August 12, 2010

ASSET PRESERVATION

Protecting Your Clients' Assets in Today's Litigious Environment

By:

David J. Akins, Esq.
Brian M. Malec, Esq.

Dean, Mead, Egerton, Bloodworth, Capouano & Bozarth, P.A.

TABLE OF CONTENTS

August 12, 2010

ASSET PRESERVATION

Protecting Your Clients' Assets in Today's Litigious Environment

By:

David J. Akins, Esq.
Brian M. Malec, Esq.
Dean, Mead, Egerton, Bloodworth, Capouano & Bozarth, P.A

I. Importance of Asset Protection in Estate Planning

Asset protection should be discussed with every estate planning client. The degree of interest in asset protection will vary from client to client, depending on factors such as the past experience of the client, whether the client's profession causes exposure to potential liability and whether the client is generally risk adverse.

A. Ways in Which Liability Can Arise

1. Contractual obligations, e.g., credit cards, consumer loans, real estate loans, and guaranties of business loans

2. Criminal penalties

3. Civil Penalties

4. Domestic Relations' Proceedings

5. Tort Judgments, e.g., injury to a person on your residence or business property, professional malpractice

6. Vicarious liability, e.g., liability arising from injury caused by a person driving your motor vehicle, liability for a person who signs a minor's application for a driver's license

7. Improper oversight as an officer or director of a company

B. How to protect your assets

1. Take advantage of exemptions provided by law

2. Protect assets through methods of ownership

3. Use of trusts

4. Use of entities

5. Maintain adequate insurance (e.g., personal liability umbrellas)

II. Exempt Assets

Florida law exempts certain assets from the claims of creditors. The exemptions apply to judgments entered by Florida courts, whether the claim arose due to a breach of contract (e.g., failure to repay a debt or perform a service, etc.) or an injury to the claimant (e.g., automobile accident, medical malpractice, etc.). The exemptions also generally apply to a Florida debtor in a bankruptcy case. The State of Florida opted to have the state law exemptions apply to cases in the United States Bankruptcy Court involving Florida debtors, rather than the federal exemptions contained in the Bankruptcy Code.

A. Homestead

1. Owner of homestead entitled to unlimited exemption from the claims of creditors under Article X, § 4(a) of the Florida Constitution.

2. Homestead not exempt from liens or judgments for ad valorem taxes, purchase money mortgages, labor, services or materials furnished to repair or improve real property (construction liens) or other obligations contracted for house, field or other labor performed on real property. Art. X, § 4(a) of the Florida Constitution.

3. Homestead is not exempt from federal tax liens. However, homestead may only be seized as a last resort if a district court judge or magistrate approves of the levy in writing. *In re McFadyen*, 216 B.R. 1006 (Bankr. M.D. Fla. 1998); *See* 26 U.S.C.S. §§ 6334(a)(13)(B) and (e).

4. What is Homestead?

   a. Interest of a natural person in real property owned by a resident which is used as his or her principal residence.

   b. Includes "conventional residential appurtenances" such as a garage, patio, pool and may even include a separate, but connected residential structure, such as a duplex. *See In re Ensenat*, 20 Fla. L. Weekly Fed. B452 (July 6, 2007) (holding that a second unit in a multifamily duplex in which the debtor's niece and her boyfriend lived qualified as homestead); *White v. Posick*, 150 So. 2d 263 (Fla. 2d DCA 1963) (holding that a garage, overhead apartment, patio and swimming pool were included as part of debtor's homestead).

5. Size limitation

   a. 160 acres of land and improvements thereon if located *outside* a municipality.

   b. One-half (1/2) acre of land upon which the residence sits if located *within* a municipality.

      i. Property which is annexed into a municipality subsequent to acquisition does not lose its protection unless owner consents. Art. X, § 4(a)(1), Fla. Const.

   c. If property is greater than size limitations, a court may subdivide the property or order the sale of the property and apportion the proceeds. *Englander v. Mills*, 95 F.3d 1028 (11th Cir. 1996). The net proceeds are allocated between the owner-debtor and the creditor on a pro rata basis. *In re Quraeshi*, 289 B.R. 240 (Bankr. S.D. Fla. 2002).

   d. If property exceeds limitations, consider contributing excess to an entity for additional protection.

6. Ownership requirement

   a. Ownership by a natural person clearly qualifies.

   b. Florida law holds that ownership by a revocable trust qualifies. See e.g., *Engelke v. Estate of Engelke*, 921 So. 2d 693 (Fla. 4th DCA 2006). There are some older federal bankruptcy cases to the contrary. Compare *In re Bosonetto*, 271 B.R. 403 (Bankr. M.D. Fla. 2001), with *Callava v. Feinberg*, 864 So. 2d 429 (Fla. 3d DCA 2004). More recent bankruptcy cases have permitted ownership in a revocable trust. *In re Alexander*, 346 B.R. 546 (Bankr. M.D. Fla. 2006); *In re Mary Edwards*, 356 B.R. 807 (Bankr. M.D. Fla. 2006).

   c. Property subject to a lease greater than 98 years qualifies.

   d. Case law conflicts as to whether cooperative unit ownership qualifies. Compare *Phillips v. Hirshon*, 958 So. 2d 425 (Fla. 3d DCA 2007), with *Walls v. Stilwell Corp.*, 810 So. 2d 566 (Fla. 5th DCA 2002).

7. Exempt even where the owner acquired the Homestead using non-exempt funds with the specific intent of hindering, delaying, or defrauding creditors in violation of the Florida Uniform Fraudulent Transfer Act. *Havaco of America, Ltd. v. Hill*, 790 So. 2d 1018 (Fla. 2001); *Willis v. Red Reef, Inc.*, 921 So. 2d 681 (Fla. 4th DCA 2006).

8. Retaining protection for devise of homestead. Art. X, § 4, Fla. Const.; F.S. § 732.401; F.S. § 732.4015.

   a. Property owned as tenants by the entirety will pass to the surviving spouse by operation of law regardless of any other devise by the decedent or direction in the statutes. F.S. § 732.401(2).

   b. If decedent is survived by a spouse, but no children - homestead may be devised outright to spouse. If property is not validly devised, then homestead passes to spouse.

   c. If decedent is survived by a spouse *and* at least one minor child - homestead may not be devised. Spouse will take a life estate with a remainder to the lineal descendants, per stirpes. Effective October 1, 2010, the spouse may instead elect to take a one-half interest as a tenant in common, with the remaining one-half interest vesting in the decedent's descendants, per stirpes.

   d. If decedent is survived by a spouse and all lineal descendants are adults, then property may be devised outright to spouse. If property is not validly devised, then spouse gets a life estate, with a remainder to the lineal descendants. Effective October 1, 2010, the spouse may instead elect to take a one-half interest as a tenant in common, with the remaining one-half interest vesting in the decedent's descendants, per stirpes.

   e. If decedent is only survived by a minor child (and no spouse), then homestead may not be devised. The homestead will pass to the lineal descendants, per stirpes.

   f. If decedent is only survived by an adult child, or is not survived by any child, then the homestead is freely transferable.

   g. Homestead passes free of claims of decedent's creditors if property is devised to an "heir" or "heirs" of the decedent.

      i. Residuary devise of "all the rest, residue and remainder of my property, both real and personal" is a sufficient devise to maintain protection for homestead. *McKean v. Warburton*, 919 So. 2d 341 (Fla. 2006); *McEnderfer v. Keefe*, 921 So. 2d 597 (Fla. 2006).

      ii. The term "heirs" includes any of those family members who are included in F.S. § 732.103 (intestacy statute). This includes descendants, ancestors, siblings, nieces and nephews, uncles & aunts. The decedent is not limited to devising homestead only to those who would have actually taken via intestacy. Therefore, if decedent is survived only by an adult child and a grandchild, the homestead will be exempt from the decedent's creditors if the decedent devises the homestead directly to the grandchild. *Snyder v. Davis*, 699 So. 2d 999 (Fla. 1997).

iii. Direction in will for personal representative to sell homestead and distribute the proceeds among heirs will cause the loss of protection and subject proceeds to creditors of decedent's estate. *Price v. West Florida Hospital*, 513 So. 2d 767 (Fla. 1st DCA 1987).

