



**THE PRIVACY & FINANCIAL SHIELD LLC (A.K.A. 'PF SHIELD')**

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**PROPOSED ASSET PROTECTION PLAN**

**FOR**

**JANE DOE**

**PREPARED UNDER THE DIRECTION OF IMA LAWYER, Esq.**

**CONFIDENTIAL**

**DISCLAIMER**

This proposed Asset Protection Plan has been prepared by PF Shield on the basis of information provided to PF Shield by Jane Doe or by Ms. Doe's attorney. To the degree that any information provided is inaccurate or incomplete, the recommendations and propositions contained herein must be adjusted accordingly. Specifically, however, it is understood that at all times that the following apply to Ms. Doe:

1. There exist no pending or threatened claims or lawsuits against her and she is not a named Defendant in any lawsuit, administrative proceeding, or other action as of this date.
2. She is not engaged, or about to become engaged, in any business or transaction for which remaining assets will be unreasonable in relation to the business or transaction.
3. She does not contemplate filing for relief under the provisions of the U.S. Bankruptcy Code or the provisions of any other law providing relief for insolvent parties, nor is she involved in any situation, business or matter that I reasonably anticipate would cause her to file for relief under any Chapter of the U.S. Bankruptcy Code, or under the provisions of any other law providing relief for insolvent parties, in the future.
4. She has read and understands the description of pertinent provisions of the Money Laundering Control Act, found in Appendix A herein, and confirms and represents that none of the assets which she may transfer was derived from any of the activities specified therein, and that none of the items of "financial misconduct," as described therein, apply to her.

Furthermore, it is understood that the advice provided in this Proposed Asset Protection Plan is preliminary, that circumstances upon which this advice is based may change (including changes in Ms. Doe circumstances and changes in applicable law), and that this advice may be relied on only to the degree that it is applicable at the time of the issuance of this Proposed Asset Protection Plan.

**NOTE: PF Shield is not a tax advisor. To the contrary PF Shield specifically disclaims any tax expertise. Any reference to tax issues herein are general, and do not apply specifically to the needs or requirements of Ms. Doe. PF Shield recommends that Ms. Doe employ the services of a separate tax accountant or other advisor with regard to tax matters. PF Shield will consult with and provide any material or other assistance to any tax advisor employed by Ms. Doe.**

## **CLIENT BACKGROUND**

Ms. Doe is an unmarried Florida resident, age 48, with no children.

Jane currently has no creditor threats; however her business is doing poorly and may go bankrupt in a year or so if business revenue does not improve. Jane has signed a personal guarantee on a lease contract for her business, with four years remaining on the lease, and the contract currently has an outstanding balance of about \$500,000. In light of the foregoing, and with a desire for asset protection in general, Jane is interested in protecting the following personal assets:

- A money market account worth \$90,000.
- Two CD accounts worth \$26,000 each.
- A Smith Barney account worth about \$500,000.
- A 2002 Lexus GS 430, with a fair market value of about \$27,000.

Jane also owns a house free and clear worth about \$600,000, but it is already protected 100% against private creditors under Florida's homestead exemption law.<sup>i</sup> She also has a \$33,500 Roth IRA that is protected from creditors under Florida law.<sup>ii</sup>

## **PROPOSED PROGRAM STRATEGIES**

### ***Protecting Jane's Vehicle***

If Jane gets a judgment against her, a creditor may seize her vehicle and sell it to help satisfy the judgment. In her situation, the best way to avoid this is to trade her vehicle in for a leased vehicle. It is best to wait until a lawsuit is actually filed before trading in her vehicle (if the creditor never obtains a judgment, then the trade-in is unnecessary), however this should be done before the creditor obtains a judgment.

Alternatively, Jane could give the vehicle to the creditor, or sell it and give the creditor cash so as to demonstrate she is trying to pay the creditor. This reduces the chance that Jane will be seen as trying to evade paying the creditor when she transfers the bulk of her assets offshore or to a domestic LLC.

### ***A Low or No-Cost Asset Protection Strategy to Protect Some of Jane's Liquid Assets***

In addition to the foregoing, any creditors that Jane needs to pay as part of her cost-of-living needs should be paid as far in advance as possible. For example, if Jane has a mortgage on her home, she should pay in advance so that she will not need to make another mortgage payment for, if possible, 2 or 3 years. Doing so has the following advantages:

- 1) Jane's home cannot be seized by a creditor.
- 2) Payments to another already existing creditor will not be undone by a judge, since one creditor (her furniture company's landlord) does not generally take priority over another creditor.
- 3) Doing this will reduce Jane's future cost-of-living expenses, which will be beneficial post-judgment, as we discuss in the section below entitled *Paying for Living Expenses While Under Creditor Threat*.

### ***Liquid Assets Option 1: Protecting Investments via a Domestic Asset Protection Program***

An onshore plan to protect liquid assets would essentially place Ms. Doe's investments in a domestic LLC. For enhanced asset protection, PF Shield recommends this LLC have at least 2 members ("member" is the term used for an LLC's owner). If Ms. Doe does not have a 2<sup>nd</sup> adult who can own at least 1% of this LLC (5% or more is preferable) then fPF Shield can draft a trust that will be the 2<sup>nd</sup> member, preferably with someone other than Ms. Doe as a beneficiary (doing so will give the trust a valid estate planning purpose). The above options are not required, but are strongly recommended. The article in Appendix B explains why multi-member LLCs provide better asset protection than single member LLCs.

If Ms. Doe decides to implement a domestic asset protection program, PF Shield will be happy to do so, however we caution that any domestic planning done while there are anticipated creditor threats, even if those threats have not yet materialized, may be subject to a fraudulent transfer ruling. A court's finding that a transfer was fraudulent will cause any domestic plan to fail. PF Shield will structure Jane's domestic plan so as to minimize the risk of a fraudulent transfer ruling, however despite our best efforts a significant risk will always remain in Jane's circumstances. Therefore PF Shield strongly recommends an offshore plan that will probably survive creditor attack even if the corresponding transfer of Jane's assets is deemed fraudulent.

If Jane wishes to learn more about fraudulent transfers, PF Shield has herein included a chapter on this topic as found in Appendix C.

### ***Liquid Assets Option 2: Protecting Liquid Assets with an Offshore LLC and Offshore Portfolio Bond***

An alternative to domestic planning is going offshore. Offshore planning does have the following advantages over a domestic plan:

- 1) Ms. Doe will have strong financial privacy (except against the U.S. government) while still retaining at least indirect control over offshore funds.
- 2) Offshore planning provides the strongest asset protection available, and if properly implemented it will usually defeat a fraudulent transfer ruling as well as alter-ego or other veil-piercing attempts, something that no domestic plan can do.
- 3) Offshore planning would allow Ms. Doe to purchase, if she desired, to foreign annuities, foreign variable universal life policies, or foreign portfolio bonds (portfolio bonds are explained in Appendix E of this report). These "insurance

wrappers” allow Ms. Doe to trade internationally in non-U.S. investments in a possibly tax-deferred or tax-advantaged manner, while also avoiding the 46-84% U.S. tax otherwise levied on capital gains from most offshore mutual fund-type investments. These foreign investments may also have the advantage of being based on a currency more stable than the U.S. dollar (which has lost over 50% of its value vs. the Euro since January 2002!) Ms. Doe could even use her offshore structure to invest in U.S.-based investments if he wished.

- 4) Having the offshore LLC purchase a foreign insurance product allows for the “transferee defense”, which is a provision of fraudulent transfer law that prohibits a judge from undoing a transfer even if it was done with intent to defeat or otherwise hinder a creditor. The chapter on fraudulent transfers, found in appendix C of this report, examines the transferee defense in greater detail.
- 5) This type of planning is generally tax neutral, meaning it offers no tax advantages or disadvantages.

If Ms. Doe desires an offshore program, PF Shield will implement a plan as follows:

- We will set up a Nevis LLC. Nevis (along with the island of St. Kitts) is a Caribbean island-nation whose LLC laws are modeled after Delaware’s LLC Act and thus will be familiar to a U.S. judge, which allows us to predict with greater certainty how the judge will treat her program. For the same reasons a domestic LLC should have more than one member, we strongly recommend the offshore LLC have 2 or more members. The majority (95-99%) owner will be Jane, and the other should be a person or trust who owns 1% or more of the offshore LLC.
- In order to purchase a foreign insurance product (life insurance, annuity, or portfolio bond) the offshore LLC must have an offshore manager, (offshore LLC manager fees are about \$750 annually.) Ms. Doe may be a co-manager of this structure so long as the offshore LLC’s operating agreement stipulates she has no power to make distributions of assets without the other offshore manager’s consent. However, retaining control in this manner will somewhat lessen the plan’s effectiveness, and therefore if feasible the offshore manager should be the offshore LLC’s only manager.
- In light of relevant case law<sup>iii</sup>, along with the fact that we should have a valid economic reason for going offshore other than just asset protection, an offshore annuity, life insurance policy, or portfolio bond should be used with the offshore structure in order to meet the burden of proof that Ms. Doe is incapable of repatriating offshore assets in the event of creditor attack. This contingency is explained more fully in the chapter contained in Appendix D of this report.

***Liquid Assets Option 3: Adding an Offshore Trust and/or Offshore Bank Account to Maximize the Protection Afforded an Offshore LLC***

Although offshore planning may be very strong, no planning is 100% effective if it is implemented after a creditor threat has already materialized and Jane remains in the United States. As a result, in such circumstances asset protection planners often use “defense-in-depth” planning. “Defense-in-depth” means a planner constructs several barriers, each of which could keep a creditor from reaching a client’s assets. Thus, even if one barrier fails, there are still other barriers to overcome before a creditor may seize the assets. Overcoming multiple barriers means a very expensive legal battle, with significant uncertainty as to whether the creditor will be successful in overcoming any of the barriers. As a result, defense-in-depth planning strongly discourages a creditor from pursuing assets he might pursue if there were only one or two barriers to overcome.

For example, the domestic program we described earlier in this report only has one barrier that needs to be overcome. If the creditor proves the transfer to a domestic entity was fraudulent (which he probably could do if he is determined and has a good attorney), then the judge will undo the transfer and the plan has failed. Using an offshore LLC with an offshore manager provides yet another barrier: first the transfer must be proven fraudulent, then the issue of whether the client has the power to repatriate (bring back ashore) the assets needs to be resolved. If the client proves they lack the ability to repatriate the asset, then the 2<sup>nd</sup> barrier holds and the assets remain safe. Investing the offshore funds in a foreign insurance product provides even more barriers. Not only are the fraudulent transfer and repatriation barriers still present, but if a transfer is found to be fraudulent, the client may assert the transferee defense (as described in the attached chapter on fraudulent transfer law), which prohibits a transfer from being undone even if it was done with the intent to defraud a creditor. Furthermore, it will be easier to prove one’s inability to repatriate an asset once it’s given to a very large, well respected foreign insurance company (and therefore in the insurance company’s control) than it would be to prove one cannot repatriate an asset under the control of an offshore manager who was hired by the client for the specific purpose of protecting the client’s assets and supposedly doing what the client wants him to do. Plus, because using an offshore insurance product makes economic sense, it will also be more difficult for a creditor to prove the transfer was done with fraudulent intent instead of for other economic reasons.

Using an offshore trust to own an offshore LLC adds yet another barrier to an asset protection plan. It creates even more distance between the client and the assets. If a trust holds the offshore LLC, and the trustee directs the offshore LLC manager to purchase the portfolio bond, a creditor will have to pierce the offshore trust, then pierce the offshore LLC, then convince a judge that the client has the power to get the foreign insurance company to return funds (assuming it can also defeat the aforementioned transferee defense) when the insurance company’s policy plainly states it will not do business with a U.S. person (if the foreign insurance company did do business with a U.S. person, then it could be subject to U.S. taxes on U.S.-source income as well as be subject to the jurisdiction of the U.S. Securities and Exchange Commission (SEC)).

In other words, using an offshore trust together with an offshore LLC and foreign portfolio bond provides the most barriers of protection, thus creating a highly formidable structure that will intimidate all but the most determined and sophisticated creditors from pursuing the offshore assets.

### ***Offshore Reporting Requirements***

An additional advantage of placing assets offshore is that some offshore jurisdictions have very strong privacy laws, which means these assets won't show up on an asset search if the offshore program is implemented and maintained properly. However, there are extensive federal reporting requirements for offshore plans. For example, if we set up an offshore LLC, and invested money or other liquid assets in a foreign insurance product (annuity, etc.), Ms. Doe would have to:

- 1) Disclose the existence of any financial account, no matter how small, on her 1040 Schedule B annual income tax return.
- 2) File form TD-Y 99.1 each year she had more than \$10,000 offshore (even if this is an annuity or other product that is not, strictly speaking, a bank or brokerage account).
- 3) File form 8832 once to elect 'disregarded entity' tax status for her offshore LLC. (PF Shield LLC will prepare this form for her.)
- 4) File form 720 or 8833 once upon purchase of a foreign insurance product. If form 720 is filed, she must pay a 1% excise tax on any premium payments paid to a foreign insurance company (due to international treaties, Swiss policies avoid this 1% excise and one would file form 8833.)
- 5) File form 8858 annually for her offshore LLC, even if it is disregarded for tax purposes (a.k.a. a 'disregarded entity' as mentioned above.)
- 6) Offshore trusts file IRS form 3520A annually (due March 15<sup>th</sup>, not April 15<sup>th</sup>!) and also possibly IRS form 3520.

Although these forms are not as difficult to complete as one may think, and PF Shield LLC would be happy to assist a client's CPA in filing the reports, the penalties for failure to file these forms are stiff; penalties are generally, at a minimum, \$10,000 or more.

### ***A Word About Financial Privacy***

Although offshore planning provides considerable financial privacy, and while such privacy has benefits, no privacy plan is 100% bulletproof, nor will it by itself provide impenetrable asset protection. If Ms. Doe loses a lawsuit, gets divorced, or goes through bankruptcy, she will almost certainly be required to divulge her interest in any onshore or offshore companies or trusts. Failing to do so could be perjury.

