indies, the Cook Islands are literally on the other side of the world, as far away as possible, selection of which becomes another attribute in pursuit of the goal.

All that said, it cannot go without saying that the utilization of any planning strategy for the protection of wealth, including self-settled, spendthrift trust planning, domestic or foreign, must be legal. No conveyances in fraud of creditors.[42] No strategies specifically proscribed by statute[43] or contrary to settled law.[44] Some courts in those states not allowing self-settled,

[40] Del. Code Ann. tit. §3573(1)
[41] Cook Islands International Trusts Act 1984 13(E); See also, Nevis International Trust Ordinance (48)
[42] Uniform Fraudulent Transfer Act §4, See also Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 1406
[43] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 548 (e).
[44] See e.g. Vincent v. Department Of Human Services, 392 Ill. App.3d 88 (2009), 910 N.E.2d 723

spendthrift trust planning have even gone so far as to declare such planning to be fraudulent *per-se*.[45]

These proscriptions have also been exemplified recently in several cases arising in the bankruptcy context. Transfers found fraudulent can be both direct, such as where a debtor conveys an asset in an attempt to shield it from seizure by a creditor, and indirect, such as where the debtor surrenders an asset or interest to a third party for the ultimate benefit of the transferee.[46] Further, Section 548(e) has been brought to bear in several cases as well to defeat a debtor's attempt to create a domestic asset protection trust structure in fraud of creditors.[47]

In conclusion, as we have seen, choice of jurisdiction can have a significant impact on the effectiveness of wealth and asset protection planning. Keeping the underlying concept in mind: to establish the most impenetrable barriers possible to prevent a creditor from reaching the wealth and assets of an asset protection client, should drive us to at least strongly consider the effectiveness of incorporating a system of laws that will only serve to heighten the barriers and protection desired.

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[45] Crane v. Illinois Merchants Trust Co., 238 Ill.App. 257 (1925) and Barash v. McReady (In re Morris), 151 B.R. 900, 906-07 (Bankr.C.D.Ill.1993)
[46] In re Craig, 144 F.3d 587, 592 (8th Cir.1998). See also: Matter of Compton Corp., 831 F.2d 586, 594-95 (5th Cir.1987) and In re Bledsoe, 350 B.R. 513, 517 (Bankr.D.Or.2006).
[47] See e.g. In re Mortensen, Case No. A09-00565-DMD (May 26, 2011) and In Re Huber 493 B.R. 798 at 808 (Bankr.W.D.Wash. 5-17-2013)

A Fly on the Wall (of the Asset Protection Attorney's Office)

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I. **Introduction** - $1.5 million in judgments.

II. **Fact Pattern**

Tom Cook, our Defendant, is a 50 year old successful business man who owns 60% of a company that manufactures a key component for all types of smart phones. He has a non-related 40% business partner. His company, Lucky Part LLC, is a Delaware Limited Liability Company. Lucky Part has approximately 50 employees, 35 of whom are in a union. The company's principal place of business is located in Detroit. Tom owns the building individually and is collecting rent from Lucky Part, but there is no written lease. Tom also owns a beautiful home in Bloomfield Hills, a condo in Miami and a two unit rental building in New Buffalo, Michigan. Tom has approximately $3,000,000 in investments and savings, a boat worth $500,000 and two nice cars. He is married with two children, one in college and one in high school. Tom has been in business for approximately 18 years and, to date, no major controversies have arisen. However, Tom realizes he now wants to protect everything he has achieved in case something goes wrong.

III. **Identify Potential Areas Exposure**

A. <u>Tom's Concerns</u>: Meeting strict cell phone contract deadlines; plant accidents; union contributions and disputes; and individual and family liability.

B. Review with Tom inside and outside liability exposure.

1. Customers with breach of contract claims could go after company assets. (Inside)
2. Employees who are injured may seek additional compensation beyond worker's comp insurance. (Inside)

3. Unions are notorious for charging significant interest and penalties if contributions are late and often conduct audits resulting in liabilities. Unions will do hesitate to go after a company's assets. (Inside)
4. Personal liabilities such as individual car accidents or damage caused by your college or high school children expose your personal and business assets to potential judgments, even if you have an umbrella insurance policy in place. (Outside)

C. Tom Cook has both inside and outside liability concerns.

IV. **Due Diligence: Ask Tom if there are any present creditor issues or potential creditor issues he anticipates**?

A. Tom explains when he met with his asset protection attorney for the first time, that no one is currently suing him, his family or his company, there are no employee disputes or disputed jobs with any customers, he is not delinquent on any debts and he does not anticipate being sued in the near future. Dream client? Maybe.

B. <u>Attorney Due Diligence</u> – The asset protection (AP) attorney is thrilled to hear what Tom has said. However, the AP attorney must do more than just take notes and make a file memo.

1. The AP attorney should have Tom sign documents such as an Affidavit of Accuracy, Solvency and Indemnification, making sound representations about his financial situation; an Affidavit of the Source of Funds eventually put into any asset protection structure, such as a foreign trust; and statutory acknowledgements under which Tom acknowledges being advised of the relevant portions of the Money Laundering Control Act, the Drug Trafficking Act, the Foreign Money Laundering Act, applicable U.S. Fraudulent Conveyance or Transfer Acts, and any applicable U.S. Bankruptcy Acts.

2. In addition, the AP attorney should ask Tom for copies of items such as bank statements, financial statements, tax returns, W-2s, K-1s, passport, driver's license, utility bills and third party reference letters. These are key documents that a good AP attorney will request at the start of any asset protect engagement. Creditor's rights attorneys should be interested in learning whether any judgment debtor who has engaged in asset protection planning made any such representations or signed such documents at the beginning of the planning process. Such written representations can be very telling and, if documents have been given to third parties, such as a trustee, they may not be privileged.

C. Discuss Fraudulent Conveyance Laws – Each state has different fraudulent conveyance or transfer laws.

1. Statute of Limitations Examples – Illinois: 4 years (740 ILCS 160/1 to 160/12); Michigan: 6 years (MCLA §§566.31, 566.43); and Delaware: 4 years (6 Del. Code §§ 1301 to 1311).

2. The Ability to Overcome the Presumption of Fraud.

   a. In Tom Cook's case, the breach of contract lawsuit was filed approximately two (2) years after Tom engaged an AP attorney and completed his planning and approximately three (3) years before the breach of contract judgment was obtained. As for the car accident, it occurred three (3) years after the asset protection planning meeting and the judgment was obtained approximately six (6) months later.

   b. Tom's argument to overcome the presumption. At the time I engaged in planning, I had no way of knowing I would be in a car accident three years in the future, and I had no way of knowing I would miss a deadline in a contract two years in the future for an order that did not yet exist. I engaged in "rainy day" planning which is permissible.

c. This argument may get Tom off the hook for a fraudulent conveyance, but that does not mean all of his business and personal assets are out of the woods yet. His asset transfers still must have been done properly, the terms of the structure he set up must be adhered to and there are other statutes such as federal bankruptcy laws that may claw back assets if bankruptcy was being considered.

V. **What are Tom's Options**?

A. Gifting

1. Generally, a gift is any complete transfer of an interest in property to the extent that the donor has not received something of value in return (exceptions for discharge of legal obligations and child support). There are two basic requirements: the gift must lack consideration in whole or in part (the recipient must give up nothing in return) and the donor must relinquish all control over the transferred interest.

2. Tom is not wild about losing control over his assets, but to the extent his and his wife's collective estate exceeds $10,860,000, he understands the estate tax advantages of gifting away assets (*see* Family LLC discussed below).

B. Tenancy by the Entirety – Limited planning tool available to husbands and wives for a primary residence creating a legal position that each individual owns an undivided one-half interest in the property that is not subject to the claims of a creditor of a single spouse.

1. Slightly more than half of the states have tenancy by the entirety statutes. However, the following states only have tenancy by the entirety for real estate: Illinois, Indiana, Kentucky, Michigan, New York, North Carolina and Oregon.
2. Tom could put his primary residence in Bloomfield Hills in tenancy by the entirety. Since the car accident judgment was only against Tom, the judgment could not be enforced against Tom's equity in the home unless Tom sells the home. Tom also could choose to put certain property (e.g., his 60% LLC membership interest) in a Tenancy by the Entirety Trust in a jurisdiction that allows such personal property TBE trusts (e.g., Delaware), but such transfer has potential marital/divorce consequences and other potential creditor attack issues (*see* discussion regarding Domestic Asset Protection Trusts below).

