

# Protecting Assets from Creditors

Basic Practical Tips; Effective and Ethical Advice

---

Joseph H. Baldiga, Chair  
Mark J. Balthazard  
Amanda C. Ellis  
Heather J. Lange  
John G. Loughnane  
David B. Madoff  
Colleen A. Murphy



Keep Raising the Bar.

# Table of Contents

<b>Section 1: Asset Protection and Estate Planning .....</b>	<b>1</b>
<i>Heather J. Lange and Colleen Murphy</i>	
➤ Introduction to Estate Planning Transfers.....	2
Fraudulent Conveyance Risk.....	2
Transfer Tax System .....	2
➤ Reduction of Donor's Estate by Gifts .....	6
➤ Outright Gifts .....	6
➤ Tax Consequences of Outright Gifts.....	7
Gift Tax .....	7
Income Tax.....	8
➤ Transfers in Trust, Generally .....	9
Gifts in Trust .....	9
Reciprocal Trust Doctrine .....	10
➤ Trusts Established by Donor for Others; Donor Retains No Interest.....	10
Trusts for Benefit of Donor's Spouse.....	10
Tax Consequences of Transfers in Trust to Spouse.....	12
Trusts Not Solely for Spouse's Benefit .....	13
Tax Consequences of Transfers in Trust .....	14
➤ Trusts Established by the Debtor in which Debtor Retains a Direct Beneficial Interest .....	19
Self-Settled Trust Defined.....	19
General Rule.....	19
Spendthrift Trusts .....	20
Revocable Trusts Provide No Protection from Settlor's Creditors.....	21
Trust under which Settlor Retains General Power of Appointment .....	21
Partial Interest Retained by Settlor in an Irrevocable Trust.....	22
Retirement Plans .....	23
Tax Consequences of Retained Interests .....	24
➤ Trusts Established by Others for Debtor .....	24
General Rule.....	24
Spendthrift Clause .....	25
Discretionary Trusts .....	29
Trusts for Support of Beneficiary Only.....	31
Powers of Appointment.....	32
Tax Consequences to Debtor-Beneficiary of Trust Settled by Others.....	33
➤ Domestic Asset Protection Jurisdictions .....	34
Alaska.....	34
Delaware .....	37
Comparison of Alaska and Delaware Asset Protection Law .....	39

Control Issues .....	40
Possible Challenges to Domestic Trusts .....	40
Estate Planning Opportunities in Asset Protection Jurisdictions .....	43
➤ Foreign Asset Protection Trusts .....	44
Preliminary Considerations .....	44
Reasons for Selecting a Foreign Trust .....	46
Disadvantages of Foreign Trusts .....	51
Donor/Debtor Friendly Foreign Jurisdictions .....	55
Structure of Self-Settled Foreign Trust .....	55
Income Tax Consequences of Foreign Trust Status for U.S. Grantor .....	56
Other Transfers which Allow Donor to Retain Some Control .....	57
➤ Comparison of Alaska/Delaware Trusts and Foreign Trusts .....	57
Level of Protection .....	57
Political Risk .....	58
Reporting Requirements of Foreign Trusts .....	58
Cost .....	59
Sanctions .....	59
Retention of Proceeds .....	59
➤ Limited Partnerships; Limited Liability Companies .....	59
Family Limited Partnerships; Family LLCs .....	59
Gift Facilitation .....	60
Appropriate Degree of Control .....	63
Special Valuation Rules .....	64
Other Important Estate Tax Issues .....	64
Income Tax Considerations .....	65
➤ Corporations/S Corporations .....	65
Familiar Form .....	65
Ease of Transfer .....	65
Restrictability of Transfers .....	65
Formalities .....	65
<b>Section 2: Exemptions: Automatic Asset Protection .....</b>	<b>67</b>
<i>John G. Loughnane and Betsy Schreuer</i>	
➤ Nonbankruptcy Exemptions .....	67
Massachusetts Exemptions .....	67
Personal Property .....	68
Real Property .....	70
Federal Nonbankruptcy Exemptions .....	73
ERISA .....	73
Government Benefits .....	73
➤ Bankruptcy Exemptions .....	73
Section 522(d) .....	74
Filing and Amending the Exemption Schedule .....	75
Joint Bankruptcy Cases .....	75

Which State Law Applies? .....
Date of Determination .....
Effect of Bankruptcy on Massachu
Homestead .....
Tenancies by the Entirety .....
Individual Retirement Account
Objections to Exemptions .....
Denial of Exemption and/or Disch

### **Section 3: Fraudulent Transfers: Your Assets? .....**

*David B. Madoff and Christopher M.*

➤ Introduction .....
Origin of Fraudulent Transfer Law
Statutes of Limitations and Reach
Actual vs. Constructive Fraudulen
The Statutes .....
➤ What Is a Transfer .....
Conversion of Non-Exempt to Ex
Transfers from Bank Accounts .....
Disclaimer of Interests under Trus
➤ Actual Fraud .....
Evidentiary Standard .....
Badges of Fraud .....
➤ Constructive Fraud .....
Reasonably Equivalent Value .....
Financial Test .....
➤ Repayments as Fraudulent Transfers
Preferential Transfers under the B
Preferences as Fraudulent Transfe

### **Section 4: Keeping Your Nose Clean: Confronting Lawyers Advising Clients on Bankruptcy Issues .....**

*Joseph H. Baldiga and Amanda C. E*

➤ Introduction .....
➤ Bankruptcy Crimes—Risk of Criminal
Pre-Bankruptcy Advice .....
Scope of Title 18 .....
Massachusetts Rules of Professional
Debtor Can Be Criminally Prosec
Punishment .....
Sentences Can Be Enhanced for M

