

PROTECTING ASSETS FROM CREDITORS

by

**Thomas M. Mullinix
Robert S. Streepy
Evans & Mullinix, P.A.
7225 Renner Road, Suite 200
Shawnee, Kansas 66217
(913) 962-8700
(913) 962-8701 (Fax)**

Recognition given to R. David Wentz, J.D., CLU, ChFC, and
Nancy Schmidt Roush, Lathrop and Gage for their contributions to the materials

Revised August, 2009

TABLE OF CONTENTS

Sources of Liability: Choice of Entity 1

 Partnership..... 1

 General Rule..... 1

 Corporation..... 1

 General Rule..... 1

 Piercing the Corporate Veil..... 1

 Supervisory Liability 2

 Professional Corporation..... 2

 General Rule..... 2

 Special Rule for Health Care Providers..... 2

 Limited Liability Company..... 2

 General Rule..... 2

 Limited Liability Partnership 2

 General Rule..... 2

 Other..... 3

 Tort Liability..... 3

 Debt..... 3

FRAUDULENT CONVEYANCES 3

 General Rule..... 3

 Bankruptcy Code on Fraudulent Conveyances 3

 11 U.S.C. § 544 3

 11 U.S.C. § 548 3

 11 U.S.C. § 727(a)(2)..... 3

 11 U.S.C. § 547(b)..... 4

 State Law: The Uniform Fraudulent Transfer Act..... 4

 K.S.A. § 33-201 - 212; R.M.S. §§ 428.005 – 428.090..... 4

 Badges of Fraud Under the Uniform Fraudulent Transfer Act..... 4

 Judicially Recognized Badges of Fraud 6

 Constructive Fraud..... 6

 Conclusive Fraud..... 7

 Statute of Limitations..... 7

 Fraudulent Transfers: A Summary of Do’s and Don’ts 7

| | |
|---|----|
| ASSET PROTECTION DEVICES..... | 8 |
| General Rule..... | 8 |
| Discourage Litigation..... | 8 |
| Post-lawsuit Savings..... | 8 |
| Kansas Exemptions: K.S.A. § 60-2301, et. seq..... | 8 |
| Homestead and Home Improvements..... | 8 |
| Household Goods..... | 9 |
| Means of Conveyance..... | 9 |
| Jewelry..... | 9 |
| Tools of the Trade..... | 9 |
| Burial plot or crypt..... | 9 |
| Statutory Exemptions..... | 9 |
| Pension Money..... | 10 |
| Qualified Retirement Plans..... | 10 |
| Individual Retirement Accounts..... | 11 |
| Life Insurance..... | 11 |
| Miscellaneous Exemptions..... | 11 |
| Missouri Exemptions: V.A.M.S. § 513.427 et seq..... | 12 |
| Family Transfers and Gifts..... | 15 |
| General Rule..... | 15 |
| Gifts To Spouse..... | 16 |
| Gifts To Children..... | 16 |
| 529 Higher Education Savings Accounts..... | 16 |
| Trusts..... | 17 |
| Irrevocable..... | 17 |
| Revocable..... | 17 |
| Spendthrift..... | 17 |
| Self-Settled or Domestic Asset Protection Trusts..... | 18 |
| Insurance..... | 19 |
| Charitable Remainder Trust..... | 19 |
| Bankruptcy Law on Trusts..... | 19 |
| Family Limited Partnership..... | 20 |
| General Rule..... | 20 |
| Structure..... | 20 |
| Estate Planning..... | 20 |
| Asset Protection..... | 20 |
| Bankruptcy Rules for FLPs..... | 21 |
| FLP Fraudulent Conveyance Concerns..... | 21 |
| Offshore Asset Protection Trusts..... | 23 |
| Internal OAPT Provisions..... | 23 |

Laws of Foreign Situs 24
 Combine OAPT With Other Asset Protection Tools 24
 Potential Issues Regarding OAPTs 25

Payment of Nondischargeable Debts (Pre-Bankruptcy) 25
 Nondischargeable Tax Debts 25
 Nondischargeable Non-Tax Debts 25
 Caution 26

CHECKLISTS 26

 Exemptions 26
 Homestead and Home Improvements 26
 Household Goods 30
 Tools of the Trade 30
 Pensions and Qualified Retirement Plans 31
 Life Insurance 32

 Gifts 34
 General Rule 34
 Gifts to Spouse 34
 Gifts to Children and Grandchildren 34

PROTECTING ASSETS FROM CREDITORS

I. SOURCES OF LIABILITY: CHOICE OF ENTITY

A. Partnership

1. General Rule. A partnership is an association of two or more persons who are co-owners of a business for profit. In a General Partnership, each partner has equal ability to control and manage the partnership. As a result, all the partners are jointly and severally liable for everything chargeable to the partnership and for all debts and obligations of the partnership. In a Limited Partnership, while the general partners have equal rights to manage and control the business and are jointly and severally liable for the debts of the partnership, the limited partners do not share in the day-to-day management of the partnership. As a result, the limited partners' liability is limited to their personal investment in the partnership.