C. Exemption Planning

1. Statutory Homestead Examples – Delaware - $125,000 for principal residence; Florida – unlimited value of real property (half acre municipal limit); Illinois -- $15,000 per individual or $30,000 per married couple for real property; Michigan – $37,775 per residence ($56,650 if over age 65).
2. Presuming the Miami condo qualifies has homestead property, the Florida exemption is a good one, but the condo still may be subject to federal bankruptcy laws. Tom may consider placing the condo in an LLC. Although insurance may protect against inside claims against the property (e.g., property damage), insurance does not protect the condo against outside claims (e.g., the car accident). As for the remainder of Tom's real estate, the exemptions in Michigan are clearly inadequate to protect Tom's interests.

D. Qualified Retirement Planning – Tom would be advised that if his company has positive excess cash flow and he wanted to reward his employees, contributions to qualified requirement plans have built in exemptions from creditors. While Tom is only 50 years old, he may not be able to tie up his cash in retirement plans which he would not have access to for at least 15 years. However, if Tom is highly compensated and if the company can support it, qualified benefit planning has the double benefit of both tax deferral and asset protection. As a creditor's rights attorney, I would want to make sure that any qualified retirement plan was implemented properly and does not discriminate against lower level employees. The easiest way to attack a qualified retirement plan is to assert facts that would make the plan non-qualified, such as a violation of the ERISA discrimination rules.

E. Life Insurance and Annuity Planning – Most proceeds from life insurance and annuity policies payable on death are exempt when a spouse, child or dependent is the beneficiary.

   1. Life insurance and annuities are only one piece of a comprehensive asset protection plan and can be utilized to the extent cash is available to invest in such products.

   2. Creditor's rights attorneys should consider who owns the policy, who has been paying the policy premiums and who the policy beneficiaries are. If the ownership and premium payments are inconsistent, this may provide an opportunity to attack the policy proceeds. If the beneficiary is Tom's company and the company is the debtor, the life insurance policy may be subject to a judgement against the company.

F. Entity Planning – Limited liability companies offer liability protection for owners/members and help segregate both business and individual assets.

1. Domestic LLCs offer charging order of protection, but are subject to the jurisdiction of U.S. Courts. A charging order is only enforceable against LLC distributions and not the underlying ownership interest.
2. Entity formalities should be kept up. Although an LLC does not have a history of formal entity requirements like corporations do, keeping up with entity formalities like maintaining separate entity accounts, holding annual meetings and preparing annual consents increases the odds that the LLC will be respected. A lack of formal paperwork gives creditors the opportunity to attack the legitimacy of the LLC.
3. <u>Separate Income Tax Returns should be Filed</u> – Typically, a multiple member LLC is taxed as a partnership, which requires a Form 1065 Partnership Income Tax Return to be filed and Schedule K-1s to be issued to the members. As a creditor's rights attorney, the Schedule K-1 will disclose the debtor's ownership percentage and the amount of distributions the debtor received in any particular year.
4. <u>Segregate Company Funds and Expenses</u> – Tom will be advised that if he sets up any domestic LLCs, he should establish separate bank accounts and should not pay personal expenses from LLC accounts. Tom should be advised that the comingling of business and personal assets is the biggest downfall of most debtors when trying to protect business assets.
5. <u>LLC Jurisdictional Considerations</u>
   a. Typically Delaware has been a leading state in limited liability company law, providing maximum asset protection.
      (1) No individual member liability;
      (2) Charging order exclusivity (the creditor's only remedy);

(3) Foreclosure on the membership interest and court ordered dissolution to satisfy a judgment is not permitted.

b. Consider debtor's lack of nexus to Delaware to apply different state's law.

(1) Has judgment creditor ever been in Delaware;

(2) Has the company conducted any business in Delaware (e.g., annual manager's meeting);

(3) Does the company have an office in Delaware or is it simply "renting" a registered agent.

G. <u>Multiple Limited Liability Companies</u>

1. <u>Business Asset LLC</u> – Tom should consider putting all of the company's equipment in a separate LLC. The equipment company can then lease the equipment to Lucky Part LLC pursuant to a written lease.

a. In the event of a judgment against Lucky Part LLC, the equipment should not be subject to the judgment, as Lucky Part LLC is not the legal titleholder.

b. Potential Attacks– The judgment creditor's attorney should see if the lease requirements have been adhered to, local landlord/tenant rules are being followed and if monthly payments are being made to a separate leasing company. Also, if there is a third party contract with, for example, an equipment leasing company, whose name that contract is in.

2. <u>Management Company</u> – Assuming Lucky Part LLC has positive excess cash flow, a management company can be established and a management contract between Lucky Part LLC and the management company can be entered into.

a. Example: $10,000 per month for example can be paid to a new management LLC (Management LLC) from Lucky Part LLC, for which Management LLC will provide "management services." The $10,000 per month should be deductible to Lucky Part LLC. Management LLC now has $10,000 per month to utilize. Management LLC could employ one or both of Tom's children who could be put on Management LLC's payroll. Management LLC could also provide qualified benefit planning for the Management LLC employees.

b. Creditor's rights attorneys should consider whether the services rendered by Management LLC are real or the entity itself could be considered a sham. If qualified benefit plans were utilized (in which case, the management company may be a C corporation), benefit discrimination between lower level employees at Lucky Part LLC and the Management LLC should be looked at as well to determine if the plan is a qualified plan entitled to asset protection. Who the ultimate beneficiary of the management fees should also be considered.

3. <u>Real Estate LLC</u> – Real estate holdings should be separated so as not to expose liability from one real estate holding to the equity of another.

   a. A separate LLC should be formed to own the building in which Lucky Part LLC operates. A written lease should be established if payments are going to be made from Lucky Part LLC to a building LLC and the terms of the lease should be respected.

      (1) If a judgment is obtained against Lucky Part LLC, the judgment should not be enforceable against the real estate if the lease is set up properly.

(2) If a non-employee (guest or invitee) slips and falls at the building, such individual may sue both Lucky Part LLC and the building LLC, but they would have to prove liability against two separate parties.

b. Placing Michigan Residence in an LLC is not practical.

(1) Placing a primary residence an LLC could lead to losing the mortgage income tax deduction, a higher mortgage interest rate (as banks typically charge LLCs more than individuals) and extra administration.

(2) Tenancy by the Entirety is available.

(3) Equity Stripping – A mortgage usually prevents creditors from enforcing judgments against the primary residence.

(4) Qualified Personal Residence Trust (QPRT)

c. Miami Condominium and New Buffalo Rental Properties – Both should be placed in separate LLCs (or a series LLC).

(1) Reliance on Florida homestead exemption alone is risky as it is not Tom's primary residence and federal bankruptcy laws may still apply.

(2) If separate LLCs were used, the equity in the condominium should not be subject to a slip and fall judgment that occurred at the rental property. However, if both the Miami Condo and the rental property are placed in the same LLC, such may be the case.

(3) Creditor's rights attorneys should check to see if the title transfers are complete and that deeds were timely recorded. Also make sure the LLC itself is respected in terms of opening its own account, having written lease agreements with the renters in the New Buffalo apartments (between the

renters and the LLC), and having the LLC pay bills related to the properties. There should also be no mixing of Tom's personal funds with the real estate LLCs' funds.

d. Personal Property – The title to the boat can be re-registered in a family LLC (discussed below). The assignment of ownership should be complete and any re-titling with the state or local marine authorities should be completed as well.

H. Family Limited Liability Companies – Family LLCs allow an individual to manage family wealth through the use of a limited liability company and gifting.

1. Tom can place his 60% membership interest in Lucky Parts in a Family LLC.
2. If Tom were interested in reducing his taxable estate, he could start gifting away minority membership interests in the Family LLC at a discounted rate, thus leveraging his annual and possibly lifetime gift tax exclusions. In this manner, Tom is able to "give away" some of his personal assets while maintaining control over them.
3. If Tom were asked in a deposition, "do you own Lucky Part LLC", he could truthfully answer no. The correct question would be, "do you have a direct or indirect ownership interest in Lucky Part LLC?" If Tom transferred his ownership interest to a Family LLC, the Family LLC would be the owner of the 60% membership interest and not Tom, individually.
4. Manager Managed or Member Managed LLC.

a. Member Managed – Easier for creditors to find members of member managed LLCs liable because it is difficult to distinguish a member's role as to whether he or she is actively managing the company.

b. Manager Managed – Roles are more clearly defined and there should be no member liability. Check the LLC's Operating Agreement.

