October 10, 2013

ASSET PROTECTION 2013 UPDATE

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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, auto accident)
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 trusts

4. Use 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 Federal 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.

a. Homestead protection is available to non-citizens as well if intent can be shown to permanently reside on the property. Possessing only a temporary visa is not sufficient. *Garcia v. Andonie*, 101 So.3d 339 (Fla 2012).

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 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 a principal residence by such person or a member of such person's family.

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., *Aronson v. Aronson,* 81 So.3d 515 (Fla. 3d DCA 2012); *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).

e. Condominium on leased land qualifies. See *Geraci v. Sunstar*, 93 So.3d 384 (Fla. 2d DCA 2012).

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. *Havoco of America, Ltd. v. Hill*, 790 So. 2d 1018 (Fla. 2001); *Willis v. Red Reef, Inc.*, 921 So. 2d 681 (Fla. 4th DCA 2006).

   a. However, courts have imposed an equitable lien on property to the extent the proceeds invested in the homestead were acquired by fraud. *Zureikat v. Shaibani,* 944 So. 2d 1019 (Fla. 5th DCA 2006).

8. Retaining protection for devise of homestead. Art. X, § 4, Fla. Const.; F.S. § 732.401; F.S. § 732.4015. (note: property owned as tenants by the entirety or as joint tenants with rights of survivorship is not subject to the foregoing devise restrictions)

   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(5).

   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.

      i. Effective October 1, 2010, the spouse may instead elect, within 6 months of decedent's death, 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.

      ii. The purpose of this election is to shift a portion of the carrying costs of the homestead to the descendants. As a life estate holder, the spouse is solely responsible for ordinary expenses to manage and preserve the property, such as mortgage interest, repairs, property taxes and insurance. If the spouse elects to have a TIC interest, then the spouse is generally responsible for half of these costs. Moreover, as a life estate holder, the spouse could not force a sale of the property, but as a tenant in common, the spouse can.

   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, or the spouse may 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. *Cutler v. Cutler*, 994 So.2d 341 (Fla. 3d DCA 2008).

   iv. CAUTION: A devise of homestead to heirs via a pour-over will to a revocable trust may cause the loss of creditor protection because it can be viewed as a devise to a trust and not an heir. See *In re Estate of Gladys Jacqueline Lane,* File No. 05-2009-CP-053957 (Brevard County Circuit Court May 4, 2012) relying on *Elmowitz v. Estate of Zimmerman*, 647 So.2d 1064 (Fla. 3d DCA 1994). However, see *HCA Gulf Coast Hospital v. Estate of Downing*, 594 So.2d 774 (Fla. 1st DCA 1992), which held that creditor protection inured to a testamentary trust for a daughter to which the homestead was devised.

a. **Therefore, when in doubt, own the homestead outside a revocable trust and specifically devise the homestead in the Will to the heirs outright.**

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 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. Homestead protection may be reduced for Florida debtors in federal bankruptcy court as opposed to state court.

    b. 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 $155,675). 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); *In re Juan Castro* 20 Fla. L. Weekly Fed. B148 (Bankr. S.D. Fla. 2006).

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, if the debtor is in federal bankruptcy court. 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).

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 Burns,* 395 B.R. 756 (Bankr. M.D. Fla. 2008); *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 $155,675). However, other cases conflict. Compare *In re Goldberg*, 229 B.R. 877 (Bankr. S.D. Fla. 1998) and *In re Mathews,* 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 *Havoco 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.

d. Funds do not lose exemption if 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.

i. Caution: Payment of retirement proceeds to a decedent's revocable trust could cause the loss of exemption. See Section II.D. below for discussion of *Morey v. Everbank*, 93 So.3d 482 (Fla. 1st DCA 2012).

f. Funds in an inherited IRA are now clearly protected in Florida as a result of legislation enacted in 2011. F.S. 222.21(2)(c). Prior to this remedial legislation, at least one Florida case found inherited IRAs not to be exempt, even though the language of F.S. § 222.21(2) already seemed to clearly exempt inherited IRAs. See *Robertson v. Deeb*, 16 So.3d 936 (Fla. 2d DCA 2009).

   i. It is still unsettled under Federal Bankruptcy law. Circuits conflict. Compare *In re Chilton*, 674 F.3d 486 (5th Cir. 2012) with *In re Clark*, 714 F.3d 559 (7th Cir. 2013)

g. 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 intended beneficiary. See Section II.B.5.

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 $1,245,475); <u>excluding</u> amounts rolled over from an exempt retirement account.

   b. There is currently a conflict among circuits as to whether federal exemption covers inherited IRAs. Compare *In re Chilton*, 674 F.3d 486 (5th Cir. 2012) with *In re Clark*, 714 F.3d 559 (7th Cir. 2013). This conflict could lead to U.S. Supreme Court review of the issue.

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), aff'd 424 Fed. Appx. 880 (11th Cir. 2011) - 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.

