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Trusts & Estates, Tax & Business Law



Asset Protection/Exempt Assets (Asset Protection Planning – The New Estate Planning)

by

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INTRODUCTION

- Asset protection planning involves the organization and reorganization of a client's business and personal affairs, ***in advance*** of the creation of debts and other obligations, to reduce, minimize, or even eliminate liability exposure.
- “The law recognizes the right of individuals to arrange their affairs so as to limit their liability to creditors.” *In re Heller*, 613 N.Y.S. 2d 809 (N.Y. Sur. Ct., 1994).

FRAUDULENT TRANSFERS

- Statute of Elizabeth. Statutes prohibiting transfers in fraud of creditors date back to the 1571 English Statute of Elizabeth.
- At common law in Florida, conveyances and transfers with the intent to hinder, delay, or defraud creditors were void. *Bayview Estates Corp. v. Southerland*, 154 So. 894, 900 (Fla. 1934).

FRAUDULENT TRANSFERS (Continued)

- Fraudulent Transfer Act. In 1987, Florida adopted the Uniform Fraudulent Transfer Act (UFTA). Fla. Stat. Ch 726. The act was substantially amended in 1997 to make *constructively* fraudulent transfers void in addition to those transfers made with actual intent to delay, hinder, or defraud. *E.g.*, Fla. Stat. § 726.106.

FRAUDULENT TRANSFERS (Continued)

- Fraudulent Conversion Act. In 1993 Florida adopted Fla. Stat. § 222.30, which expressly declared that a *conversion* of a non-exempt asset into an exempt asset is void if made with the intent to hinder, delay, or defraud creditors. Fla. Stat. §§ 726.105 and 222.30 are to be read in tandem.

FRAUDULENT TRANSFERS (Continued)

- Intent.
 - The common thread running from the common law through the modern statutes is the avoidance of transfers made with intent to hinder, delay, or defraud creditors, most commonly involving transfers when the debtor/transferor receives less than equivalent value in exchange, and his remaining assets are insufficient to pay his just debts.

FRAUDULENT TRANSFERS (Continued)

- Intent (continued)

- The right to devise, alienate, or gift one's property is a constitutional right. Fla. Const. Art. I, § 2. *Shriners Hospital v. Zrillic*, 563 So. 2d 64, 67 (Fla. 1990).
- This right extends to completed inter vivos transfers, including transfers to trusts, even when those transfers are for the purpose of diminishing the transferor's probate estate, and even when the transfer was done with the specific intent to diminish a spouse's elective share rights. *Freidberg v. Sunbank/Miami*, 648 So. 2d 204 (Fla. 3d DCA 1995) (citing *Traub v. Zlatkiss*, 559 So. 2d 443, 446 (Fla. 5th DCA 1990)).

FRAUDULENT TRANSFERS (Continued)

- The common law and the UFTA allow a “defrauded” creditor to avoid or reverse certain types of transfers under specific circumstances.

FRAUDULENT TRANSFERS (Continued)

- Fla. Stat. § 726.105 Transfers fraudulent as to present and future creditors.
 - (1) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation incurred, if the debtor made the transfer or incurred the obligation:
 - (a) With actual intent to hinder, delay or defraud any creditor of the debtor; or

FRAUDULENT TRANSFERS (Continued)

(b) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:

1. Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

2. Intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay them as they became due.

FRAUDULENT TRANSFERS (Continued)

- Badges of Fraud. Fla. Stat. § 726.105(2) sets forth the following factors to be considered in determining fraudulent intent.
 - The transfer or obligation was to an insider.
 - The debtor retained possession or control of the property transferred, after the transfer.
 - The transfer or obligation was disclosed or concealed.
 - Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit.
 - The transfer was of substantially all the debtor's assets.
 - The debtor absconded.

FRAUDULENT TRANSFERS (Continued)

- Badges of Fraud. Fla. Stat. § 726.105(2) sets forth the following factors to be considered in determining fraudulent intent. (contended)
 - The debtor removed or concealed assets.
 - The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred.
 - The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred.
 - The transfer occurred shortly before or shortly after a substantial debt was incurred.
 - The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

FRAUDULENT TRANSFERS (Continued)

- Complementary to U.S. Bankruptcy Code
 - Section 544(b) of the Bankruptcy Code authorizes the avoidance of any transfer of . . . the debtor in property that is voidable under applicable laws, including state laws to avoid fraudulent transfers, by a creditor holding an allowable unsecured claim.

FRAUDULENT TRANSFERS (Continued)

- Uniform Voidable Transactions Act
 - In 2014, the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) promulgated an overhaul of the UFTA. In many instances, the changes to the UFTA are marginal, but the Official Comments provide new interpretations of what was heretofore established law and are very controversial.