5. Why not a Limited Partnership?

a. General partner is required and general partners are subject to potential liability.

b. The general partner can be a corporation, but corporate formalities must be maintained or the corporate veil can be attacked.

I. <u>Domestic or Foreign Asset Protection Trusts</u>

1. Self-Settled Spend Thrift Trusts that permit individuals to place their own assets in trust for their own benefit and have the trust assets be protected from creditors.

2. Many formalities and requirements that must be adhered to.

VI. **Domestic Asset Protection Trusts**

A. Currently 16 states have Domestic Asset Protection Trust laws. Some of the leading states include Nevada, South Dakota, Ohio and Delaware.

B. Domestic Asset Protection Trusts are self-settled spend thrift trust under which the grantor also can be the beneficiary.

1. Typically a third party corporate trustee is required.

2. The trust account established with a financial institution should be controlled by the corporate trustee not the grantor.

a. Communications should be with the trustee and not with the financial institution holding the assets.

b. The signatory on the account should be the trustee only, although many clients desire co-signatory authority.

C. Although less compliance is involved then with a foreign trust, all Domestic Asset Protection Trusts are subject to U.S. jurisdiction and attacks by super creditors such as the U.S. Government or bankruptcy trustees.

1. What is the grantor's level of communication and control? Is the grantor communicating with the trustee every day? Are they withdrawing money at regular intervals?
2. Risk of attach under the full faith credit laws of the U.S. Constitution and state conflict of law statutes. E.g., "the school bus accident".
3. Not a significant amount of case law attaching and defending Domestic Asset Protection Trusts.

D. State Tenancy by the Entirety Trust – These are specific domestic asset protection trusts that avail themselves of state tenancy by the entirety statutes governing personal property.

1. Requires a third party trustee.
2. Has marital/divorce implications.
3. Subject to U.S. jurisdiction and the same risks discussed above for DAPTs.

VII. **Foreign Asset Protection Trusts**

A. Advantages – Typically a jurisdiction that has not entered into a treaty with the U.S. is selected.

1. Short statute of limitations on claims and fraudulent conveyances
2. Does not recognize U.S. Judgments
3. Required to file suit locally
4. Required to use local counsel; no contingent fee arrangements

5. Required to post a bond, looser pays

B. Consider whether the settlor visited the jurisdiction, the foreign trustee's office or executed the documents in the foreign jurisdiction. Lack of nexus or contact with the selected jurisdiction could be used to attack the trust.

C. Does the foreign trust utilize only a foreign trustee or also a U.S. co-trustee who resigns or is relieved or his or her authority in an event of duress? Creates potential control issues.

D. Trust Beneficiaries – Can be both the grantor and the grantor's family.

E. Where are the trust assets actually located?

 1. Typically not where the trustee is located. E.g., A Nevis bank is subject to the jurisdiction of the Nevis' court system.

 2. Consider if the assets are in the U.S.

  a. Foreign financial institution with no U.S. branches. The grantor has to weigh lack of reach by the U.S. courts with country stability.

  b. Foreign financial institution with U.S. branches, but main office outside U.S. E.g., RBC. Does the grantor avoid U.S. deposits and U.S. banking activity?

  c. U.S. financial institution with foreign branches. Maybe not the trust account, but could be used for a domestic LLC owned by the trust.

  d. Consider where the financial activity is occurring?

F. "Pure" Trust Account vs. LLC Account where LLC membership interest is transferred to foreign trust – Consider who the account signatories are. The trustee, or the trustee and the grantor.

G. Contact and Control – Consider how often the grantor/debtor contacts the trustee, makes financial decisions, makes withdrawals, where they are made, how they are made, etc.

H. Foreign Reporting Compliance

1. The Form 3520 Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts is an annual reporting form which requires all financial activity of a foreign trust to be documented by a U.S. transferor.
2. The Form 3520A Annual Information Return of a Foreign Trust with a U.S. Owner is an annual form that includes both an income statement and balance sheet for the foreign trust.
3. Severe penalties for failure to file or late filing.
4. If trust is foreign for U.S. tax purposes (does not meet the control and court tests), these two forms will provide valuable information about the foreign trust. If the trust is treated as domestic for U.S. tax purposes, a trust income tax return will be required which can also provide valuable information.

I. Funding the Foreign Trust

1. Depending on where the foreign trust account is located, a Form 114 Report of Foreign Bank and Financial Accounts (FBAR) likely will be required.
2. Not typically funded with U.S. Real Estate – Cannot take the jurisdiction out of the real estate.
3. LLC Interests that hold assets are often transferred to the foreign trust.
   a. Make sure assignments and title documents are complete.

b. Foreign ownership of U.S. entities creates additional foreign tax filing requirements. E.g. , Form 1065, Schedule B-1 Information on Partners Owning 50% of More of the Partnership.

c. Determine if transfers are permitted under the relevant LLC operating agreements.

d. Is the ownership structure being respected going forward? In other words, are the flow of assets and funds occurring properly from the LLC to the foreign trust?

VIII. **Conclusion** – Settle!

Best Practices in Debtor Representation: Pre-Bankruptcy Asset Protection Planning

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INTRODUCTION

Have you ever stopped to consider what are the duties of a debtor's attorney to properly counsel their client regarding the decision to file a bankruptcy, the timing of the filing and what, if anything, the client can do to protect their assets from risk of loss to a Chapter 7 Trustee or to minimize their Chapter 13 payments? Proper pre-bankruptcy planning begins with a thorough review of a client's assets and liabilities and income and expenses, for the purpose of determining whether the filing of a bankruptcy is a good option for managing or even eliminating some or all of their debt. Factors to consider include the nature of the debt, whether there are sufficient assets or income to pay or settle with creditors, the client's overall financial picture and their short-term and long-term goals. Consideration should also be given to what else is going on in their lives, how urgent their financial concerns are, and whether non-bankruptcy options are available. To assist you in your initial client meetings, we have prepared and provided a New Client Checklist in the Appendix.

Clients who have the benefit of time and who are not currently insolvent may also be able to engage in asset protection planning to protect some or all of their otherwise non-exempt assets in a bankruptcy. No, we are not advocating that we encourage our clients to engage in fraudulent transfers or otherwise hinder, delay or defraud their creditors. However, as the following survey of cases shows, clients may, under the appropriate circumstances, take advantage of their available state and federal law exemptions by converting non-exempt assets into exempt assets and thereby shelter certain assets that would otherwise fall into the hands of their creditors.

Whether a debtor's conversion of nonexempt assets into exempt assets will survive a court's scrutiny depends upon the jurisdiction and a variety of other factors. Debtors who engage in asset protection planning with the intent to hinder, delay, or defraud creditors put themselves at risk of having the transaction set aside as a fraudulent transfer, having the exemption denied, having their discharge denied, or having their petition dismissed. Attorneys who assist their clients in such conduct are also at risk of being sanctioned. Typically, the analytical framework used to resolve these issues is the "badges of fraud." Commonly cited badges of fraud include: (1) the family or insider relationship between the transferor and transferee; (2) the debtor retaining control of the property in question; (3) the transfer taking place abruptly, i.e. immediately following the filing of a lawsuit, after entry of a judgment or right before a bankruptcy; (4) the debtor becoming insolvent as a result of the transfer; (5) the conversion occurring after the entry of a large judgment against the debtor; (6) the secrecy of the transaction; (7) the debtor not receiving adequate consideration for the transfer; and (8) the failure to make full disclosure of assets.

The following survey of cases addresses various types of asset protection planning. Section I addresses the purchase of property with the intent to convert into exempt property or in fraud of creditors. Section II addresses the fraudulent transfer of assets into a self-settled trust or similar device. Section III addresses restrictions on debt relief agencies. Section IV addresses attorney sanctions for improper disclosure. Sections V and VI address permissible and impermissible attempts at pre-bankruptcy asset protection planning. Lastly, the conclusion is found in Section VII.