4. Roth Conversion

a. The owner of a traditional IRA must begin taking required minimum distributions ("RMDs") upon attaining age 70 and ½. Once RMDs are distributed to the owner, they become subject to the owner's creditors. Because a Roth IRA owner is not required to take RMDs, an owner of a traditional IRA who is approaching age 70 and ½ and is concerned about creditors might consider converting the traditional IRA to a Roth IRA.

b. The conversion may be subject to attack by creditors under Florida's fraudulent conversion laws but such an attack would be difficult because a fraudulent conversion claim requires not only a conversion but also a showing that the creditor converted the Roth IRA with the intent to hinder, delay, or defraud the creditor.

c. Since Roth conversions are usually motivated by economic and tax planning opportunities, it may be difficult for creditors to prove the requisite actual intent necessary for a successful fraudulent conversion claim.

d. Owner can pay resulting income taxes of conversion from non-exempt assets thus removing additional assets from the reach of creditors.

5. 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 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.

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.

   a. CAUTION: In *Morey v. Everbank*, 93 So.3d 482 (Fla. 1st DCA 2012), the court held that life insurance proceeds payable to a decedent's revocable trust were available to creditors of the decedent's estate. The court focused on language in the revocable trust which directed the trustee to pay such amounts certified by the personal representative to be required to pay the settlor's death obligations, including estate administration expenses and enforceable debts. Since F.S. § 733.808(1) states that the proceeds paid to a trustee "shall be held and disposed of by the trustee in accordance with the terms of the trust", the court held that the settlor waived the statutory exemption in F.S. § 222.13.

      i. The reason *Morey* is concerning is because provisions directing a trustee of a decedent's revocable trust to pay estate debts are typically included as boilerplate in revocable trusts.

   b. As a result of *Morey*, proposed legislation from RPPTL will be included in the 2014 Florida legislative session to clarify that insurance proceeds paid to a revocable trust are not available to the decedent's creditors unless the instrument provides that F.S. 733.808(4) shall not apply.

   c. Solutions to *Morey*:

      i. Include explicit language in your revocable trusts that insurance proceeds shall never be available to pay debts; or

      ii. Name the beneficiaries of the revocable trust directly as the designated beneficiary.

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.

   a. Note: TBE protection in Florida probably does not extend to same-sex couples even if they are lawfully married in another state because Florida expressly refuses to recognize such marriages for state law purposes. Art. 1, § 27, Fla. Const.. No Florida cases have addressed this issue yet.

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); *Losey v. Losey*, 221 So.2d 417 (Fla. 1969);

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.

iii. RPPTL is currently working on proposed legislation that would permit TBE protection for personal property without requiring the unities of time and title. This means one could create TBE by transferring property from himself to himself and his wife as TBE without using an intermediary (i.e., a "straw man"). The proposed legislation would also treat all property transferred to a husband and wife as TBE unless a contrary intent is expressed in writing.

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.

i. F.S. § 655.79(1) - provides that any deposit or account in the name of husband and wife is considered TBE unless otherwise specified in writing.

ii. CAUTION: READ THE ACCOUNT PAPERWORK: *Wexler v. Rich*, 80 So.3d 1097 (Fla. 4th DCA 2012) – Court held account owners expressly disclaimed entireties account status when the financial institution provided owners with account agreements that included the option to select a tenancy by the entireties, among other options, but the joint tenants with rights of survivorship option was selected by a bank employee (even though the bank employee never explained the account ownership options). The account owners had an opportunity to review the account agreements before they signed them and they are presumed to know the contents of the agreements they signed.

iii. 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 and expose all TBE assets. 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 (e.g., SLAT, QTIP)

1. Property will be subject to creditors of transferee 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 into a discretionary trust with a spendthrift provision.

b. *In re Quaid*, 2011 WL 5572605 (M.D. Fla. 2011) – Funds from TBE bank account were transferred to wife's revocable trust 4 months prior to her death. The court found that Wife was the sole settlor of her revocable trust because she alone had right to revoke or withdraw assets of the trust during her lifetime. Husband was therefore not a settlor of the trust, so his beneficial interest in the trust was protected from his bankruptcy creditors by the trust's 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 (See Sec. IV.A below)

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 (Revocable and Irrevocable)

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); *Menotte v. Brown*, 303 F. 3d 1261 (11th Cir. 2002); *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. Without a spendthrift provision, the beneficiary must generally rely on the discretionary nature of his or her interest to avoid losing such interest to a creditor. Under F.S. § 736.0504(2)(a), a creditor cannot compel a discretionary distribution regardless of whether or not the trust contains a spendthrift provision.

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, such as health, education, maintenance or support. 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. But see discussion in Section 3.f immediately below.

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); *Zlatkiss v. All America Team Concepts, LLC* 38 Fla. L. Weekly 1194 (Fla. 5th DCA 2013) (finding that spendthrift trust protection dates back to common-law and does not violate constitutional right of access to courts).