.... 40	Which State Law Applies? .....	75
.... 40	Date of Determination .....	76
.... 43	Effect of Bankruptcy on Massachusetts Exemptions .....	76
.... 44	Homestead .....	76
.... 44	Tenancies by the Entirety.....	77
.... 46	Individual Retirement Accounts .....	78
.... 51	Objections to Exemptions .....	78
.... 55	Denial of Exemption and/or Discharge .....	79
.... 55		
.... 56	<b>Section 3: Fraudulent Transfers: When Is it Too Late to Protect</b>	
.... 57	<b>Your Assets? .....</b>	<b>81</b>
.... 57	<i>David B. Madoff and Christopher M. Candon</i>	
.... 57	> Introduction.....	81
.... 58	Origin of Fraudulent Transfer Law .....	81
.... 58	Statutes of Limitations and Reach-Back Periods .....	82
.... 59	Actual vs. Constructive Fraudulent Transfers .....	84
.... 59	The Statutes.....	84
.... 59	> What Is a Transfer.....	85
.... 59	Conversion of Non-Exempt to Exempt Property .....	86
.... 59	Transfers from Bank Accounts.....	88
.... 60	Disclaimer of Interests under Trusts or Wills.....	89
.... 63	> Actual Fraud.....	89
.... 64	Evidentiary Standard .....	89
.... 64	Badges of Fraud .....	89
.... 65	> Constructive Fraud.....	92
.... 65	Reasonably Equivalent Value .....	92
.... 65	Financial Test .....	94
.... 65	> Repayments as Fraudulent Transfers .....	96
.... 65	Preferential Transfers under the Bankruptcy Code .....	97
.... 65	Preferences as Fraudulent Transfers under the UFTA .....	98
....67		
....67	<b>Section 4: Keeping Your Nose Clean: Ethical and Legal Issues</b>	
....67	<b>Confronting Lawyers Advising Clients on Asset Protection</b>	
....67	<b>Issues.....</b>	<b>99</b>
....67	<i>Joseph H. Baldiga and Amanda C. Ellis</i>	
....68	> Introduction.....	99
....70	> Bankruptcy Crimes—Risk of Criminal Sanctions Arising from	
....73	Pre-Bankruptcy Advice.....	101
....73	Scope of Title 18 .....	101
....73	Massachusetts Rules of Professional Conduct .....	102
....73	Debtor Can Be Criminally Prosecuted Even After Bankruptcy Court	
....74	Punishment.....	104
....75	Sentences Can Be Enhanced for Multiple Violations.....	104
....75		

Case May Be Referred for Federal Prosecution Even After Debtor Receives Discharge .....	105
➤ Pre-Bankruptcy Transfers .....	105
Pre-Bankruptcy Movement of Non-Exempt Assets from One Form or Location to Another Non-Exempt Form or Location.....	106
Pre-Bankruptcy Transfers of Non-Exempt Assets to Third Parties.....	109
Transfers to Third Parties—Can Improper Transfers Be Cured with a Retransfer? .....	109
Transfers to Creditors and Objection to Discharge.....	114
Other Considerations: Is a Post-Petition Retransfer to the Debtor Sufficient to Vest Title in the Asset in the Bankruptcy Estate? .....	117
Exemption Planning: Pre-Bankruptcy Conversion of Non-Exempt Assets to Exempt Assets.....	118
Homestead Exemption.....	118
Purchase of Exempt Assets with Proceeds of Sale of Non-Exempt Assets .....	121
Pre-Bankruptcy Transfers of Exempt Assets—Subject to Avoidance as Fraudulent Transfers?.....	123
Other Pre-Petition Transfers.....	125
Mortgage Foreclosure as Fraudulent Transfer .....	125
➤ Dischargeability and Substantial Abuse Issues in Individual Bankruptcy Cases.....	126
Dischargeability of Credit Card Debt under Section 523(a)(2)(A) .....	126
Section 707(b) and Substantial Abuse.....	130
Ability to Pay .....	131
Totality of the Circumstances .....	132
Hybrid .....	134
➤ Exhibit: Verified Statement by Debtor as to Accuracy of Bankruptcy Schedules and Statement of Affairs .....	135
<b>Section 5: Materials Submitted by the United States Attorney's Office, Boston.....</b>	<b>137</b>
<i>Mark J. Balthazard</i>	
➤ Alan Rosen Sentencing .....	139
➤ Kristine H. Anderstrom Sentencing.....	141
➤ Wendy B. Golenbock and Cheryl B. Stein Sentencing.....	143
➤ Paul B. Morley, Sr. Sentencing.....	145
➤ Sheldon Newman Plea.....	147

## Secti ASSET PROTECT PLAN]

Heather J. I  
Taylor, Ganson & I

Colleen Mu  
Mintz, Levin, Cohn, Ferris, Gl

<sup>1</sup> The following materials update, amend and expand similar MCLE programs by:

Guy B. Moss, Esq.  
Bingham McCutchen LLP  
150 Federal Street  
Boston, Massachusetts 02110

Judith C  
Sullivan  
One Po  
Boston,

Michael J. Pappone, Esq.  
Goodwin Procter LLP  
Exchange Place  
Boston, Massachusetts 02109

Joel L. '1  
Sullivan  
One Po  
Boston,

Mary-Kathleen O'Connell, Esq.  
Goodwin Procter LLP  
Exchange Place  
Boston, Massachusetts 02109

Heather  
Taylor, I  
160 Fed  
Boston,

Nancy Nearing Go, Esq.  
Goodwin Procter LLP  
Exchange Place  
Boston, Massachusetts 02109



## Section 2

# EXEMPTIONS: AUTOMATIC ASSET PROTECTION<sup>1</sup>

John G. Loughnane, Esq.  
Betsy Schreuer, Esq.  
*Gadsby Hannah LLP, Boston*

Every state permits its residents to keep certain types and certain amounts of property unavailable to the claims of creditors. In addition, federal law protects certain assets such as ERISA qualified pension plans from creditors. State and federal laws which "exempt" assets from collection are known as "nonbankruptcy exemptions." The United States Bankruptcy Code also contains its own set of "bankruptcy exemptions," which are distinct from the nonbankruptcy exemptions. In most (but not all) cases, both kinds of exemptions are automatic, i.e., nothing need be done by the debtor to benefit from them.