I. 735 ILCS 5/12-1001. PERSONAL PROPERTY EXEMPT

1. **If a debtor owns property exempt under this Section and he or she purchased that property with the intent of converting nonexempt property into exempt property or in fraud of his or her creditors, that property shall not be exempt from judgment, attachment, or distress for rent. Property acquired within 6 months of the filing of the petition for bankruptcy shall be presumed to have been acquired in contemplation of bankruptcy. 735 ILCS 5/12-1001.**

a. ***Medaris v. Commercial Bank of Champaign***, 118 Ill. 2d 443 (1987) (debtors could not claim any portion of automobile as exempt where automobile was acquired less than five months prior to their filing for bankruptcy).

   i. **Key Factor(s):** plaintiffs acquired automobile less than five months prior to filing for bankruptcy.

b. ***Soc'y of Lloyd's v. Collins***, 284 F.3d 727 (7th Cir. 2002) (premiums paid on life insurance policies owned by judgment debtor could not be garnished by judgment creditor, even if statute applied, given absence of showing that judgment debtor acted with requisite intent to convert nonexempt property to exempt property; Judgment creditor failed to raise presumption that judgment debtor's continued payment of premiums for life insurance policies he owned was fraudulent given that judgment debtor was solvent and did not transfer property for inadequate consideration).

   i. **Key Factor(s):** no showing that debtor acted with intent to convert nonexempt property to exempt property; debtor was solvent and did not transfer property for inadequate consideration.

c. ***In re Holtermann***, 1999 WL 33582613 (Bankr. C.D. Ill. June 21, 1999) (court allowed trustee's objection to debtors' claim of exemption despite debtors' claim that the balance of funds they withdrew from an individual retirement account and held in a savings account were exempt).

   i. **Key Factor(s):** debtors did not roll the cash value into a spendthrift trust, IRA, or other protected plan; funds "lost the attributes of life insurance proceeds" once they were transferred to the debtors' account.

II. 11 U.S.C. § 548. FRAUDULENT TRANSFERS AND OBLIGATIONS

1. **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. 11 U.S.C. § 548(e)(1).

a. ***In re Castellano***, 2014 WL 3881338 (Bankr. N.D. Ill. Aug. 6, 2014) (transfer of debtor's interest in assets of living trust to spendthrift trust was avoidable fraudulent conveyance).

   i. **Key Factor(s):** debtor was beneficiary of spendthrift trust; timing of creation of the spendthrift trust account appeared to have been dictated in large part by debtor's insolvency and bankruptcy petition; debtor's understanding was that the spendthrift trust account was created to prevent her creditors from reaching the assets; timing of transfer of funds was delayed until a spendthrift trust had been created.

b. ***In re Mortensen***, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011) (debtor transferred real property to trust with "actual intent to hinder, delay, or defraud his creditors").

   i. **Key Factor(s):** debtor was well "under water" when he sought to put the property out of reach of his creditors by placing it in the trust; debtor used trust as a vehicle for making stock market investments (as well as to make loans to acquaintances), not for its stated purpose to preserve property for his children.

c. ***In re Mastro***, 465 B.R. 576 (Bankr. W.D. Wash. 2011) (transfers by involuntary Chapter 7 debtor of residential properties and other assets into self-settled trusts were both void).

   i. **Key Factor(s):** debtor made transfers with intent to hinder, delay, or defraud creditors; no consideration was paid for transfers; transfers occurred at a time when debtor was insolvent.

III. 11 U.S.C. § 526(a)(2). RESTRICTIONS ON DEBT RELIEF AGENCIES

1. **A debt relief agency shall not make any statement, or counsel or advise any assisted person or prospective assisted person to make a statement in a document filed in a case or proceeding under this title, that is untrue or misleading, or that upon the**

exercise of reasonable care, should have been known by such agency to be untrue or misleading. 11 U.S.C. § 526(a)(2).

a. ***Parker v. Jacobs***, 466 B.R. 542 (M.D. Ala. 2012) *aff'd sub nom. In re Parker*, 485 F. App'x 989 (11th Cir. 2012) (attorney disbarred from practice of law in district's bankruptcy court; attorney repeatedly violated Rule 9011(b)(3) and § 526(a)(2) by filing materially false petitions and schedules and repeatedly withheld payment of filing fees).

   i. **Key Factor(s):** numerous instances in which attorney had filed petitions and other papers knowing that they contained false information; attorney's fraudulent conduct in his own Chapter 7 case where he falsified his name and home address to avoid creditor detection; 28 cases in which attorney did not include required filing fee; record demonstrated violations of state professional conduct rule; attorney habitually came to court late and unprepared and, many times, did not attend scheduled hearings at all.

b. ***In re Casavalencia***, 389 B.R. 292 (Bankr. S.D. Fla. 2008) (Chapter 13 petition filed by debtor in attempt to discharge debts arising out of deliberately fraudulent scheme to deceive investors dismissed as having been filed in bad faith, so as to permit investors to proceed with their suits against debtor, where debtor, in omitting numerous assets from bankruptcy schedules and in failing to disclose, on petition, the alias under which he had consistently held himself out to investors, had sought bankruptcy relief while engaging in deliberate effort to mislead creditors and court).

   i. **Key Factor(s):** petition and schedules filed were untrue and misleading and at least some of them (particularly including the debtor's nomenclature) would have been known to debtor's attorney upon the exercise of reasonable care.

c. ***In re Clink***, 497 B.R. 44 (W.D. Mo. 2013) (former attorney for debtor sanctioned for advising his client to omit any reference to potentially preferential prepetition transfer to client's mother in documents filed in bankruptcy case).

   i. **Key Factor(s):** attorney recommended that client conceal from the official records a substantial transaction with her mother that looked like a preference for a favored creditor; attorney condoned a reported practice of minimizing the reporting of assets such as pets, including horses, some of which, as in this case, may have significant value; attorney disregarded procedural rules such as having a written contract with a debtor and obtaining signed verification of final drafts of papers prior to filing.

IV. SANCTIONS AGAINST DEBTOR'S COUNSEL FOR IMPROPER DISCLOSURES

1. **Counsel sanctioned under 11 U.S.C. §§ 105 and 329 and Model Rule 3.3 for their failure to file a materially accurate Schedule B on behalf of the Debtor, and timely file a fee disclosure statement required under § 329(a) and Bankruptcy Rule 2016(b).**
   a. ***In re Varan***, 2014 WL 2881162 (Bankr. N.D. Ill. June 24, 2014) (attorneys failed to accurately disclose assets in schedules and failed to comply with fee disclosure requirements; bankruptcy court ordered the debtor's attorneys to disgorge all fees, reimburse the U.S. Trustee for the cost of pursuing a sanctions motion against them, and complete of a professional responsibility course at an ABA-approved law school).
      i. **Key Factor(s):** documents produced during discovery and the debtor's deposition testimony shows that attorneys knew or should have known that schedules were materially inaccurate as filed; absolute duty to disclose assets in his schedules, regardless of the value of such assets; disclosure of assets to trustee is not sufficient to comply with the Bankruptcy Code's requirement of the filing of accurate schedules; attorneys failed to comply with fee disclosure requirements on numerous occasions.

V. PERMISSIBLE PRE-BANKRUPTCY ASSET PROTECTION PLANNING

1. **Engage in exemption planning while faced with financial distress.**
   a. ***In re Woller***, 483 B.R. 886 (Bankr. W.D. Wis. 2012) (debtors sought to protect $200,000 in exempt assets and discharge $164,000 in debt; noting "[t]he fact that a debtor engages in exemption planning while faced with financial distress is not itself evidence of fraudulent conduct. … the use of exemptions is at least a legitimate form of asset protection, and debtors should only be penalized when they go beyond taking advantage of the exemption laws themselves;" the court went on to describe the

absence of extrinsic evidence of fraud even though certain sale proceeds were held by a lawyer for 18 months before the funds were converted to an exempt annuity).

i. **Key Factor(s):** no sufficient evidence of "extrinsic" activity actually intended to hold creditors at bay while debtors purchased the annuity; debtors' exemption planning did not rise to the level of fraudulent conduct – "conduct which forestalled or potentially deceived creditors, buying time while they surreptitiously converted non-exempt assets into exempt ones" – as would have warranted denial of their exemption of the annuity; exemption statute did not automatically prohibit debtors from exempting vehicle – a semi-trailer – under the business property exemption; nothing in the statute limited "income" to wages from employment, as opposed to money owed to independent contractors.