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. EXCEPTION CREDITORS: Under F.S. 736.0503, 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. These remedies are available to exception creditors only as a last resort after a showing that traditional methods of enforcing the claim are insufficient.

f. The interest of a beneficiary who may only receive discretionary distributions should still be protected against any creditor, including exception creditors. See F.S. § 736.0504(2).

i. CAUTION: Recently, some practitioners have raised concerns that, despite the express language of F.S. 736.0504(2), exception creditors may be able to garnish distributions from discretionary trusts, which means that distributions could not be made to *or for the benefit of* a beneficiary who has an exception creditor without paying the exception creditor first. This arises out of *Bacardi* and the legislative history concerning the subsequent enactment of F.S. 736.0504. This does not mean the exception creditor could reach inside the trust to get undistributed assets or otherwise force distributions. It means that if the trustee and beneficiary do not want the creditor to get any trust assets, distributions would need to be suspended until the debt is otherwise satisfied or settled. See Barry Nelson, *Bacardi on the Rocks*, 86 Fla. Bar Journal No. 3 (March 2012); and Barry Nelson, *Are Trust Funds Safe from Claims for Alimony or Child Support*, (April 2013)

ii. Other jurisdictions, such as Nevada and South Dakota, have legislation clarifying that trust assets can still be used to pay expenses for a beneficiary who has an exception creditor without jeopardizing trust assets or subjecting the trustee to personal liability. It is unclear at this time whether Florida will attempt to enact similar legislation. There is still debate as to whether such legislation is even necessary given the language of F.S. 736.0504(2).

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. 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 <u>and</u> 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. Fifteen states have now adopted legislation that allows for the creation of a self-settled domestic asset protection trust (Alaska, Colorado, Delaware, Hawaii, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia and Wyoming).

   a. 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 in 2010, but failed to receive the support of 2/3 of the Executive Council required for approval. It does not appear DAPT legislation will be coming to Florida any time soon.

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. Recent caselaw in another jurisdiction held that creditors could reach assets in a DAPT created outside the state of residency.

a. *In re Huber,* 201 B.R. 685 (Bankr. W.D.WA. May 17, 2013) - In 2008, Huber established an Alaska asset protection trust (the "Trust") and transferred ownership of several assets located in Washington, including his interest in several development projects, shopping centers, residences, and various accounts receivable, and one asset located in Alaska, a $10,000 CD. The beneficiaries of the Trust were Mr. Huber, his children and step-children (all of whom were Washington residents). The co-trustees of the Trust included Mr. Huber's son, Kevin Huber, and the Alaska USA Trust Company. Mr. Huber filed for bankruptcy protection in 2011 and the bankruptcy trustee sought to include assets transferred to the Trust in Mr. Huber's bankruptcy estate, thereby making such assets distributable to Mr. Huber's creditors. The court considered the following three issues to determine whether the assets of the Trust were part of Mr. Huber's bankruptcy estate and, therefore, available to his creditors:

    i. First, whether the Alaska DAPT should be invalidated by application of Washington law. The bankruptcy court applied federal choice of law rules and determined that Alaska did not have a substantial relation to the Trust because Mr. Huber resided in Washington, almost all of the property placed into the Trust was transferred from Washington, the creditors were located in Washington, and the Trust beneficiaries were Washington residents. Additionally, Washington State had a strong public policy against self-settled asset protection trusts. Accordingly, the court disregarded Mr. Huber's choice of Alaska law and applied Washington law in determining that the transfers to the Trust were void as transfers made into a self-settled trust.

    ii. Second, whether the transfers to the Trust could be avoided by the bankruptcy trustee pursuant to 11 U.S.C. § 548(e)(1) because they were made within 10 years before filing of the bankruptcy petition and, among other conditions, Mr. Huber made the transfers to the Trust "with actual intent to hinder, delay, or defraud" current or future creditors. The bankruptcy court considered several common "badges of fraud," and found that, at the time of the transfers to the Trust, (1) there was threatened litigation against Mr. Huber, (2) Mr. Huber transferred all or substantially all of his property to the Trust, (3) Mr. Huber had substantial indebtedness, (4) there was a special relationship between Mr. Huber and the Trust, and (5) following the transfers, Mr. Huber effectively retained the property transferred to the Trust. Thus, sufficient badges of fraud existed to conclude that Mr. Huber had an actual intent to hinder, delay or defraud his creditors, and § 548(e)(1) applied to make the assets transferred to the Trust available for distribution to Mr. Huber's creditors.

iii. Third, whether the transfers to the Trust could be avoided pursuant to 11 U.S.C. § 544(b)(1), which allows a bankruptcy trustee to bring an action under state law to avoid fraudulent transfers under the Uniform Fraudulent Transfers Act if the debtor transfers assets with actual intent to hinder, delay or defraud a creditor. The bankruptcy court considered several badges of fraud set forth in Section 19.40.041(b), Revised Code of Washington, and determined that the evidence was overwhelming that Mr. Huber transferred assets to the Trust with actual intent to hinder, delay or defraud creditors. Accordingly, § 544(b)(1) applied to avoid the transfers to the Trust under state law.

b. See also *Rush University Medical Center v. Sessions*, 980 N.E.2d 45 (Ill. 2012) in Section IV.C.5 below, which, although it dealt with an offshore asset protection trust, is indicative of what could happen with a DAPT created by a resident of a non-DAPT jurisdiction.

3. 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.