Exemption awareness and planning are important whether or not bankruptcy is being contemplated. Lawyers need to be aware of the ability of individuals to convert non-exempt assets into exempt assets (while simultaneously being cognizant of fraudulent conveyance issues). This awareness will allow an individual debtor the ability to maximize the value of his/her exemptions. Conversely, awareness by the creditor will help it maximize its chances for recovery on its claim. Even once bankruptcy is on the horizon, nonbankruptcy exemptions remain relevant because, depending on where the debtor lives, he/she may be required to use the nonbankruptcy exemptions of his/her state or may voluntarily choose the latter over the bankruptcy exemptions.

## I. NONBANKRUPTCY EXEMPTIONS

### A. Massachusetts Exemptions

In Massachusetts, the state statutory exemptions<sup>2</sup> for personal property prevent both the attachment of and execution upon the exempt property. Real property may be attached, but there are several protections from execution.

---

<sup>1</sup> The authors gratefully acknowledge the significant contribution through prior chapters of MCLE materials on this topic by M. Ellen Carpenter of Roach & Carpenter, P.C. and Daniel C. Cohn and David B. Madoff of Cohn Khoury Madoff & Whitesell LLP.

## 1. Personal Property

### a. General Exemptions:

M.G.L. ch. 235, § 34 is the main exemption statute. The exemptions listed therein, however, are both outdated and inadequate. Examples of exemptions that remain relevant (in category if not amount) include clothes, beds and bedding; a heating unit and up to \$75 per month to pay for heat, necessary furniture not to exceed \$3000 in value; \$500 worth of tools and \$500 worth of materials necessary for a trade or business; \$300 for provisions; estates of homestead as defined in M.G.L. ch. 188 or up to \$200 for each rental period to pay rent for family dwelling; cash, savings or other money up to \$125 or all state and federal public assistance money (e.g. veterans' benefits, social security, supplemental security income, unemployment compensation, aid to families with dependent children); and a car worth up to \$700 (car must be necessary for personal transportation or employment).

### b. Workers' Compensation

M.G.L. ch. 152, § 47 provides that workers' compensation payments are not assignable, subject to attachment or liable in any way for debts, except to satisfy family support obligations. A lump sum payment made pursuant to M.G.L. ch. 152, § 48 is also exempt from attachment and execution. *Fox & Abrams, P.C. v. Fraoli*, 1984 Mass.App.Div. 64 (1984).

### c. Life Insurance

M.G.L. ch. 175, § 125 provides that proceeds from a life insurance policy are exempt from attachment by the insured's creditors as long as the insured is not the beneficiary of the policy, even if the insured retained the right to change the beneficiary. Annuities (M.G.L. ch. 175, § 132C) and group life policies (M.G.L. ch. 175, § 135) are also exempt, except to satisfy family support obligations.

<sup>2</sup> There are also common law exemptions, but they are inapplicable to the vast majority of modern debtors.

### d. Disability Insurance

Pursuant to M.G.L. ch. 17, of up to \$400 per week and not apply when the under period of disability.

### e. Bank accounts

M.G.L. ch. 246, § 28A provides that the account is name of a business, trust or is per person at any time has more than once account all the accounts is exempt depositor is presumed to count. To the extent that exempt sources, e.g., disability benefits, they may also be

### f. Wages

Wages may only be attached by judgment and only if (a) M.G.L. ch. 235, § 34 for graph A.1.a above, (b) the and signed by the judge met. M.G.L. ch. 246, § 30 met, the first \$125 per week § 28. Furthermore, federal an individual's weekly disposable minus amounts required to See 5 U.S.C. § 5520a. If earnings exceed \$500, the

### g. Pension Benefits

M.G.L. ch. 246, § 28 (as any amounts held for an when the attachment is a plan includes annuity, the plan subject to the Empl U.S.C. § 1001 *et seq.*, ("E under certain circumstances the amount in a pension

d. Disability Insurance

Pursuant to M.G.L. ch.175, § 110A, disability insurance payment of up to \$400 per week are exempt. However, this exemption does not apply when the underlying debt is for "necessaries" during the period of disability.

e. Bank accounts

M.G.L. ch. 246, § 28A protects up to \$500 in a bank account provided that the account is held by a natural person, i.e., not in the name of a business, trust or other organization. The \$500 exemption is per person at any one time, not per account; thus if a person has more than one account, only \$500 of the total amount held in all the accounts is exempt. If the account is held jointly, then each depositor is presumed to own one-half of the amount in the account. To the extent that other funds in the account can be traced to exempt sources, e.g., disability insurance payments or government benefits, they may also be exempt.

f. Wages

Wages may only be attached after a claim has been reduced to judgment and only if (a) the wages are not exempt pursuant to M.G.L. ch. 235, § 34 for any of the reasons mentioned in Paragraph A.1.a above, (b) the attachment was approved in advance and signed by the judge and (c) special notice requirements are met. M.G.L. ch. 246, § 32, cl. 8. Even if all those requirements are met, the first \$125 per week is exempt pursuant to M.G.L. ch. 246, § 28. Furthermore, federal law provides that no more than 25% of an individual's weekly disposable earnings (defined as gross wages minus amounts required to be withheld by law) may be garnished. See 5 U.S.C. § 5520a. Thus, if an individual's disposable weekly earnings exceed \$500, the federal wage exemption will apply.

g. Pension Benefits

M.G.L. ch. 246, § 28 (as amended by M.G.L. ch. 374, § 2) protects any amounts held for an individual in a pension plan, other than when the attachment is sought to satisfy a support order. Pension plan includes annuity, pension, profit sharing or other retirement plan subject to the Employee Retirement Income Security Act, 29 U.S.C. §1001 *et seq.*, ("ERISA"), as well as Keogh Plans and IRAs under certain circumstances. The Massachusetts exemption limits the amount in a pension plan that can be exempted by excluding



"sums deposited in said plans in excess of seven percent of the total income of such individual within five years of the individual's declaration of bankruptcy or entry of judgment." The purpose and effect of this limitation (which is ineffective against ERISA qualified plans because they are governed by federal law) is to prevent people from salting away disproportionate amounts of their income as they approach a financial crisis.