9. Exemption of proceeds from sale during life

a. Proceeds remain exempt so long as the owner intends to reinvest the proceeds in a replacement homestead within a reasonable time after the sale. *Rossano v. Britesmile, Inc.* 919 So. 2d 551 (Fla. 3d DCA 2005); *Orange Brevard Plumbing & Heating Co. v. LaCroix*, 137 So. 2d 201 (Fla. 1962).

b. Only those proceeds which are intended to be reinvested in a new homestead remain exempt. Once a new homestead is purchased, creditors can reach the excess proceeds which are not used towards the purchase. *In re McDonald*, 100 B.R. 598 (Bankr. S.D. Fla. 1989).

c. Do not commingle proceeds from sale of homestead with other assets and do not use proceeds for any other purpose. Create a separate account. Act quickly.

10. Federal bankruptcy law

a. Exemption of an interest in Homestead acquired within 1,215 (3 years and 4 months) days prior to filing petition for bankruptcy is limited to $125,000 adjusted for inflation (currently $136,875). Note that the cap will apply even if the debtor owned the homestead for more than 1,215 days under certain circumstances (e.g., violation of federal or state securities laws, any criminal act, intentional tort or willful or reckless misconduct that causes serious injury or death to another in the preceding 5 years).

i. If debtor owned a homestead for more than 1,215 days, and then moved into a new homestead within the 1,215 day period immediately prior to filing bankruptcy, the federal cap will still apply, except that the proceeds applied to the new homestead from the sale of the former homestead will be exempt from the cap if the debtor's previous and current residences are in the same state. 11 U.S.C. § 522(p).

ii. Bankruptcy courts have allowed spouses to stack exemptions, thereby doubling the amount of the exemption. *In re Alfred Rasmussen and Billie Jo Rasmussen*, 349 B.R. 747 (Bankr. M.D. Fla. 2006); *In re William Limperis and Janet Limperis*, 370 B.R. 859 (Bankr. S.D. Fla. 2007).

iii. Federal cap applies even in states which have opted out of the Bankruptcy Code exemptions, such as Florida. The term "opt out" refers to states which require debtors to rely solely on state exemptions for protection in bankruptcy proceedings rather than permitting debtors to seek protection under federal exemptions. See *In re Buonopane*, 344 B.R. 675 (Bankr. S.D. Fla. 2006).

b. Proceeds from the sale of an exempt Homestead in Florida rolled over into the purchase of a new Homestead are exempt and not counted towards federal cap. *In re Juan Castro* 20 Fla. L. Weekly Fed. B148 (Bankr. S.D. Fla. 2006).

c. Post acquisition appreciation in value of homestead within 1,215 day period is exempt. *In re Rasmussen,* 349 B.R. 747 (Bankr. M.D. Fla. 2006); *In re Blair*, 334 B.R. 374 (Bankr. N.D. Tex. 2005).

d. Regular mortgage payments applied to principal within the 1,215 day period probably are exempt because such payments are not treated as "acquiring" an interest in the homestead for purposes of triggering the federal cap. The federal cap is triggered by the acquisition of title to the property (e.g., purchasing the property). See *In re Blair*, 334 B.R. 374 (Bankr. N.D. Tex. 2005); *In re Sainlar*, 344 B.R. 669 (Bankr. M.D. Fla. 2006). But see, *In re Rasmussen*, 349 B.R. 747, fn. 5 (Bankr. M.D. Fla. 2006) (finding that the term "interest" as used in 11 U.S.C. § 522(p) refers to equity in the homestead acquired by the debtor within 1,215 days).

e. Under *In re Rasmussen,* the use of other exempt assets to purchase a Homestead or pay off mortgage will constitute an acquisition and such amounts will lose their exemption for 1,215 days (to the extent they exceed $136,875). Compare *In re Goldberg*, 229 B.R. 877 (Bankr. S.D. Fla. 1998) and *In re Matthews,* 360 B.R. 732 (Bankr. M.D. Fla. 2007) with *In re Rasmussen,* 349 B.R. 747 (Bankr. M.D. Fla. 2006).

f. Federal homestead protection is denied to the extent that the value of a homestead is attributable to any non-exempt property transferred by the debtor in the 10 year period ending on the bankruptcy filing date *with the intent to hinder, delay or defraud a creditor*. 11 U.S.C. § 522(o).

i. However, in a state court action, Florida law may still permit the use of non-exempt assets to pay down a mortgage even if made with the specific intent of hindering, delaying or defrauding creditors, unless the funds paid to the mortgagee were procured by fraud. See *Havaco of America, Ltd., v. Hill*, 197 F.3d 1135 (11th Cir. 1999); *Chauncey v. Dzikowski*, 454 F.3d 1292 (11th Cir. 2006).

g. A debtor must generally reside in a State for 730 days before he or she can seek State protections in a Federal bankruptcy proceeding. This restricts the ability of a debtor to move to a more favorable jurisdiction shortly prior to filing bankruptcy.

i. If debtor has not been domiciled in a single state for the 730 day period ending on the bankruptcy filing date, the debtor's domicile will be considered as the place where the debtor was located for 180 days immediately preceding the 730 day period.

B. Retirement Accounts

1. Florida law

a. Unlimited exemption for money or assets in a qualified plan, 403(a) and 403(b) plan, traditional and Roth IRA, 457(b) plan. F.S. § 222.21(2)(a).

b. If plan is determined to be noncompliant, then money or assets will remain exempt if owner can show that the plan substantially complies with Tax Code requirements, or the plan would have been in substantial compliance if not for the negligent or wrongful conduct of a person other than the owner claiming exemption.

c. Express language of the statute provides that the exemption applies to "owner, participant or beneficiary" of the designated plans or accounts. However, it is unclear who exactly falls into the category of a "beneficiary" (see *Robertson v. Deeb* in B.1.f. below).

d. Funds do not lose exemption if funds are rolled over into another exempt account (e.g., Roth conversion, rollover IRA). F.S. § 222.21(2)(c).

e. Need to use a beneficiary designation. Assets will not remain exempt if paid to estate, either because designated as such or because no designation used. However, a designation to pay proceeds to a testamentary trust or a decedent's revocable trust will retain protection from decedent's creditors. F.S. § 733.808.

f. Be aware – A recent Florida case holds that assets in an inherited IRA are not exempt from creditors of the beneficiary. See *Robertson v. Deeb*, 16 So. 3d 936 (Fla. 2d DCA 2009).

i. Robertson has been criticized for a number of reasons -

a. The Court misapplied F.S. § 222.21(2)(a), which renders "money or other assets payable to an owner, a participant or a beneficiary" exempt if it is exempt from taxation under the Internal Revenue Code.

b. The Court relied on several federal bankruptcy cases that were decided based on the state law exemptions in states other than Florida.

c. The Court presumed to find legislative intent that supported its opinion, when no evidence of such intent exists. In fact, one of the drafters of the statutes has stated that the intent was to exempt the interest of a beneficiary in an inherited IRA.

d. However, Robertson is the law for now, at least in the counties included in the Second Judicial District - Pasco, Pinellas, Hardee, Highlands, Polk, De Soto, Manatee, Sarasota, Hillsboro, Charlotte, Collier, Glades, Hendy and Lee.

ii. Under the reasoning applied in *Robertson*, an argument could be made that a spousal rollover is distinguishable from the inherited IRA found to be non-exempt in *Robertson*. A spouse is treated as the owner of any amounts rolled into his or her own IRA and distribution of such amounts may be deferred until age 70.5. Therefore, amounts which are rolled into the surviving spouse's IRA may be preserved for retirement.

iii. Consider designating a trust for a spouse or child who has current or potential exposure to creditor's claims as the beneficiary of a retirement account. As long as the trust is drafted properly, distributions can be stretched out over the life of the oldest trust beneficiary. See Section IV.A.6.