4. *Battley v. Mortensen*, 2011WL 5025249 (Bankr. D. Alaska May 26, 2011)

a. Alaska Bankruptcy court voided the transfer of property to an Alaska asset protection trust because it found the trust was created with the intent to hinder, delay or defraud future creditors.

b. Mr. Mortensen, an Alaska resident, created the Mortensen Seldovia Trust (an Alaska domestic asset protection trust) (the "Trust") on February 1, 2005 and deeded real property in Seldovia, Alaska, worth approximately $60,000 to the Trust. Mr. Mortensen's mother also gave him $100,000 to transfer to the Trust. At the time of the transfers, Mortensen was having financial problems, but was apparently solvent. The stated purpose of the Trust was to preserve the Seldovia property for family members and protect assets from creditors. In 2009, Mr. Mortensen became ill, incurred substantial credit card debt (over $250,000), and ultimately filed for Chapter 7 bankruptcy.

c. The bankruptcy court found that Mr. Mortensen created a valid Alaska asset preservation trust because he was solvent at the time of the Trust's creation. Consequently, the determinative issue in this case was whether Mr. Mortensen transferred the Seldovia property to the Trust "with actual intent to hinder, delay, or defraud" his creditors in violation of 11 U.S.C. § 548(e), which contains a 10 year limitation period for setting aside a fraudulent transfer to a self-settled trust. The bankruptcy court considered (i) the Trust's stated purpose of protecting assets from a beneficiary's potential future creditors, (ii) Mr. Mortensen's low income relative to his expenses, and (iii) Mr. Mortensen's speculative stock investments with the Trust's cash assets, in concluding that Mr. Mortensen's transfer of the Seldovia property and cash to the Trust constituted persuasive evidence of an intent to hinder, delay or defraud creditors. Consequently, the transfer of the Seldovia property to the Trust was voided by the bankruptcy court.

d. This case is notable for DAPT planning because it shows the impact that federal law can have on state law asset protection planning. The Trust likely would have been protected under Alaska state law, which has only a 4 year lookback period. However, federal law applied the 10 year lookback period under § 548(e), which voids any transfer made to a self-settled trust with the actual intent to hinder, delay or defraud present or future creditors. Although this seemingly creates a 10 year statute of limitations for a DAPT, it is important to point out that 548(e) applies only if the bankruptcy court finds actual intent to hinder, delay or defraud present or future creditors.

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.

5. CAUTION: Offshore asset protection trusts may not protect assets in a US jurisdiction. See *Rush University Medical Center v. Sessions*, 980 N.E.2d 45 (Ill. 2012)

a. In 1994, Mr. Sessions created an irrevocable self-settled spendthrift trust that was governed by the laws of the Cook Islands (the "Trust"). Mr. Sessions transferred his 99% limited partnership interest in Sessions Family Partners, Ltd., a Colorado limited partnership, and real property in Illinois to the Trust. Mr. Sessions was a lifetime beneficiary and Trust Protector of the Trust. In 1995, Mr. Sessions made a pledge of $1.5 million to Rush University Medical Center ("Rush U") for the construction of a Rush U presidential residence, which was later constructed even though no payments were made towards the $1.5 million pledge. In 2005, Mr. Sessions was diagnosed with terminal cancer. He blamed the doctors at Rush U for not diagnosing his cancer early enough for treatment to be effective. As a result, Mr. Sessions amended his estate planning documents so that his pledge would not be satisfied at his death, which occurred on April 25, 2005. At the time of his death, Mr. Sessions had less than $100,000 in his estate (not nearly enough to fulfill his pledge to Rush U), but the assets in the Trust were valued at approximately $19 million, including over $2.7 million of real property in Illinois. Consequently, Rush U sued the Trust alleging breach of contract and that the Trust should be voided based on the Illinois common-law that self-settled spendthrift trusts are deemed to be fraudulent and per se void, and their assets reachable by creditors of the settlor/beneficiary.

b. The IL Supreme Court held that the adoption by IL of the Uniform Fraudulent Transfers Act ("UFTA") in 2006 did not supplant the state common law rule that DAPTs are not permitted. Although the opinion does not expressly state what assets of the Trust can be recovered by Rush U, presumably Rush U would be able to recover the real property located in IL. However, the Cook Islands courts are not bound by the decision of the IL Supreme Court, so it is unlikely the assets located offshore could be reached.

c. It is important to point out that the IL court applied IL law to determine the validity of the transfers. The court did not apply Cook Islands law even though the trust was governed by Cook Islands law. This is indicative of what may happen if a resident in a non-DAPT jurisdiction creates a DAPT in another jurisdiction. The state of residence may apply the home state's law regarding creditor protection and disregard the law governing the trust, at least as to assets located in the state of residence.

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. One primary reason for the charging order concept is to protect other business owners from the personal creditors of an individual owner.

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) or multi-member LLC interest. However, a court may order the foreclosure of the interest subject to the charging order if the interest charged is in a general partnership. Also, it is possible under limited circumstances to foreclose on a single-member LLC interest. Compare F.S. §§ 620.1703 and 608.433 with 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. Some 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. However, this issue is not entirely clear. Other planners believe the member will still be liable for the income tax. 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. Type of 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. In 2010, the Florida Supreme Court issued *Olmstead v. Federal Trade Commission*, No. SC08-1009 (June 24, 2010), which 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 was not limited to a charging order for a single-member LLC, but instead, may reach the assets of the single-member LLC in satisfying a judgment.

i. In response to *Olmstead*, F.S. 608.433 was amended in 2011 to provide that a charging order is the sole and exclusive remedy to satisfy a judgment against a member's interest in all LLCs, subject to certain limited exceptions that apply only to single-member LLCs.

ii. Exception: If a creditor can show that distributions under a charging order will not satisfy the judgment within a reasonable time, then a court may order the sale of the single-member LLC interest pursuant to a foreclosure sale.

iii. This limited exception does not apply to multi-member LLCs.