2. **Liquidate nonexempt assets to reduce or prepay mortgage on homestead.**

a. ***In re Carey***, 938 F.2d 1073 (10th Cir. 1991) (debtor's negotiating a mortgage to permit prepayment of principal without penalty does not infer any fraud on creditors; conversion is insufficient to support denial of discharge).

i. **Key Factor(s):** debtor had no intent to hinder, delay, or defraud her creditors; debtor fully disclosed all payments and transfers in her bankruptcy schedules and at the meeting of creditors; debtor retained no beneficial interest in any converted property; debtor did not obtain credit to purchase exempt property.

b. ***In re Meyer***, 244 F.3d 352 (4th Cir. 2001) (debtor's use of nonexempt fund to prepay mortgage debt and to increase equity in homestead property was not avoidable as transfer which was made other than "upon consideration deemed valuable in law;" release of mortgage lien constituted "valuable consideration" for debtor's prepayment, and foreclosed application of voluntary conveyance statute).

i. **Key Factor(s):** release of mortgage lien constituted "valuable consideration" for debtor's prepayment.

c. ***In re Martiny***, 378 B.R. 52 (Bankr. W.D. N.Y. 2007) (pre-bankruptcy planning was approved whereby debtors increase equity in homestead by using nonexempt assets to reduce the mortgage; court held that absent fraud, such planning and execution was not improper).

i. **Key Factor(s):** no provision of the Bankruptcy Code or of the New York statute prohibits pre-bankruptcy planning for the purpose of maximizing the exemptions allowed to a debtor; exemption was enhanced to a level within the statutory limit.

d. ***In re Addison***, 540 F.3d 805 (8th Cir. 2008) (conversion of $11,500 of nonexempt assets to pay down mortgage on exempt homestead was proper even though: (i) a transfer was made to an insider, (ii) the debtor retained control of the property, and (iii) the debtor was insolvent, none of which constituted evidence of fraud extrinsic to the very conversion. The only such evidence, i.e., transaction occurred in the face of litigation, was insufficient to result in a denial of the exemption; the court ruled the same with respect to debtor's $4,000 IRA; the court also declined to deny the debtor's discharge, ruling that the "the same standard applies to determine whether a discharge should be denied or whether a transfer of nonexempt property to exempt property should be voided; both require proof that the debtor acted with the intent to hinder, delay, or defraud a creditor.")

i. **Key Factor(s):** debtor did not act with intent to hinder, delay or defraud creditors; no extrinsic evidence of any intent to defraud creditors.

3. **Convert nonexempt funds into reasonable amount of exempt insurance.**

a. ***In re Holt***, 894 F.2d 1005 (8th Cir. 1990) (court upheld lower court finding of no fraud in connection with the conversion of nonexempt funds into reasonable amount of exempt insurance; the court confirmed that a debtor may convert nonexempt assets into exempt assets on the eve of bankruptcy; the conversion, however, must not be done with intent to defraud creditors as manifested by extrinsic evidence).

i. **Key Factor(s):** no intent to defraud creditors; debtors did not have exorbitant amounts of existing life insurance coverage before they openly purchased reasonable amounts of additional coverage; money placed into exempt property was not borrowed; no evidence that they lied to or misled creditors.

4. **Transfer assets to a retirement plan.**

a. ***Schwartzman v. Wilshinsky***, 50 Cal. App. 4th 619 (2d Dist. 1996) (transfer of assets to a retirement plan which might otherwise be fraudulent is permitted if the funds qualify for an exemption; lower court erred in denying the judgment debtor's claim of exemption as to all employee contributions and matching employer contributions held in the 401K profit-sharing account established by the judgment debtor's employer).

i. **Key Factor(s):** no evidence the debtor had kind of control that would show a nonretirement purpose.

5. **Conduct fire sale to convert nonexempt assets to exempt assets.**

a. ***In re Kemmer***, 265 B.R. 224 (Bankr. E.D. Cal. 2001) (mere act of conversion not fraudulent; actual fraudulent intent not established by fire sale undertaken solely in an attempt to convert nonexempt assets into exempt assets, which did not exceed the bounds of acceptable exemption planning; transfer was made for less than "reasonably equivalent value" and was subject to avoidance on that basis).

i. **Key Factor(s):** no actual fraudulent intent; debtors were not seeking to hide their assets but merely to make maximum use of available exemptions.

6. **Convert nonexempt assets into an exempt annuity.**

a. ***In re Vangen***, 334 B.R. 241 (Bankr. W.D. Wis. 2005) (conversion of nonexempt into exempt assets was not improper absent evidence of fraud extrinsic to the very act of conversion; limitations on amount of funds converted is for the legislature to determine not the courts; accordingly, debtor was allowed to convert $136,000 into an exempt annuity, which the court characterized as "not particularly sizeable").

i. **Key Factor(s):** plaintiffs failed to present sufficient extrinsic evidence of fraud to overcome the general rule that a debtor may arrange her affairs so as to take full advantage of the exemptions available to her under state law; no basis for considering the money the debtor used to fund the annuities to have been "tainted" in any way; no evidence that she sold her interest in a building for anything other than fair market value; motivation was to create a retirement fund for debtor's future.

b. ***In re Simms***, 243 B.R. 156 (Bankr. S.D. Fla. 2000) (conversion into exempt annuity was approved where debtors were concerned about their advancing ages and declining health and, therefore, were interested in long-term investment, which the annuity provided).

i. **Key Factor(s):** trustee failed to establish that debtors' act of converting the non-exempt funds into an exempt annuity was done with intent to hinder, delay, or defraud creditors; debtors decided a full year before filing bankruptcy to sell their prior homestead property and establish the subject property as homestead, and their reasons for doing so were legitimate, compelling, and independent of any alleged scheme to defraud creditors.

c. ***In re Robinson***, 271 B.R. 437 (Bankr. N.D. N.Y. 2001) (conversion of nonexempt real property into exempt annuities for $5,000 made seven months before filing a petition and the advice of counsel was allowed).

   i. **Key Factor(s):** lack of evidence of extrinsic fraud; debtors were elderly and insolvent but paid fair consideration; husband was 74 years old and was continuing to work to support his family; his wife was in ill health; the annuities were purchased in anticipation of their future needs; the conversion was made seven months before the bankruptcy petition was filed.

d. ***In re Bogue***, 240 B.R. 742 (Bankr. E.D. Wis. 1999) (pre-bankruptcy conversion of assets from nonexempt to exempt within a year of filing a bankruptcy petition is not necessarily fraudulent to creditors, and to find such fraudulent intent there must be "extrinsic signs of fraud").

   i. **Key Factor(s):** no extrinsic signs of fraud shown; amount of exemption not exorbitant; funds used by the debtors to purchase the annuities were not tainted; no misrepresentations or concealment; purpose was to create a retirement fund for their future.

7. **Convert nonexempt proceeds from personal property sold with debtor's house into homestead property.**

a. ***In re Danduran***, 657 F.3d 749 (8th Cir. 2011) (Noting that the proceeds from the sale of personal property could qualify for the homestead exemption "but if directed properly;" noting that "[i]t is well established … that a debtor's conversion of non-exempt property to exempt property on the eve of bankruptcy for the express purpose of placing that property beyond the reach of creditors, without more, will not deprive the debtor of the exemption to which he otherwise would be entitled").

   i. **Key Factor(s):** trustee failed to meet burden of establishing conversion was invalid absent evidence that the proceeds of the sale of the house and personal property were ever segregated or that only the proceeds of real property (and none of the proceeds of personal property) were used to pay off the mortgage.