2. Federal bankruptcy law

a. Exemptions are the same as Florida law, with one significant exception:

i. Traditional and Roth IRAs are subject to an aggregate cap of $1,000,000 adjusted for inflation (currently $1,095,000); <u>excluding</u> amounts rolled over from an exempt retirement account.

b. There is currently a conflict among states as to whether federal exemption covers inherited IRAs. Compare *In re Nessa*, 105 AFTR 2d 2010-609 (Bankr. MN, 2010) (holding that an inherited IRA is exempt under federal exemption statute 11 U.S.C. § 522(d)(12)) with *In re Chilton,* 105 AFTR 2d 2010-1271 (Bankr. E.D. Tex. 2010) (holding that a debtor's inherited IRA is not exempt under the federal exemption statute).

3. Improper management of the IRA will cause the loss of exemption

a. *In re Ernest Willis*, 411 B.R. 783 (Bankr. S.D. Fla. 2009) - Debtor engaged in prohibited transactions with respect to his IRA 14 years prior to filing bankruptcy. Specifically, in 1993, debtor borrowed money from his IRA to purchase a mortgage owed by a company in which he held a 50% interest, and repaid the loan 64 days later. Four years later, debtor engaged in a "check swapping" scheme using funds from his IRA which also constituted prohibited borrowing. Debtor also created two additional IRAs by rolling over funds from his initial IRA.

i. The court held that funds in the debtor's initial IRA ceased to be exempt as of the beginning of 1993 as a result of the prohibited transactions. Additionally, any funds in the two newer IRAs which were traceable back to the non-exempt initial IRA were held to be non-exempt.

ii. The court stated that a favorable determination as to the form of the IRA by the IRS under Section 7805 which is in effect at the time of filing the petition only creates a rebuttable presumption that the funds contained therein are exempt. The presumption may be rebutted by evidence that the IRA was operated improperly.

C. Education, Health and Other Savings Accounts

1. Section 529 Accounts (e.g., Florida Prepaid College Tuition Plans) – Money, assets and income are exempt from creditors of participant, owner or contributor, or program beneficiary. Applies to funds inside account and funds paid out of account. F.S. § 222.22(1).

2. Health Savings Accounts ("HSAs") and Archer Medical Savings Accounts – Money, assets and income inside account or paid out of account are exempt from creditors of participant, purchaser, owner or account beneficiary. F.S. § 222.22(2).

3. Coverdell Education Savings Account ("Educational IRA") – Money, assets and income inside Section 530 account or paid out of such account are exempt from creditors of participant, purchaser, owner or account beneficiary. F.S. § 222.22(3).

D. Life Insurance

1. Cash surrender value of a policy is exempt from creditors of the insured. F.S. § 222.14.

    a. Note that the cash surrender value of a policy on the life of another is not protected from creditors of the owner of the policy. *In re Allen*, 203 B.R. 786 (Bankr. M.D. Fla. 1996).

2. Proceeds paid at death are generally exempt from creditors of the insured, except where proceeds are payable to the insured's estate. In that situation, the proceeds become part of the insured's estate and are administered as part of the estate in the same manner as other non-exempt assets of the insured's estate. F.S. § 222.13(1).

3. Statutory exemption exists for proceeds paid to decedent's revocable trust or a testamentary trust. F.S. § 733.808.

4. Need beneficiary designation!

E. Annuities

1. Both the cash value of the annuity and the income stream from the annuity are exempt from creditors of the annuitant/beneficiary. F.S. § 222.14.

2. Annuity proceeds remain exempt even after they are paid to the debtor as long as they can be traced. *In re McCollam*, 955 F.2d 678 (11th Cir. 1992); *In re Benedict*, 88 B.R. 390 (Bankr. M.D. Fla. 1988).

3. Statutory exemption for death benefits paid to a decedent's revocable trust or a testamentary trust. F.S. § 733.808.

4. Lottery proceeds in the form of an annuity which are paid directly by the State (and not from the insurance company who pays the proceeds to the State) are not exempt. *In re Pizzi*, 153 B.R. 357 (Bankr. S.D. Fla. 1993). However, selling a lottery annuity for its present value may be protected. See *In re Jack*, 297 B.R. 279 (Bankr. S.D. Fla. 2003).

a. Note that private annuities in which the issuer is not licensed to underwrite risk may not be exempt from creditors. See *In re Soloman*, 95 F. 3d 1076 (11th Cir. 1996).

5. Need beneficiary designation!

F. Wage Exemption

1. Does not apply if the debtor controls the business and has full discretion over the debtor's compensation. *In re Zamora*, 187 B.R. 783 (Bankr. S.D. Fla. 1995).

2. Disposable earnings of a head of family are generally exempt. F.S. § 222.11.

   a. "Disposable earnings" = the earnings of a head of family that are remaining after deduction of any amounts required by law to be withheld.

   b. "Earnings" means wages, salary, commissions and bonuses.

   c. "Head of family" means the person providing more than one-half of the support for a child or other dependent pursuant to a legal duty arising out of the family relationship. F.S. § 222.11(1)(c); *Killian v. Lawson*, 387 So. 2d 960 (Fla. 1980).

3. Disposable earnings for a week of a person other than a head of family are exempt to the extent they exceed the lesser of (i) 25% of the person's disposable earnings for the week, or (ii) 30 times the Federal minimum hourly wage. F.S. § 222.11(2)(c).

4. Professional practices should have employment agreements that give the employer control over the amount and timing of compensation.

5. Wage Account

   a. Exempt earnings are protected from attachment for 6 months after they are deposited in a financial institution if they can be traced and properly identified. Commingling exempt funds does not automatically defeat the ability of a head of family to trace earnings, but makes it substantially more difficult to show. F.S. § 222.11(3).

   b. Open a separate account and call it the "Wage Account" and do not deposit funds from any other source in the account. Every month, the amount in excess of the prior 6 month's wages should be cleaned out.

6. Wages due at death

   a. Employer may pay wages or travel expenses due to an employee at death directly to spouse, or if none, to children if they are over 18, and if none, to parents. Same applies to unemployment compensation. F.S. § 222.15.

   b. Wages, unemployment compensation or travel expenses (up to $300) paid directly to another person as provided in (a) are not assets of the estate subject to claims (note: still assets of estate for federal estate tax purposes). F.S. § 222.16.

III. Protection through Ownership

A. Tenancy by the Entirety

1. Form of joint ownership with right of survivorship, limited to property owned by husband and wife. The concept is that each tenant possesses a right to 100% of the interest and the interest cannot be transferred or severed except by the joint action of the husband and wife.

2. Six unities must be present at the time the property is acquired to create a tenancy by the entirety:

   a. Unity of possession (joint ownership and control);

   b. Unity of interest (interests are identical);

   c. Unity of title (interests originated from the same instrument, such as a deed or assignment);

   d. Unity of time (interests acquired at same time);

   e. Survivorship (interest of deceased tenant automatically passes at death to surviving tenant); and

   f. Unity of marriage (at the time the property is titled in joint names).

3. A joint tenancy with right of survivorship (JTWROS) requires all of the same unities as tenancy by the entirety, except for the unity of marriage.

   a. Other differences between tenancy by the entirety and a joint tenancy with right of survivorship include:

      i. JTWROS is unilaterally severable by any joint tenant, and thus, a creditor of one tenant can reach that tenant's interest during the tenant's lifetime; and

      ii. JTWROS can have more than two (2) tenants.