The statutory limitation can have capricious effects. In *In re Goldman*, 182 B.R. 622 (Bankr. D. Mass. 1995) (Hillman, J.), *aff'd*, *Goldman v. Harris*, 192 B.R. 1 (D. Mass. 1996) (Young, J.), a debtor had rolled over his interest in a terminated ERISA-qualified plan, which would have been wholly exempt, into an IRA. The debtor claimed that his IRA was entirely exempt under Massachusetts law. The trustee challenged the exemption, arguing that the rollover was a deposit within five years of the petition date, and thus subject to the seven percent cap. The Bankruptcy Court agreed, 182 B.R. at 625-26, and the District Court affirmed on the basis that the statute unambiguously included all deposits into the IRA, no matter their source. 192 B.R. at 7. It is possible that *Goldman* will no longer be followed in light of the Supreme Judicial Court's subsequent admonition that Massachusetts exemptions should be liberally construed. *Dwyer v. Campellin*, 424 Mass. 26, 673 N.E.2d 863, 866 (1996).

## 2. Real Property

### a. Homestead Exemption

Pursuant to M.G.L. ch. 188, an individual may exempt his/her homestead in the amount of \$300,000 (the exemption is also \$300,000 for debtors who are 62 or older or are disabled). What is a homestead? The intent to occupy a home is sufficient and actual residency is not required. *In re Sebio*, 237 B.R. 1 (Bankr. D. Mass. 1999). Of course, intent is a factual issue, to be determined by the court if a debtor does not live in the house. A home can include separately deed parcels if all them together are used as a home. See *In re Fiffy*, 293 B.R. 550, (B.A.P. 1st Cir. 2003).

Only one owner of the residence may declare a homestead for the benefit of his/her family, which means that spouses may not separately record homesteads and then "stack" them to double the amount of the exemption. See *In re Garran*, 338 F.3d. 1 (1st Cir. 2003). The homestead exemption is not effective against consensual liens on the residence. In other words, a debtor cannot use the

homestead exemption to mortgage. Outside of bankruptcy, the homestead exemption protects a debtor from the liquidation of homestead. M.G.L. ch. 188A is so important that the deed conveying the home at the time the home is purchased must be recorded to record the homestead until the mortgage is paid. It may be the debtor's only protection discussed in greater detail. The homestead also protects the recording of the home.

It is important to note that the homestead exemption is automatic. Rather, a debtor must file a deed conveying the homestead exemption. The writing, recorded in the homestead exemption. However, the Supreme Court has held that a homestead declaration which impairs the rights of two persons was never nature appears first. 117 N.E.2d 863 (1996). The homestead exemption should be liberally construed in favor of protecting the family.

In addition, as to the effect of the homestead exemption on the filing of bankruptcy courts, the homestead exemption permits the debtor to protect more than the first \$300,000 (summed by mortgages) (Bankr. D. Mass. 1999). The court in *Giarrizzo* acknowledged that the homestead exemption has not addressed the

**Note:** If you are repleading a homestead exemption, you must file a copy. Debtors are often required to file with respect to the

### b. Tenancies by the Entirety

When real property is owned by a husband and wife as tenants by the entirety, the creditor of one can at the time of execution destroys the tenancy in common a

homestead exemption to defeat a properly recorded, consensual mortgage. Outside of bankruptcy, a declaration of homestead on protects a debtor from debts which arise subsequent to the declaration of homestead. M.G.L. ch. 188, § 1. This prohibition is why is so important that the declaration of homestead be recorded at the time the home is purchased. If it is not, and the debtor does not record the homestead until after a large debt is incurred, bankruptcy may be the debtor's only way to save his/her home because, as is discussed in greater detail below, once bankruptcy is filed, the homestead also protects a debtor from debts incurred *prior* to the recordation of the homestead.

It is important to note that the homestead exemption is *not* automatic. Rather, a debtor must declare a homestead estate, either in the deed conveying the property to the debtor, or in a subsequent writing, recorded in the registry of deeds. M.G.L. ch. 188, § 2. The homestead exemption must be properly drafted and recorded. However, the Supreme Judicial Court has held that a homestead declaration which improperly declared a homestead on behalf of two persons was nevertheless valid as to the declarant whose signature appears first. *Dwyer v. Campellin*, 424 Mass. 26, 673 N.E.2d 863 (1996). The Court opined that exemption laws "should be liberally construed so as to comport with their beneficent spirit of protecting the family home." 673 N.E.2d at 866.

In addition, as to encumbered property, the overwhelming majority of bankruptcy courts have held that the homestead exemption permits the debtor to protect \$300,000 of *equity* in the home, rather than the first \$300,000 of value in the home (which might be consumed by mortgages). See *In re Giarrizzo*, 128 B.R. 321, 322 (Bankr. D. Mass. 1991), and cases cited therein. However, as the court in *Giarrizzo* acknowledges, the state courts of Massachusetts have not addressed the issue.

**Note:** If you are representing a debtor who says that he or she has recorded a homestead exemption, make sure you see a file-stamped copy. Debtors are often confused about what documents have been filed with respect to their real estate.

b. Tenancies by the Entirety

When real property is held by more than person as joint tenants, a creditor of one can attach and execute upon the property. A levy of execution destroys the joint tenancy and turns the ownership into a tenancy in common and the creditor may seek partition.