### ***Paying Living Expenses While Under Creditor Threat***

Part of our asset protection strategy involves proving Jane is unable, at least in the immediate future, to access funds she transfers offshore. If she can access the funds, then so may a creditor. However, this leads to a dilemma. If Jane leaves some money onshore (\$50,000 for example) in order to pay her foreseeable cost-of-living expenses (assuming she will have no other source of income for the next 6-12 months), then a creditor can seize those funds. If she takes all of her money offshore, and has no other funds available, she will have to take some funds back onshore, which may lead a judge to believe she can access all of her offshore funds, even if she can only access some funds. This in turn could weaken her asset protection program.

How do we solve this dilemma? The best answer is two-fold. First, Jane should leave enough funds onshore to pay her cost-of-living expenses before she gets a judgment against her. Jane's creditors cannot seize these funds until they actually obtain a judgment. However, any funds in excess of a relatively small amount of cash or precious metals (maybe \$10,000) held in a safe in her house may be seized by a creditor post-judgment. The solution to this dilemma is for Jane to obtain a line of credit on her home as soon as possible, and to use the line of credit to pay for her cost-of-living expenses post-judgment until she has another income stream to support herself (however Jane should be aware that a creditor may try and attach her income post-judgment if she gets a job or starts a new business). This line of credit will ideally be large enough to pay for Jane's cost-of-living expenses for two years following any judgment she gets against her. A creditor will not be able to attach a line of credit account, as the line of credit is the bank's money and not Jane's. We must note that Jane will probably not have to use this line of credit to support herself for 2 years following a judgment, but if possible she should get a large line of credit just in case! We want Jane to be prepared for *all* contingencies, even a worst-case scenario where a creditor is very determined, sophisticated, and pursues her aggressively.

Also, remember Jane can reduce her cost-of-living expenses by, among other things, making advance payments on her home's mortgage (if there is one) before she gets a judgment against her.

A final note of warning: the longer Jane waits, the more difficult it will be for her to obtain a home equity line of credit. Among other things, most banks ask if she has any lawsuits pending on the line of credit application. Right now she has now lawsuits pending, but once she's sued she can't say that, and she will certainly be turned away by most if not all banks. Furthermore, once Jane's business fails it may also be very difficult to obtain a line of credit. Therefore, we recommend she get a line of credit now, before things deteriorate further. The line of credit costs nothing until it is used.

**SUMMARY/RECOMMENDED COURSE OF ACTION**

**Option 1: Domestic Only Program**

Domestic LLC for Ms. Doe's investments	= \$XXXX
Attorney's fee to supervise the project and provide Attorney/client privilege	= \$XXXX
<b>Total</b>	<b>= \$XXXX</b>

**Option 2: "Best Bang for the Buck" Offshore Program**

Offshore LLC and foreign portfolio bond or annuity for liquid assets	= \$XXXX
Attorney's fee to supervise the project and provide Attorney/client privilege	= \$XXXX
<b>Total</b>	<b>= \$XXXX</b>

**Option 3: Maximum Protection Offshore Program**

Offshore trust to hold offshore LLC interest	= \$XXXX
Offshore LLC and foreign annuity or portfolio bond for liquid assets	= \$XXXX
Attorney's fee to supervise the project and provide Attorney/client privilege	= \$XXXX
<b>Total</b>	<b>= \$XXXXX</b>

**Optional Services (add a la carte)**

Offshore bank account – not necessary to implement an asset protection program, but may be convenient for holding non-portfolio bond/annuity assets offshore	= \$XXXX
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Please allow 5-10 weeks from the date of sending payment for PF Shield to implement your program. Offshore entities and supporting documentation will be completed within this time frame, however the opening of offshore bank accounts or the purchase of offshore annuities or portfolio bonds may take longer. If you need us to expedite the work, let us know and we will discuss accommodating your proposed deadline. PF Shield takes payment in cash or certified funds (such as a certified check) made payable to PF Shield LLC or your attorney, if we work under attorney supervision.

If you have any questions, feel free to call Ryan Fowler or Tim Costello at 800-798-2008, or send us an e-mail at [privacyman@hush.com](mailto:privacyman@hush.com). We look forward to serving you!

## **APPENDIX A:**

### **DESCRIPTION OF PERTINENT PROVISIONS OF THE MONEY LAUNDERING CONTROL ACT:**

The Money Laundering Control Act (“the Act”) makes it criminal for anyone to conduct or attempt to conduct certain financial activities which involve the proceeds of unlawful activities. As the transfer of assets into a limited partnership, trust, or other entity may constitute a financial activity within the scope of the Act, it is necessary that you swear under oath that none of the assets intended to be transferred into such entities was derived from any of the criminal activities specified in the Act.

The specified unlawful activities under the Act consist primarily of drug-trafficking offenses, financial misconduct, and environmental crimes. Drug-trafficking offenses include the manufacture, importation, sale or distribution of controlled substances; the commission of acts constituting a continuing criminal enterprise; the illegal procurement of essential or precursor chemicals; and transportation of drug paraphernalia.

Covered financial misconduct includes the concealment of assets from a receiver, custodian, trustee, marshal, or other officer of the court, from creditors in a bankruptcy proceeding, or from the Federal Deposit Insurance Corporation, the Resolution Trust Corporation, or a similar agency or person; the making of a fraudulent conveyance in contemplation of a bankruptcy proceeding or with the intent to defeat the bankruptcy law; the giving of false oaths or claims in relation to a bankruptcy proceeding; bribery; the giving of commissions or gifts for the procurement of loans; theft, embezzlement, or misapplication of bank funds or funds of other lending, credit or insurance institutions; the making of fraudulent bank or credit institution entries on loan or credit applications; and mail, wire or bank fraud, or bank or postal robbery or theft.

Environmental crimes include violations of the Federal Water Pollution Control Act, the Ocean Dumping Act, the Safe Drinking Water Act, the Resources Conservation and Recovery Act, and similar federal statutes.

Other specified crimes include counterfeiting, espionage, kidnapping or hostage-taking, copyright infringement, entry of goods by means of false statements, smuggling goods into the United States, removing goods from the custody of customs, illegally exporting arms, and trading with enemies of the United States.

## APPENDIX B

### Single Member vs. Multi-Member LLC's

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Because of a recent court case, there is some confusion regarding whether a single member LLC offers effective asset protection, and whether it would be preferable to instead form only multi-member LLC's for this purpose. In order to clear up any misconceptions, let's analyze this case and see what we can find out. The case in question is part of a Chapter 7 bankruptcy proceeding (In re: Ashley Albright, Case No. 01-11367, U.S. Bankruptcy Court for the district of Colorado.) Here is an excerpt from the case that gives us some background information:

**Ashley Albright was the sole member and manager of Western Blue Sky LLC. The LLC held real estate property in Colorado. Ashley Albright filed Chapter 13 bankruptcy, which was then converted to Chapter 7 bankruptcy in July 2001.**

**After declaring bankruptcy, the trustee of the bankruptcy estate filed a motion to obtain exclusive ownership and control of Western Blue Sky LLC, in order to liquidate its assets as payment to Ashley's creditors. Ms. Albright argued that since the property was in an LLC, the trustee was only entitled to distributions from the LLC, and not to the assets or a membership interest in the LLC itself.**

It is very important to note the primary law, which the judge refers to in this case, is the Colorado Limited Liability Company Act. The judge ultimately decides that in a bankruptcy proceeding, although the Colorado LLC Act prohibits anyone from gaining a membership or management interest in a multi-member LLC without the non-debtor members' consent, this same restriction does not apply to a single member LLC. Here is an excerpt from the case, which explains the judge's line of reasoning (all emphasis is mine):

**Pursuant to the Colorado limited liability company statute, the Debtor's membership interest constitutes the personal property of the member. Upon the Debtor's bankruptcy filing, she effectively transferred her membership interest to the estate. See 11 U.S.C. § 541(a). n4 Because there are no other members in the LLC, the entire membership interest passed to the bankruptcy estate, and the Trustee has become a "substituted member." n5**

n4 11 U.S.C. § 541(a)(1) provides, in relevant part: "The commencement of a case ... creates an estate. Such estate is comprised of ... all legal or equitable interests of the debtor in property as of the commencement of the case."

n5 Colo. Rev. Stat. § 7-80-702 provides (emphasis added):

**(1) The interest of each member in a limited liability company constitutes the personal property of the member and may be transferred or assigned. However, if all of the other members of the limited liability company other than the member proposing to dispose of her or its interest do not approve of the proposed transfer or assignment by unanimous written consent, the transferee of the member's interest shall have no right to participate in the management of the business and affairs of the limited liability company or to become a member. The transferee shall only be entitled**

to receive the share of profits or other compensation by way of income and the return of contributions to which that member would otherwise be entitled.

(2) A substituted member is a person admitted to all the rights of a member who has died or has assigned her interest in a limited liability company with the approval of all the members of the limited liability company by unanimous written consent. The substituted member has all the rights and powers and is subject to all the restrictions and liabilities of her assignor; except that the substitution of the assignee does not release the assignor from liability to the limited liability company under section 7-80-502.

Section 7-80-702 of the Limited Liability Company Act requires the unanimous consent of "other members" in order to allow a transferee to participate in the management of the LLC. n6 Because there are no other members in the LLC, no written unanimous approval of the transfer was necessary. Consequently, the Debtor's bankruptcy filing effectively assigned her entire membership interest in the LLC to the bankruptcy estate, and the Trustee obtained all her rights, including the right to control the management of the LLC. n7

n6 This reading of § 7-80-702 is reinforced in Colo. Rev. Stat. § 7-80-108(3)(a). Section 108 sets forth the effect of an operating agreement and what provisions are non-waivable. Section 108(3) states that "unless contained in a written operating agreement or other writing approved in accordance with a written operating agreement, no operating agreement may [...] vary the requirement under section 7-80-702(1) that, if all of the other members of the limited liability company other than the member proposing to dispose of the member's interest do not approve of the proposed transfer or assignment by unanimous written consent, the transferee of the member's interest shall have no right to participate in the management of the business and affairs of the limited liability company or to become a member." Colo. Rev. Stat. § 7-80-108(3)(a). The clause "other than the member proposing to dispose of the member's interest" confirms that the "other members" identified in § 7-80-702 does not include the transferee.

At this point, it behooves us to point out a few things. First, the Colorado LLC Act makes a membership interest a person's personal property. Second, this is a bankruptcy proceeding, and in Chapter 7 bankruptcy, an individual's non-exempt personal property is transferred to the bankruptcy estate. Ashley Albright contends that the "charging order" provisions in the Colorado LLC Act prevent this from happening. However, the judge explains that this is not so, in the case of a single member LLC, because there are no other members to object to the transfer of Ashley's membership interest. There is an important part of the Colorado LLC Act that the judge does *not* elaborate on however. It is outlined above, and I'll restate it here:

**"if all of the other members of the limited liability company other than the member proposing to dispose of the member's interest do not approve of the proposed transfer or assignment by unanimous written consent, the transferee of the member's interest shall have no right to participate in the management of the business and affairs of the limited liability company or to become a member..."**

The judge talks about the "other members" in her opinion, but he doesn't elaborate on the part of the statute that says "the member proposing to dispose of the member's interest." The member who is proposing to dispose of the member's interest is, of course, Ashley Albright. When, then, did she propose to dispose of her interest? When she declared bankruptcy. "Upon the Debtor's bankruptcy filing, she effectively transferred her membership interest to the estate." (See the first paragraph of the case excerpt, above.) What this means, then, is that in the state of Colorado, a single member LLC won't protect one's assets in a bankruptcy proceeding, because when a single

member LLC member declares bankruptcy, he is essentially declaring the transfer of her membership interest in the LLC to the bankruptcy estate. This also means that the LLC acts of other states may likewise offer no asset protection to a single member LLC in a bankruptcy proceeding. This will depend, of course, on a state's LLC Act. The New Mexico LLC Act is written in a manner to, in the author's opinion, offer more protection to a single member New Mexico LLC in this situation than Ms. Albright's Colorado LLC offered her. However, the law is not completely clear on this matter. Things could go either way.

There is another section of this court case that also should be carefully scrutinized:

**“The Debtor argues that the Trustee acts merely for her creditors and is only entitled to a charging order against distributions made on account of her LLC member interest. However, the charging order, as set forth in Section 703 of the Colorado Limited Liability Company Act, exists to protect other members of an LLC from having involuntarily to share governance responsibilities with someone they did not choose, or from having to accept a creditor of another member as a co-manager. A charging order protects the autonomy of the original members, and their ability to manage their own enterprise. In a single member entity, there are no non-debtor members to protect. The charging order limitation serves no purpose in a single member limited liability company, because there are no other parties' interests affected.”**

This excerpt may prove to be the most dangerous part of the court opinion to single member LLC's. Although this excerpt is only talking about the Colorado Limited Liability Company Act, it may set a precedent for similar rulings towards LLC's organized in other states, even in non-bankruptcy cases. This is less likely to occur with some state's LLC laws than with others, depending on how the LLC laws are written, but we must also throw into the fray the fact that a New Mexico LLC, for example, may be judged under another state's laws, if that New Mexico LLC holds assets or does business in another state. Therefore, because it is not always clear which state's laws will be given jurisdiction in any given court proceeding, PF Shield recommends that, for maximum asset protection, a multi-member LLC is preferable over a single member LLC. This contention is actually reinforced by another segment from the Ashley Albright case:

**“n7 Under Colo. Rev. Stat. § 7-80-702, supra, the result would be different if there were other non-debtor members in the LLC. Where a single member files bankruptcy while the other members of a multi-member LLC do not, and where the non-debtor members do not consent to a substitute member status for a member interest transferee, the bankruptcy estate is only entitled to receive the share of profits or other compensation by way of income and the return of the contributions to which that member would otherwise be entitled.**

...

**n9 The harder question would involve an LLC where one member effectively controls and dominates the membership and management of an LLC that also involves a passive member with a minimal interest. If the dominant member files bankruptcy, would a trustee obtain the right to govern the LLC? Pursuant to Colo. Rev. Stat. § 7-80-702, if the non-debtor member did not consent, even if she held only an infinitesimal interest, the answer would be no. The Trustee would only be entitled to a share of distributions, and would have no role in the voting or governance of the company. Notwithstanding this limitation, 7-80-702 does not create an asset shelter for clever debtors. To the extent a debtor intends to hinder, delay or defraud**

**creditors through a multi-member LLC with "peppercorn" co-members, bankruptcy avoidance provisions and fraudulent transfer law would provide creditors or a bankruptcy trustee with recourse. 11 U.S.C. § § 544(b)(1) and 548(a)"**

Notice that this excerpt mentions fraudulent transfers, and that a multi-member LLC, which is set up so as to hinder, delay or defraud creditors, will not necessarily protect the LLC members from its creditors like it otherwise would. This is an important point, and is why an entire section in Chapter 1 of this guide focuses on how to avoid a fraudulent transfer ruling.