4. Property owned as tenants by the entirety is exempt from creditors of one spouse (includes bankruptcy proceedings as well - 11 U.S.C. § 522(b)(3)(B)).

   a. Exceptions

      i. Joint creditor of husband and wife.

      ii. Federal tax liens (to the extent of the debtor's interest in the entireties property). *U.S. v. Craft*, 535 U.S. 274 (2002).

   b. Protection is terminated by the death of a spouse or divorce.

      i. Property owned as tenants by the entireties or as JTWROS is exempt from the creditors of the deceased tenant, even though with respect to property owned as JTWROS the creditors of the deceased tenant could have reached his or her interest in the property during his or her lifetime, because ownership in the property vests in the survivor at the moment of death. *Hurlbert v. Shackleton*, 560 So. 2d 1276 (Fla. 1st DCA 1990); *Perrott v. Frankie*, 605 So. 2d 118 (Fla. 2d DCA 1992).

      ii. If the property owned as tenants by the entirety at the time of death or divorce is the principal residence of the spouse ascending to sole ownership, then such property may still be protected after death or divorce if it qualifies under homestead laws. However, the creditor protection afforded under homestead laws may not be as substantial as the protection afforded when such property was owned as tenants by the entirety.

      iii. If the death of the non-debtor tenant can be anticipated, consider pre-death planning to prevent creditors of debtor tenant from reaching the assets after the death of non-debtor spouse. For example, the property could be transferred to the non-debtor spouse, and then devised to a trust for the benefit of the debtor spouse. Under the general principle that a creditor cannot attack transfers of exempt property by a debtor even if made with the intent to hinder, delay or defraud such creditor, this type of planning may be successful. However, there is no direct authority on point.

5. Property held in joint names of husband and wife (without further description of manner of ownership) is generally presumed to be tenants by the entirety as long as six (6) unities are present, but such presumption is rebuttable. The burden is shifted to the creditor to prove by a

preponderance of evidence that the property was not held as tenants by the entireties.

a. Real property. See *First National Bank of Leesburg v. Hector Supply Co.*, 254 So. 2d 777 (Fla. 1971);

   i. Remember that property must be acquired during marriage to create a tenancy by the entirety. The subsequent marriage of joint owners does not by itself cause the joint tenancy to become a tenancy by the entirety. To remedy, execute a new deed conveying the property into the name of both spouses as tenants by the entirety. F.S. § 689.11

   ii. Best practice is to avoid relying on presumption and use express words in the conveyance document, such as "to X and Y, his wife" or "to X and Y, as husband and wife" or "to X and Y, as tenants by the entireties".

b. Personal property. No blanket presumption exists for all personal property.

   i. The designation of "X <u>or</u> Y" is generally interpreted as joint ownership, while the designation of "X <u>and</u> Y" is generally interpreted as tenancy by the entirety (assuming the six unities are present). If uncertainty or ambiguity exists, presumption is tenancy by the entirety as long as six (6) unities are present.

   ii. Be sure that ownership as tenancy by the entirety is clearly designated and that ownership records do not state "joint tenants with right of survivorship". Additionally, be aware of the fine print on applications which may contain an express disclaimer of tenancy by the entirety ownership.

c. Bank Accounts. *Beal Bank v. Almand and Associates*, 780 So. 2d 45 (Fla. 2001) created a presumption in favor of a tenancy by the entirety for accounts owned by a husband and wife which meet the six unities. See also, F.S. § 655.79(1). Best practice is to be sure that signature card and account application are clearly marked to reflect "tenancy by the entirety". To protect funds held in a premarital account, open a new account as tenants by the entirety after marriage.

d. Stock certificates. *Cacciatore v. Fisherman's Wharf Realty Ltd. Partnership*, 821 So. 2d 1251 (Fla. 4th DCA 2002) extended *Beal Bank* to ownership of stock certificates.

e. Membership interests in LLC. There is no presumption that membership interests in an LLC which are held by husband and wife are owned as tenants by the entirety. If tenancy by the entirety protection is desired, then ownership records (operating agreement, certificates, tax returns, etc.) should specifically state that the interest is owned "as tenants by the entirety".

f. Tax refunds. *In re Freeman*, 387 B.R. 871 (Bankr. M.D. Fla. 2008) extended *Beal Bank* to income tax refunds.

6. Avoid joint ownership and cross ownership of assets that may cause liability. Florida law imposes liability on the owner and operator of vehicles. Therefore, having both spouses on the title will cause joint liability in the event of a crash by either spouse. Tenancy by the entirety will not create protection for a joint liability.

a. Automobile

i. F.S. § 322.09 provides that a driver's license application for any person under the age of 18 must also be signed and verified by a parent or guardian. Any negligence or willful misconduct by the minor when driving an automobile is imputed to the adult signor. Such adult is jointly and severally liable for any damages resulting from such minor's negligence or willful misconduct.

b. Watercraft

c. Airplane

7. General rule is that situs of property determines governing law. The situs of real property is the physical location of the property while the situs of personal property (including intangible property) is the domicile of the person.

a. Non-residents who own real property in Florida may own and receive protection for tenants by the entirety.

b. Florida residents who own real property in a state which does not have tenancy by the entirety may be able to achieve protection by contributing real property to an LLC and owning the LLC interests as tenants by the entirety.

8. In bankruptcy context, property owned as tenants by the entirety is not subject to the dollar limits and the 730 day residency requirement that are applicable to Homestead property. See Section II.A.10; *In re Schwarz*, 362 B.R. 532 (Bankr. S.D. Fla. 2007); *In re Zolnierowicz*, 380 B.R. 84 (Bankr. M.D. Fla. 2007). *See also* 11 U.S.C. § 522(b)(3)(B).

B. Ownership by Spouse or Trust for Spouse

1. Property will be subject to creditors of spouse if transferred outright, but will generally be free from creditors of transferor spouse.

    a. If spouse's estate plan provides for property to revert back to transferor, then property should be transferred back in a trust with a spendthrift provision.

2. Property transferred to a spouse in a lifetime QTIP trust will protect the transferred property from the creditors of both spouses.

    a. F.S. § 736.0505 was amended, effective July 1, 2010, to add subsection (3), which provides that assets in a lifetime QTIP trust are considered, upon the death of the beneficiary spouse, to have been transferred by the beneficiary spouse and not by the donor spouse. This creates the opportunity for a donor to have a self-settled trust upon the death of the beneficiary spouse if the assets are designated to be held in trust for the benefit of the donor spouse.

3. Common to have spouse of a professional in a high risk profession (doctors, developers, etc.) own the majority of assets which are not exempt.

C. Trust for Children

1. Irrevocable trusts which contain a spendthrift provision will generally protect assets from the creditors of the beneficiary.

2. The trust should contain language permitting the trustee to make distributions "for the benefit of" the beneficiary so that the trust funds can still be used for the support of the beneficiary. The trustee can pick and choose which debts to pay directly on behalf of the beneficiary.

3. Assets will generally be protected from marital claims in a divorce proceeding.

4. Custodial accounts established under the Florida Uniform Transfers to Minors Act (UTMA) are exempt from the claims of the custodian's creditors, but not the creditors of the minor.

IV. Trusts

A. Interests in Trusts

1. Self-settled Trust

a. Property in a revocable trust is subject to claims of the settlor's creditors during life to the same extent as if owned directly by the settlor. F.S. §§ 736.0505(1)

b. Property owned by a decedent's revocable trust is liable for the expenses of administration and obligations of the decedent's estate to the extent the estate is insufficient to otherwise pay such claims. F.S. § 733.707(3).

c. Florida currently does not recognize self-settled asset protection trusts; a creditor of the settlor of a trust can reach the maximum amount that can be distributed to or for the settlor's benefit. F.S. § 736.0505(1)(b); *In re Lichstrahl*, 750 F. 2d 1488 (11th Cir. 1985); *In re Witlin*, 640 F. 2d 661 (5th Cir. 1981).