HOMESTEAD

- Under Fla. Const. Art. X, §4, a Florida resident's homestead is protected from any forced sale and liens resulting from judgments, decrees, or executions if the homestead is:
 - ***owned by a natural person***;
 - the permanent residence of the owner or a legal or natural dependent of the owner;
 - located within a municipality, the homestead is limited to 1/2 acre of contiguous land; and
 - located outside of a municipality, the homestead is limited to 160 acres of contiguous land.

HOMESTEAD

- Fla. Stat. § 732.405(1) directs that ***the homestead shall not be subject to DEVISE if the OWNER is survived by a spouse or minor child***, except that the homestead may be devised to the owner's spouse if there is no minor child.
 - However, Fla. Stat. § 732.405(2) includes as an “OWNER” the grantor of a revocable living trust and includes a disposition of the homestead from such trust as a “DEVISE.”
 - The homestead rights of a surviving spouse may be waived by a written contract signed by the surviving spouse in the presence of two subscribing witnesses. Each spouse must make a fair disclosure to the other of the spouse's estate if the waiver is executed after marriage. Fla. Stat. § 732.702.

LIFE INSURANCE

- Fla. Stat. § 222.13 provides that the life insurance proceeds payable upon the death of a Florida resident shall be exempt from the claims of creditors of the insured and shall inure for the exclusive benefit of the beneficiary of the policy unless the insurance policy or valid assignment thereof provides otherwise.
- Exceptions. No asset protection is provided from the claims of the insured if the life insurance proceeds are payable to the insured or his estate or to his executors, administrators, or assigns. Fla. Stat. § 222.13(1).

LIFE INSURANCE (Continued)

- Fla. Stat. § 733.808(4) provides:
(4) ***Unless the trust agreement, declaration of trust, or will expressly refers to this subsection and directs that it does not apply***, death benefits payable as provided in subsection (1), subsection (2), or subsection (3), unless paid to a personal representative under the provisions of subsection (3), shall not be deemed to be part of the decedent's estate and shall not be subject to any obligation to pay the expenses of the administration and obligations of the decedent's estate or for contribution required from a trust under s. 733.607(2) to any greater extent than if the proceeds were payable directly to the beneficiaries named in the trust.

LIFE INSURANCE (Continued)

- Corresponding Fla. Stat. § 736.05053(1), provides in part:
 - (1) A trustee of a trust described in s. 733.707(3) shall pay to the personal representative of a settlor's estate any amounts that the personal representative certifies in writing to the trustee are required to pay the expenses of the administration and obligations of the settlor's estate. Payments made by a trustee, unless otherwise provided in the trust instrument, must be charged as expenses of the trust without a contribution from anyone. The interests of all beneficiaries of such a trust are subject to the provisions of this subsection; however, the payment must be made from assets, property, or the proceeds of the assets or property that are included in the settlor's gross estate for federal estate tax purposes and may not be made from assets proscribed in s. 733.707(3) or ***death benefits described in s. 733.808(4) unless the trust instrument expressly refers to s. 733.808(4) and directs that it does not apply.***

CASH SURRENDER VALUES AND ANNUITIES

- The cash surrender value of a life insurance policy issued on the life of a Florida resident and the proceeds of an annuity issued to a Florida resident shall not be subject to attachment, garnishment, or legal process in favor of any creditor *of the person whose life was insured* or who was the beneficiary of the annuity unless the policy or annuity was purchased for the benefit of the creditor. Fla. Stat. § 222.14.

QUALIFIED PLANS

- Any money or assets payable to a participant or beneficiary from or in a retirement or profit-sharing plan that is qualified under IRC §§ 401(a), 403(b), 408, or 409 is exempt from all claims of creditors of the beneficiary or participant. Fla. Stat. § 222.21(2)(a).
- Any interest in a fund or account that is otherwise exempt from claims of the creditors of the owner of the account do not cease to be exempt upon the owner's death, including direct transfers of the account or rollovers to an inherited IRA. Thus, an inherited IRA, such as the amount the surviving spouse "rolls-over" to her own IRA should be protected from creditors' claims.

TENANCY BY THE ENTIRETY

- Tenancy by the Entireties (“TBE”) is a form of property ownership available only to married persons when each spouse is deemed to own the undivided whole, or the entirety, coupled with the right of survivorship. Thus, the whole property is considered to be owned by the spouses together and is owned by neither spouse individually.
- There are six unities necessary to establish TBE ownership:
 - Possession (joint ownership and control);
 - Interest (interests in the account/asset must be identical);
 - Title (interests originated in same instrument);
 - Time (interests must have commenced simultaneously);
 - Ownership (interest remains in the survivor); and
 - Marriage.