To summarize our analysis of *In re: Ashley Albright*, PF Shield contends that:

- A. A Colorado single member LLC offers no asset protection in a bankruptcy proceeding.
- B. This may also be the case for bankruptcy proceedings that involve single member LLC's in other states, depending on a variety of factors.
- C. A single member LLC may or may not effectively protect its members assets from an external creditor attack, depending on a variety of factors, and
- D. That this case reinforces the fact that multi-member LLC's generally offer excellent asset protection.

## APPENDIX C

### CHAPTER 5

#### FRAUDULENT TRANSFERS

BY W. RYAN FOWLER

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When an asset protection plan fails, it is almost always due to one of the following:

- 1) The entity is pierced (meaning a creditor of an entity is able to disregard the entity's limited-liability shield, and hold its owner(s) liable for entity debts).
- 2) The entity is reverse-pierced (meaning a creditor of an entity's owner is able to disregard the entity as being separate from the owner, and thereby attach the entity's assets to satisfy its owner's debt.)
- 3) The transfer of assets into an entity is deemed fraudulent.
- 4) In regards to offshore planning, if #2 or 3 above occur, then a creditor may be able to force the debtor to repatriate offshore assets, and the debtor could be subject to civil contempt consequences (i.e. incarceration) if s/he fails to obey the order<sup>iv</sup>.

Of the above, fraudulent transfers are the most common reason for an asset protection plan's failure. This chapter defines and addresses fraudulent transfer issues. The chapter on corporations and limited liability concepts covers veil piercing, and the chapter entitled "Asset Protection a Judge Will Respect" addresses reverse-piercing and repatriation order issues.

#### *A Brief History of Fraudulent Transfer Law*

U.S. fraudulent transfer law is very well-developed. It originates from the statute of 13 Elizabeth, which was enacted in 1570. Even before that, fraudulent transfer issues were considered as early as 1376, when the Statute of Edward allowed creditors to void certain transfers their debtors had made as a means of avoiding their debt obligations. Of particular note, this statute considered what is known today as "badges of fraud", or indicators that a transfer was made to hinder creditors rather than as a result of one's normal course of business<sup>v</sup>. In the U.S., 13 Elizabeth (a part of U.S. common law) was subsequently replaced with the Uniform Fraudulent Conveyance Act of 1918 (UFCA), and since then 41 states have adopted the Uniform Fraudulent Transfer Act (UFTA), which was drafted in 1983<sup>vi</sup>. Although these acts are based on a single uniform body of law, some of the states that ratified the Acts have made (mostly minor) changes to these Acts. **Consequently, we must caution the reader that this chapter only discusses fraudulent transfer law in general; one must consult the fraudulent transfer law and associated case law of their state to thoroughly understand how any particular transfer might fare in a fraudulent transfer context.**

## ***Fraudulent Transfers vs. Actual Fraud***

The term ‘fraudulent transfer’ should not be confused with actual fraud. Actual fraud involves knowingly deceiving someone in a manner that causes damage.<sup>vii</sup> A fraudulent transfer usually involves no misrepresentation to a creditor (typically no representations are made at all, for that matter, since the creditor is normally not a party to the transfer) and does not usually cause damage to a creditor. Furthermore, fraud is a crime whereas a fraudulent transfer, in most cases, is not.<sup>viii</sup> Instead of fraud *per se*, then, a fraudulent transfer is the transfer of an asset so as to frustrate a creditor’s attempts to collect a debt. The goal of the UFTA is not to punish, fine, or penalize the offender. Rather, it is a civil remedy that assists a creditor in recovering their debt, if the debtor has fraudulently transferred his asset(s). Nowhere in the UFTA is there any mention of a fine or other penalty for committing a fraudulent transfer. However, particularly flagrant fraudulent transfers have on rare occasion resulted in fines against the debtor as well as possibly his attorney or asset protection planner, as we’ll discuss shortly.

## ***Solvency, Reasonably Equivalent Value, Insiders, and Bright-Line Tests That Determine Whether a Transfer is Fraudulent***

Sections 4 and 5 of the UFTA determine whether a transfer is fraudulent. From these sections, we may derive 3 types of fraudulent transfers:

- 1) Transfers that are constructively fraudulent as to present (already existing) creditors only;<sup>ix</sup>
- 2) Transfers that are constructively fraudulent as to both present and future creditors;<sup>x</sup>
- 3) Transfers that are not fraudulent in and of themselves, but are fraudulent because they were made with intent to hinder, delay or defraud present and/or future creditors.<sup>xi</sup>

Items 1 and 2, above, are determined by bright-line tests. In other words, these tests consist of clearly defined standards with little room for interpretation. The bright-line tests do not consider intent; one may commit a fraudulent transfer under these rules, even if one had no intention of hindering, delaying, or defrauding a creditor.

There are two primary criteria used to determine if a fraudulent transfer occurred under the first bright-line test. The first criterion requires that the debtor be insolvent at the time of the transfer, or becomes insolvent as a result of the transfer, or becomes insolvent shortly after the transfer<sup>xii</sup>. Solvency, more or less, is defined as a person’s ability to pay their debts<sup>xiii</sup>. If they are unable to pay their debts, or are currently not paying their debts even if able, then they are deemed insolvent<sup>xiv</sup>. It is important to note that, for purposes of determining solvency, any claim to one’s assets could be considered a debt, even if the claim has not yet been reduced to judgment.<sup>xv</sup> Therefore, if someone threatens to sue you for \$1 million, their “claim” on your assets may be considered a liability for the purposes of determining your solvency.<sup>xvi</sup> In other words, if you have net assets worth \$900,000, and are threatened with a \$1 million lawsuit, you may be considered insolvent under the UFTA, even though you don’t actually owe the \$1 million (yet). Fortunately, solvency is *not* the only criteria for determining whether a transfer is

fraudulent under the bright-line tests; one must also transfer the asset for less than reasonably equivalent value in addition to being insolvent.

The second criterion examines whether the debtor received an asset of reasonably equivalent value in exchange for the transfer. Reasonably equivalent value is generally considered to be cash or an item of equivalent cash value that is equal to the fair market value of the asset being transferred. The term ‘reasonably’ does give us some wiggle room, however an exchange (except in the case of a non-collusive foreclosure<sup>xvii</sup>) will usually not be considered to have reasonably equivalent value if the consideration for the transfer is worth less than 70% of the transferred asset’s fair market value. Furthermore, an unperformed promise may not be considered to have reasonably equivalent value.<sup>xviii</sup> Therefore, if a promissory note is given in exchange for the transfer, it must be considered within the ordinary course of business of the lender (e.g. a bank giving a loan), or their should be at least a partial up front payment made, and ongoing cash payments should be made on the note so that it fits within the realm of a standard business transaction.

With the foregoing in mind, we can fully understand how the first bright-line test determines whether a transfer is fraudulent. This test stipulates that if a debtor is (or is about to be) insolvent, and he transfers an asset without receiving something of reasonably equivalent value in exchange, then the transfer is fraudulent. In this instance the transfer is fraudulent even if the creditor has no claim on the debtor’s assets at the time of the transfer. A creditor could actually have no claim until just before the statute of limitations under the UFTA (or other applicable law) expires, and yet they could then still file a claim and the transfer would be deemed fraudulent.<sup>xix</sup> This statute of limitations could be 4 years or longer after the transfer occurs, depending on the circumstances and local laws the matter is subject to.<sup>xx</sup>

For us to fully understand the 2<sup>nd</sup> bright-line test, we must define what an insider is. The full definition of ‘insider’ is found in §§1(1) and 1(7) of the UFTA. However, a simplified definition of an insider is anyone who is a relative of the debtor, any company the debtor has significant control or influence over, or, if the debtor is a company or trust, anyone who has significant control over the company or trust. The foregoing, however, is not an all-encompassing definition of what an insider is. A court could conceivably consider anyone over whom the debtor has significant influence or control to be an insider.

With the foregoing in mind, the 2<sup>nd</sup> bright-line test involves a much narrower set of circumstances. This test, which only applies if the creditor challenging the transfer has a claim before the transfer occurred, shows a transfer to be fraudulent if the transfer was made to an insider to pay a debt that existed prior to the transfer, the debtor was insolvent at that time, and the insider had reasonable cause to believe that the debtor was insolvent.<sup>xxi</sup> This, of course, does not mean payment of a debt to a non-insider is a fraudulent transfer. On the contrary, paying off such a debt, as long as the debt is valid, is a great way to reduce the exposure of one’s assets after the threat of litigation or other hostile creditor attack materializes. We’ll discuss this strategy shortly.

### ***Using Badges of Fraud to Determine Fraudulent Intent***

The final criterion for determining whether a fraudulent transfer occurred is found in § 4(1)(a) of the UFTA. In this case, a transfer is fraudulent as to present or future creditors if it was made “...with actual intent to hinder, delay, or defraud any creditor of

the debtor.” There is no bright-line rule here. Instead, a judge looks for indicia or “badges” of fraud that may indicate fraudulent intent. A judge has broad discretion in determining whether the presence of one or more badges of fraud indeed indicates a transfer is fraudulent. Furthermore, the standard of proof that must be met to indicate fraudulent intent is not the “beyond a shadow of a reasonable doubt” standard of criminal trials, but rather the less rigorous “preponderance of evidence” standard of civil litigation.

A partial list of potential badges of fraud is found in §4(b) of the UFTA, which are as follows (our comments are in italics below each badge of fraud):

1. The transfer or obligation was to an insider;

*This may or may not be a factor in determining whether a fraudulent transfer has occurred. For example, it is common business practice for someone to transfer personal property into a business they control (such as an LLC, LP, or a closely held corporation) in order to capitalize it; such a transfer, if done while creditor seas are calm, will almost certainly not be considered fraudulent, especially if the transferor receives an interest in the company that is equivalent to their capital contribution. On the other hand, transferring real estate to one’s uncle the week before a lawsuit commences will likely be deemed fraudulent.*

2. The debtor retained possession or control of the property transferred after the transfer;

*This may or may not be a factor in a fraudulent transfer case. For example, although a lien is a transfer of equity, mortgaged real estate typically remains in the owner’s possession as a matter of standard business practice. In contrast, placing one’s home in an offshore trust and then continuing to live in it rent-free is likely to be seen as a fraudulent transfer. Furthermore, secured personal property may or may not need to be possessed by the lien holder in order to avoid this badge of fraud.*

3. The transfer or obligation was concealed;

*See the comment for badge of fraud (7), below.*

4. Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

*Some transfers (such as a gift to an insider) are very vulnerable to a fraudulent transfer ruling if they occur after a creditor threat arises. At the same time, no judge would expect you to stop your normal business activities once you’ve been sued, especially considering that a lawsuit may drag out for years. Of course, some of these business activities may involve transfers of assets. Consequently, if you are facing a lawsuit, it is important to transfer property so there is a plausible reason for the transfer, besides trying to protect assets. For example, by taking money and investing it in an LLC, you can protect the money while honestly claiming that you were just engaging in a business venture, instead of trying to defeat a creditor. At the same time, your claim of*

*having a valid business purpose may be insufficient if other badges of fraud point to the fact that you did indeed transfer the asset in order to hinder, delay, or defraud your creditors.*

5. The transfer was of substantially all the debtor's assets;

*This badge of fraud ties in to §4(a)(2)(i) of the UFTA. The most important consideration here is the need to avoid insolvency through a single transfer. Assuming one remains solvent, it is also a very good idea to stagger the implementation of an asset protection plan over time. For example, don't equity-strip all 5 of your rental units on the same day. Instead, it is best to have a few months' space in between each transfer.*

6. The debtor absconded;

*This is a very strong badge of fraud, which by itself would probably cause a transfer to be deemed fraudulent.*

7. The debtor removed or concealed assets;

*Oftentimes there is a good reason for financial privacy, besides trying to defeat a creditor. Depending on your reasons, it may or may not be safe to conceal assets while the creditor seas are calm. However, this is usually not a good idea once one is threatened with creditor attack. Remember: everything can and will usually be revealed in court, and privacy is more for lawsuit prevention than anything else. Above all, remember that no plan should rely exclusively on secrecy, and that improper (but not all) financial privacy measures are usually considered a badge of fraud.*

8. The value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

*This is why trusts are often (but not always) a poor choice for protecting assets, since property is almost always gifted into the trust. This badge of fraud demonstrates that gifting in general is usually a bad idea from an asset protection standpoint. In contrast, when someone transfers an asset to an LLC, they receive an LLC membership interest in return. If done correctly, this membership interest constitutes an equivalent value of consideration received for the transfer.*

9. The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

*This is a strong badge of fraud, and it ties in with §§4(a)(2)(ii) and 5(a) of the UFTA. Implementing an asset protection plan and then failing to pay one's debts as they become due, whether through inability to do so or otherwise, is a big no-no.*

10. The transfer occurred shortly before or shortly after a substantial debt was incurred; and

*Same as (9), above.*

11. The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

*This is a common technique used in the past to avoid fraudulent transfer rulings. The courts have obviously wised up to this. This badge of fraud ties in to §5(b) of the UFTA.*

It is important to realize that badges of fraud are not black and white indicators. A judge is given wide latitude to interpret the types and number of badges of fraud present when considering whether a fraudulent transfer has occurred. On rare occasions a single badge of fraud will denote a fraudulent transfer, whereas in other situations multiple badges of fraud will not be enough to prove fraudulent intent. Regardless, in an asset protection program it is best to avoid badges of fraud whenever possible, the possible exception being when a badge of fraud is irrelevant since it occurs commonly in the regular course of doing business.

Above all, remember that the purpose of §4(b) of the UFTA is to help a judge determine whether a particular transfer smells fishy. If there's not a plausible economic reason for a transfer, and if the transfer is not a part of "business as usual", then it might not stand up if challenged in court, and will almost always carry at least one badge of fraud.