2. Third-party Trusts (Without a Spendthrift Provision)

a. Creditor cannot compel a discretionary distribution. F.S. § 736.0504(2)(a).

b. Creditor cannot reach the interest of a beneficiary that is the result of the trustee's authority to make discretionary distributions to or for the benefit of the beneficiary regardless of whether the discretion is expressed in the form of a standard of distribution. F.S. § 736.0504(2)(b).

c. Creditor cannot compel a distribution or reach the interest of a beneficiary who is also the trustee as long as the trustee's discretion is limited by an ascertainable standard (e.g., health, education, maintenance and support). F.S. § 736.0504(3).

d. Trusts should permit trustees to make distributions "to *or for the benefit of*" the beneficiary in order to allow trustee to pay expenses of beneficiary (rent, mortgage, etc.) directly.

3. Third-Party Trusts (With a Spendthrift Provision)

a. Creditor cannot reach the interest of a beneficiary subject to a spendthrift provision before the beneficiary receives the interest or distribution. F.S. § 736.0502(3); See, e.g., *In re Knowles*, 123 B.R. 428 (Bankr. M.D. Fla. 1991).

b. Beneficiary cannot transfer an interest in a trust subject to a spendthrift provision.

c. If the sole beneficiary who holds a vested interest is also the sole trustee, there is likely a merger of the legal and equitable title in the trust and the protection of a spendthrift provision will likely be lost. *In re Scott*, 21 Fla. L. Weekly Fed. B13 (Bankr. S.D. Fla. 2007).

d. A spendthrift provision is unenforceable against:

   i. A beneficiary's child, spouse or ex-spouse who has a judgment or court order for support or maintenance. See *Bacardi v. White*, 463 So. 2d 218 (Fla. 1985);

   ii. A judgment creditor who has provided services for the protection of a beneficiary's interest in the trust (i.e., attorney's fees); and

   iii. A claim of the State or United States to the extent the law otherwise provides (such as a tax lien). F.S. § 736.0503.

e. However, the interest of a beneficiary who may only receive discretionary distributions is still protected against the creditors listed above. See F.S. § 736.0504(2).

f. Remedies are available only as a last resort after a showing that traditional methods of enforcing the claim are insufficient.

4. Withdrawal Rights / General Power of Appointment (GPOA)

   a. Debtor's unrestricted control over trust property, such as the right to request the trustee to distribute some or all of the assets of the trust to the debtor is reachable by creditors of the beneficiary even if the trust contains a spendthrift provision. *In re May*, 83 B.R. 812 (Bankr. M.D. Fla. 1988).

   b. The lapse of a Crummey power to the extent it exceeds the greater of (1) the amount in I.R.C. § 2041(b)(2) or 2514(e) (currently, $5,000 or 5% of the trust corpus), or (2) the gift tax annual exclusion in I.R.C. § 2503(b) (currently $13,000), results in the Crummey holder being treated as the settlor of the trust as to the lapsed portion, and thus, may be reachable by creditors. If the donor was married at the time of the gift to the trust, then the protected amount is twice the gift tax annual exclusion. F. S. § 736.0505(2).

5. Limited Power of Appointment

   a. Creditor of powerholder cannot reach assets subject to the limited power.

6. Trusts as Beneficiaries of Retirement Accounts

a. Only certain trusts qualify as a "designated beneficiary".

   i. If trust does not qualify as a designated beneficiary, then:

      a. If participant died before required beginning date for distributions, then all benefits must be distributed no later than December 31 of the year that contains the fifth (5^{th}) anniversary of the participant's death. Treas. Reg. § 1.401(a)(9)-3, A-2.

      b. If participant died after the required beginning date, then benefits can only be extended over the participant's remaining life expectancy at the time of the participant's death (but plan can require faster payout). Treas. Reg. § 1.401(a)(9)-2, A-5.

   ii. If the trust qualifies as a designated beneficiary, then the benefits may be stretched out over the life expectancy of the oldest trust beneficiary. Treas. Reg. 1.401(a)(9)-4, A-5.

b. Requirements for a trust to qualify as a designated beneficiary (also known as a "see-through trust"):

   i. Trust must be valid under state law;

   ii. Trust is irrevocable or becomes irrevocable upon death of participant;

   iii. Beneficiaries are identifiable from the trust instrument;

   iv. Certain documentation is provided to the plan administrator by October 31 of the year following the participant's death; and

   v. All trust beneficiaries are individuals. Treas. Reg. § 1.401(a)(9)-4, A-5(b).

c. Types of trusts to receive retirement benefits

   i. "Conduit Trust"

      a. A trust under which the trustee is required by the terms of the trust to distribute to the individual trust beneficiary or beneficiaries any distribution the trustee receives from the retirement plan.

b. Trustee has no power to accumulate plan distributions in the trust.

c. Individual trust beneficiary is generally in the same position as if he or she had been named directly, except that beneficiary does not have power to decide when and how to take the benefits. Therefore, benefits are payable over life expectancy of the trust beneficiary, except that if the spouse is the trust beneficiary, he or she can defer distributions until age 70.5. Treas. Reg. 1.401(a)(9)-5, A-7(c)(3), Ex. 2.

d. Look only to the conduit beneficiary for purposes of determining whether the trust qualifies as a "see-through" trust. Remainder beneficiaries are not considered and, therefore, do not need to be individuals.

e. Uncertainty exists as to whether distribution of retirement benefits can be made "for the benefit of" the individual beneficiary or whether distributions must be made directly "to" the beneficiary.

   i. There is not any reliable IRS guidance on this point.

   ii. This is significant for creditor protection purposes because once benefits are paid to the beneficiary, they can be reached by creditors.

f. Taxable distributions from the retirement plan which flow out to the beneficiary carry out DNI. Therefore, distributions are taxed at individual tax rates, not under the compressed trust income tax brackets.

ii. Accumulation Trust

a. Trust has power to accumulate all or part of plan distributions within the trust, which prevents exposure of the assets to creditors of the beneficiary.

b. Current and remainder beneficiaries are generally counted for purposes of determining whether the trust qualifies as a "see-through trust".

i. Caution: In PLR 201021038, the IRS refused to give retroactive effect for federal tax purposes to a local state court order which permitted reformation of a trust to remove charities as permissible appointees of a limited power or appointment. The purpose of the reformation action was to qualify the trust as a designated beneficiary. Because the reformation was not given retroactive effect for tax purposes, the trust, as it existed on the date of the decedent's death, had a potential beneficiary who was not an individual and thus, the trust failed to qualify as a designated beneficiary.

ii. PLR 201021038 seems to represent a change in the position of the IRS with respect to reformations. See PLRs 200235038 and 200620026. Without the ability to reform a trust post-death to qualify as a designated beneficiary, practitioners must be extremely careful to draft the trust correctly the first time.

c. Trustee can have discretion on when and how much to pay to trust beneficiaries.

d. Assets can be retained inside the trust for later distribution to remainder beneficiaries.

e. In accumulating distributions, consider that amounts accumulated in the trust will be taxed under the compressed income tax brackets for trusts.

i. Note that distributions from a Roth IRA would not be taxable to the trust. Thus, an accumulation trust which receives distributions from a Roth IRA does not have the income tax disadvantage present when an accumulation trust receives distributions from a traditional IRA.

iii. "Toggle" Trust

a. Based on PLR 200537044 - beneficiary designation named nine (9) sub-trusts structured as conduit trusts. Trust Protector had the authority under the trust to convert any conduit trust to an accumulation trust, and an accumulation trust to a conduit trust. Trust Protector also had the power to eliminate contingent beneficiaries who were older than the single beneficiary of the sub-trust, and to restrict the beneficiary's power to appoint trust assets to non-individuals or individuals older than the single beneficiary. Under the trust agreement, the effect of eliminating non-individual beneficiaries and older beneficiaries was to make such interests void ab initio.

i. Within 9 months of death and prior to September 30 of the year following the death (the "beneficiary determination date"), the Trust Protector exercised the power to convert a conduit trust into an accumulation trust, limited to class of permissible appointees and takers in default to individuals younger than the beneficiary.

ii. IRS ruled that distributions could be stretched out over the life expectancy of the beneficiary of the converted trust.

b. It is uncertain whether this would work if such powers were exercised after the disclaimer period (if any time limit imposed by state law) and after the beneficiary determination date. To be safe, the protector should not be permitted to exercise the power after either date. See PLR 201021038.

c. Both trusts (before and after exercise of the amendment power) must qualify as see-through trusts.

iv. Individual Retirement Annuity

a. In states (including Florida) where the protection afforded to an inherited IRA is possibly not as great as the protection for an annuity, it may be possible to enhance the protection of the IRA assets by investing in an individual retirement annuity.