8. **Convert assets from nonexempt to exempt prior filing bankruptcy.**
    a. ***In re Wadley***, 263 B.R. 857 (Bankr. S.D. Ohio 2001) (debtor sold motorcycle for $12,000 and used proceeds to acquire various exempt assets; court confirmed that the mere conversion of nonexempt assets into exempt assets does not, by itself, establish fraud: "the intent to effect such a transfer is merely the intent to exercise a valid right [i.e., use of an exemption] rather than an intent to defraud;" the court also noted absence of concealment or attempt to mislead creditors and a full disclosure was made to the bankruptcy trustee; further the amount involved was modest and there was no indication that this was less than reasonably equivalent value).
        i. **Key Factor(s):** absence of concealment or attempt to mislead creditors; full disclosure to bankruptcy trustee; modest amount involved that was reasonably equivalent value.
    b. ***In re Bradley***, 294 B.R. 64 (B.A.P. 8th Cir. 2003) (debtors carved out one-quarter acre as their homestead, and claimed the one-quarter acre as exempt; trustee alleged that because the debtors converted non-exempt assets into the homestead, they were not entitled to claim the homestead as exempt; under the Bankruptcy Code, the conversion of nonexempt assets into exempt assets, without more, will not deprive a debtor of the right to claim the exemption to which he is otherwise entitled; the court so held even though substantially all of the debtor's assets were converted and the debtor was insolvent at the time of the transfer).
        i. **Key Factor(s):** debtor was concerned about tax obligations that might arise from being released from liability for his personal obligation to a corporation he formed to finance the $45 million purchase price of a division at another corporation; debtor received advice of counsel that the purchase of exempt property would reduce his tax exposure if he were to obtain a release of the obligations – court found that the advice, and not the intent to defraud his creditors, prompted debtor to purchase the homestead.
    c. ***In re Bronk***, 775 F.3d 871 (7th Cir. 2015) (trustee filed objections to debtor's claimed exemptions under Wisconsin statutes to shield debtor's college savings

accounts that he set up for his grandchildren, as well as recently-purchased annuity; the bankruptcy court erred in denying exemptions for college savings accounts since relevant statute clearly allowed debtor to exempt his interest in said accounts; also, the bankruptcy court did not err in finding that debtor's annuity was fully exempt where said annuity contained a death benefit).

   i. **Key Factor(s):** no evidence that debtor acted with intent to hinder, delay, or defraud creditors; trustee waived argument that debtor's annuity with death benefit did not comply with Internal Revenue Code as required by the exemption statute protecting certain retirement benefits.

9. **Prepay taxes prior to filing for bankruptcy relief.**

   a. ***In re Graves***, 609 F.3d 1153 (10th Cir. 2010) (prior to filing for bankruptcy relief, Chapter 7 debtors had irrevocably applied their prepetition tax refund to prepayment of their taxes for the next tax year; turnover of debtor's tax refund was inappropriate because, during the case, debtors were never in "possession, custody, or control" of their contingent reversionary interest in the prepayment of their taxes for the subject year; if, after debtors' tax liability for the next tax year was determined, they were entitled to a refund, trustee was entitled to demand turnover of any amount of such refund attributable to prepetition earnings).

      i. **Key Factor(s):** instead of choosing to receive tax refund, debtors elected to leave those funds on deposit with the United States and apply the overpayment to their future tax liability – election was irrevocable; debtors were never in "possession, custody, or control" of their contingent reversionary interest in the prepayment of their taxes for the subject year; debtors presumably controlled the refund before they made their election to apply it to future taxes, but that control was pre-petition and thus not "during the case" as required by § 542(a).

   b. ***In re Middendorf***, 381 B.R. 774 (Bankr. D. Kan. 2008) (estimated tax prepayment made by debtors shortly after realizing a profit from sale of stock was supported by "reasonably equivalent value," and could not be avoided as constructively fraudulent transfer; tax refund to which debtors were entitled as result of their overpayment of federal income taxes, both as result of wage withholding that occurred both pre- and postpetition and due to debtors' estimated prepayment of taxes, using prepetition income, had to be allocated between pre and postpetition periods, for purpose of determining what portion of refund was estate property and what portion was debtors' separate property).

i. **Key Factor(s):** debtors, at time of this tax prepayment, were facing significant tax liability and obtained dollar-for-dollar credit against that potential liability and a right to refund if their tax debt was ultimately less than what they had estimated; debtors could not know, at time of their estimated tax prepayment, that their deductions would be such as to significantly reduce their actual tax liability.

10. **Transfer interest in jointly owned property to spouse, who simultaneously conveyed property to a qualified residential property trust.**

a. ***In re Geer***, 522 B.R. 365 (Bankr. N.D. Ga. 2014) (debtor's transfer of his interest in his jointly owned house to his wife, who simultaneously conveyed the house to a qualified residential property trust (QRPT), was not done with intent to hinder, delay, or defraud his creditors, so as to warrant denial of his discharge; although debtor was insolvent when transfer was made, transfer occurred more than two years prepetition, creation of QRPT occurred at the same time as debtor formed a limited liability company (LLC) and a self-settled family trust, all three entities were created on the advice of non-bankruptcy counsel as part of an overall estate plan, not as part of bankruptcy planning, debtor was trustee but not a beneficiary of the QRPT, debtor disclosed the QRPT as the owner of the house in Schedule F, and though debtor did not disclose the benefit he received from currently living in the house in SOFA Question 10b, he and counsel reasonably understood the question as asking for only legal "beneficiaries").

i. **Key Factor(s):** timing (2 years before filing); advice was from non-bankruptcy counsel as part of overall estate plan; debtor was not beneficiary of QRPT; and disclosure of QRPT.

VI. IMPERMISSIBLE PRE-BANKRUPTCY ASSET PROTECTION PLANNING

1. **Engage in fraud directed at specific creditors.**

a. ***In re Gepfrich***, 118 B.R. 135 (Bankr. S.D. Fla. 1990) (debtor attempted to convert a marital asset (an investment) into an exempt annuity; debtor's wife sought to enforce her rights under a divorce decree; court denied a discharge because the proceeds, which were converted into exempt property, were obtained from marital assets in which the wife had an interest; In addition, the court looked to the debtor's conduct of misleading both his wife and the state court as to the availability of funds as well as making gifts to his children of a previous marriage).

   i. **Key Factor(s):** amounts involved; timing; fact that the proceeds were derived from marital assets the wife had an interest in; misleading wife and state court as to the availability of the certificate of deposit; and insolvency of the debtor.

2. **Convert borrowed funds and assets relied on by creditors.**

a. ***Matter of Armstrong***, 97 B.R. 565 (Bankr. D. Neb. 1989) *subsequently aff'd,* 931 F.2d 1233 (8th Cir. 1991) (debtors encumbered certain property to assist a related party to generate cash that was used by debtors to acquire exempt property; in denying discharge, the bankruptcy court stated that "if a debtor was only 'looking to his future wellbeing,' a discharge would be granted but if the debtor had a particular creditor in mind in trying to remove his assets from that creditor's reach, then a discharge would be denied").

   i. **Key Factor(s):** family relationship between the parties; the retention of possession, benefit or use of the property; insolvency of the debtor; intent to hinder, delay or defraud creditor (transfers of property occurred after debtors were aware of bank's imminent lawsuit).

3. **Convert business assets.**

a. ***In re Collins***, 19 B.R. 874 (Bankr. N.D. Fla. 1982) (on the eve of bankruptcy, debtor transferred $55,000 from his business resources and converted the funds into homestead property; Court held that conversion was improper; in commenting on the propriety of converting nonexempt assets into exempt assets, the court noted the following "Some transfers [that accomplish a conversion of nonexempt to exempt property] certainly are permissible and should be encouraged. However, in cases with a factual scenario which reveal that business assets which belong to creditors are being used to delete individual debts will not be permitted").

i. **Key Factor(s):** debtor's transfer and omission from schedules of transfer of $55,000 of business resources to satisfy mortgage on debtor's homestead; timing of the transfer on the eve of bankruptcy.

4. **Spend money so that it does not fall into the hand of creditors.**
   a. ***In re Rice***, 109 B.R. 405 (Bankr. E.D. Cal. 1989) (denial of discharge where bankruptcy counsel advised debtor to draw as much money as he could from his bank account and spend it, and debtor did so, including transfer of funds to mother who resided with him).
      i. **Key Factor(s):** transfer of property of the debtor, within one year before the date of the filing of the petition, with actual intent to hinder and delay a creditor and the bankruptcy trustee; advice from counsel to "spend" the money in this case was unaccompanied by any advice about legitimate exemption planning and about the risks of improper transfers; and transfer to mother was not revealed on the schedules.
   b. ***In re Lubin***, 61 B.R. 511 (Bankr. S.D.N.Y. 1986) (funds transferred to a child in order to pay for a trip to Europe and to pay child's automobile loan held to be fraudulent transfer resulting in denial of discharge).
      i. **Key Factor(s):** family relationship between the parties; transfer of property of the debtor within one year before the date of the filing of her petition with actual intent to hinder, delay or defraud her creditors; debtor knowingly and fraudulently made a false oath.
5. **Prepay domestic support obligations.**
   a. ***Matter re Swift***, 3 F.3d 929 (5th Cir. 1993) (debtor's transactions with relatives sufficient to deny discharge; debtor's transactions included prepaying alimony to ex-wife, transferring insurance policies to son who, after borrowing against them, transferred funds back to ex-wife who then loaned funds back to debtor who gave her promissory note day before bankruptcy, and borrowing money from daughter in exchange for promissory notes secured by debtor's interests in personal property).

i. **Key Factor(s):** the family relationship between the parties; debtor transferred, concealed, or disposed of property within one year before filing with intent to hinder, delay, or defraud creditors.