### ***Strategies for Reducing the Likelihood of a Fraudulent Transfer Ruling***

Because fraudulent transfer rulings are so detrimental to asset protection, it should be a planner's highest priority to structure their plan so as to, as much as possible, avoid the likelihood of such a ruling. The following are some strategies that can be effective in achieving this.

- 1) **First and foremost, get your assets out of your name while the creditor seas are calm, even if it's to a very simple structure.** As long as the entity itself is not a debtor, then a subsequent transfer by that entity will not be considered fraudulent under the UFTA. Accordingly, when creditor threat arises, you can then reinforce the entity or transfer the asset to a new entity, with reduced fraudulent transfer concerns. This is because the UFTA only considers transfers the debtor makes as being fraudulent.<sup>xxii</sup> Furthermore, restructuring an entity so that a creditor of the entity's owner cannot reach the entity's assets for its owner's debts usually does not involve a transfer, and is therefore not considered by the fraudulent transfer laws of most states. Even if it did, as long as the entity is not a debtor, then a transfer from the non-debtor entity to another entity is usually not considered fraudulent under fraudulent transfer law.<sup>xxiii</sup> This maxim is echoed on at least one occasion by the courts, as seen in *Lakeside Lumber Products, Inc. v. Evans*<sup>xxiv</sup>.

In *Lakeside*, the court considered whether the restructuring of trusteeship (management) of a trust so as to deny a creditor access to trust assets was a fraudulent transfer. The controversy arose over a 1996 personal

guarantee that the guarantor, Dan Evans, defaulted on. In 1989 he had quitclaimed his house into a living trust, with him and his wife as co-trustees and his wife as the sole trust beneficiary. After he defaulted on his 1996 guarantee, Dan relinquished control of trust assets by resigning his trusteeship (thus surrendering his power to take trust assets out of the trust to give them to a creditor; apparently Dan also retained no control to amend or revoke the trust as its grantor.) The plaintiff challenged the transfer as fraudulent, however the courts responded to the contrary:

“With regard to the 1989 conveyance, Lakeside argues that two indicia of fraud are present: (1) Dan Evans transferred the home to an "insider"; and (2) Dan Evans has continued to reside in the home, effectively retaining control of the property. Assuming, without deciding, that Lakeside's contentions are true, we conclude that these indicia of fraud, considered in conjunction with "other factors," fail to create a triable issue of fact in this case. Crucial to our determination is the temporal remoteness of the 1989 conveyance to both the 1996 guarantee agreement and Dan Evans's 1999 petition for bankruptcy. Lakeside has pointed to no facts suggesting that in 1989, or shortly thereafter, Dan Evans was insolvent or experiencing other financial difficulties. Likewise, there are no facts in the record that would suggest that the 1989 transfer was part of a larger scheme to defraud future creditors such as Lakeside. Based merely on the indicia of fraud cited by Lakeside--transfer to an insider and retaining control of the transferred property--a jury could not rationally conclude that Dan Evans transferred the property with an intent to defraud creditors... Lakeside contests the district court's conclusion that the 1997 amendment to the trust was not a transfer, but simply a modification of the trust agreement. Under the Act, a transfer is defined as "every mode ... of disposing of or parting with an asset or an interest in an asset."... We conclude that these actions did not effectuate a transfer... Dan Evans did not part with an asset or an interest in an asset by signing the quitclaim deed as a trustee. The purpose of the amendment and the quitclaim deed was to reflect Dan Evans's resignation as trustee. The district court did not err in determining that the 1997 amendment was not a transfer.”

In light of the above, we can clearly see that setting up a structure far in advance of creditor attack will likely keep the transfer from being deemed fraudulent, even if there are multiple badges of fraud associated with the transfer. Furthermore, restructuring a non-debtor entity, even after the debtor becomes insolvent, is not likely to be considered a fraudulent transfer, as long as the debtor never transfers any of his or her assets while doing so.

With that said, it's still far better to set up a proper structure rather than a faulty one from the very beginning. Although in our opinion it's less susceptible to failure than an actual transfer done after creditor threat arises, there is a chance that reinforcing a faultily structured entity against creditors may not work, if the reinforcement is done after creditor threat has

materialized. The fact of the matter is Mr. and Mrs. Evans kept their home only because the creditor did not make the proper argument in court. At the time this case was decided, Utah law did not allow a trust in which the grantor (the person who transfers assets to the trust) remains a beneficiary to keep those assets safe from creditors. If the plaintiff in this case had convinced the court that Mr. Evans was, in fact, a beneficiary of the trust, then they probably could have attached their judgment lien to at least part of the home's equity. However, because they failed to demonstrate such, the home remained untouched. Long story short, Mr. and Mrs. Evans got lucky. A more sophisticated creditor might have prevailed. If this was the case, then in this instance the trust could have been reverse-pierced. A court might then treat a reverse-piercing as meaning the asset was, in fact, an asset of the debtor. Therefore, if the entity made subsequent transfers, then those transfers might actually be considered transfers of the debtor, and thus they could be deemed fraudulent under applicable fraudulent transfer law. We could, of course, reinforce a plan further to guard against this contingency, but such measures may be much more costly than if we had a solid structure in the first place.

Furthermore, although a restructuring of an entity is not a fraudulent transfer, per se, the restructuring may be challenged under laws other than the UFTA. For example, in *Walker v. Weese*<sup>xxv</sup> a debtor transferred millions of dollars in assets to an offshore trust, shortly after she defaulted on a promissory note. She was the protector of the trust, and consequently had the power to repatriate trust assets to the U.S. (this is *not* a good way to draft an offshore trust!) Upon being forced into bankruptcy, she resigned her position as protector. The bankruptcy trustee sought to, among other things, overturn her resignation and re-instate her as trust protector, so that he could then have the court order her to repatriate the assets. Although this case was settled before the court ordered the debtor's reinstatement as protector, the court noted:

“Plaintiff correctly points out that a fiduciary position such as Protector of the Trust, unlike the assets in the Trust, is an intangible right with no intrinsic value. [Citations omitted.] The resolution of a claim involving an intangible right, such as one's position as the Protector of a trust or as the trustee of a trust, can be adjudicated within the equitable powers of a court.”

Another example where reinforcement may fail is where one converts the nature of an asset (without effecting a transfer) into an asset that is exempt from creditor attachment under state law. This strategy may work in a state that doesn't have a fraudulent conversion statute, however in Florida and a few other states that do have such statutes,<sup>xxvi</sup> a creditor may undo the conversion of a non-exempt asset into an exempt asset if s/he proves the conversion was done with fraudulent intent. Purchasing an annuity with intent to defraud creditors, for example, could be undone under the fraudulent conversion statutes, even though the annuity is exempt from creditors under Florida law.<sup>xxvii</sup> Furthermore, although this tactic is more obscure, converting a corporation into an LLC may or may not be a fraudulent conversion, since

corporate stock, which is freely attachable, is converted to an LLC interest, which is not attachable outright. It is important to note that nowhere in the Florida LLC Act is an LLC interest technically considered exempt from creditors. Rather, a creditor's remedy against the debtor-owner of an LLC is limited to the charging order.<sup>xxviii</sup> Because a creditor remedy nonetheless remains, this tactic may not be considered a fraudulent conversion; we won't know for sure until the matter is decided in court.

The foregoing reinforces the fact that restructuring a faulty plan may or may not work, and it's best to do solid planning from the start, although it's certainly better to do faulty planning in advance of creditor attack than to have assets in your name when creditor threat arises. In addition to the foregoing, we must also note the psychological factors that would affect a judge in a *Walker*-type case over a case such as *Lakeside*. In *Lakeside*, the transfer was done long before creditor threat arose, and involved a claim of \$200,000. In *Walker*, the transfer occurred shortly after the debt was due, and involved a claim of about \$25 million. In circumstances where transfers occur after creditor threat has already arisen, we will usually see a court act more sympathetic to the creditor's motions than the debtor's. Furthermore, in larger cases the creditor's attorneys are often more sophisticated at challenging the debtor's maneuverings.

- 2) **Build up assets in a structure. Since these assets were never yours to begin with, there is no fraudulent transfer issue, period!** This approach works best with an income-producing business or investments. For example, if you own a business, then instead of transferring all profits to you, have another entity own the business. You can then take enough money from this entity to pay your cost of living, and the rest can remain in the entity, where it can be invested and grown. Because this money remains inside the entity, the assets never came into your possession. Consequently, if you're sued there is no fraudulent transfer issue, period!
- 3) **If you do asset protection after creditor threat arises, do all transfers so that you receive an asset of equivalent value in exchange for your transfer.** The trick here is to receive an asset that is exempt from creditor attachment in exchange for your transfer, or you could purchase an asset a creditor couldn't otherwise touch (such as an offshore annuity held in a properly structured offshore entity)<sup>xxix</sup>. Remember, under the UFTA you have to not receive equivalent value for your exchange *in addition to being insolvent* for a fraudulent transfer to have occurred (unless, of course, a creditor can prove the transfer was done with intent to delay, hinder, or defraud the creditor per §4(a)(1) of the UFTA; fraudulent transfers are significantly more difficult to prove under §4(a)(1) than under the bright-line tests of §4(a)(2) and §5). In light of the above, after creditor threats arise it goes almost without saying that one should avoid gifting whenever possible!
- 4) **In addition to avoiding the badge of fraud in (3), avoid other badges of fraud whenever possible.** Not all transfers carry badges of fraud, even if the transfer incidentally protects the asset from creditors. For example, if one

were to trade in their old car for a new, expensive leased vehicle, this transfer of cash for the lease (which will have little value to a creditor) will almost certainly not be considered a fraudulent transfer. Even if badges of fraud 4 (making the transfer after creditor threats materialized) and 9 (making a transfer while insolvent) are present. As long as the transfer is a bona fide business transaction for equivalent value with a truly independent 3<sup>rd</sup> party, badges 4 and 9, even if present, are much less relevant (nonetheless we should still avoid these badges of fraud if at all possible). Compare this to gifting your vehicle to your mother after creditor threat arises while one is insolvent, and then moving to another state in a hard to locate area and continuing to drive the vehicle. This type of transfer carries badges of fraud #1, 2, 4, 6, 7, 8, 9, and 10 – a dead giveaway of fraudulent intent, not to mention a failure of the UFTA §§4(a)(2)(ii) and 5(a) bright-line tests.

A tactic we often use that avoids or minimizes badges of fraud is to transfer one's assets to an LLC or limited partnership in exchange for a limited (non-managing) interest in the entity. Under §1(7)(i)(B) of the UFTA, a company of which someone is only a limited partner or member is *not* defined as an insider.<sup>xxx</sup> We can also transfer assets to a corporation without the corporation being considered an insider, as long as the debtor holds less than 20% voting stock in the corporation, and s/he is not an officer or director<sup>xxxi</sup> (however since corporate stock may be seized by a creditor, this is usually not a good idea.) Properly using this tactic will, at the very least, avoid badge #'s 1, 2, 3, 6, 7, 8, and 11, and will also pass both bright-line tests. Of course, you still have to worry about (and avoid to the greatest extent possible) badge #'s 4, 5, 9, and 10, but as long as the asset can have a valid business purpose, then this strategy definitely moves things in the right direction.

- 5) **Do you have other creditors who are not insiders? If so, and you come under creditor attack, then pay your non-hostile creditors off.** This is an excellent tactic that works even after creditor threat has arisen. The U.S. Supreme Court has even noted that “In many [States], if not in all, a debtor may prefer one creditor to another, in discharging his debts, whose assets are wholly insufficient to pay all the debts.”<sup>xxxii</sup> Here's an example of how we could use this truism to our advantage: suppose you have a 5 year commercial lease on your office space. If you come under creditor attack, you can place some of your cash reserves beyond the hostile creditor's reach by paying off the entire lease balance. This works because you receive something of equivalent value for paying off the debt, which is your right to use the office space. Furthermore, per the terms of the lease contract a creditor almost certainly wouldn't be able to use your office space (nor would he likely want to) and he almost certainly wouldn't be able to get a court to force the landlord to hand over your payment, as long as the lease is a valid, pre-existing debt. You could also pay your anticipated tax debts through the end of the year. Do you think the IRS would *ever* give that money to one of your creditors? Do you think a judge would ever consider paying your taxes to be a fraudulent transfer? No way!

6) **When is a fraudulent transfer not a fraudulent transfer? When you buy a Florida homestead so as to protect your wealth from creditors.** In a rather shocking decision, the Florida Supreme Court in *Havoco of America v. Elmer C. Hill*<sup>xxxiii</sup> decided that a “homestead acquired by a debtor with the specific intent to hinder, delay, or defraud creditors is not excepted from the protection of article X, section 4 [of the Florida Constitution, which protects homesteads from creditor attachment.]”<sup>xxxiv</sup> What this means is that you can buy a Florida home after creditor threat arises and, even if doing so is a fraudulent transfer, the creditor cannot touch the home as long as it’s your bona fide homestead. This home is protected no matter what its value is. Therefore, a sure-fire way to protect \$20 million in assets is to buy a \$20 million homestead in Florida!<sup>xxxv</sup>

7) **If creditor threat has already arisen, then use a proper offshore plan to purchase a foreign annuity. This transaction will likely be protected under §8(a)(1) of the UFTA.** Although strategies 3 and 4 (above) minimize the likelihood a fraudulent transfer ruling, they don’t completely eliminate it. Furthermore, strategies 5 and 6 may not protect all of your assets, or may not be feasible. If therefore the strategies we’ve discussed up to this point are inadequate, and creditor threats already loom, then consider offshore planning.

The first thing you need to know about offshore planning is not all offshore plans are immune from creditors. In fact, most aren’t, because most aren’t set up properly. Several high-end, expensive offshore plans (all involving a straightforward transfer of assets to an offshore trust) have, in actuality, failed when put to the test.<sup>xxxvi</sup> The good news about offshore planning is your assets move outside a U.S. judge’s jurisdiction. Therefore, when implemented in a careful and proper manner, offshore planning may work even if the transfer is deemed fraudulent. However, the bad news is while your assets are outside a judge’s grasp, you are in the judge’s grasp while you remain in the U.S. A judge could order you to repatriate offshore assets, and unless you can prove your inability to do so, he can incarcerate you for failing to do so. In light of the above, it is best to treat your offshore transactions as if they were still subject to U.S. law (because you are!) If the transfer is not voidable under U.S. law, then you don’t even test the offshore aspect of your plan. In other words, you’ll have other layers of defense that need to be breached before the offshore aspect kicks in. This is what asset protection planners refer to as multi-layered protection or defense-in-depth. In regards to this strategy, it’s usually not wise to use an offshore asset protection trust as a first line of defense, because under the laws of 42 states, the trust’s assets are attachable by creditors. This means a U.S. judge might not look too kindly on your offshore trust.