7. Disclaiming Interests

a. A disclaimer may not be made if the disclaimant is insolvent when the disclaimer becomes irrevocable. F.S. § 739.402(2)(d).

i. "Insolvent" means that the sum of a person's debts is greater than the value of all of the person's assets and the person is generally not paying his or her debts as they become due. F.S. § 739.102(8).

b. Assets considered include any property of the debtor other than property to the extent covered by a valid lien, property generally exempt under state law, and property held as tenants by the entireties to the extent not reachable by the creditor of one spouse. F.S. § 726.102(2).

c. Post mortem planning is limited when dealing with a debtor who is inheriting property outright. Therefore, planning needs to be done by property owner prior to his or her death. Inherited assets would not be reachable by creditors if they were devised in a spendthrift trust for the benefit of the surviving debtor.

B. Domestic Asset Protection Trusts

1. Twelve states have adopted legislation that allows for the creation of a self-settled domestic asset protection trust (Alaska, Colorado, Delaware, Hawaii, Missouri, Nevada, New Hampshire, Rhode Island, South Dakota, Tennessee, Utah and Wyoming).

2. Florida residents may create trusts in states which allow DAPTs, but there is no case law or statutory authority which says this will work to prevent creditors of settlor from reaching assets inside DAPT.

3. The Asset Preservation Committee of the Real Property, Probate & Trust Law ("RPPTL") Section of the Florida Bar worked for several years drafting proposed legislation to allow self-settled asset protection trusts in Florida. The proposal was submitted to the Executive Council of the RPPTL Section for approval on August 7, 2010. The proposal failed to receive the support of 2/3 of the Executive Council required for approval.

4. In a bankruptcy context, a self-settled trust created within ten years of filing the bankruptcy with actual intent to delay, defraud or hinder an existing or future creditor can be set aside.

C. Offshore Asset Protection Trusts

1. The laws of certain nations permit creation of a self-settled asset protection trust with the settlor retaining limited control and benefits.

2. Legal challenges to the trust must be brought in the foreign jurisdiction; judgments from U.S. courts are not recognized.

3. Creditors typically carry a heavier burden to show fraud.

4. U.S. Courts have jailed debtors on contempt who refused to repatriate assets from foreign trusts. See *In re Lawrence,* 279 F.3d 1294 (11th Cir. 2002); *FTC v. Affordable Medic, LLC,* 179 F.3d 1228 (9th Cir. 1999).

a. *SEC v. Solow*, 682 F. Supp. 2d 1312 (S.D. Fla. 2010) - SEC brought suit alleging that Solow engaged in a fraudulent trading scheme which involved collateralized mortgage obligations. A "judgment of disgorgement" was entered against Solow for $6 million. The judgment went unsatisfied and the SEC moved the Court for an Order to Show Cause why Solow should not be held in contempt.

i. Solow transferred most of his assets to his wife prior to the SEC bringing suit, some of which were prior to the facts giving rise to the SEC case. After the claim, but prior to the jury trial, wife placed $6.4 million in mortgage liens on a condo and Florida beach property, and placed the proceeds into an offshore trust in the Cook Islands Mr. Solow's consent was required to encumber the properties.

ii. The court held Solow in contempt, finding that he engaged in a "purposeful campaign of asset dissipation by transferring his assets to his wife". Although Solow argued that he did not have the ability to comply with the judgment, the court found that the inability to comply was self created and thus, unavailable as a defense.

iii. Case has been criticized for several reasons, but it does teach us at least 1) do your planning prior to problems arising, and 2) federal agencies beyond the IRS may be "super-creditors" from which state law exemptions may not protect.

V. Entities that Provide Protection

A. Goal is to protect personal assets from creditors of business ("inside liabilities") and to protect business assets from personal creditors of individual member/partner ("outside liabilities").

B. Charging Order Concept

1. Confers on the judgment creditor only the rights of an assignee of an interest in the entity. It does not entitle the creditor to become a partner or member of the entity.

2. Judgment creditor cannot participate in the management of the entity.

3. Judgment creditor is only entitled to receive the distributions that the debtor partner would have received, but it does not confer any ability to affect the timing or amount of those distributions.

    a. Partnership agreements are often drafted to give the general partner sole discretion to determine when to make distributions and how much to distribute. Therefore, the cooperation of the general partner is important for the debtor to negotiate a settlement with the creditor.

4. Judgment creditor cannot foreclose on the charging order in Florida if the charging order is obtained on a limited partnership interest (although several other states allow). However, a court may order the foreclosure of the interest subject to the charging order if the interest charged is in a general partnership. Compare F.S. §§ 620.1703 and 620.8504.

5. An assignee who does not become a member is limited to receiving only those distributions to which the assignor was entitled.

    a. Many planners believe that this will result in the assignee becoming liable for income taxes resulting the flow-through income and gain, yet the LLC may not be required to make any distributions. Compare Rev. Rul. 77-137, 1977-1 C.B. 178, and GCM 36960.

    b. Since the assignee cannot participate in the management of the company, the assignee may not have any prospect of receiving distributions from the LLC. The debtor will be in a favorable negotiating position to buy-out the assignee's interest at a discounted amount.

C. Entities for Ownership of Assets

1. Limited Liability Company ("LLC")

    a. A member is generally liable for inside liabilities only to the extent of his of her capital contribution to the LLC. Protection can be lost when member(s) fails to respect the separate identity of LLC (e.g., commingling of funds with personal assets, paying personal expenses with business assets, executing documents in the personal name of member rather than in the name of the LLC, etc.)

    b. Prior to recent Florida Supreme Court case of *Olmstead*, with respect to outside liabilities, it was unclear whether the sole remedy of a judgment creditor against an LLC member's interest was a charging order.

i. F.S. § 608.433(4) does not expressly designate the charging order as the sole remedy for the creditor of a member (as in the limited partnership statute), but many practitioners believe that the statute should be interpreted that way.

ii. Prior to the amendment of the limited partnership statutes in 2005 to specifically provide that a charging order is the exclusive remedy for a creditor of a partner, case law interpreted the partnership statutes to make the charging order the sole remedy even though the express language of the partnership statutes did not specify the charging order as the *exclusive* remedy. *Myrick v. Second Nat'l Bank of Clearwater,* 355 So. 2d 343 (Fla. 2d DCA 1976); *Atlantic Mobile Homes, Inc. v. LeFever*, 481 So. 2d 1002 (Fla. 2d DCA 1986); and *Givens v. Nat'l Loan Investors, L.P.*, 724 So. 2d 610 (Fla. 5th DCA 1998).

c. A judgment creditor who acquires a charging order acquires the rights of an assignee. An assignee cannot exercise any rights or powers as a member unless the assignee becomes a member by the unanimous consent of all members of the LLC. F.S. §§ 608.4032 and 608.0433.