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. §§ 608.432 and 608.433.

d. Protection under the new Florida Revised LLC Act (Ch. 605)

i. Retains charging order protection "as is" for multi-member and single-member LLCs.

e. Is it safe to form LLCs in Florida?

i. Multi-member LLCs – Yes. Charging order is sole remedy, regardless of characteristics of LLC. Judicial foreclosure of the charging order is not permitted.

ii. Single-member LLCs – Other states still have stronger protections for single-member LLCs. If a client wants to create a single-member LLC primarily to protect LLC assets from personal creditors, then either (i) make it a Florida multi-member LLC or (ii) consider creating the single-member LLC in a more-favorable jurisdiction, such as Delaware or Nevada.

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 a 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. In addition, a LLLP election can be made to protect the general partner from 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 currently operates as a corporation, consider converting or merging into a different entity which offers greater protection for outside liabilities. For example, corporations (even S corporations) can be converted to LLCs tax-free without changing the tax status of the entity. An LLC can still be taxed as an S corporation.

4. Exposure of Officers and Directors for company insolvency

a. *In re Trafford Distributing Center, Inc.*, 431 B.R. 263, 288 (Bankr. S.D. Fla. 2010).

i. Caution: Officers and directors owe duties of loyalty and care to the corporation, but when the corporation becomes insolvent or is in the "vicinity of insolvency", fiduciary duties are extended to creditors of the corporation. Officers and directors who mismanage company assets or otherwise breach their fiduciary duty to the creditor can be held personally liable for damages incurred by a creditor.

ii. In *Trafford*, the sole director made several payments to insiders, including tripling rent payments to her husband's LLC, while in the "vicinity of insolvency" which resulted in the company having insufficient assets to satisfy a creditor's judgment. The court found her actions arose to gross negligence and "more fairly characterized as willful fraud" and held that she breached her fiduciary duties to the company and the creditors. Therefore, the director was liable for the damages incurred by the creditor

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. *U.S. v. Evseroff*, No. 00-CV-06029 (E.D.N.Y, April 30, 2012)

1. Although this is a New York case, it has become an important case nationwide in asset protection law.

2. In this case, Jacob Evseroff owed taxes to the federal government, which the government sought to collect from assets held by a trust created by Evseroff in 1992 for his two sons. Evseroff was aware of his tax liabilities since December of 1990.

3. The trust held cash and Evseroff's primary residence, which he continued to use as if he owned it.

4. The court found that the transfers to the trust were fraudulent transfers after examining the "badges of fraud." Evseroff's solvency at the time of the transfers did not absolve him of liability because the transfers had the effect of making collection efforts much more difficult.

5. The court then found that the trust was Evseroff's nominee and that the government could collect from the trust with regard to the residence since no consideration was paid to Evseroff for the property, the transfer was in anticipation of Evseroff's liabilities, Evseroff remaining in possession and control of the property, and the close relationship between Evseroff and the trustees.

6. In addition, the trust was found to be Evseroff's alter ego, allowing the government to collect from all assets of the trust. This finding was supported by the failure to observe trust formalities, Evseroff being the trust's decision maker, and Evseroff's continued control over the trust property.

C. 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 Professional 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 (*see Goldberg v. Rosen*, 493 Fed. Appx. 11 (11^{th} Cir. Fla. 2012) (holding that the record supported a finding of solvency where a bankruptcy trustee sought to recover against the attorneys who drafted asset protection documents of a debtor when the debtor executed an Affidavit of Solvency prior to drafting)) 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?

IRS Recognizes All Same Sex Marriages

Published: August 29th, 2013

By: Matthew J. Ahearn

Posted in Asset Protection, Business Succession, Charitable Contributions, Estate & Trust Administrations, Estate Tax, Estate, Gift & GST Planning, Estate, Gift & GST Tax, Federal Taxation, Gift & GST Planning, Gift & GST Tax, Income Taxes, Internal Revenue Service, International Estate Planning, Post Mortem Planning, Practice Before IRS, Retirement Plans, S Corporations, Tax, Tax Controversies, Tax Planning, Tax Reform, Trustees & Personal Representatives, Trusts & Estates

Today, the United States Treasury Department and the Internal Revenue Service issued a very significant and consequential ruling, Revenue Ruling 2013-17, addressing tax issues arising from the recent U.S. Supreme Court decision of U.S. v. Windsor, 133 S. Ct. 2675, issued on June 26, 2013.

For federal tax purposes, the IRS will now recognize all same-sex marriages validly entered into in any domestic or foreign jurisdiction sanctioning such marriages, regardless of the law of the individual's domicile. This means, for example, a same-sex coupe married under New York law will be treated as married for federal tax purposes even if they are domiciled in Florida, a state that constitutionally bans the recognition of such marriages.

The IRS will interpret all gender neutral terms to include same-sex married individuals. For example, the term "spouse" will include an individual married to a person of the same sex in a jurisdiction sanctioning such marriages, and the term "marriage" will include same sex marriages entered into in a jurisdiction sanctioning such marriages. The IRS will also interpret gender specific terms, such as "husband" and "wife", to include individuals married to a person of the same sex in a jurisdiction sanctioning such marriages.