The trick is to avoid badges of fraud as much as possible, make your transfer an exchange of equivalent value, use charging order protection<sup>xxxvii</sup> (which is recognized under U.S. law, as opposed to a foreign jurisdiction’s self-settled asset protection trust law, which isn’t), and have a valid economic purpose for your transfer so as to demonstrate your transfer was done with an intent other than to defraud a creditor. After all the foregoing has been done, you still need to make sure your transfer offshore is done so that you can

prove to a court it's impossible for you to repatriate assets, especially if you do offshore planning after creditor threats arise (thus, if your transfer is deemed fraudulent, you can't be held in contempt). The chapter in this book entitled "Asset Protection a Judge Will Respect" gives a more in-depth analysis regarding the critical matter of repatriation orders and offshore planning.

With the above in mind, there is a provision of the UFTA that gives a *proper* offshore plan a *lot* of power. This provision is so powerful that one may call it the "Holy Grail" of asset protection planning. It may be the *only* way to fully protect your assets if a storm-of-the-century lawsuit arises and you don't yet have an asset protection plan (which means anything you do is at risk of being deemed a fraudulent transfer under §4(a)(1) of the UFTA).

This provision is §8(a) of the UFTA. It states:

"(a) A transfer or obligation is not voidable under Section 4(a)(1) against a person who took in good faith and for a reasonably equivalent value or against any subsequent transferee or obligee."

Did you get that? The UFTA gives one and only one situation where a transfer is *not* voidable (meaning the transfer won't be undone) *even if the transfer was done with fraudulent intent*: the transferee must have given the transferor something of equivalent value for the transfer, and the transferee must have done the transaction in good faith.

Setting up an offshore trust or LLC by itself *does not* meet these criteria. Transferring assets to an offshore trust almost always involves a gift and therefore there is no exchange of equivalent value. Although an exchange of equivalent value is present when you capitalize an offshore LLC (you get an interest in the company in exchange for giving the LLC assets), the LLC will probably not be considered a transferee in good faith if you are the one who set up the company. For the good faith criterion to be met beyond dispute, the transferee must be a completely impartial 3<sup>rd</sup> party who does the transaction in their normal course of business. Fortunately, there is such a transferee: an offshore insurance company.

Let's examine the following scenario: there is a European insurance company who manages \$250 billion in assets and has been in business over 100 years. A creditor threat materializes, and you're caught with your pants down because you haven't yet done any asset protection, or your asset protection plan is seriously flawed. Consequently, you place your liquid assets in an offshore LLC, and you suck the equity out of real estate and other assets by setting up and exercising lines of credit (LOCs) with the hard assets as security for the LOCs. You then place LOC funds offshore as well. Afterwards, your offshore LLC uses these funds to purchase a foreign annuity from the foreign insurer. In doing so, you have accomplished the following:

- You've transferred your assets to a non-insider for something of equivalent value (the annuity contract) that has little or no worth to a creditor (after all, even if they could seize the annuity contract, which they couldn't, they'd have to wait years to receive enough

payments to satisfy their judgment). There is a viable economic purpose for this other than asset protection (as is explained in the chapter entitled “Asset Protection a Judge Will Respect”), and therefore you make it harder for a creditor to prove the transfer was done with fraudulent intent.

- Because the transfer was made in exchange for an item of equivalent value, and the annuity purchase was done in good faith in regards to the transferee (the insurance company), the transfer is not voidable under §8(a) of the UFTA, even if the debtor did it to hinder, delay, or defraud a creditor!
- The foreign insurer is a large, reputable, and well-established, and is in a jurisdiction that not only does not recognize a U.S. court order, but forbids annuity contracts from being surrendered to creditors. This is almost certainly ample evidence that the debtor is unable to repatriate assets if the transfer is voidable, which greatly reduces the chance of being held in contempt if assets are not repatriated.

We must note that you may be able to use this strategy by purchasing a domestic annuity, however there are some problems with the domestic approach:

- Notwithstanding §8(a) of the UFTA, some states’ laws may specifically set aside purchases of annuities or life insurance if done with fraudulent intent.<sup>xxxviii</sup>
- It is almost impossible to set up an annuity where payments are made to an LLC (or other entity the debtor could then receive distributions from) without that entity being subject to reverse piercing. For example, if an LLC received annuity payments, this might not be considered a valid business purpose for the LLC, and thus the LLC could be reverse-pierced. In comparison, an offshore structure *must* be used in order to purchase an offshore annuity, as the foreign insurer will not do business directly with a U.S. person. Consequently, if annuity payments are made to the debtor (or to an entity he holds an interest in), then a creditor may or may not attach those payments when they’re made, depending on whether or not those payments are exempt from attachment in a particular state.
- Offshore planning has the additional advantage of placing assets outside a U.S. court’s jurisdiction (assuming we can prove it’s impossible to repatriate assets, of course.)
- Offshore annuities are much more flexible, and typically have a much higher rate-of-return than domestic ones.

- 8) **Remember to consult your state’s statutory and case law regarding fraudulent transfers.** There may be subtle differences between your state’s law and the UFTA that could work to one’s advantage, or detriment if one isn’t careful. Merely relying on the UFTA in general may be a critical mistake!

*When Is It Too Late to Do Asset Protection?*

Before we discuss when not to do asset protection, we should examine when doing asset protection is safe. As long as asset protection does not involve fraud or blatant illegal acts (such as hiding assets offshore without filing the required reports with the U.S. government), it is safe to do asset protection while creditor seas are calm and the debtor is not insolvent as defined by §2 of the UFTA. In doing so, even flawed asset protection programs may have a fighting chance of holding up when challenged (such as the trust we discussed in *Lakeside v. Evans*<sup>xxxix</sup> earlier in this chapter. Remember however that solid asset protection has a much higher chance of surviving scrutiny than flawed planning.)

Once creditor threat has arisen, asset protection may still be done, although our available options are now somewhat diminished. Nonetheless, the U.S. Supreme Court case *Grupo Mexican v. Alliance Bond Fund* states, “[we] follow the well-established general rule that a judgment establishing the debt was necessary before a court of equity would interfere with the debtor’s use of the property.”<sup>xi</sup> Another court even noted that an attorney who represents a client under creditor attack should “protect [the client] from the claims of creditors, to the fullest permissible extent.”<sup>xli</sup> This obviously gives us some wiggle room, and an attorney may even have an *obligation* to recommend asset protection for his client in certain situations, however the key phrase is we must do our planning “to the fullest *permissible* extent”. This means planning while under creditor duress should only be done while fully considering the UFTA. Furthermore, there are several pitfalls (as discussed below) that should be avoided at all costs.

This brings us finally to circumstances where asset protection should not be done. Planning done in these instances can not only cause a program to fail, but could result in additional fines and penalties against the debtor, the planner, and possibly professional discipline against the debtor’s attorney. Such circumstances can be broken down into four categories:

- 1) Planning against a creditor who has a direct interest in the property;
- 2) Planning against a post-judgment creditor;
- 3) Planning that involves dishonesty, misrepresentation, or committing a fraud against the court; and
- 4) Planning that is a blatant and egregious fraudulent transfer under the UFTA.

Almost without exception, planning should not be done to protect an asset that a creditor has a direct interest in. Doing so could give rise to a civil conspiracy claim if two or more individuals are involved (which is almost always the case, since protecting assets typically involves a transferor and transferee.) For example, in *Miller v. Lomax*, an estate’s executor (Mr. Lomax) conspired with the decedent’s children to transfer assets out of the reach of the estate’s beneficiaries. Because this was done to cheat the beneficiaries of an asset they had a specific right to, the court noted that the defendant was guilty of civil conspiracy as well as committing fraudulent transfers. This stands in stark contrast to planning done to protect assets from a litigant who is not a secured creditor, and who does not have a claim to any specific property of the debtor. In another case, *Lane v. Sharp Packaging System, Inc.*, the Wisconsin Supreme Court held an attorney liable for conspiring to transfer assets out of the reach of his client’s former employee. Although the employee had a contractual right to a stock option purchase as a part of his employment agreement, the attorney advised his client to gradually transfer

assets out of the company so as to make the purchase impossible. This was of course not only a fraudulent transfer of assets the employee had a direct interest in, but a breach of contract and a bad faith act by the company's board of directors. A third example an Arizona court of appeals case, *McElhanon v. Hing*<sup>xlii</sup>. In this case, an attorney conspired with his clients (who were two of three stockholders of a corporation, of which each stockholder held a one-third interest) to render their corporate stock worthless via a bankruptcy proceeding, which essentially defrauded the third stockholder of his interest in the company. The court found both the attorney and his clients guilty of civil conspiracy.

The second instance where asset protection planning should not be implemented is after a creditor obtains a judgment, except when the debtor arranges to pay the creditor and only does general planning, or planning to protect against other threats that have not yet been reduced to judgment. Again we quote from *Grupo Mexican v. Alliance Bond Fund*, which states that "before judgment (or its equivalent) an unsecured creditor has no rights at law or in equity in the property of his debtor."<sup>xliii</sup> This of course means that once a creditor has a judgment, then s/he *does* have rights to property of the debtor, and an attempt to thwart those rights will be viewed in a much harsher light than if asset protection was done pre-judgment, wherein "the debtor has full dominion over his property; he may convert one species of property into another, and he may alienate to a purchase."<sup>xliv</sup> Instances of post-judgment planning gone sour include *Morganroth v. Delorean*<sup>xlv</sup> (where sanctions were imposed on both the debtors and their attorneys for attempting to evade a post-judgment claim of another law firm's legal fees), *Fischer v. Brancato*<sup>xlvi</sup> (where an orthopedic surgeon diverted his income post-judgment to his wife's corporation, and was thus held liable on civil conspiracy as well as fraudulent transfer rulings), and *Professional Collection Consultants Inc. v. Griffis* (which found the defendant guilty of civil conspiracy and committing several fraudulent transfers post-judgment via a series of title transfers, encumbrances via deeds of trust, and foreclosure sales of various real properties).

The third "don't" of asset protection does not involve a circumstance, but rather involves a type of asset protection planning. In a nutshell, no type of asset protection should be done if it involves the necessity of lying, misrepresenting facts, or committing a fraud upon the court. This is far different from dual-purpose asset protection (which is asset protection that has an estate, business, tax, or retirement planning objective in addition to asset protection), or asset protection that benefits from attorney/client privilege. This is asset protection that essentially involves perjury or the equivalent. Such activities may be dealt with harshly by the courts. For example, in *In re Complaint as to Conduct of Verden L. Hockett*,<sup>xlvii</sup> an attorney was sanctioned for having his clients transfer assets to their spouses via expedited divorce proceedings. These divorce proceedings required the spouses to lie under oath as to the purpose for the divorce, which essentially meant they committed a fraud upon the court. In *In re Depamphilis*,<sup>xlviii</sup> 153 A.2d 680 (N.J. 07/31/1959), an attorney was sanctioned for advising his clients to transfer cash to their uncle, purportedly to pay a pre-existing debt that in actuality did not exist. This of course involved misrepresentations under oath as to the nature and validity of the transfer. (Ironically, after the transfer was set aside as fraudulent, the sanctions arose when the attorney's client sued him for malpractice, meaning the sanction arose from an action brought by the very client he was trying to protect.) The fact of the matter is, a good asset protection plan does not require one to commit perjury or deceive a creditor. It also never relies exclusively on secrecy, and the privacy aspects of the

planning are only used to prevent or discourage litigation. In other words, solid planning is always done so that, if required in order to comply with a discovery request or debtor's exam, the entire plan and all transfers are fully disclosed to the court. If the planning is solid, then the assets should remain outside a creditor's grasp even if the mechanics of the plan are fully exposed.

Finally, although rare, particularly blatant violations of the UFTA (that do not otherwise involve one of the three foregoing "don'ts") can lead to sanctions above and beyond setting aside a fraudulent transfer and paying the plaintiff's attorneys fees for doing so. *Such instances historically have always involved transfers done without consideration while the debtor was insolvent*, and there are often harsher sanctions against attorneys who are well-versed in the law and therefore, in the courts eyes, should have known better. Such instances include the indefinite suspension of former attorney William S. Reed's Colorado law license for trying to protect his assets against creditors by filing "friendly liens" on his assets (the liens were basically a sham since there was no valid basis for the lien).<sup>xlix</sup> In *In the Matter of Breen*,<sup>1</sup> a Florida attorney was disbarred for trying to protect his assets by filing four bogus liens against his property (as with Mr. Reed's case, the liens had no reason or consideration), and transferring assets to his friend (again, without receiving consideration in exchange for the transfer.)

In light of the above, some clients may be hesitant to do asset protection of any type once a creditor threat has materialized. This would be a grave mistake, as failing to do so at this point could cause them to lose their entire life savings – everything they have worked so hard their entire life to accumulate. Except when a debt has been reduced to judgment, or when doing asset protection would involve defrauding a creditor of their direct rights to property, it is not a question of *whether* to do asset protection so much as it is *how* to do asset protection. Because of the complexity of fraudulent transfer law (both under the UFTA, associated case law, and the variations of the UFCA and UFTA between states), a competent, experienced, and skilled planner should be engaged, especially when creditor attack is imminent. Asset protection is like brain surgery: it is not a "do it yourself" endeavor.

## APPENDIX D

### SELLING YOUR ASSET PROTECTION PLAN TO A JUDGE

By W. Ryan Fowler

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Asset protection plans are put to the ultimate test when scrutinized in court. Knowing how to structure a plan to survive such scrutiny is what separates a great planner from the mediocre masses. Fortunately, the courts themselves have told us what types of planning will and won't be respected.

