

Planning Can Keep Assets Out Of Debtor's Bankruptcy Estate

By Bruce Givner

On February 4, the 9th U.S. Circuit Court of Appeals ruled that a Los Angeles lawyer's transfer of individual retirement account funds into a corporate pension plan was not a fraudulent conveyance, even though it was done on the eve of bankruptcy and accompanied by several traditional badges of fraud. *In re Stern*, 317 F.3d 111 (9th Cir. 2003), amended, reh'g denied, 2003 U.S.App.LEXIS 20365 (9th Cir. Feb. 7, 2003), reprinted as amended, 2003 U.S.App.LEXIS 20368 (9th Cir. Feb. 7, 2003).

The *Stern* majority felt "controlled" by *Wadrick v. Clements*, 451 F.2d 988 (9th Cir. 1971), in which the 9th Circuit ruled "that the purposeful conversion of nonexempt assets to exempt assets on the eve of bankruptcy is not fraudulent per se." The court also cited *Love v. Menick*, 341 F.2d 680 (9th Cir. 1965), for the proposition that fraud must be established by "clear and convincing" evidence.

ERISA-qualified retirement plans from a debtor's bankruptcy estate. The 9th Circuit, however, held that the ERISA exemption did not protect Stern's retirement plan because the plan did not cover a rank-and-file employee. However, the court held that California's exemption, Code of Civil Procedure Section 704.115(e), did protect Stern's plan.

Stern raises a striking question, particularly for attorneys, who are attractive litigation targets. Why don't more lawyers take simple steps in advance to protect their most attractive assets in case they file for bankruptcy?

Many lawyers practice as sole proprietors, yet their pension and profit-sharing plan benefits do not qualify for the absolute protection of ERISA. The same applies for lawyers who practice in single-member LLPs (unless the LLP is taxed as a corporation) and partnerships.

Instead, the state's limited exemption for "self-employed retirement plans" will cover their plans. Under Section 704.115(e), however, those retirement plans "are exempt only to the extent nec-

essary to provide for the support of the judgment debtor when the judgment debtor retires and for the support of the spouse and dependents of the judgment debtor, taking into account all resources that are likely to be available for the support of the judgment debtor when the judgment debtor retires."

What are the creditor's rights once the qualified personal-residence trust has been in residence for five years of a 25-year term? The husband and wife no longer own the home, which is in the name of the trustee of their qualified personal-residence trusts. (The husband and wife should not be the trustees.) A creditor cannot force the trustee to sell the home.

Under Probate Code Section 15307 ("Satisfaction of Money Judgment Paid After Education and Support"), any amount to which a beneficiary is entitled, or that the trustee discretionarily has determined to pay to a beneficiary, may be applied to satisfy a creditor's money judgment ("The court may order the trustee to satisfy the judgment out of the beneficiary's interest...").

However, Section 15306.5 contains an exception for amounts needed to maintain the beneficiary's education and standard of living.

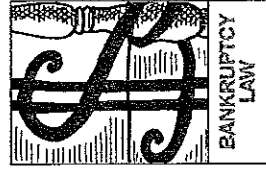
Because all that the husband and wife have is the right to live in the home rent-free, the creditor does not have much to receive. Presumably, the trustee will determine that they need to stay in the house to maintain their standard of living.

The relationship between Sections 15307 and 15306.5 is unclear. Probably, a creditor that is unsatisfied with the trustee's response under Section 15307 would ask the judge to determine the beneficiary's standard of living under Section 15306.5.

The judge can order the trustee to satisfy the judgment out of "payments to which the beneficiary is entitled under the trust instrument or that the trustee, in the exercise of the trustee's discretion, has determined or determines in the future to pay to the beneficiary." Section 15306.5(a).

However, that order "may not require that the trustee pay in satisfaction of the judgment an amount exceeding 25 percent of the payment that otherwise would be made to, or for the benefit of, the beneficiary." Section 15306.5(b).

Of course, attorneys may have other assets to protect, such as personal savings, rental real estate or trust deeds. The artful use of conventional estate-planning devices can address these assets through, for example, a family limited partnership with a corporate general partner, wholly owned by an irrevocable trust for the benefit of the heirs.



By using a qualified personal-residence trust, the couple can transfer a home with \$1 million of equity to their heirs with a gift-tax value of only \$300,000.

A chronology of the facts shows why Judge Arthur L. Alarcón dissented. He felt that the 9th Circuit should have remanded the case for the trial court to determine whether the defendant intended to hinder, delay or defraud his creditors.

All of the events took place in 1992. On Sept. 15, plaintiff Dove Audio Inc. received a \$4,500,000 arbitration award against defendant Steven Stern. On Sept. 30, Stern learned of the award. Stern filed for divorce on Oct. 14 and received a default judgment of dissolution, which included a stipulated property-settlement agreement, on Oct. 15.

From Oct. 19 to Oct. 21, pursuant to the property-settlement agreement, Stern transferred all of his community property, over \$2 million in assets, to his former spouse without benefit of appraisals. Community property is included in a debtor's bankruptcy estate. Stern retained only assets that supposedly would be exempt from his bankruptcy estate. He also assumed the arbitration award, a community debt.

On Oct. 23, Stern executed documents to establish a pension plan. On approximately Oct. 30, he rolled \$1.4 million from his IRA into the new pension plan. On Nov. 2, Stern filed for bankruptcy.

The federal Employee Retirement Income Security Act of 1974 exempts

Bruce Givner is a tax attorney in Los Angeles.