The Ruling, however, does not recognize registered domestic partnerships, civil unions or other similar formal relationships as marriages.

The Ruling is applied prospectively as of September 16, 2013. Therefore, all lawfully married, same-sex taxpayers will need to file 2013 returns as married individuals (either jointly or as married filing separately).

Importantly, the Ruling may be relied upon for the purpose of filing amended returns and claims for refund, provided the applicable statute of limitations period has not expired. Generally, the statute of limitations on a claim for refund expires upon the later 3 years from the date the return was filed or 2 years from the date the tax was paid. Lawfully married, same-sex taxpayers should explore whether claims for refund should be filed for prior open tax years.

Only for the purpose of filing returns, the Ruling may be applied retroactively with respect to employer-provided health coverage benefits or fringe benefits. Therefore, an individual participant under a section 125 cafeteria plan (a plan where pre-tax money is used to pay for health coverage) who also elected to provide health coverage for a same-sex spouse on an after-tax basis under the employer's group health plan, can now treat amounts paid for health coverage on an after tax basis as pre-tax salary reduction amounts.

The IRS specifically stated that it intends to issue further guidance on the retroactive application of the Windsor decision to other employee benefits.

This Ruling brings some welcome certainty and clarity to these tax issues after the Windsor decision, but there are still many unanswered questions. Please stay tuned to our blog for further information and analysis regarding this landmark case and tax guidance.

DEAN MEAD

TRUSTS & ESTATES TAX LAW

What Does the Demise of DOMA Mean for Floridians?

Published: October 8th, 2013

By: Matthew J. Ahearn

Posted in Estate & Trust Administrations, Estate, Gift & GST Planning, Estate, Gift & GST Tax, Gift & GST Planning, Gift & GST Tax, Homestead, Trusts & Estates

What Does the Demise of DOMA mean for Floridians?

Section 3 of the of the Defense of Marriage Act (commonly known as DOMA) amended the Dictionary Act in Title 1, Section 7 of the United States Code to define "marriage" as only a legal union between one man and one woman as husband and wife and "spouse" as only a person of the opposite sex who is a husband or a wife. Those definitions effected over a 1,000 federal laws, nearly 200 of which were statutory provisions under the Internal Revenue Service. In U.S. v. Windsor, the U.S. Supreme Court held that Section 3 of DOMA (hereinafter, unless otherwise noted when referring to DOMA, I will be referring to Section 3 of DOMA) is unconstitutional.[1] The Windsor ruling does not authorize same-sex marriages; rather, it provides that the definition of marriage is a state law determination.

DOMA was enacted in 1996 before any U.S. jurisdiction recognized same-sex marriages. Since that time, thirteen (13) jurisdictions[2] have come to recognize same-sex marriages and eight (8) jurisdictions[3] have civil union or domestic partnership statutes, most of which grant rights and responsibilities common to a marriage.

For same-sex couples who are lawfully married and residing in one of the thirteen (13) jurisdictions that, as of this writing, recognize same-sex marriages, the Windsor decision provides that they will be recognized as married for federal law purposes as well. Those same-sex married individuals will enjoy the federal benefits previously offered only to opposite-sex married individuals, such as the ability to:

- File joint income tax returns;[4]

- Claim increased exclusion from gain on sale of principal residence;

- Claim unlimited marital deduction for federal estate and gift tax purposes;

- Roll over qualified plan benefits to a new qualified retirement plan for the surviving spouse, thereby allowing longer deferral of federal income taxes;

- Elect portability for the unused estate tax exemption of the spouse;

- Elect to treat gifts made during the year as made one-half by each spouse (i.e., gift-splitting);

- Receive tax preferences on divorce; and

- Claim Social Security, Medicare and Medicaid benefits.

However, the Windsor decision did not resolve the federal treatment of lawfully married same-sex couples domiciled in jurisdictions that do not recognize same-sex marriages, such as Florida. The primary question was whether federal law would look to the state of the ceremony and treat the same-sex couple as married for federal law purposes or to the state of domicile that does not recognize the same-sex marriage and treat each individual as single for federal law purposes.

Florida's Definition of Marriage

Article I, Section 27 of the Florida Constitution provides that the term "marriage" means the legal union of one man and one woman as husband and wife, and no other union that is treated as marriage or the substantial equivalent thereof shall be valid or recognized. The amendment of Florida's constitution requires approval of sixty percent (60%) of the voters.[5] Section 741.212, Florida Statutes, amplifies that a same-sex marriage entered into in any jurisdiction will not be recognized in Florida. Thus, Florida has clearly provided that it will not recognize same-sex marriages. But is Florida required to recognize same-sex couples lawfully married in other jurisdictions?

Full Faith and Credit

The Full Faith and Credit clause of the U.S. Constitution (which provides that full faith and credit shall be given in each state to the public acts, records and judicial proceedings of every other state) has generally not been extended to a state's definition of marriage. Furthermore, Section 2 of DOMA, which was not invalidated in the Windsor decision, provides that states are not required to recognize same-sex marriages from other states. Lastly, states are not required to give full faith and credit to the acts of another state that would violate its public policy, which appears to be the case in Florida given its constitutional amendment. Therefore, under current law, Florida is not required to recognize same-sex couples lawfully married in another jurisdiction.