#### *Having a Legitimate Purpose for Your Plan*

In one case, a court gives clear instruction on what kinds of asset protection planning are or are not acceptable when it says:

“‘Asset protection’ is not illegal and is honored by the law if done for a legitimate purpose. For example, an individual may do business through a corporation or limited liability company and will not be held personally liable for the debts of the entity. The assets of the corporation or limited liability company will not be considered the assets of the individual interest holder. However, an entity or series of entities may not be created with no business purpose and personal assets transferred to them with no relationship to any business purpose, simply as a means of shielding them from creditors. Under such circumstances, the law views the entity as the alter ego of the individual debtor and will disregard it to prevent injustice.”<sup>li</sup>

It is of further note that this case mentions the defendants' meeting with and use of an asset protection planner as evidence that the plan was implemented to thwart creditors. The asset protection planner was even subpoenaed and forced to testify! Subsequently, the defendant's structure was deemed a sham, and the defendants lost their wealth. (This could have been avoided if the planner had worked under an attorney, which we'll discuss shortly.)

There are some situations where estate or tax planning, instead of a business purpose, is a legitimate alternative reason for using certain entities. This is especially true of non-self-settled trusts, which are often statutorily protected from creditors if they contain a spendthrift clause<sup>lii</sup>. However, using business entities (such as family limited partnerships) solely for estate or tax planning, with no business purpose behind it, can be a recipe for disaster. This was the case with *Strangi v. CIR*, wherein a family limited partnership was pierced because it had no business purpose and had not invested its assets in any form of business venture.<sup>liii</sup>

The above cases lead us to deduce the following:

- 1) It's better for an asset protection planner to work under an attorney rather than work for a client directly (although initial contact with a planner should not give cause for concern). This insures that the program will be protected by attorney/client privilege and privileged work product, which will preclude the planner from being forced to give testimony that may very well undo your program.
- 2) Business entities, such as LLCs, corporations, and limited partnerships, should always have a bona fide, demonstrable business purpose.<sup>liv</sup> If the business entity holds investments, then it is best to trade or exchange more than just a *de minimis* amount of its investments from time to time to demonstrate that the entity is actively engaging in business rather than merely holding assets.

**In addition to the foregoing, there is a simple and effective litmus test for determining whether an asset protection program is likely to pass court scrutiny. Simply ask yourself: “if a judge asked me why I set up my affairs the way I did, what will I say?” (I put this litmus test in bold print because it is very important! It should be used when structuring ANY asset protection program that does not have a built-in business purpose.)** If the only answer you can think of is “I set up my financial affairs so as to avoid creditors” then you have a program that will likely fall apart when challenged. This is not only true when a program is set up after a lawsuit arises; it may also be true even if the plan is set up while creditor seas are calm. The case *U.S. v. Townley* validates this fact<sup>lv</sup>. In this case, Mr. and Mrs. Townley had transferred their home into a non-self-settled trust years before they ran afoul of the IRS. However, Mr. Townley's own testimony as to the reason for the trust proved to be her undoing. The court notes:

“...a transfer of property made with actual intent to delay, hinder, or defraud a creditor is prohibited... Mr. Townley stated in her deposition that he was concerned about potential ‘lawsuits from the exposure we had from liability from troubled boys in the State of Washington.’ (Ct. Rec. 58, Ex. 1). Additionally, Mr. Townley stated that it was her goal to protect her assets from anyone who might get a judgment against him... Plaintiff asserts that *Mr. Townley's statements that he intended to protect her assets from anyone who might get a judgment against him is conclusive, direct evidence of intent to hinder, delay, or defraud. The Court agrees.*” [emphasis is mine]

Some people might think structuring a program with a bona fide business purpose would require an excessive time and effort commitment. For the most part, this is simply not so. For example, a home can be equity stripped via an LLC capitalization tactic (discussed in Chapter 12) where the LLC trades stocks and bonds; this program, although slightly more effort intensive, has a built-in business purpose and will save a client thousands of dollars in interest payments over using a debt-based equity stripping program. Cash can be placed in an LLC and then invested into stocks, bonds, real estate, or other assets that are likely to appreciate and generate profit. Retirement funds may be rolled over to a self-directed IRA that invests in an offshore LLC, which in turn either operates as a business or actively engages in investment activity. Life insurance policies could be placed in an Irrevocable Life Insurance Trust (ILIT), which need have no business purpose. The list goes on and on. These are things many financially savvy

individuals would do anyway, regardless of whether they were trying to protect assets. Of course a skilled planner needs to be knowledgeable about a wide variety of business entities and trusts, so as to be able to creatively and skillfully use these entities in a manner that will appear legitimate when scrutinized in court.

If desired, the above entities can be structured so as to be disregarded for tax purposes. This minimizes or even eliminates the requirement to file informational tax returns. Instead, incomes from the entities are often simply reported on the owner's or grantor's 1040 Schedule C return.<sup>lvi</sup>

### ***The Offshore Annuity and Other Economic Reasons for Going Offshore***

But what about going offshore? Even if your offshore program has a valid business purpose, a judge may well ask "why couldn't you have just done that onshore?"<sup>lvii</sup> We need to have a plausible response. Fortunately, the trend of a weakening U.S. dollar provides us with an answer. For example, between January 2002 and January 2005, the dollar weakened against the Euro an astounding 56%. Imagine how much better off you would have been financially had you invested in an offshore annuity earning 4% annually, especially if that annuity had been based on the Euro! Personally, I think it's essential for anyone of significant wealth to invest a portion of their liquid assets in an offshore annuity based on a stable, nearly debt-free currency such as the Euro or Swiss Franc (note that the Swiss Franc has the additional stabilizing benefit of being gold-backed, which is a chief reason why it is historically the world's most stable currency). And although an offshore entity is not needed to merely buy these currencies, you *must* have an offshore entity if you want to purchase an offshore annuity or other structured financial product in order to receive a guaranteed additional return on your investment. Therefore, going offshore may give you a bona fide economic benefit you wouldn't be able to achieve any other way.

In light of the above, do you think a judge would agree that it sometimes makes economic sense to go offshore, in order to gain a benefit you couldn't obtain otherwise? Of course he would, and that's what we need to get a judge to agree to in order for him to respect your program.

### ***Avoiding Repatriation and Civil Contempt Nightmares***

The primary advantage of offshore planning is the location and control of assets is outside the jurisdictional reach of a U.S. judge. Even if a transfer offshore is determined to be fraudulent, the judge may not have the ability to aid a creditor in retrieving those assets. However, case law has shown that if a judge believes a debtor has the power to repatriate offshore assets, notwithstanding their claims to the contrary, he will issue a repatriation order. Failure to comply with this order can (and has) landed more than one debtor in jail.<sup>lviii</sup> Furthermore, if a debtor transfers assets offshore after creditor threat has arisen, in an egregious manner, then her 'self-created impossibility' of being unable to repatriate assets may not be believed by a judge. In other words, the debtor has placed himself in a position where he doesn't have the power to repatriate assets, but a judge doesn't believe her claim of powerlessness, and therefore he has no choice but to spend time in jail due to civil contempt of court!<sup>lix</sup>

A few planners have cited examples of these occurrences to mean that offshore planning will, when challenged in court, always subject one to a repatriation order and

threat of civil contempt consequences for failure to comply. Case law, however, demonstrates this is simply not so. Even when assuming the offshore transfer is fraudulent, or that the plan otherwise fails, the U.S. Supreme Court notes that a finding of contempt for failing to obey a repatriation order is not always appropriate:

“In a civil contempt proceeding such as this, of course, a defendant may assert a present inability to comply with the order in question. *Maggio v. Zeitz*, supra, at 75-76; *Oriel v. Russell*, 278 U.S. 358, 366 (1929). While the court is bound by the enforcement order, it will not be blind to evidence that compliance is now factually impossible. Where compliance is impossible, neither the moving party nor the court has any reason to proceed with the civil contempt action. *It is settled, however, that in raising this defense, the defendant has a burden of production.*”<sup>lx</sup> [Emphasis is mine.]

An analysis of relevant cases (such as the infamous “Anderson” case<sup>lxi</sup>) in conjunction with the above excerpt shows that debtors who were held in contempt were not incarcerated for failing to repatriate assets; rather, their critical blunder was failing to prove their inability to repatriate assets. It is perhaps most important to note that debtors who were subsequently held in contempt, without exception, took extraordinary measures to effect a ‘self-created impossibility’ to repatriate assets, which did nothing but invoke the suspicion and wrath of a judge whose orders were being flaunted.<sup>lxii</sup>

There are many things that can be done to avoid the repatriation/contempt problem. For example, most U.S.-situs courts are biased against offshore asset protection trusts, since 42 states currently don’t allow self-settled trusts of any kind to provide asset protection. However, an offshore LLC, like a domestic LLC, benefits from charging order protection as long as it is used for a valid business purpose, and is thus a much more acceptable entity in the eyes of a judge. If the LLC then invests cash into an annuity or other policy that’s administered by a large, well-respected offshore insurance company, before creditor threat arises, then a production of the policy contract provides ample evidence that the LLC’s owner is unable to repatriate those assets (and, unlike offshore trusts, we have a reason for the policy besides asset protection!) An operating agreement can also appoint an offshore manager, or at least forbid the LLC members from distributing offshore assets without the approval of an offshore individual (the LLC members who are U.S.-based would ideally never be signers on any offshore accounts, and language should be placed in the operating agreement that shows one of the LLC’s purposes is to build capital within the company. In other words, the LLC’s operating agreement makes it clear from the start that distributions are to be limited.)

Even if additional contributions to the offshore structure are made after creditor threat arises (thus placing more assets offshore), these transfers are likely to be seen as acceptable if a program has been implemented and funded in advance of creditor threat, and the subsequent transfers have a demonstrable economic benefit. Furthermore, offshore asset protection is not the first line of defense for most of our assets. Most assets will be held in domestic entities before creditor threat arises. Therefore any assets placed offshore after creditor threat arises were not the debtor’s in the first place (and thus wouldn’t be subject to creditor attachment unless the domestic entities were pierced); the offshore component is just another layer of protection reinforcing a plan.

To summarize, instead of being obvious about what we’re doing, we are subtle. We use camouflage. We have a bona fide reason for doing what we’re doing besides

asset protection. We do things so as to be able to prove our inability to repatriate assets if needed. We have liability insurance that will pay a reasonable amount of the claim, thus ensuring that the plaintiff's attorney gets an easy payout, which serves to divert him from the tough and uncertain uphill battle he'll have to wage if he wants any significant portion of the debtor's personal wealth. We appear to be conducting 'business as usual'. In fact, we really are doing 'business as usual', which is why our program stands up in court.

### ***Structuring an Entity a Judge Will Respect: the Devil is in the Details***

The intent and purpose for forming an entity is not all we must pay attention to. The legal structure of an entity must also be carefully planned if it's to hold up in court.

As discussed in chapter \_\_\_\_\_<sup>lxiii</sup>, an analysis of the case *In re: Ashley Albright*<sup>lxiv</sup> shows us single member LLCs are sometimes susceptible to losing their charging order protection. However, although rare, even multi-member LLCs sometimes find their charging order protection compromised. Fortunately, multi-member LLCs can be reinforced against this threat through the utilization of a method created by the author, known as Entanglement Theory®.

Before discussing Entanglement Theory®, we must examine the circumstances in which a multi-member LLC's charging order protection fails. Besides *In re: Ashley Albright*<sup>lxv</sup>, three other cases are relevant to this topic. The first two, *Crocker National Bank v. Perroton*<sup>lxvi</sup>, and *Hellman v. Anderson*<sup>lxvii</sup>, come from California district courts. In both cases, the court decides to ignore a limited partnership's charging order protection because, the court ruled, charging order protection was originally enacted as a means of protecting the non-debtor partners, and to insure that partnership business is not interrupted<sup>lxviii</sup>, not so that a debtor partner can escape paying her debts. In both cases the partnership interest could be transferred to the creditor without causing an interruption in partnership business. As a result, the courts on both occasions decided that charging order protection did not apply, and the partnership interest was transferred to the creditor. Although the court only allowed this transfer with the other partners' consent in the Crocker case, in Hellman the court allowed the transfer without the consent of the non-debtor partners. Although these cases currently only apply in California, they set a precedent that may be imitated in other courts nationwide.

Another situation in which charging order protection may fail is found in a recent bankruptcy proceeding, *In re: Ehmman*<sup>lxix</sup>. The court ruled in *Ehmman* that the debtor's LLC membership interest in Fiesta Investments, LLC was forfeit to the bankruptcy estate due to the fact that the LLC's operating agreement was not an executory contract. Under bankruptcy law, an executory contract would include an agreement wherein the member and the LLC have reciprocal obligations. Such an executory contract would be subject to §§ 365(c) and (e) of the Bankruptcy Code (Title 11 U.S.C.), which would uphold the limitations of state or other applicable law. The court makes it clear however, that §§ 365 (c) and (e) do not apply to non-executory contracts when it states:

“The Court here concludes that because the operating agreement of a limited liability company imposes no obligations on its members, it is not an executory contract. Consequently when a member who is not the manager files a Chapter 7 case... the limitations of §§ 365(c) and (e) do not apply.”

If an operating agreement is non-executory, the LLC interest would instead be subject to Title 11 U.S.C. §§ 541(a) and (c)(1). As the court noted:

“Code § 541(c)(1) expressly provides that an interest of the debtor becomes property of the estate notwithstanding any agreement or applicable law that would otherwise restrict or condition transfer of such interest by the debtor. All of the limitations in the Operating Agreement, and all of the provisions of Arizona law on which Fiesta [Investments LLC] relies, constitute conditions and restrictions upon the member's transfer of her interest. Code § 541(c)(1) renders those restrictions inapplicable. *This necessarily implies the Trustee has all of the rights and powers with respect to Fiesta that the Debtor held as of the commencement of the case.*” [Emphasis is mine.]

Although there was plenty in Fiesta Investments, LLC’s operating agreement that obligated the LLC and its manager to the debtor, there was nothing that obligated the debtor to perform any service or make any contribution to the LLC. Therefore, the operating agreement was non-executory, and the debtor’s membership interest was forfeit, statutory charging order protection notwithstanding.

In light of the above cases, there is yet another situation wherein charging order protection may be circumvented. That is where all members of the LLC are debtors to the same creditor. In this situation, the underlying reasons for charging order protection would not apply to the fact pattern, and therefore a court could conceivably disregard charging order restrictions.