Married couples, however, are eligible to record the deed as tenants by the entirety. M.G.L. ch. 209, § 1 provides that when property held by the entirety is the principal residence of the nondebtor spouse, the debtor spouse's interest in the property is not subject to seizure or execution by the debtor spouse's creditors. In Massachusetts, while a debtor's interest in a tenancy by the entirety cannot be levied upon, it can be attached. See *Peebles v. Minnis*, 402 Mass. 282, 521 N.E.2d 1372 (1988). Based on *Peebles*, at least two judges in Massachusetts have held that a Massachusetts tenancy by the entirety is not exempt from process. See *In re McConchie*, No. 89-0277-S, slip op. (D. Mass. February 21, 1990) (Skinner, J.), cited in *In re Robbins*, 187 B.R. 400, 404 (Bankr. D. Mass. 1995) (Feeney, J.); *In re Hull*, 169 B.R. 4, 6 (Bankr. D. Mass. 1994) (Boroff, J.); *In re Digaudio*, 127 B.R. 713, 714 (Bankr. D. Mass. 1991) (Queenan, J.). Thus, a tenancy by the entirety may not be exempt. A tenancy by the entirety may nevertheless be an effective asset-protection device, because of the difficulties faced by a creditor, and even by a bankruptcy trustee, in trying to realize upon entireties property to satisfy the debt of only one spouse.

Prior to 1980, tenancies by the entirety were governed by common law. See *In re Robbins*, 187 B.R. 400, 402 (Bankr. D. Mass. 1995) (Feeney, J.). Under the common law, a "creditor of the debtor tenant husband may take possession of the property for as long as the debtor tenant shall live, subject to the non-debtor wife's right of survivorship." *Id.* (quoting *Somerset Savings Bank v. Goldberg*, 166 B.R. 776, 777-778 (D. Mass. 1994)). Mass. Gen. L. ch. 209, § 1A permits common law tenants by the entirety to elect to have their tenancy treated as a "new" tenancy by the entirety being subject to chapter 209, § 1.

It is important to remember that a tenancy by the entirety (i) does not exempt joint debts of the spouses; and (ii) can be attached which means that there will be a cloud on the title that will likely need to be reckoned with if the debtor tries to sell the property, gets divorced, or predeceases the non-debtor spouse (bankruptcy trustees may attempt to exact a payment in exchange for discharge of their attachment).

## B. Federal Nonbankruptcy Ex

### 1. ERISA

The Employee Retirement Inc ERISA-qualified plans are no U.S.C. § 1056(d)(1). By reas ISA-qualified plan cannot be in a bankruptcy of the benef ruptcy estate. *Patterson v. Shi*

It is important to note that al they do not enjoy any protect

### 2. Government Benefits

Certain federal statutes speci from attachment by credito benefits), 42 U.S.C. § 407 1383(d) (SSI benefits). As n tance benefits are also protec

## II. BANKRUPTCY EX

Under section 541 of the Bankruptcy debtor in property as of the comm estate, including exempt property. F retained by the debtor and will not b creditors. Property is claimed as ex the claimed exemption, on Schedul of affairs.

Once an individual files for bankru he becomes eligible to choose betw domicile state (and of federal law, U.S.C. § 522(d). In the other 34 stat ions are available to the residents ruptcy. This is because these states tions. In New England, only Main may only exempt property in accor tions. In Massachusetts, New Har mont, the debtor may choose betw

## **B. Federal Nonbankruptcy Exemptions**

### **1. ERISA**

The Employee Retirement Income Security Act (ERISA) provides that ERISA-qualified plans are not subject to assignment or alienation. 29 U.S.C. § 1056(d)(1). By reason of this spendthrift provision, an ERISA-qualified plan cannot be attached or levied upon by creditors and in a bankruptcy of the beneficiary, never becomes part of the bankruptcy estate. *Patterson v. Shumate*, 504 U.S. 753 (1992).

It is important to note that although IRAs are creatures of federal law, they do not enjoy any protection from creditors by federal law.

### **2. Government Benefits**

Certain federal statutes specifically protect federal government benefits from attachment by creditors. See, e.g., 38 U.S.C. § 562 (veterans' benefits), 42 U.S.C. § 407 (social security benefits) and 42 U.S.C. § 1383(d) (SSI benefits). As noted above, these and federal public assistance benefits are also protected pursuant to M.G.L. ch. 235, § 34.

## **II. BANKRUPTCY EXEMPTIONS**

Under section 541 of the Bankruptcy Code, all legal or equitable interests of the debtor in property as of the commencement of the case become property of the estate, including exempt property. Property properly claimed as exempt will be retained by the debtor and will not be liquidated by the Trustee for the benefit of creditors. Property is claimed as exempt by listing it, with the basis asserted for the claimed exemption, on Schedule C of the debtor's schedules and statement of affairs.

Once an individual files for bankruptcy, in 16 states (including Massachusetts), he becomes eligible to choose between the nonbankruptcy exemptions of his/her domicile state (and of federal law) or the bankruptcy exemptions found in 11 U.S.C. § 522(d). In the other 34 states, however, only the nonbankruptcy exemptions are available to the residents of that state, even once they have filed bankruptcy. This is because these states have "opted out" of the bankruptcy exemptions. In New England, only Maine has "opted out", so individuals in that state may only exempt property in accordance with Maine's statute governing exemptions. In Massachusetts, New Hampshire, Rhode Island, Connecticut and Vermont, the debtor may choose between the bankruptcy exemptions or the exemp-

tions found in his/her domicile state. This election must be made when the debtor files his bankruptcy schedules.

There are advantages and disadvantages to both kinds of exemption schemes. Homeowners will almost always choose the nonbankruptcy exemptions because the latter permit them to protect much more equity in their homes and to retain their state law protection of their interests in property held as tenants by the entirety. Debtors who do not own a home generally prefer the bankruptcy exemptions because they are more generous regarding the maximum value of the personalty that debtors are allowed to keep, especially cars and household items.

### A. Section 522(d)

Section 522(d)(2) of the Bankruptcy Code exempts 11 general categories of property, many of which have dollar limits. The following is a partial list:

- i. Up to \$17,425 of equity in the debtor's home;
- ii. Up to \$2,775 of equity in one automobile;
- iii. Household items with an aggregate value of \$9,300, with no one item with a value greater than \$450;
- iv. Jewelry with an aggregate value of \$1,150;
- v. Tools with an aggregate value of \$1,750;
- vi. Health aids;
- vii. Debtor's right to receive a social security benefit, unemployment compensation, a public assistance benefit, a veterans' benefit, a disability, illness or unemployment benefit, or alimony, support or separate maintenance;
- viii. Debtor's right to receive payment under a pension, stock bonus plan, profit-sharing, or similar plan, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor; and
- ix. Miscellaneous interest in other property not to exceed \$925, plus up to \$8,725 of any unused amount of the residence exemption.