WAGE PLANS

- Fla. Stat. § 222.11 provides that all of the disposable earnings of a head of family may be exempt from attachment or garnishment.
 - “Earnings” are defined as compensation paid for personal services or labor whether determined as wages, salary, Commissions, or bonuses.
 - In *In Re Harrison*, 216 B.R. 451 (Bank. S.D. Fla. 1997), the debtor was a dentist and the funds he distributed to himself from the business were not exempt simply because he called them “wages.” Payments of wages cannot be purely discretionary – they must constitute regular compensation dictated by the terms of an arm’s length employment agreement.

ENTITY PROTECTION

- Limited Liability Limited Partnerships (“LLLPs”)

Fla. Stat. § 620.1703 Rights of creditor of partner or transferee.

(1) On application to a court of competent jurisdiction by any judgment creditor of a partner or transferee, the court may ***charge the partnership interest of the partner*** or transferable interest of a transferee with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of a transferee of the partnership interest.

(3) ***This section provides the exclusive remedy*** which a judgment creditor of a partner or transferee may use to satisfy a judgment out of the judgment debtor’s interest in the limited partnership or transferable interest. ***Other remedies, including foreclosure on the partner’s interest in the limited partnership or a transferee’s transferable interest and a court order for directions, accounts, and inquires that the debtor general or limited partner might have made, are not available to the judgment creditor attempting to satisfy the judgment out of the judgment debtor’s interest in the limited partnership and may not be ordered by a court.***

ENTITY PROTECTION (Continued)

- Limited Liability Companies (“LLCs”)

Fla. Stat. § 605.0503 Charging Order.

(1) On application to a court of competent jurisdiction by a judgment creditor of a member or transferee, the court may enter a charging order against the transferable interest of the member or transferring for payment the unsatisfied amount of the judgment plus interest. Except as provided in subsection (5), charging order constitutes a lien on the judgment debtor’s transferable interest and requires the limited liability company to pay over to the judgment creditor a distribution that would otherwise be paid to the judgment debtor.

(3) Except as provided in subsections (4) and (5), a charging order is the sole and exclusive remedy by which a judgment creditor of a member or member’s transferee may satisfy a judgment from the judgment debtor’s interest in a limited liability company or rights to distributions from the limited liability company.

(4) In the case of a limited liability company that has only one member . . .

(5) If a limited liability company has only one member . . .

SPENDTHRIFT TRUSTS

- Fla. Stat. § 736.0502 Spendthrift provision:

(3) A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this part, ***a creditor or assignee of the beneficiary may not reach the interest or distribution by the trustee before receipt of the interest or distribution by the beneficiary.***

SPENDTHRIFT TRUSTS (Continued)

Fla. Stat. § 736.0503 Exceptions to spendthrift provision.

(2) To the extent provided in subsection (3), a spendthrift provision is unenforceable against:

(a) A beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support of maintenance.

(3) Except as otherwise provided in this subsection, a claimant against which a spendthrift provision may not be enforced may obtain from a court, or pursuant to the Uniform Interstate Family Support Act, an order attaching present or future distributions to or for the benefit of the beneficiary. The court may limit the award to such relief as is appropriate under the circumstances. Notwithstanding this subsection, the remedies provided in this subsection apply to a claim by a beneficiary's child, spouse, former spouse, or a judgment creditor described in paragraph (2)(a) or paragraph (2)(b) only as a last resort upon an initial showing that traditional methods of enforcing the claim are insufficient.

SPENDTHRIFT TRUSTS (Continued)

Fla. Stat. § 736.0504 Discretionary trusts; effect of standard.

(1) As used in the section, the term “discretionary distribution” means a distribution that is subject to the trustee’s discretion whether or not the discretion is expressed in the form of a standard of distribution and whether or not the trustee has abused the discretion.

(2) Whether or not a trust contains a spendthrift provision, if a trustee may make discretionary distributions to or for the benefit of a beneficiary, a creditor of the beneficiary, including a creditor as described in s. 736.0503 (2), may not:

(a) Compel a distribution that is subject to the trustee’s discretion; or

(b) Attach or otherwise reach the interest, if any, which the beneficiary might have as a result of the trustee’s authority to make a discretionary distributions to or for the benefit of the beneficiary.

SPENDTHRIFT TRUSTS (Continued)

Fla. Stat. § 736.0505 Creditors' claims against settlor.