d. *Olmstead v. Federal Trade Commission*, No. SC08-1009 (June 24, 2010)

i. Defendants operated a credit card scam by sending out solicitations creating the impression that consumers would receive a platinum visa with a $5,000 credit limit for a small sum. The consumers instead only received a card usable at the debtor's personal merchandise catalog instead of a Visa or Mastercard. FTC claimed that defendants violated federal laws against unfair or deceptive trade practices and entered a judgment against the defendants for $10 million in restitution. Among the assets placed in a receivership were several single member LLCs in which one of the defendants was the sole member.

ii. Florida Supreme Court held that a court may order a judgment debtor to surrender all right, title and interest in a single-member LLC to satisfy a judgment. In other words, a creditor is not limited to a charging order, but instead, may reach the assets of the LLC in satisfying a judgment.

iii. The Court relied on the plain language of the statute and found that the failure of the Legislature to expressly include in the LLC statute that the charging order is the "exclusive" remedy (as opposed to the exclusive remedy language included in the Florida limited partnership statute) was evidence that the legislature did not intend for the charging order to be a creditor's sole remedy.

iv. This decision of the Court is very troubling for several reasons:

a. The reasoning of the Court implies that the charging order is not the exclusive remedy for multi-member LLCs as well. In rendering its judgment, the Court relied on the specific language used in the LLC statutes, which does not distinguish between single-member and multi-member LLCs.

b. The Court's analysis of the legislative history is incomplete. The LLC statute was adopted in 1993, when the charging order was a relatively new concept. The limited partnership statute, which expressly provides that the charging order is the "exclusive remedy", was substantially revised in 2005. See F.S. §§ 620.1703.

c. The Court does not indicate what, if any, effect the restrictions contained in an LLC's operating agreement will have on the remedies available to a creditor.

d. Note that *Olmstead* does not impact the current law regarding the protection of a single member's personal assets from inside liabilities of the LLC; Olmstead deals with outside liabilities only.

e. Other jurisdictions have held that the primary purpose for the charging order does not apply where there are not any non-debtor members to protect.

i. *In re Albright*, 291 B.R. 538 (Bankr. D. Colo. 2003) - Bankruptcy court held that assets of a single member LLC were available to creditors instead of a charging order. The court reasoned that the purpose of a charging order is to protect the other members of an LLC from involuntarily having to share responsibilities with someone they did not choose. However, in a single member LLC, there are no additional members to protect, and thus, the charging order does not serve a purpose.

ii. The language of the relevant Florida statute is different than the Colorado statute at issue in *Albright*. However, the concept applies equally to a Florida single member LLC. The Florida Supreme Court in *Olmstead* cited *Albright*, but did not appear to base its holding on the same line of reasoning.

f. Expect to see attempts in next year's legislative session to insert language into F.S. § 608.433 to make the charging order the "exclusive" remedy for creditors seeking to reach a debtor's interest in an LLC, although the legislation may be limited to multi-member LLCs.

g. Until the LLC statutes are legislatively "fixed", practitioners should:

i. Alert clients that assets held in a single-member LLC, and possibly a multi-member LLC, are not protected from personal creditors;

ii. Consider using LPs or LLLPs instead of LLCs for newly created entities.

iii. Consider converting existing LLCs to LPs or LLLPs.

iv. Create LLCs in states, or even offshore jurisdictions, that have well-settled law or clear legislation regarding charging orders as the exclusive remedy (*e.g.*, Nevada, South Dakota, Alaska, etc.). Jurisdictions which do not permit foreclosure of a charging order are more protective to the debtor than jurisdictions which do not.

v. Bifurcate ownership interests into voting and non-voting, then allocate voting interests among different persons or an irrevocable grantor trust.

2. Limited Partnership ("LP") and Limited Liability Limited Partnership ("LLLP")

a. F.S. § 620.1703 expressly provides that the sole remedy of a judgment creditor against a partner's interest in a limited partnership is a charging order. Additionally, foreclosure of the charging order is expressly prohibited.

b. Although using an LP requires a general partner who is obligated for the debts of the partnership, limited liability entities such as an LLC or corporation are often used as general partners to avoid subjecting the individual owner of the general partner of the LP to personal liability. This limits the liability of the general partner and effectively eliminates the risk of personal liability to the person(s) in charge of the general partnership interest for the inside liabilities of the partnership.

i. Query what protection is afforded to a single member LLC acting as the general partner of a limited partnership? Can a creditor of the sole member gain ownership of the general partnership interest owned by the LLC through foreclosure of a charging order, and then control the actions of the LP?

a. A well-drafted partnership agreement will address the consequences of an involuntary transfer of a general or limited partnership interest, including the involuntary transfer of a controlling membership interest in the LLC acting as the general partner. Often, a partnership agreement will provide for a buy-out of the interest involuntarily transferred, or that a general partnership interest is converted into a limited partnership interest.

3. C or S Corporation

a. Personal assets of a shareholder are generally protected from inside liabilities of the business.

b. However, creditors of individual shareholders can reach the shares of a debtor. In the case of a sole or majority shareholder, a creditor who acquires enough shares to control the corporation would be able to reach the corporation's assets through a liquidation or force distributions.

c. If an existing company is currently operating as a corporation, consider converting or merging into a different entity which offers greater protection for outside liabilities.

VI. Effect of Fraudulent Transfers and Conversions

A. Florida Uniform Fraudulent Transfer Act. F.S. Ch 726 ("FUFTA")

1. Transfers to third parties or obligations incurred by a debtor are considered fraudulent whether they are made before or after a claim arises if the transfer was made or the obligation was incurred:

a. With actual intent to hinder, delay or defraud a creditor; or

b. Without receiving reasonably equivalent value in exchange, and the debtor:

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

ii. Intended to incur, or believed or reasonably should have believed that he or she would incur debts beyond his or her ability to pay as they became due. F.S. § 726.105.

2. Reasonably equivalent value is a facts and circumstances test. The court will consider factors such as good faith of parties, disparity between fair value of property received and the property transferred, and whether the transactions were at arm's length. *In re Dealers Agency Service, Inc.*, 380 B.R. 608 (Bankr. M.D. Fla. 2007).

3. Fraudulent intent is determined by facts and circumstances test, but considerations of the court include whether:

   a. Transfer or obligation was to an insider;

   b. Debtor retained control of the transferred property;

   c. Transfer was concealed; and

   d. Transfer was made after debtor was threatened with suit.

4. Despite the broad literal language in F.S. § 726.105(1) concerning its application to both present and future creditors, courts in Florida have drawn a distinction in the case of future creditors, depending on whether they are reasonably foreseeable.

   a. A creditor whose claim arises after a conveyance by a debtor must establish actual intent on the part of the debtor to defraud the creditor. *Hurlbert v. Shackleton,* 560 So. 2d 1276 (Fla. 1st DCA 1990).

   b. In order to be fraudulent, a transfer must interfere with the existing rights of other persons – there must be a creditor to defraud. *Bay View Estates Corporation v. Southerland,* 154 So. 894 (Fla. 1934).

   c. A debtor who makes a transfer must have actual fraudulent intent toward a specific creditor in order to establish that a transfer is fraudulent. *In re Piper Aircraft Corp.,* 168 B.R. 434 (S.D. Fla. 1994), aff'd 58 F.3d 1573.

5. Certain transfers are considered fraudulent as to present creditors, regardless of intent. A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer if the debtor made the

transfer without receiving reasonably equivalent value in exchange and the debtor was insolvent at the time of the transfer or became insolvent as a result of the transfer. F.S. § 726.106.

a. A debtor is insolvent if the sum of the debtor's debts is greater than the fair value of all the debtor's assets. F.S. § 726.103(1).

b. A debtor is presumed to be insolvent if the debtor is generally not paying his or her debts as they become due. F.S. § 726.103(2).