These amounts are adjusted every three years and are tied to the Consumer Price Index.

As noted above, because 29 U.S.C. § 1053(c)(2) provides that the alienation of ERISA qualified plans is not a transferable interest in the bankruptcy estate, and, therefore, not a claim against the estate, ERISA-qualified plans are not included in the bankruptcy estate. Thus, ERISA-qualified plans are not subject to the nonbankruptcy or bankruptcy claims of the bankruptcy estate.

## B. Filing and Amending the

An individual debtor must file exemptions, within 15 days after the filing of the petition, or the court will grant an extension. If the debtor fails to file exemptions, the court will rule on the debtor's behalf with

Failure to make an election b  
results in the application of th  
domicile is an "opt out" state  
ply. However, the debtor ma  
changing the exemptions fro  
ruptcy federal or vice versa)  
faith and if there is no preju  
B.R. 1 (B.A.P. 1st Cir. 2001)

### C. Joint Bankruptcy Case

In joint cases, both the husband and wife can double the value of the protected Massachusetts homestead exemption (see the discussion below). Both the husband and wife can also elect the joint tenancy with right of survivorship scheme. In other words, if both the husband and the wife are bankrupt, and both have opted-out, in which

**D. Which State Law Applies?**

An issue may arise as to what state where the debtor was filing the bankruptcy filing, recent case, *In re Drenttel* this rule. In *Drenttel*, the home in Arizona with the for bankruptcy in Minne

As noted above, because 29 U.S.C. § 1056(d)(1) prevents the assignment or alienation of ERISA qualified plans, the latter do not become property of the bankruptcy estate, and, therefore no exemption is necessary to protect such plans. Thus, ERISA-qualified plans are effectively "exempt" whether the debtor elects the nonbankruptcy or bankruptcy law exemptions.

## **B. Filing and Amending the Exemption Schedule**

An individual debtor must file his/her schedules, including the schedule of exemptions, within 15 days after the petition date, unless the court grants an extension. If the debtor fails to claim exemptions, then another party with interest in the property (most likely a non-debtor spouse) can file the schedule on the debtor's behalf within 30 days.

Failure to make an election between the bankruptcy and state exemptions results in the application of the bankruptcy exemptions unless the debtor's domicile is an "opt out" state in which case the exemptions of that state apply. However, the debtor may amend its exemption schedule (including changing the exemptions from to bankruptcy (if available) to nonbankruptcy federal or vice versa) at any time if the amendment is done in good faith and if there is no prejudice to creditors. *See, e.g., In re Snyder*, 279 B.R. 1 (B.A.P. 1st Cir. 2001).

## **C. Joint Bankruptcy Cases**

In joint cases, both the husband and wife can claim exemptions, thereby doubling the value of the property exempted in most cases (except for the Massachusetts homestead exemption which may not be doubled—see discussion below). Both the husband and wife must choose the same exemption scheme. In other words, one cannot choose the bankruptcy exemptions and the other the nonbankruptcy. If the spouses cannot agree on the exemptions, they will be deemed to have elected the federal exemptions unless the state has opted-out, in which case the state exemptions obviously apply.

## **D. Which State Law Applies?**

An issue may arise as to which state exemptions a debtor may choose. Pursuant to section 522(b)(2)(A), the debtor must use the exemptions of the state where the debtor was domiciled for the 180 days immediately preceding the bankruptcy filing, or for a longer 180 period than any other state. A recent case, *In re Drenttel*, 302 B.R. 26 (Bankr.D.Minn. 2003), illustrates this rule. In *Drenttel*, the debtors sold their home in Minnesota, bought a home in Arizona with the proceeds from the sale and one month later filed for bankruptcy in Minnesota. Because they had only lived in Arizona for



one month, they claimed their interest in their home was exempt pursuant to Minnesota law. Concerned about forum shopping (Minnesota's homestead exemption was \$200,000 versus Arizona's \$100,000), the court held that the debtors could not apply the Minnesota homestead exemption to property outside of Minnesota and the debtors were unable to exempt their home at all.

Sometimes the law of a state that is not the debtor's domicile will effect the debtor's exemptions. For example, section 522(b)(2)(B) provides that, if the debtor chooses state exemptions, he/she may also exempt any interest in property held as a tenant by the entirety to the extent that the property is exempt under "applicable nonbankruptcy law". In *McNeilly v. Geremia (In re McNeilly)*, 249 B.R. 576 (1<sup>st</sup> Cir. BAP 2000), a Rhode Island domiciliary who filed a bankruptcy case there claimed as exempt funds in a Vermont bank account held as tenants by the entirety by the debtor and his nondebtor spouse. The Bankruptcy Appellate Panel held that the "applicable nonbankruptcy law" to determine whether the account was protected from creditors was Vermont law since it was the situs of the account, not Rhode Island law, even though the debtor chose Rhode Island exemptions.

## E. Date of Determination

Whether an asset is exempt, the maximum amount of the exemption that can be claimed in an asset and the value of the asset are determined as of the date of the commencement of the bankruptcy case. If the case is later converted to another chapter of the Bankruptcy Code, the original filing date will be the controlling date. *In re Beshirs*, 236 B.R. 42 (Bankr. D. Kan. 1999).

## F. Effect of Bankruptcy on Massachusetts Exemptions

### 1. Homestead

Outside of bankruptcy, a declaration of homestead only protects a debtor from debts which arise subsequent to the declaration of homestead. Mass. Gen. L. ch. 188, § 1. However, the First Circuit Court of Appeals held that Section 522(c) of the Bankruptcy Code preempts the state law exclusion of debts arising prior to the declaration of homestead. See *In re Weinstein*, 164 F. 3d 677 (1<sup>st</sup> Cir. 1999). Accordingly, the exempt property will pass through a bankruptcy case free from pre-declaration as well as post-declaration claims. This is obviously a planning advantage for debtors. As noted above, if a debtor has not recorded a homestead exemption, debtor's counsel must do so before the

bankruptcy petition is filed i exemption.