(b) ***With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit.*** If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

SPENDTHRIFT TRUSTS (Continued)

- The distinction between the rights of a creditor of a beneficiary of a “spendthrift trust” described in Fla. Stat. §§ 736.0502 and 736.0503 and a “discretionary trust” described in Fla. Stat. § 736.0504 appear, on their face, inconsequential.
- However, in *Berlinger v. Casselberry*, 2013 Fla. App. LEXIS 18908, 38 Fla. L. Weekly D2484 (Fla. 2d DCA 2013) the court held in favor of the creditors “because the court had the ability to enter an order granting writs of garnishment against the *discretionary trusts*”

DOMESTIC ASSET PROTECTION TRUSTS (“DAPTs”)

- Several states have enacted legislation providing for self-settled asset protection trusts or DAPTs.
 - In 1989, Missouri was the first DAPT state.
 - In 1997, Alaska enacted milestone DAPT legislation in an attempt to compete with offshore asset protection trusts, and Delaware quickly followed suit.
 - In 1999, Nevada and Rhode Island joined the club.
 - There are now 17 states that have adopted DAPT legislation (the foregoing, plus Colorado, Hawaii, Michigan, Mississippi, New Hampshire, Ohio, Oklahoma, South Dakota, Tennessee, Utah, Wyoming, and West Virginia).

DOMESTIC ASSET PROTECTION TRUSTS (“DAPTs”) (Continued)

- Potential Challenges to DAPT.

- Corporations are subject to the jurisdiction of the courts in the state of their incorporation, as well as any court in a state where they do business. Accordingly, jurisdiction potentially could be obtained over large corporate trustees in the courts of many states. Fla. Stat. § 48.193 sets forth acts subjecting persons to jurisdiction of our state courts, in part, as follows:

(1) (a) Any person, whether or not a citizen or resident of this state, who personally or through an agent does any of the acts enumerated in this subsection thereby submits himself or herself and, if he or she is a natural person, his or her personal representative to the jurisdiction of the courts of this state for any cause of action arising from the doing of any of the following acts:

1. Operating, conducting, engaging in, or carrying on a business or business venture in this state or having an office or agency in this state.

DOMESTIC ASSET PROTECTION TRUSTS (“DAPTs”) (Continued)

- *In re Huber*, 493 B.R. 798 (Bankr. W.D. Wash. 2013)

The court granted summary judgment to the bankruptcy trustee, finding that the trust did not protect its assets from the settlor’s creditors. In determining the choice of law rules, the court stated that since the Ninth Circuit, to which the case was appealable, applies the choice of law which directs that a provision in an inter vivos trust of personal property that specifies that the validity of the trust will be controlled by the laws of a specific state will be followed only if:

- (a) the state declared in the trust instrument as controlling has a substantial relationship to the trust and
- (b) the application of its local law does not violate a strong public policy of the state with which the trust has its most significant relationships.

Alaska law would apply if Alaska had a substantial relationships to the trust, but Alaska had only a minimal relationship to the trust; whereas Washington had a strong public policy against self-settled asset protection trusts and thus the transfers into the DAPT were void.

DOMESTIC ASSET PROTECTION TRUSTS (“DAPTs”) (Continued)

Fla. Stat. § 736.0202, entitled “Jurisdiction over trustee and beneficiary,” provides:

(2) PERSONAL JURISDICTION. –

(a) Any trustee, trust beneficiary, or other person, whether or not a citizen or resident of this state, who personally or through an agent does any of the following acts related to a trust, submits to the jurisdiction of the courts of this state involving that trust:

. . .

3. Serves as trustee of a trust created by a settlor who was resident of this state at the time of creation of the trust or serves as trustee of a trust having its principal place of administration in this state.

DOMESTIC ASSET PROTECTION TRUSTS (“DAPTs”) (Continued)

Fla. Stat. § 736.0107 entitled “Governing law” provides:

The meaning and effect of the terms of a trust are determined by:

- (1) The law of the jurisdiction designated in the terms of the trust, *provided there is sufficient nexus to the designated jurisdiction* at the time of the creation of the trust or during the trust administration, including, but not limited, to the location of real property held by the trust or the residence or location of an office of the settlor, trustee, or any beneficiary; or
- (2) In the absence of a controlling designation in the terms of the trust, the law of the jurisdiction where the settlor resides at the time the trust is first created.

Notwithstanding subsections (1) or (2), a designation in the terms of a trust is *not controlling as to any matter for which the designation would be contrary to a strong public policy of this state*.

OFFSHORE ASSET PROTECTION TRUSTS (“OAPTs”)

- These are 3 primary legal advantages of the OAPT over the DAPT:
 - DAPTs may be forced to recognize judgments in other states under the Full Faith and Credit or Due Process Clauses of the U.S. Constitution.
 - OAPTs usually have a shorter statute of limitations on fraudulent conveyances, and the burden of proving a fraudulent conveyance is shifted to the creditor.
 - The laws of most OAPT jurisdictions do not except out child support claims, matrimonial rights, or other statutorily identified claims that may be enforceable against DAPTs in the U.S.

THE END