6. Remedies for fraudulent transfers include setting aside the transfer to the extent necessary to satisfy claim, attachment of assets transferred, injunction against further transfer by debtor or transferee of asset transferred or of other property, and appointment of a receiver. F.S. § 726.108.

7. A transfer is not voidable to the extent the transferee purchased the asset in good faith and for reasonably equivalent value. F.S. § 726.109.

8. Claim must generally be brought within 4 years after transfer was made or the obligation was incurred, except that if the transfer was made or obligation was incurred with actual intent to hinder, delay or defraud a present or future creditor, the claim may be brought within 1 year after the creditor discovers or could have reasonably discovered the transfer was made or the obligation was incurred. F.S. § 726.110.

B. Fraudulent conversion of non-exempt assets into exempt assets (see, I-VI above).

1. Any conversion by a debtor of assets that results in the proceeds of a non-exempt asset becoming exempt from creditors, whether before or after a creditor's claim arises, *if the debtor made the conversion with the intent to hinder, delay or defraud the creditor.* F.S. § 222.30.

2. "Conversion" broadly defined to cover any changing or disposing of an asset such that the product or proceeds of the asset become exempt from creditors, but remain the property of the decedent.

3. Remedies include setting aside conversion to the extent necessary to satisfy the creditor's claim, attachment of converted asset, injunction against conversion of other assets by debtor, or levy of execution on converted asset or its proceeds.

4. Claim must be brought within 4 years of conversion.

VII. Ethical Issues

A. The Florida Rules of Profession Conduct for Attorneys

1. Rule 4-1.2(d) - [a] lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows or reasonably should know is criminal or fraudulent.

2. Rule 4-4.4(a) - a lawyer shall not use means that have no substantial purpose other than to embarrass, delay, or burden a third person or knowingly use methods of obtaining evidence that violate the legal rights of such a person.

3. Rule 4-8.4(c) - lawyer may not engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.

B. Fraud is a type of civil cause of action requiring intent (an intentional tort), with the following elements:

1. A false statement concerning a specific material fact;

2. The maker's knowledge that the representation is false;

3. An intention that the representation induces another's reliance; and

4. Consequent injury by the other party acting in reliance on the representation. *Lopez-Infante v. Union Central Life Insurance Co.*, 809 So. 2d 13, 15 (Fla. 3d DCA 2002).

C. Fraudulent Conversion and Fraudulent Transfers

1. Neither section 222.30 (fraudulent conversion) nor chapter 726 (fraudulent transfers), Florida Statutes, creates a cause of action for fraud against a party who allegedly assists a debtor in a fraudulent conversion or transfer of property, unless the person comes into possession of the property. *BankFirst v. UBS Paine Webber, Inc.*, 842 So. 2d 155 (Fla. 5th DCA 2003).

2. A fraudulent transfer action is simply another creditor's remedy to collect on a valid claim, and as such is not a separate action against a debtor (in personam) for failure to pay. It is an action against the property itself (in rem) and transferees of the property. *Yusem v. South Florida Water Management District*, 770 So. 2d 746 (Fla. 4th DCA 2000).

3. A fraudulent conveyance is not a tortious act, and does not give the court jurisdiction over an individual (in personam) over which it otherwise lacked jurisdiction, because it is an action against the property (in rem). *Beta Real Corp. v. Graham*, 839 So. 2d 890 (Fla. 3d DCA 2003).

4. The Florida Supreme Court has held that an action under the FUFTA is a creditor's equitable remedy, and it gives creditors no cause of action in tort

against non-transferees for aiding and abetting or civil conspiracy. *Freeman v. First Union National Bank*, 865 So. 2d 1272, (Fla. 2004).

5. If the attorney is not assisting a client in committing common-law fraud, as opposed to assisting with a transaction that may later be determined to be a fraudulent transfer, asset protection appears not to constitute unethical conduct.

    a. The determination of what is ethical will turn on whether the transaction involved present or future creditors.

    b. With a fraudulent transfer as to a present creditor, the intentional elements of fraud could be established, because the debtor is specifically attempting to prevent a known creditor from collecting on a valid claim.

    c. There can be no such intent when a future, unforeseeable creditor is involved.

    d. Attorney was subject to sanctions for advising a client (the attorney's son) to transfer assets to the attorney after the entry of a judgment against the client, and then making a false statement about his knowledge of the existing judgment. *The Florida Bar v. Rood*, 622 So. 2d 974 (Fla. 1993).

    e. Attorney was subject to sanctions for participating in the transfer of assets from an entity, for which he had initiated bankruptcy proceedings, to a new entity in an attempt to protect the assets. *The Florida Bar v. Klein*, 774 So. 2d 685 (Fla. 2000).

D. Types of Clients

1. Client against whom a judgment has been entered

    a. Do not provide advice concerning transfers that would be fraudulent in respect to existing creditors.

    b. Revise estate plans of parents, spouse, siblings, etc. to leave assets passing to debtor in trust rather than outright.

    c. Convey exempt property that is owned with spouse as tenants by the entirety to spouse or inter vivos QTIP Trust for spouse to avoid possibility spouse might predecease debtor resulting in loss of the exemption.

2. Client with foreseeable future creditor

a. Limit transfers so that they do not leave client insolvent after taking into account the potential debt.

b. Provide that existing claims will be satisfied by the transferee to the extent the client is unable to do so.

3. Client with no foreseeable future creditors

a. The best time to do asset protection planning.

E. Due Diligence

1. Know your client

a. Source of client's wealth.

b. Client's business or employment.

c. Client's reasons for seeking asset protection advice and assistance.

d. Who referred client.

e. Whether client has current creditors or foreseeable future creditors.

2. Have the client sign a solvency statement which includes statements of the following:

a. No pending or threatened claims, except those specifically identified;

b. Not presently under any investigation by any governmental agency;

c. Not involved in any governmental administrative proceedings;

d. No situation has occurred which is reasonably anticipated to develop into a legal problem in the future;

e. Not in default of a child support obligation;

f. Following any intended transfers the client will remain solvent and able to pay the client's reasonably anticipated debts as they become due;

g. None of the assets which the client may transfer were derived from any of the "specified unlawful activities" which are set forth under the Money Laundering Control Act of 1986; and

h. Not contemplating filing for bankruptcy.

3. Review the client's circumstances.

4. Retainer letter, signed by the prospective client, disclosing:

    a. What constitutes a fraudulent conveyance;

    b. Potential consequences of the making of a fraudulent conveyance;

    c. The attorney will not assist the client in any transfer which the attorney believes might constitute a fraudulent conveyance;

    d. The attorney is necessarily relying upon full and continuing disclosure by the client in the attorney's assessment of whether the transfers are, in fact, permissible; and

    e. A breach of the client's required full and continuing disclosure will constitute grounds for the attorney to resign.

5. Questionnaire completed by the prospective client:

    a. Whether the client, or any company with which the client has been closely connected, has ever filed for relief in bankruptcy.

    b. Whether the client's federal, state and local tax reporting is current.

    c. Whether the client is currently being audited by any tax authority.

    d. Whether the client has any direct or indirect liability for any loan.

    e. Whether the client or any company with which the client has been closely connected has ever been convicted of a crime.

6. Documentation to be provided by Prospective Client:

    a. Copies of most recent personal income tax returns;

    b. Personal financial statement; and

    c. If the client is closely connected with any company, copies of that company's most recent income tax returns and a current financial statement of the company.

7. Personal References from Prospective Client's:

    a. Primary banker;

    b. Personal attorney; and

    c. Personal accountant.

8. Independent Research

a. Any lawsuit in which the client or any company with which the client is closely connected is named as a defendant?

b. Any judgment under which the client or any company with which the client is closely connected is named as a judgment debtor?

c. Any liens which have been filed against the client?

d. Any bankruptcy filings which may have been made by the client or any company with which the client is closely connected, at any time?