### 2. Tenancies by the Entirety

Notwithstanding the protection of tenancy by the entirety under the laws of Massachusetts, Section 541(c)(2) of the Bankruptcy Code prevents the debtor from exempting property held by the debtor and a nondebtor spouse (or other person) if:

- (1) partition in kind of such property among the owners is impracticable;
- (2) sale of the estate's undivided interest would significantly less for the interests of such co-owners;
- (3) the benefit to the estate of the co-owners outweighs the benefits to the co-owners; and
- (4) such property is not used for the production, for sale, of electricity, heat, light, or power.

Thus, if a court finds that a court's determination of the entirety outweighs the debtor's interest in the property, the court may authorize a sale. See *Howison v. Howison*, 1996 Me. 1996 (finding that the debtor's interest in the property outweighs the debtor's interest in the property); *Salem v. Coombs*, 800 F. Supp. 2d 100 (D. Mass. 1996) (holding, on remand, that the debtor's interest in the property outweighs the debtor's interest in the property).

But, even if a sale were authorized, whether a trustee would be authorized to sell such sale. Compare *Salem v. Coombs* with *Howison v. Hidler*, 1996 Me. 1996 (holding, on remand, that the debtor's interest in the property outweighs the debtor's interest in the property).

bankruptcy petition is filed in order to take advantage of the generous exemption.

## 2. *Tenancies by the Entirety*

Notwithstanding the protections afforded to property held by the entirety under the laws of Massachusetts and many other states, section 363(h) of the Bankruptcy Code permits a trustee to sell property that is held by the debtor and a non-debtor (including property held as tenants by the entirety) if:

- (1) partition in kind of such property among the estate and such co-owners is impracticable;
- (2) sale of the estate's undivided interest in such property would realize significantly less for the estate than sale of such property free of the interests of such co-owners;
- (3) the benefit to the estate of a sale of such property free of the interests of co-owners outweighs the detriment, if any, to such co-owners; and
- (4) such property is not used in the production, transmission, or distribution, for sale, of electric energy or of natural or synthetic gas for heat, light, or power.

Thus, if a court finds that a sale of property subject to a tenancy by the entirety outweighs the detriment to the non-debtor spouse, it can authorize a sale. *See Howison v. Hidler*, 192 B.R. 790, 795 (Bankr. D. Me. 1996) (finding that benefits of sale to creditors outweighed detriments to non-debtor spouse, and authorizing the sale of entireties property); *Salem v. Coombs*, 86 B.R. 314, 318 (Bankr. D. Mass. 1988) (Queenan, J.) (holding, on the particular facts, that detriment to non-debtor spouse from sale of entireties property outweighed benefit to the estate).

But, even if a sale were authorized under Section 363(h), it is not clear whether a trustee would be authorized to distribute the proceeds from such sale. *Compare Salem v. Coombs, supra* (stating that proceeds would remain subject to the non-debtor spouse's right of survivorship and, accordingly, could not be distributed during their joint lifetime), *with Howison v. Hidler, supra* (stating that proceeds could be distributed under Section 363(j)). If the proceeds were distributable, the non-debtor spouse would receive his or her share of the proceeds free from the trustee and the debtor's creditors.

### 3. Individual Retirement Accounts

Neither federal nonbankruptcy law nor section 522(d) exempts a debtor's interest in an IRA. See, e.g., *In re Rousey*, 347 F.3d 689 (8th Cir. 2003). To the extent that Massachusetts law protects an IRA, does the debtor need to elect the nonbankruptcy law exemptions to obtain the benefit of it? The courts are split. Relying on the Supreme Court's reasoning in *Patterson v. Shumate*, two court of appeals decisions have held that when state law exempts IRAs from judicial process or alienation, the IRA never becomes part of the bankruptcy estate. See *Orr v. Yuhas*, 104 F.3d 612, 614-616 (3d Cir.), cert. denied, 117 S. Ct. 2481 (1997); *In re Meehan*, 102 F.3d 1209, 1214 (11th Cir. 1997). But see *Walker v. Mather*, 959 F.2d 894, 898 (10th Cir. 1992) (holding that Oklahoma IRA could be assigned, and was thus property of estate). The Court of Appeals for the First Circuit has not addressed the issue, and lower courts in Massachusetts have assumed that IRAs are estate property, analyzing their exempt status under Section 522(d)(10)(E). See *Shaddock v. Rodolakis*, 221 B.R. 573, 581 (D. Mass. 1998) (Young, J.) (noting in dicta that IRA could be subject to process).

Even if the IRA is part of the bankruptcy estate and the debtor wishes to elect the bankruptcy law exemptions, the IRA may still be exempt if it meets the requirements of Bankruptcy Code Section 522(d)(10)(E), which exempts a debtor's right to receive:

- a payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor. . . .

See *Carmichael v. Osherow*, 100 F.3d 375 (5th Cir. 1996) (remanding to bankruptcy court for determination of whether IRA was reasonably necessary for support); *In re Link*, 172 B.R. 707 (Bankr. D. Mass. 1994) (Feeney, J.) and *In re Lima*, 169 B.R. 486 (Bankr. D. Mass. 1994) (Hillman, J.) (both holding that IRAs can be exempt under Section 522(d)(10)(E), but finding in those cases that funds were not reasonably necessary for support).