6. **Purchase exempt property as a means of temporarily protecting funds.**
   a. ***In re Johnson***, 124 B.R. 290 (Bankr. D. Minn. 1991) (debtor was denied discharge where he liquidated various nonexempt business investments and used part of the proceeds to purchase minor amounts of exempt whole life insurance and converted certain personal property into exempt musical instruments with the intent of realizing the cash value of the exempt property after bankruptcy proceeding).
      i. **Key Factor(s):** debtor never had an intent to use the life insurance policy to maintain insurance coverage on his life for the indefinite future; trading of nonexempt personalty for harpsichord and baby grand piano which he also claimed as exempt under Minnesota law, showed that debtor acted with intent to hinder, delay, and defraud creditors.
   b. ***In re Preston***, 233 B.R. 375 (Bankr. E.D. Tex. 1999) (relying on policy to prevent parking of assets, no exemption was allowed for burial plots where there was no explanation as to why it was reasonable for the debtor to claim more than one burial plot as exempt).
      i. **Key Factor(s):** no explanation why debtor needed four separate burial plots or as to persons for whom other three plots were being held; by eliminating term "family" from exemption statute, Texas legislature intended to broaden exemption to allow debtors to exempt plots not intended for burial of immediate family members, but not to create unlimited exemption.
7. **Convert nonexempt assets into exempt assets for parking purposes.**
   a. ***In re Zouhar***, 10 B.R. 154 (Bankr. D.N.M. 1981) (discharge was denied when a debtor converted funds into exempt annuities and insurance policies on the grounds that the debtor had no interest in the annuity for a retirement or insurance purpose).
      i. **Key Factor(s):** debtor forthrightly admitted that he had no interest in the annuity for any retirement or insurance purpose; debtor utilized this method as a device to shield his assets from his creditors.
8. **Park property with an accommodating party.**

a. ***In re Lafferty***, 469 B.R. 235 (Bankr. D.S.C. 2012) (denial of homestead when debtors first transferred homestead to their paramours "with the wrongful intent to defraud" a creditor and avoid its judgment, then recovered the property after debtors "realized that the transfer would not benefit them").

i. **Key Factor(s):** debtors were not truthful in bankruptcy proceedings; property transferred to debtors' paramours for no consideration and with the wrongful intent to defraud a creditor and avoid its judgment; once debtors realized that the transfer would not benefit them they requested that the property be transferred back to them so they could obtain homestead exemptions when they filed their bankruptcy petitions.

9. Unreasonably exercise exemption.

a. ***In re Englander***, 156 B.R. 862 (Bankr. N.D. Fla. 1992), *aff'd,* 95 F.3d 1028 (11th Cir. 1996) (debtors had a little more than an acre of land and sought to configure the exemption so that the remainder of the land could not be used because they could only exempt one-half acre – court held that the configuration was not reasonable in that it prevented all access to the other portions of the land except by helicopter).

i. **Key Factor(s):** debtors attempt to limit the amount of assets available for distribution to their creditors by first misidentifying the size of their homestead and later partitioning the tract containing his residence in such a manner as to render the nonexempt portion of that tract valueless.

10. Acquire title to a house for no other reason than to defraud creditors.

a. ***In re Sholdan***, 217 F.3d 1006 (8th Cir. 2000) (debtor was a retired farmer, ninety years of age, afflicted with serious medical problems, and had been recently named a defendant in a personal injury suit with claimed damages well in excess of his liability insurance coverage; court upheld a lower court finding that purchase of a residence was a fraudulent transfer where debtor moved out of an assisted care facility and purchased a home for approximately $135,000 and, after the purchase of the house, the debtor's total income was reduced to $486 per month; court stated: "[i]t is one thing to convert nonexempt assets into exempt property for the purpose of holding it as a homestead and thereby putting the property beyond the reach of creditors...however, it is quite another thing to acquire title to a house for no other reason than to defraud creditors").

1. **Key Factor(s):** evidence extrinsic to the mere conversion of assets that showed fraudulent intent on the part of the debtor; court's refusal to allow homestead right to operate as a vehicle for fraud and rank injustice.

11. Secretly convert nonexempt property into exempt property postpetition.

a. ***In re Koss***, 319 B.R. 317 (Bankr. D. Mass. 2005) (postpetition conversion of significant nonexempt insurance proceeds that belonged to the bankruptcy estate may result in denial of exemption where debtor did so intentionally and in secret).

   i. **Key Factor(s):** debtor intentionally concealed estate property; debtor failed to deposit insurance proceeds – after a fire destroyed residence and all personal property therein – into the Chapter 11 debtor in possession bank account, report insurance proceeds to the Court, or include the insurance proceeds in his reports to the UST.

12. Overfund retirement plan in violation of IRS/IRC rules.

a. ***In re Rucker***, 570 F.3d 1155 (9th Cir. 2009) (debtor secretly funded plans using a wholly owned offshore corporation and a foreign bank account and one of the plans purchased property on which the debtor resided rent free; the court concluded that debtor used the plans to shield assets from creditors rather than for retirement purposes).

   i. **Key Factor(s):** debtor consistently funded plans in excess of the contribution limits imposed by the IRC; debtor secretly contributed money to his plans using a wholly owned offshore corporation and a foreign bank account; underreporting of amount of money contributed to plan; debtor's admission that he never intended to pay another cent on creditor's "black hole" judgment.

13. Claim an exemption on an amended petition in bad faith.[1]

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[1] It is unclear whether the United States Supreme Court's decision in *Law v. Siegel*, 134 S. Ct. 1188 (2014), abrogates the power of bankruptcy courts to deny exemptions (or bar a debtor from amending a schedule to claim exemptions) on grounds of a debtor's bad faith conduct. In *Siegel*, the Supreme Court, reversing the Ninth Circuit, held that a bankruptcy court exceeded the limits of its statutory and inherent authority when it ordered, as a sanction, that $75,000 protected by a Chapter 7 debtor's homestead exemption be surcharged to pay attorney's fees incurred

a. ***In re Wunderlich***, 369 B.R. 80 (Bankr. D.N.H. 2007) (debtor's bad faith in claiming New Hampshire exemptions, which prejudiced creditors, prevented him from amending petition to claim New York exemptions).

   i. **Key Factor(s):** debtor repeatedly maintained throughout 341 meeting and Rule 2004 examination that he did not reside in New York; debtor undervalued his retirement plan; there were potential benefits to claiming New Hampshire exemptions, court had previously denied debtor's discharge because of his bad faith concealment of mortgage proceeds.

b. ***In re Hannigan***, 409 F.3d 480 (1st Cir. 2005) (the Court may deny the amendment of exemptions where the amendment would prejudice creditors or where the debtor has acted in bad faith or concealed assets).[2]

   i. **Key Factor(s):** debtor intentionally undervalued his property in documents submitted to trustee, which consisted of a 1.36-acre house parcel and an adjoining 33-acre parcel; debtor had acted in bad faith in initially valuing, at only $135,000, homestead property that he later sought to claim as exempt, in

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by the bankruptcy estate due to debtor's bad faith litigation conduct. Bankruptcy courts may not exercise their authority pursuant to 11 U.S.C. § 105(a) to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of" the Bankruptcy Code in contravention of specific provisions of the Bankruptcy Code. In *Siegel*, the bankruptcy court's surcharge contravened 11 U.S.C. § 522, which, by reference to California law, permitted the debtor to exempt $75,000 of equity in his home from the bankruptcy estate while also making those funds "not liable for payment of any administrative expense," which included the trustee's reasonable attorney fees. Thus, the Supreme Court held that the bankruptcy court exceeded the limits of its statutory and inherent powers by ordering funds protected by the exemption to be made available to offset the trustee's attorney's fees. However, *Siegel* does not abrogate the power of bankruptcy courts to deny exemptions due to a debtor's bad faith conduct because the Supreme Court was examining whether bankruptcy courts had the authority to surcharge a previously allowed and unobjected-to exemption using its "inherent powers" under 11 U.S.C. § 105(a) in direct contravention of specific provisions of the Bankruptcy Code. *See, e.g., In re Woolner*, 2014 WL 7184042 (Bankr. E.D. Mich. Dec. 15, 2014).