To summarize, we can see that the following factors may jeopardize the charging order component of an asset protection plan:

- 1) The LLC is a single member LLC - this is especially dangerous.
- 2) The LLC’s operating agreement is non-executory in nature (however this is currently only a problem in bankruptcy.)
- 3) The forfeiture of a debtor’s membership interest to a creditor would not interrupt partnership business.
- 4) All members of the LLC become a debtor of the same creditor.

It is obvious that if we wish to structure an LLC or LP<sup>lxx</sup> for maximum asset protection, we must effectively counter the above pitfalls. These pitfalls are sidestepped with the utilization of Entanglement Theory®. Entanglement Theory® is the process of “entangling” the relationships of various LLC members with the LLC and each other (in connection with their obligations and rights to benefit from LLC membership) so that if a particular member of the LLC was taken out of the picture, then the business of the LLC, and the interests of the other members, would be significantly impaired. We are fortunate to have case law that confirms the efficacy of this strategy, since the courts generally forbid a ‘reverse-piercing’<sup>lxxi</sup> of an entity (even a non-charging order protected entity, such as a corporation) if innocent company owners or creditors of the company would be harmed. In one case, for example, we read the following:

“We recognize ... that there are other equities to be considered in the reverse piercing situation -- namely, whether the rights of innocent shareholders or creditors are harmed by the pierce.<sup>lxxii,</sup>”

Another case echoes this sentiment in greater detail:

“In addition, the reverse-pierce theory presents many problems. . . . third parties may be unfairly prejudiced if the corporation’s assets can be attached directly. Although . . . our particular concern was with non-culpable third-party shareholders of the corporation being unfairly prejudiced, no greater culpability should attach to the third-party corporate creditors harmed by reverse-piercing in this case. See *id.* (“... the doctrine cannot be applied to prejudice the rights of an innocent third party.”) (quoting 1 William Meade Fletcher et al., *Fletcher Cyclopedia of the Law of Private Corporations* § 41.20, at 413 (1988 Supp.)) . . . ; see also *Hamilton v. Hamilton Properties Corp.*, 186 B.R. 991, 1000 (Bankr. D. Col. 1995) (“The reverse piercing theory is an aberration which, if invoked, would prejudice . . . the rightful creditors of the corporation whose assets are subsumed for the benefit of the creditors of the individual. What of the creditors of [the corporation] who relied on its separate corporate existence in doing business with it?”); *Cargill, Inc. v. Hedge*, 375 N.W.2d 477, 479 (Minn. 1985) (holding that in considering propriety of reverse pierce, “also important is whether others, such as a creditor or other shareholders, would be harmed by a pierce”).<sup>lxxiii</sup>

Obviously, if there is only one member in an LLC, there is no one else to become entangled with (especially if there are no LLC creditors), so the first thing we must do is make an LLC multi-member. There is no real obstacle to doing this with what would otherwise be a single member LLC, since a grantor trust can easily be added as a 2<sup>nd</sup> member, thus preserving its disregarded entity status if such is desired for tax reasons.<sup>lxxiv</sup>

The next thing we must do is ensure that the LLC operating agreement is executory. It goes without saying that there are many considerations that must be made when drafting an operating agreement, in order to ensure that the highest possible degree of asset protection is obtained. Such considerations are without the scope of this article, yet we’ll explore a few ideas for making such an agreement executory. *In re: Ehmman* shows us that an LLC agreement is executory when the members have the following obligations:

- 1) Ongoing obligations to contribute cash to the entity;
- 2) Ongoing obligations to contribute non-managerial services to the entity;
- 3) Ongoing obligations to contribute equipment or other property to the entity; or
- 4) Ongoing obligations to manage the entity.

The easiest way to accomplish this is to require every LLC member to do one of the following:

- 1) A managing member should have a written agreement to act as a company manager as long as he holds a membership interest, as a condition of continued membership.
- 2) A non-managing member should agree to act in an advisory or consulting role to the company as long as he is a member, as a condition of continued membership. These services should be demonstrable in court. For example, he could submit an annual report to the company, giving her recommendations as to how the company could increase its profits and become more efficient. Such a report could then be submitted to a court to prove that ongoing executory obligations are being performed.

In addition to the foregoing, the company operating agreement should stipulate that members and managers, unless incapacitated, cannot transfer their obligations while they remain members, due to the fact that their intimate involvement with company affairs uniquely qualifies them to know how to best advise or manage the company.

Lastly, we must make sure that never, under any circumstance, could all members of the LLC personally become debtors of the same creditor. This could be done one of the following ways:

- 1) Make sure at least one of the LLC members is never exposed to liability. This may be accomplished by making one of the members a trust, LLC or other entity that only engages in “safe” activities, or;
- 2) Make sure that at least one member is not an insider or affiliate of any other member under the U.F.T.A.

Obviously, this type of structuring necessitates a very high level of skill. However, when implemented correctly, Entanglement Theory® poses an extremely formidable asset protection barrier that would survive many situations a lesser plan would not.

## APPENDIX E

### What is a Foreign Portfolio Bond?

*Rather unfamiliar to many offshore investors is an investment structure called a Portfolio Bond. It combines the best of two worlds -- banking and insurance -- in a safe offshore jurisdiction.*

#### **How it works**

The Portfolio Bond can be considered as a simple holding structure through which the investor (or his/her adviser) can direct the insurance company to invest in a wide range of investment vehicles such as stocks, bonds, mutual funds, or cash deposits. The underlying investments can be freely selected. Any investment can be held in the Portfolio Bond so long as the value can be established (e.g., non-listed stock, real estate and shares of the investor's own company).

Specifically, the investor closes a contract in his name with an insurance company, usually domiciled in an offshore tax haven. The insurance company opens an account with a bank selected by the investor, who in turn receives a policy from the insurance company. Legally, the investor is the client of the insurance company and the insurance company is a client of the bank. The investor can maintain full control of his assets as the policyowner or may choose to have the bank or an investment adviser manage the account. The policy value consists precisely of the value of the assets placed there by the insurance company on the investor's behalf and grows as managed. Legal entities and natural persons can be designated as beneficiaries. With certain annuities and insurance companies, the policyowner may be a legal entity. The person insured, however, must in all cases be a natural person.

#### **Overview of benefits**

A Portfolio Bond provides the important benefits of an offshore account with a private bank: confidentiality and privacy, professional and individualized asset management, personal attention. As an insurance investment, a Portfolio Bond also provides the following substantial benefits:

#### **Asset Protection**

Properly structured and established in the right jurisdiction, Portfolio Bonds enjoy legal protection from creditors. Interestingly, Liechtenstein's laws on the protection accorded life insurance policies and annuities is directly taken from the relevant Swiss laws. To summarize, where a person not residing in Switzerland or Liechtenstein (the "policy owner") purchases an insurance policy from a Swiss or Liechtenstein insurance company and designates his spouse or his descendants as beneficiaries of such insurance policy, or irrevocably designates any other third party as beneficiary (e.g., a legal entity such as a Trust), this insurance policy will be protected by law against any debt collection procedures instituted by the creditors of the policy owner and will also not be included in any Swiss or Liechtenstein bankruptcy procedure in this regard. Even where a foreign

judgment or court order expressly decrees the seizure of such policy, or its inclusion in the estate in bankruptcy, such an insurance policy may not be seized in Switzerland or Liechtenstein or included in the estate in bankruptcy, except where it is considered a fraudulent conveyance.

In case of bankruptcy of the owner, protection is also guaranteed since the ownership is transferred to the beneficiaries automatically. Any instructions from the original policy owner which are forced upon him can no longer be acted upon; only his beneficiaries, as the new owners can give instructions to the insurance company.

The Swiss insurance company can only act upon orders of the owner if his actions are deemed not to have been made under duress. If there is any evidence that an order has been forced upon the owner, such as in the case where the owner revokes in writing the beneficiary designation prior to a bankruptcy declaration, the insurance company cannot follow the instructions so issued. In such a case, it is important that the beneficiaries inform the insurance company.

### **Separate and Simple Estate Planning Device**

Although a legal entity such as an estate planning trust can be named as irrevocable beneficiary of the Portfolio Bond, this type of investment is also well-suited for making distributions separate from the policy owner's estate. However, depending on his home jurisdiction, some compulsory portions for legal heirs may be reserved. Neither power-of-attorney, nor last will nor certificate of inheritance is required for payments to be made upon the owner's death. Beneficiaries get immediate access to the funds according to the payment method chosen by the policyowner.

### **Confidentiality and Privacy**

In addition to the confidentiality provided by a bank account in the name of the insurance company, a second layer of confidentiality is provided by insurance confidentiality. In certain jurisdictions insurance companies treat client information as would their banking counterparts. No information can be provided to any third party (natural person or legal entity). In Liechtenstein, for example, a separate insurance secrecy law protects the privacy of policy owners. This law subjects not only persons affiliated with or acting on behalf of insurance undertakings to professional secrecy but also representatives of public agencies.

With the introduction of U.S. withholding taxes on U.S. assets held in foreign accounts and with the tough reporting requirements for investments made through offshore trusts, offshore insurance vehicles, if correctly structured and from the right jurisdiction, can add strong privacy to your existing investments in a trust or a bank account.

### **Tax advantages**

Unlike many offshore investments and structures, Portfolio Bonds are, in certain jurisdictions, completely free of local taxes. As far as income, capital gains, estate or

withholding taxes are concerned, the law of the investor's tax domicile is decisive. In many countries insurance policies enjoy substantial tax benefits if correctly structured, i.e., the Portfolio Bond can be tailor-made to fit the legal requirements for privileged tax treatment. For U.S. persons this includes:

- Tax deferral during the insured's life. The inside build-up of the Portfolio Bond is generally income and gains tax-free. For U.S. individuals and corporations with assets abroad, using a Portfolio Bond as a holding structure for these assets provides an efficient mechanism for sidestepping the new 31% withholding tax on income and gains from U.S. assets held in foreign accounts. [NOTE: Tax deferral for portfolio bonds does not apply in the U.S., although you do sidestep the withholding issues. You can have tax deferral with an offshore variable annuity, however.]
- No income taxes on insurance proceeds. At the policyowner's death, the insurance proceeds are generally income tax exempt. [NOTE: this applies only to life insurance policies or portfolio bonds qualified as such.]
- No estate taxes on insurance proceeds. With proper planning (such as through the use of an irrevocable trust under which the insured has no control or benefits) insurance proceeds can avoid estate taxation at the death of the insured.

The Portfolio Bond qualifies as a life insurance policy for U.S. income tax purposes:

- If it is based on a segregated investment account and the segregated account is adequately diversified, i.e.:
  - No more than 55% of the value of the total assets of the account is represented by any one investment;
  - No more than 70% of the value of the total assets of the account is represented by any two investments;
  - No more than 80% of the value of the total assets of the account is represented by any three investments; and
  - No more than 90% of the value of the total assets of the account is represented by any four investments. To make certain that the segregated accounts comply with this "diversification rule", the portfolio needs to be re-balanced at the end of the first policy year and on a quarterly calendar basis thereafter.
- If it satisfies Internal Revenue Code rules on death benefits. These ensure that the insurance protection meets certain minimum requirements from the inception of the policy.
- If it is not self-directed, i.e., the policyowner must be deemed to have surrendered ownership or control of the assets. The income from Portfolio Bond is tax-free if the owner (or his adviser) is not managing the investments himself. Conversely, the insurance company is deemed to be the beneficial owner of the segregated account. Policyowners are permitted to choose investment categories, but they may not choose the actual investments. If they do, they are treated as the beneficial owners of the underlying assets, not the insurance company, and the income generated by those assets would be taxable. Similarly, policyowners are not permitted to appoint an investment adviser to make the investment decisions on the underlying assets nor to control the adviser in such decisions. The

insurance company as beneficial owner is permitted to appoint an independent investment adviser.

### **Trust Compatibility**

A Portfolio Bond is not necessarily a structure to replace offshore trusts, rather it can be used to complement a trust and to strengthen its protection. For example, assigning investments to an offshore trust is much cheaper and easier if they are grouped together under one Portfolio Bond. This greatly simplifies the tax treatment of the structure, and consequently, the reporting requirements, either through a reduction in the number of assets to be listed or through the fulfillment of the conditions for tax deferral. Assets held within a portfolio bond are considered to be held by the insurance company. This allows an investor or a trust to hold assets privately also under the new regulations on U.S. withholding taxes on U.S. assets held in foreign accounts.

### **Insurance Coverage**

Depending on the investor's own needs and requirements for his heirs, additional insurance coverage can be provided in case of death. Coverage can also be adjusted during the term of the contract. This feature can be very important if a remaining spouse is forced to pay off a mortgage or if heirs need cash to buy out business partners.

### **Flexibility**

Apart from being able to choose the amount of insurance coverage, the policy owner can choose to receive an annuity as well as choose to pay several premiums or a single one. As the underlying investments can be freely selected from a global palette of investments not available to the general public, the policy owner or his investment advisor (the latter for tax deferral) can optimize performance through wide diversification or hedging strategies.

### **Conclusion**

Either in combination with offshore or domestic planning structures or alone, a Portfolio Bond is a useful and cost-effective tool to upgrade an existing portfolio of investments. A portfolio's features can be added or improved with regard to asset protection, confidentiality, reporting burden, insurance coverage, and flexibility, reducing costs and taxes, including transfer taxes as wealth passes from one generation to another. Whether they are concerned with taxes or the threat of litigation or are looking to diversify assets globally, with the Portfolio Bond, wealthy individuals can address those concerns as well as have access to leading investment managers and to investments otherwise not available to the public.

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<sup>i</sup> Florida Constitution, Article VII, section 6. See Also Florida Statutes, Title XV, chapter 222.

<sup>ii</sup> Florida Statutes, Title XV, § 222.21(2)(a).

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<sup>iii</sup> See *FTC v. Affordable Media LLC*, 179 F.3d 1228 (9th Cir., 1999); *In re: Lawrence*, 238 B.R. 498 (Bankr. S.D. Fla. 1999), *aff'd* 251 B.R. 630 (S.D. Fla. 2000), *aff'd* 279 F. 3d 1294 (11<sup>th</sup> Cir. 2002).

<sup>iv</sup> *FTC v. Affordable Media LLC*, 179 F.3d 1228 (9th Cir., 1999); *In re: Lawrence*, 238 B.R. 498 (Bankr. S.D. Fla. 1999), *aff'd* 251 B.R. 630 (S.D. Fla. 2000), *aff'd* 279 F. 3d 1294 (11<sup>th</sup> Cir. 2002).