Federalism Problem

Now that DOMA has been invalidated, federal law must turn to state law to determine when a marriage will be recognized. Florida's law conflicts with the law in other jurisdictions that allow or recognize same-sex marriages, which means that federal law must choose between the laws of competing jurisdictions.

The issue can arise in a number of different contexts. For example, a same-sex couple may be lawfully married for years in one jurisdiction and subsequently move to Florida. Will the couple become divorced for federal law purposes when they relocate to Florida? Long time Florida residents can travel to, and marry in, a jurisdiction that recognizes same-sex marriages, and then return to Florida. Should federal law look to Florida to define marriage in that instance? Will federal law choose between competing states based on the facts and circumstances of each case? Will the federal choice of law rules vary depending on the type of federal statute at issue (i.e., will the term spouse under the tax code mean something different than for immigration purposes)?

Federal Choice of Law

There are federal choice of law rules incorporated into certain statutes (they had been largely superseded by DOMA), but such rules have not been consistently incorporated into federal statutes and are by no means uniform. To the extent the choice of law rules are not already incorporated into federal statutory provisions, which is largely true, the federal common law would apply. However, there is no uniform federal choice of law rule applicable to the same-sex marriage issue.

In diversity cases (cases involving citizens of different states that do not involve a federal question), federal courts will follow the choice of law of the state in which the federal court sits. Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487 (1941). However, the Klaxon rule has not been extended to cases involving federal questions (the meaning of marriage or spouse would be a federal question as it is a matter of construing a federal statute).[6] Consequently, the questions concerning same-sex marriage are largely unanswered under federal common law.

Congress

Congress has the authority to solve the choice of law problem, and should act to provide uniformity and predictability to this area. However, considering the current political environment in Washington, it seems unlikely that Congress will act to resolve this problem in the near term. In the absence of Congressional action, can administrative agencies, such as the Treasury Department, act to resolve the problem?

Administrative Agencies

There is authority for an administrative agency promulgating choice of law rules concerning marriages. Therefore, the Treasury Department could issue regulations providing choice of law rules to determine the meaning of marriage and spouse for federal tax law purposes. However, regulatory action can be a time intensive process.

There is also authority for administrative rulings (as opposed to regulations) having the authority to control the definition of marriage. For example, IRS Revenue Ruling 58-66, 1958-1 CB 60 provides that for federal income tax purposes, the IRS will recognize a common-law marriage created in a state that recognizes such marriages and will continue to do so if the taxpayers move to a state that requires a marriage ceremony.

Although there are certain drawbacks with administrative agencies determining the definitions of marriage and spouse, such as the potential for lack of uniformity between various administrative agencies, it seems that the current situation necessitates administrative agencies to act quickly to bring some clarity to the current situation.

Revenue Ruling 2013-17

On August 29, 2013, the United States Treasury Department and Internal Revenue Service issued Revenue Ruling 2013-17 addressing issues arising from the Windsor decision. For Federal tax purposes, the IRS will now recognize all same-sex marriages validly entered into in any domestic or foreign jurisdiction sanctioning such marriages, regardless of the law of the individual's domicile. Therefore, all Floridians of the same-sex that were married in a jurisdiction sanctioning such marriages will be treated as married for Federal tax purposes even though Florida does not recognize such marriages. See our blog post for a more detailed discussion of Revenue Ruling 2013-17.

How Should Such Floridians Report Their Federal Taxes?

With respect to the federal income tax, the extended due date for filing 2012 income and gift tax returns is October 15. The effective date of Revenue Ruling 2013-17 is September 16, 2013. Therefore, lawfully married same-sex couples may file their 2012 income tax returns as married individuals or as single individuals if they filed before September 16, 2013. For taxpayers reporting their 2012 taxes after September 16, 2013 and for 2013 and subsequent years, lawfully married same-sex couples will be required to file their income taxes as married filing separately or jointly.

Retroactivity

The U.S. Supreme Court's holding that DOMA is unconstitutional means DOMA was never valid and effective. DOMA was passed into law in 1996. Massachusetts was the first U.S.

jurisdiction to allow same-sex couples to marry in 2004.[7] Therefore, there have been nine (9) calendar years during which same-sex couples have been forced to file returns as separate, single taxpayers under DOMA.[8] It seems that individuals in a same-sex marriage have a claim that DOMA unconstitutionally deprived them (or his or her estate in the case of estate taxes) of property in the form of higher tax payments. Assuming such claims are valid, can they be limited to "open" years not closed by the applicable statute of limitations? Generally, the statute of limitations period for tax returns is three (3) years from the date of filing, which means that such taxpayers may have suffered damages in a number of now closed years.

Although not free from doubt, there is some case law[9] support for the proposition that the statute of limitations trumps a taxpayer's constitutional claims. Furthermore, there is an argument that the taxpayer had a procedural remedy available to him or her in those now closed years. The taxpayer could have filed a protective claim for refund based on his or her claim of being lawfully married. If a taxpayer did not file such a protective claim for refund to keep open the statute of limitations period, that taxpayer cannot seek to re-open those now closed periods. In Revenue Ruling 2013-17, the IRS and U.S. Treasury Department made it clear that they will accept refund claims only for open years.