[2] *Hannigan* was impliedly overruled by *United States v. Ledee*, which stated by way of footnote that ". . . [*Law v. Siegel*, 134 S. Ct. 1188 (2014),] appears to overrule . . . *Hannigan* to the extent [that the holdings in *Siegel*] limited exemptions based on bad-faith conduct." *United States v. Ledee*, 772 F.3d 21, 29 n.10 (1st Cir. 2014). However, *Woolner* declined to follow *Ledee* and similar cases that applied the "problematic" language in *Siegel* – "[T]he Bankruptcy Code admits no such [general, equitable power in bankruptcy courts to deny exemptions based on a debtor's bad-faith conduct]." *Siegel*, 134 S. Ct. at 1196 – to hold or imply that bankruptcy courts lacked the power to deny exemptions on the grounds of a debtor's bad faith. *See Woolner*, 2014 WL 7184042. The court in *Woolner*, in affirming and elaborating upon the authority to deny an amendment to a claimed exemption due to bad faith, found that such denial was within its inherent powers and the application of *Siegel* would only act as an open invitation for debtors to commit fraud in claiming exemptions. *Id.* at *3. Thus, *Woolner* held that *Siegel* was not dispositive in determining whether courts had the power to deny an amendment due to debtor's bad faith because, "in [*Siegal*], the validity of the debtor's claim of exemption was not directly contested or challenged[; instead,] the issue was whether the bankruptcy court had authority to "surcharge" an already allowed exemption because of the debtor's bad acts." *Id.* at *4.

proposed amendment to his exemption schedules, in amount of $300,000; debtor testified that he knew that the information provided to the trustee was not what she had requested and yet did nothing to fix the problem or even bring it to the trustee's attention.

c. ***In re Akulova***, 407 B.R. 602 (Bankr. D. Del. 2009) (court denied debtor's attempt to amend exemption schedule to include exempt personal injury award when trustee relied on debtor to prosecute personal injury claim; court characterized debtor's conduct as bad faith since she failed to disclose the claim and sought to claim the exemption only after the trustee expended resources to liquidate the claim).

    i. **Key Factor(s):** trustee, in reliance on fact that debtor had not claimed exemption in her prepetition personal injury claim, had retained debtor's personal injury attorney as special counsel and successfully prosecuted personal injury claim to settlement on what trustee believed to be creditors' behalf.

d. ***In re Barrows***, 408 B.R. 239 (B.A.P. 8th Cir. 2009) (bad faith misrepresentation of balance in bank account as $325, when the actual amount was enhanced by $17,000 loan from debtor's 401(k) plan, minus certain expenditures, justified court's denial of an attempt to amend his exemption to claim the increased amount in the bank account as exempt).

    i. **Key Factor(s):** debtors' failure to accurately disclose the amount of funds in their bank accounts and then asserting an exemption therein only after the trustee demanded turnover of the funds in excess of the originally disclosed amount; evidence that debtors provided inaccurate schedules and statements and that they subsequently failed to correct the material falsehoods therein.

e. ***In re Bauer***, 298 B.R. 353 (B.A.P. 8th Cir. 2003) ("the Debtors were not truthful in their disclosures with respect to their home. They substantially undervalued their home in schedules signed under penalty of perjury to reflect no equity. The irony here is that if the Debtors had accurately disclosed the true value of their home from the outset, they may have been entitled to exempt their equity in it. For the price of accurate disclosure, they might have obtained an unencumbered fresh start and retained the equity in their home").

i. **Key Factor(s):** debtors were not truthful in their disclosures with respect to their home – substantially undervalued their home in schedules signed under penalty of perjury to reflect no equity; only amended their schedules to increase the value of the home after the trustee had learned of its true value following the fire and accompanied their belated updated disclosure with a bad faith attempt to assert a homestead exemption.

14. Use fraudulently obtained funds to obtain exempt property.

a. ***Chiu v. Wong***, 16 F.3d 306 (8th Cir. 1994) (debtor wrongfully terminated a partnership and deprived his partner of rights in specific partnership property; to the extent the funds were used to purchase the homestead, the exemption would be denied and a constructive trust or implied trust imposed).

i. **Key Factor(s):** Lai's wrongful conversion of partnership assets; Chiu sufficiently traced the proceeds of his partnership property into Wong's homestead.

b. ***Palm Beach Sav. & Loan Ass'n v. Fishbein***, 619 So. 2d 267 (Fla. 1993) (creditor can have an equitable lien on property, such as when fraudulently obtained property – loan obtained after husband forged wife's signature on loan documents – was used to purchase a homestead).

i. **Key Factor(s):** husband's forgery of wife's signature on loan documents.

c. ***Casterline v. Roberts***, 284 P.3d 743 (Wash. App. Div. 2 2012) ("homestead protection does not extend to equitable liens imposed when the homestead claimant purchases the homestead property with wrongfully obtained funds; "defendant wrongfully took money from a trust and attempted to shield those funds in a homestead).

i. **Key Factor(s):** trustee's violation of fiduciary duty by investing trust funds in home which did not benefit the trust and then wrongfully transferring the property to husband.

VII. CONCLUSION

As the cases above illustrate, the effective use of state and federal exemptions coupled with prompt and complete disclosure is an excellent strategy that debtors use to protect their assets from being seized by creditors. However, debtors and debtors' attorneys must take extra care to ensure that prebankruptcy asset protection planning does not include fraudulent transfers or acts that otherwise hinder, delay, or defraud their creditors. To best create a clear picture of a debtor's financial condition, the New Client Checklist provided in the Appendix is a great tool that is ideally utilized when you first sit with a client to discuss their options before filing for bankruptcy. If you have any questions about pre-bankruptcy planning, or reorganization and bankruptcy in general, please do not hesitate to contact Barbara Yong of Golan & Christie LLP by phone at (312) 696-2034 or email at blyong@golanchristie.com.

APPENDIX

NEW CLIENT CHECKLIST

1. Introduction

- Be thorough; review paperwork
- Ask client to complete intake questionnaire
- Insist on full disclosure (§526(a)(2) – Attorney reasonably should have known)
- Review non-bankruptcy alternatives
- Understand circumstances, i.e.
  - marital status/divorce
  - employment status/prospects
  - residence/mortgage debt
  - business debt/guaranties, wages, union dues
  - tax debt – income, sales or employee withholding (how old)
  - student loans – government or private, how old, hardship
  - credit cards – interest rates, business or personal use
  - residency for last 3 years
- Let client know what you will and will not be able to do for them, what is included in flat fee and what will be billed separately
- If retained, get signed engagement letter

2. Assets

- Get a complete list
- Transfers within the past 4 years, outside ordinary course of business
- Transfers within the past 10 years to a self-settled trust
- Causes of action
- Possible future inheritances
- Valuation – reasonable basis
- Owned individually or jointly
- How is title held, i.e. tenancy by the entireties (Only effective if H&W, residence, not joint debt), joint tenancy, tenants in common
- Understand exemptions
  - homestead
  - life insurance
  - qualified retirement accounts (inherited IRA's not exempt)
  - vehicle
  - wildcard
  - tools, supplies
  - clothes
- Cash/savings – possible uses
  - Warn about potential preferences; fraudulent transfers
  - pending lawsuits or potential claims

- ownership interest in businesses
- Remove name from joint accounts if co-signer for convenience only, i.e. elderly parent or child

3. **Liabilities**

- Dischargeable vs. non-dischargeable
  - fraud
  - student loans
  - taxes (income taxes more than 3 years old)
  - support vs. property settlement (ch. 7 neither support nor property settlement are dischargeable, but in ch. 13 - §1328(a)(2) only excepts DSO from discharge - §523(a)(5) not (a)(15))
  - Under §1328(a) certain debts can be discharged in ch. 13 notwithstanding that they are not dischargeable in ch. 7 under §523(a)(6), (7) and (10) through (19)
- Disputed/consider litigating
- Attempt modification
- Negotiate settlement or payment plan
- Pay down highest interest credit cards
- Student loans – hardship exemption
- Reaffirmation or surrender
- Consider ramifications on co-debtors

4. **Income**

- For chap. 13 plan or means test
- Get documentation
- Abuse defined under §707(b)(2) and (b)(3)
- Income from employment
- Income from other sources
  - rental income
  - unemployment
  - social security/disability/pension
  - dividends and distributions
  - support and maintenance