### G. Objections to Exemptions

A trustee or any creditor may object to a claimed exemption within 30 days of the section 341 meeting of creditors, or within such further time as may be allowed by the court upon a timely filed motion for additional time. Fed.R.Bank.P. 4003(b). If a timely objection is not filed, the exemptions are

automatically allowed as filed. Exempt property which he/she is *land & Kronz*, 503 U.S. 638 (Rule 4003(b) does not apply to which lien the debtor later tries the deadline for such lienholder avoidance of lien on exemption meeting. See *In re Schoonover*, *takis*, 293 B.R. 82 (Bankr. D. M

### H. Denial of Exemption and

A debtor who converts non-exempt property into exempt property in bankruptcy runs the risk that the exemption (even the legitimately claimed exemption) will be denied. A trustee will object to his or her conversion of non-exempt property into exempt property. A debtor may be including if he or she, with intent to defraud, converts non-exempt property into exempt property. Whether the debtor's conversion demonstrates this fraudulent intent is a question for the court.

For example, in *In re Wood*, 291 F.3d 1001 (9th Cir. 2002), the Bankruptcy Court affirmed the denial of the debtor's conversion in her workers' compensation claim. The debtor intentionally failed to schedule

In *In re Reed*, 700 F.2d 986 (9th Cir. 1982), the debtor who converts nonexempt property into exempt property before bankruptcy with intent to defraud is denied a discharge. The debtor, in this case, committed several acts, including depositing funds into a new bank account that was used to pay a personal loan. Mr. Reed's intent to reduce the mortgage to reach the equity. In holding that the debtor's conversion of his discharge, the Fifth Circuit affirmed the bankruptcy court's determination that the debtor had committed fraud his creditors when he converted non-exempt property into exempt property.

automatically allowed as filed. This is true even if the debtor claim as exempt property which he/she is not entitled to exempt. See *Taylor v. Free-land & Kronz*, 503 U.S. 638 (1992). However, the deadline imposed by Rule 4003(b) does not apply to a creditor who holds a lien on property which lien the debtor later tries to avoid as impairing an exemption; rather, the deadline for such lienholder runs from date of debtor's motion for the avoidance of lien on exemption impairment grounds, and not from the 341 meeting. See *In re Schoonover*, 331 F.3d 575 (7th Cir. 2003); *In re Here-takis*, 293 B.R. 82 (Bankr. D. Mass. 2003).

## H. Denial of Exemption and/or Discharge

A debtor who converts non-exempt assets into exempt assets and then files bankruptcy runs the risk that he/she will lose the ability to claim any exemption (even the legitimately exempt portion) and that a creditor or the trustee will object to his or her discharge under section 727 of the Bankruptcy Code. A debtor may be denied a discharge in certain circumstances, including if he or she, with intent to hinder, delay or defraud a creditor or officer of the estate, transferred, removed, destroyed, mutilated, concealed, or permitted the same to occur to any property within one year of the bankruptcy filing or at any time after the date of the filing of the petition. Whether the debtor's conversion of non-exempt assets into exempt assets demonstrates this fraudulent intent is a question of fact for the Bankruptcy Court.

For example, in *In re Wood*, 291 B.R. (B.A.P. 1st Cir. 2003), the Court affirmed the Bankruptcy Court's decision which denied a debtor an exemption in her workers' compensation settlement on the grounds that she had intentionally failed to schedule or disclose the settlement.

In *In re Reed*, 700 F. 2d 986 (5th Cir.1983), the Fifth Circuit held that a debtor who converts nonexempt assets to an exempt homestead immediately before bankruptcy with the intent to defraud his creditors must be denied a discharge. The debtor, Hugh Reed, had engaged in a number of unsavory acts, including depositing the receipts from his department store into a new bank account that was unknown to his creditors and using those funds to pay a personal loan. Mr. Reed also sold personal property, and applied the proceeds to reduce the mortgage on his residence. Under Texas law, he had an unlimited homestead exemption, so his creditors were not able to reach the equity. In holding that Mr. Reed's actions were sufficient to deny his discharge, the Fifth Circuit found that the evidence "amply supports" the bankruptcy court's determination that Mr. Reed had an actual intent to defraud his creditors when he converted his non-exempt assets into exempt assets.

In *Norwest Bank Nebraska, N.A. v. Tveten*, 848 F. 2d 871 (8th Cir. 1988), Dr. Tveten faced \$19 million in debts from a failed real estate venture. He used 17 transfers to sell his land and liquidate his non-exempt life insurance and retirement accounts, all for fair market value. He deposited the \$700,000 proceeds in life insurance and annuity contracts that were exempt under Minnesota law, with no dollar limit. The bankruptcy court denied Dr. Tveten's discharge. The district court affirmed the decision, as did the Court of Appeals.

The very same day with the very same panel, the Eighth Circuit issued its opinion in *Hanson v. First Nat. Bank in Brookings*, 848 F. 2d 866 (8th Cir. 1999). The Hansons were farmers who sold their non-exempt assets to family and friends; the purchasers allowed the Hansons to retain the items. They used the \$27,115 proceeds to pay down their mortgage and buy exempt life insurance annuities. Despite the similarities to the *Tveten* case, the Eighth Circuit affirmed the bankruptcy court order granting the Hansons their discharges.

## Sec FRAUDULENT TRANSFERS TOO LATE TO PRO

David B.  
Christopher  
Cohn Khoury Madoj

### A. INTRODUCTION

Sometimes, it may be too late to protect a person or entity. If a transfer is made to a creditor or a transferee, it is likely to be closely scrutinized by the bankruptcy trustee or by the transferee.

#### 1. Origin of Fraudulent Transfers

Since the end of the 16<sup>th</sup> century, English courts to invalidate "transfers to hinder, delay, or defraud." Because subjective intent was the doctrine of "badges of fraud," facts (such as a secretive conveyance for grossly inadequate value) would permit the court to infer fraud. Rep. 809 (K.B. 1601).

This statute became part of the Uniform Fraudulent Conveyance Act ("UFTA"), and subsequently, was codified in the Uniform Fraudulent Transfers Act ("UFTA"), in place of the Uniform Fraudulent Conveyance Act ("UFTA").<sup>1</sup> In bankruptcy cases, the UFTA is a large part from the UFCA, p

<sup>1</sup> The section numbers under the Massachusetts UFTA, since Massachusetts added a Section 542 to the general UFTA. These mater