<sup>v</sup> 50 Edw. III (1376) ch. 6. Set out in Am Jur 2d Desk Book Document No. 106.

<sup>vi</sup> The UFTA is essentially an update of the UFCA. Unlike the UFCA, however, it specifically addresses transfers that are fraudulent as to future creditors as well as existing ones. Also, the word “conveyance” was replaced with “transfer” due to the fact that “conveyance” has a connotation restricting it to personal property transfers. See Uniform Fraudulent Transfer Act, Prefatory Note.

<sup>vii</sup> W. Prosser, Torts § 105, at 684-685 (4th ed. 1971).

<sup>viii</sup> A very few states, such as California, consider a fraudulent transfer to be a crime (see Calif. Penal Code § 154). Even in California, however, the criminal statute is very rarely enforced.

<sup>ix</sup> UFTA § 5.

<sup>x</sup> UFTA §(4)(a)(2).

<sup>xi</sup> UFTA §(4)(a)(1).

<sup>xii</sup> This criterion is based on §§4(a)(1)(i),(ii) and 5(a) of the UFTA.

<sup>xiii</sup> §2(a) of the UFTA says “A debtor is insolvent if the sum of the debtor’s debts is greater than all of the debtor’s assets, at a fair valuation.” This statute is usually interpreted to mean “debts as they come due” rather than total debt. For example, if a person has \$50,000 cash, a \$200,000 mortgage, and no other assets, they are generally considered solvent even though their liabilities outweigh their assets, because they are able to make payments on their mortgage in a timely manner. However, if the same individual had \$50,000 cash and a \$200,000 judgment lien, or a debt of equivalent value that is immediately due and payable, they would be insolvent unless they made an installment arrangement to pay the debt, and made the payments in a timely manner.

<sup>xiv</sup> UFTA §2(b).

<sup>xv</sup> *Tolle v. Fenley* 132 P.3d 63, 2006 UT App 78, 546 Utah Adv. Rep. 34 (03/02/2006). Note that §1(3) of the UFTA defines a claim as “a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured” and §1(4) defines a creditor as “a person who has a claim”. §1(5) defines a debt as “liability on a claim”.

<sup>xvi</sup> This method of determining solvency is not technically set forth in the UFTA, but it is considered by the UFTA from a practical standpoint. Although the UFTA defines a debt as “liability on a claim” in §1(5) (which liability, in regards to a claim being litigated, would not materialize until a settlement or judgment in favor of the creditor is reached), it also says in §4(a)(2) that “[a transfer is fraudulent if] without receiving a reasonably equivalent value in exchange for the transfer or obligation, ... the debtor ... (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.” The courts generally agree with the foregoing statement. See *United States v. Green*, 201 F.3d 251, 257 (3d Cir.2000) (citing *Baker v. Geist*, 457 Pa. 73, 321 A.2d 634 (1974), for the holding that mere “awareness of a probable legal action against a debtor amounts to a debt” for purposes of the Pennsylvania Uniform Fraudulent Conveyances Act); *Bradford*, 1999 UT App 373 at ¶ 16, 993 P.2d 887; 37 Am. Jur. 2d Fraudulent Conveyances and Transfers § 3 (2001) (“The existence of a debt is a requirement for bringing a fraudulent conveyance action and generally speaking, the awareness of probable legal action against a debtor amounts to a ‘debt’”).

<sup>xvii</sup> UFTA §3(b).

<sup>xviii</sup> UFTA §3(a).

<sup>xix</sup> UFTA §9.

<sup>xx</sup> According to §9(a) of the UFTA, a transfer made with actual intent to hinder, delay or defraud a creditor has a statute of limitations of “...4 years after the transfer was made or the obligation was incurred *or, if later*, within one year after the transfer or obligation was or could reasonably have been discovered by the claimant.” [Emphasis is mine.] Some states have an even longer statute of limitations.

<sup>xxi</sup> UFTA 5(b).

<sup>xxii</sup> §4(a) of the UFTA only considers “...if the debtor made the transfer...”; §5(a) only considers “A transfer made... by a debtor...”, and §5(b) only considers “A transfer made by a debtor.” Nowhere in the Act does the UFTA consider transfers made by non-debtors as being fraudulent. Furthermore, restructuring an entity does not involve a transfer, and is thus not considered anywhere in the UFTA.

<sup>xxiii</sup> *Ibid*.

<sup>xxiv</sup> *Lakeside Lumber Products, Inc. v. Evans*<sup>xxiv</sup>, 2005 UT App 87 (Utah App. 02/25/2005).

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<sup>xxv</sup> *Walker v. Weese*, No. JFM-02-2768 (D.Md. 11/19/2002).

<sup>xxvi</sup> See Florida Statutes, Title XV, §222.30.

<sup>xxvii</sup> Note, however, that the Florida Supreme Court has ruled that a purchase of a Florida homestead (which is 100% exempt from creditors), even if done with fraudulent intent, is not voidable and is still protected by Florida's exemption laws. See *Havoco of America v. Elmer C. Hill*, 790 So. 2d 1018 (Fla. 06/12/2001).

<sup>xxviii</sup> The chapter in this book on limited partnerships discusses charging order protection.

<sup>xxix</sup> See the chapter in this book entitled "Asset Protection a Judge Will Respect" for more information on how this type of offshore arrangement might work.

<sup>xxx</sup> This is also the case with the bankruptcy code; see title 11 U.S.C. §101(31)(A)(2). Note that the list of who is considered an insider under the UFTA and bankruptcy code is *not* all-inclusive. Therefore, if the debtor retains too much direct or indirect control over an asset, then notwithstanding the fact that the asset was transferred to a partnership the debtor doesn't control, the partnership may nonetheless be considered an insider.

<sup>xxxi</sup> See UFTA §§1(1)(ii), 1(7)(i)(D).

<sup>xxxii</sup> *Grupo Mexicano de Desarrollo, S.A., et al. v. Alliance Bond Fund Inc., et al*, 527 U.S. 308 (1999), p. 13.

<sup>xxxiii</sup> *Havoco of America v. Elmer C. Hill*, 790 So. 2d 1018 (Fla. 06/12/2001).

<sup>xxxiv</sup> *Ibid*, p. 1.

<sup>xxxv</sup> This does assume, however, that you don't voluntarily or involuntarily file for bankruptcy. Under §522(p) of the bankruptcy code (title 11 U.S.C.), if one files for bankruptcy within 1215 days of purchasing a homestead, their homestead exemption may not exceed \$125,000, state exemption laws to the contrary notwithstanding.

<sup>xxxvi</sup> *Bank of America v. Weese*, 277 B.R. 241 (D.Md. 04/29/2002) (see also *Walker v. Weese*, No. JFM-02-2768 (D.Md. 11/19/2002), and *Plaint. No. 17/2001 in the High Court of the Cook Islands*), *Brown v. Higashi* No. A95-00200-DMD (Fed. B. Alaska 03/11/1996), *FTC v. Affordable Media LLC*, 179 F.3d 1228 (9th Cir., 1999); *In re: Lawrence*, 238 B.R. 498 (Bankr. S.D. Fla. 1999), *aff'd* 251 B.R. 630 (S.D. Fla. 2000), *aff'd* 279 F. 3d 1294 (11<sup>th</sup> Cir. 2002).

<sup>xxxvii</sup> The chapter entitled \_\_\_\_\_ explains how charging order protection protects assets.

<sup>xxxviii</sup> See, for example, Florida's fraudulent conversion law, Title XV §222.30. This law would cover annuities since annuities are exempt assets, and this law may be used to reverse the purchase of exempt assets if the purchase is done with fraudulent intent.

<sup>xxxix</sup> *Lakeside Lumber Products, Inc. v. Evans*<sup>xxxix</sup>, 2005 UT App 87 (Utah App. 02/25/2005).

<sup>xl</sup> *Grupo Mexicano de Desarrollo, S.A., et al. v. Alliance Bond Fund Inc., et al*, 527 U.S. 308 (1999). In footnote 6 of this case, we find a more detailed explanation of the Supreme Court's position on this matter as follows: "Our laws determine with accuracy the time and manner in which the property of a debtor ceases to be subject to his disposition, and becomes subject to the rights of his creditor. A creditor acquires a lien upon the lands of his debtor by a judgment; and upon the personal goods of the debtor, by the delivery of an execution to the sheriff. It is only by these liens that a creditor has any vested or specific right in the property of his debtor. Before these liens are acquired, the debtor has full dominion over his property; he may convert one species of property into another, and he may alienate to a purchase. The rights of the debtor, and those of a creditor, are thus defined by positive rules and the points at which the power of the debtor ceases, and the right of the creditor commences, are clearly established. These regulations cannot be contravened or vailed by any interposition of equity" (quoting *Moran v. Dawes*, 1 Hopk. Ch. 365, 367 (N.Y. 1825))."

<sup>xli</sup> *In re Complaint as to Conduct of Verden L. Hockett*, 734 P.2d 877 (Or. 03/31/1987)

<sup>xlii</sup> *McElhanon v. Hing* 728 P.2d 256 (Ariz. Ct. App. 1 1985).

<sup>xliiii</sup> *Grupo Mexicano de Desarrollo, S.A., et al. v. Alliance Bond Fund Inc., et al*, 527 U.S. 308 (1999), p. 22.

<sup>xliiv</sup> *Ibid*, f.n. 6.

<sup>xlv</sup> *Morganroth & Morganroth v. Delorean* 123 F.3d. 374 (6th Cir. 1997).

<sup>xlvi</sup> *Ronald J. Fischer v. Donald H. Brancato, et al.*, No. ED86014 (Mo.App. E.D. 10/25/2005).

<sup>xlvii</sup> *In re Complaint as to Conduct of Verden L. Hockett*, 734 P.2d 877 (Or. 03/31/1987).

<sup>xlviii</sup> *In re Depamphilis*,<sup>xlviii</sup> 153 A.2d 680 (N.J. 07/31/1959).

<sup>xlix</sup> Interestingly enough, after the suspension of his license, Mr. Reed formed Asset Protection Group, Inc., an asset protection consulting firm that heavily marketed Nevada corporations, which was later shut down by the FTC for deceptive trade practices.

<sup>l</sup> *In the Matter of Breen*, 113 N.J. 522, 552 A.2d 105 (1989).

<sup>li</sup> *In re Turner*, 335 B.R. 140 (Bkrpt. N.D. Cal 2005).

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<sup>lii</sup> A spendthrift clause prohibits a creditor of a beneficiary from attaching trust assets so long as they remain undistributed.

<sup>liii</sup> *Albert Strangi v. CIR*, 417 F.3d 468 (5th Cir. 07/15/2005).

<sup>liv</sup> Some statutes, including the LLC Acts of several states, do not require a business entity to have a business purpose. For example, §53-19-6 of the New Mexico LLC Act allows LLCs to be formed for “any lawful business or purpose.” [emphasis is mine] However, because New Mexico courts have not yet ruled on this matter, and New Mexico LLCs might be subject to litigation in other, more restrictive states, it’s safest to use LLCs for only legitimate business endeavors.

<sup>lv</sup> *U.S. v. Bryce W. Townley*, No. CS-02-0384-RHW (USDC E. Wash., Jul. 29, 2004).

<sup>lvi</sup> The general rule is that domestic entities that are disregarded for tax purposes need file no informational or other return. Offshore entities, however, always file some sort of return if their owner is a U.S. person. Note, however, that these returns may be simpler than the return filed by an offshore entity that is not disregarded from its owner(s) for tax purposes, e.g. an IRS 5471 (offshore corporation) or 8865 return versus the simpler 8858 disregarded entity return.

<sup>lvii</sup> A judge asked this same question in *Brown v. Higashi* No. A95-00200-DMD (Fed.B. Alaska 03/11/1996).

<sup>lviii</sup> *FTC v. Affordable Media LLC*, 179 F.3d 1228 (9th Cir., 1999); *In re: Lawrence*, 238 B.R. 498 (Bankr. S.D. Fla. 1999), *aff’d* 251 B.R. 630 (S.D. Fla. 2000), *aff’d* 279 F. 3d 1294 (11<sup>th</sup> Cir. 2002).

<sup>lix</sup> *Ibid*.

<sup>lx</sup> *U.S. v. Rylander*, 460 U.S. 752 (1983).

<sup>lxi</sup> See footnote 8, above.

<sup>lxii</sup> A particularly egregious example of this is *JSC Foreign Economic Assoc. Tech v. Int’l Development and Trade Services, Inc.*, 306 Supp. 2d 482 (S.D.N.Y., 2004).

<sup>lxiii</sup> This is the chapter on LLC’s.

<sup>lxiv</sup> *In re: Ashley Albright*, No. 01-11367 (Bkrptc.D.Col. 04/04/2003).

<sup>lxv</sup> *Ibid*.

<sup>lxvi</sup> *Crocker National Bank v. Perroton*, (208 Cal. App. 3d 1, 1989).

<sup>lxvii</sup> *Hellman v. Anderson*, (233 Cal. App. 3d 840, 1991).

<sup>lxviii</sup> Note that this observation was also made by the Colorado District Bankruptcy Court in the *In re: Ashley Albright* case. See chapter \_\_\_\_\_ for more information.

<sup>lxix</sup> *In re: Ehmann* (2005 WL 78921 (Bankr. D. Ariz. 2005)).

<sup>lxx</sup> For the purposes of this chapter, we will hereafter consider LLCs and LPs as one and the same, unless otherwise noted.

<sup>lxxi</sup> ‘Reverse Piercing’ is where the creditor of a company’s owner is allowed to reach company assets for the owner’s debt. This is the same situation in which charging order protection would prevent company assets and/or control from falling into the hands of an owner’s creditor.

<sup>lxxii</sup> *LFC Marketing Group, Inc. v. Cebe W. Loomis*, 116 Nev. 896; 8 P.3d 841 (Nev. S.C., 2000).

<sup>lxxiii</sup> *Floyd v. I.R.S.*, 151 F.3d 1295, 1300 (10th Cir. 1998).

<sup>lxxiv</sup> See IRS Rev. Rul. 2004-77, which demonstrates it is possible to structure a multi-member LLC that is disregarded from its owner for tax purposes.