Employers and Employees

In Notice 2013-61, the IRS provided guidance for employers and employees to make claims for refund or adjustments of overpayments of FICA taxes and employment taxes with respect to certain benefits provided to same-sex spouses and compensation paid to same-sex spouses. The Notice sets out special administrative procedures for employers to correct overpayments of employment taxes for 2013 and prior years, including overpayments that result from a taxpayer's retroactive application of Rev. Rul. 2013-17, that are designed to reduce filing and reporting burdens.

Select Federal Tax Issues

After Rev. Rul. 2013-17, there are still many unanswered federal tax questions. The holdings in Rev. Rul. 2013-17 are applied prospectively after September 16, 2013, which essentially means that same-sex married taxpayers have an opportunity to choose their tax status for open prior years (i.e., likely, they filed separately in prior years and can amend returns to file jointly or married filing separately, if beneficial).

This prospective application indicates that the IRS is not going to challenge the tax status (i.e., married or single) of lawfully married same-sex taxpayers for tax filings made prior to September 16, 2013. Thus, this general rule should allow these taxpayers to determine the tax result for rules that automatically apply (i.e., no election by the taxpayer is required).

For example, if the taxpayers sold a principal residence and otherwise met the qualification requirements under Code § 121, they should be able to exclude up to $500,000 of gain from income as opposed to the $250,000 limitation for single taxpayers. Similarly, if there were transfers between same-sex married individuals for consideration (i.e., an income tax event) or for no consideration (i.e., a gift), these taxpayers can amend returns to avoid income tax recognition under Code § 1041 or gift tax pursuant to the unlimited marital deduction under Code § 2523, but they do not have to amend returns if it is not beneficial to do so.

The questions concerning the application of the Windsor ruling apply to those situations where the taxpayer had to take some affirmative action to obtain the benefits afforded to married taxpayers. Taxpayers have to exercise those actions by certain dates or the opportunity is lost. Therefore, the question in those circumstances is whether the IRS will provide taxpayers relief to make retroactive elections for prior periods. The following are some examples of this situation.

- Spousal rollover of a qualified plan
- QTIP/QDOT Elections (lifetime and testamentary)
- Portability Election
- Election to split gifts
- Allocation of basis increase under Code § 1022
- Code § 2032A election to specially value farm property

State Law Issues

As previously stated, the U.S. Supreme Court in the Windsor decision found that the definition of marriage was in the purview of the States. In Hollingsworth v. Perry,[10] the U.S. Supreme Court avoided state constitutional issues by holding that the petitioners lacked standing.[11] Therefore, each state can still define the term "marriage" and Florida's definition of marriage as being any between one man and one woman is still good law. Because the IRS and U.S. Treasury Department, as well as most other Federal agencies, have adopted a state of ceremony rule to determine whether a couple is married, same-sex couples domiciled in Florida but lawfully married in another jurisdiction will be considered married for most Federal law purposes, but will not be married under Florida. Consequently, same-sex married individuals will not enjoy the marital rights afforded to opposite-sex married individuals, such as:

- Homestead
- Tenants by the Entirety
- Elective Share
- Preference in appointment as Personal Representative

- Medical decisions
- Burial decisions

Conclusion

There are still many unresolved issues concerning same-sex marriages; however, it is clear that same-sex married individuals should take some action now. Those individuals should review their tax situation with their advisors to determine if it is advisable to file a claims for refund for open tax years.

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[1] U.S. v. Windsor, 111 AFTR 2d 2013-839.

[2] Connecticut, Delaware, District of Columbia, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Rhode Island, Vermont and Washington.

[3] California, Colorado, Hawaii, Nevada, New Jersey, Oregon, Wisconsin and Illinois.

[4] If both individuals earn $36,250 of income or more annually (i.e., in a bracket greater than the 15% bracket) and each individual earns a similar amount of income to the other, then it is likely that the individuals will pay overall higher income taxes (commonly referred to as the marriage penalty) when filing jointly or married filing separately.

[5] Section 5 of Article XI, Florida Constitution.

[6] Interestingly, there is some authority that federal tax law can determine the meaning of marriage independent of state law. In Estate of Borax v. Commissioner, 349 F.2d 666 (2d Cir 1965), the Second Circuit held, with respect to the divorce of a NY resident in Mexico that NY found invalid, that the test was not whether the divorce would be invalid in every state, but whether the divorce frustrated the revenue purposes of the federal tax laws.

[7] Only five (5) foreign jurisdictions, the Netherlands, Belgium, Ontario, British Columbia and Quebec, allowed same-sex marriages at that time.

[8] This period might be longer for same-sex couples lawfully married in a foreign jurisdiction.

[9] *See* McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, Dept. of Business, 496 U.S. 18 and Stone Container Corp. v. U.S., 229 F.3d 1345 (Fed. Cir. 2000).

[10] 130 S.Ct. 705 (2013).

[11] This holding essentially made the California District Court's ruling that Proposition 8, which amended California's constitution to provide that only marriage between a man and a woman would be recognized in California, was unconstitutional, the controlling decision.