B. Corporation

1. General Rule. Directors or officers of a corporation do not incur personal liability for its acts merely by reason of their official character; however, if an officer commits or participates in the commission of a wrongful act, he or she may be liable to third persons injured thereby. Kansas Commission on Civil Rights v. Service Envelope Co., Inc., 233 Kan. 20 (1983); Boyd v. Wimes, 664 S.W.2d 596 (Mo. Ct. App. 1984). Both the individual committing a wrongful act and the corporation are liable if the individual was acting within the scope of employment. However, the corporate shareholders, officers, directors and employees who are not directly involved in the wrongful act are insulated from liability by the corporate structure which protects these individuals from the wrongful acts of other employees and from most corporate debt liability. If your spouse serves as a shareholder, director, officer or employee, you may risk tainting the spouse with the business' liabilities.

2. Piercing the Corporate Veil. The non-acting employees, directors and officers may incur personal liability if the claimant "pierces the corporate veil" by proving that the corporation is merely a shell that was constructed for no other purpose than to provide liability protection for the debtor. This can be accomplished by showing the following:

- a. Undercapitalization;
- b. Failure to observe corporate formalities;
- c. Siphoning of corporate funds by the shareholders;
- d. Non-functioning of officers or directors;
- e. Absence of corporate records;
- f. Commingled personal and corporate records and assets;
- g. Failure to hold out to the public as a corporation; and
- h. Use of the corporate entity in promoting injustice or fraud.

See *Amoco Chemicals Corp. v. Bach*, 222 Kan. 589, 567 P.2d 1337 (1977); *Mackey v. Burke*, 751 F.2d 322 (10th Cir. 1984); *Sampson Distrib. Co. v. Cherry*, 346 Mo. 885 (1940).

3. Supervisory Liability. Directors, officers, and other responsible persons in a corporation can be held personally liable if they have been negligent in supervising the corporate employees. Generally, directors and officers are not liable for tortious acts of officers, agents, or employees of the corporation unless they participated in, directed, or authorized the wrongful act. 18B Am.Jur.2d *Corporations* § 1879 (1985); 90 A.L.R.3d 916 §2 (1979).

C. Professional Corporation

1. General Rule. Incorporation of a professional does not affect the liability that a professional would have for his or her own negligence or malpractice. However, it does provide protection for malpractice committed by another professional in the same corporation. K.S.A. §§ 17-2701, et. seq. and 17-2715; V.A.M.S. § 356.171.

2. Special Rule for Health Care Providers. K.S.A. § 40-3403(h) provides that a health care provider who is qualified for coverage under the health care stabilization fund shall have neither vicarious liability nor responsibility for any injury or death arising out of professional services by any other health care provider. See Chapter 3, § 3.5 of *Kansas Corporation Law and Practice*, 3rd Edition, by James K. Logan, Alison R. Martin, and Daniel R. Ray, published by the Kansas Bar Association, for a further discussion of professional liability and incorporation. In Missouri, V.M.A.S. § 354.125 provides that a health care corporation, as defined in § 354.010, is not liable for injuries resulting from neglect, misfeasance, malfeasance, or malpractice on the part of any person, organization, agency or corporation rendering health services to the health services corporation's members and beneficiaries.

D. Limited Liability Company

1. General Rule. A limited liability company provides the protection of a corporation, shielding officers, shareholders, and directors from personal liability for wrongful acts of a company employee or debts of the company. LLC's may also be structured to allow flow-through taxation, as in a partnership. K.S.A. § 17-7662, et. seq.; V.A.M.S. § 347.010.

E. Limited Liability Partnership

1. General Rule. A limited liability partnership organized in Kansas or Missouri accomplishes the same goals of a limited liability company. The specifics regarding their legal status remain relatively untested by the courts. See K.S.A. §§ 56a-902, et. seq.; V.A.M.S. § 358.020 et seq.

F. Other

1. Tort Liability. Owners of certain closely-held businesses may be subject to potential tort liability, depending on the type of business, e.g. construction (personal injury), manufacturing (products liability), real estate development (hazardous waste). Many of these potential torts can be insured, but the amount is unpredictable.

2. Debt. An owner of a closely-held business can be subject to significant liability to lenders, either through direct liability or a guarantee, for debts incurred by the business. If a corporation is released by bankruptcy from a debt which has been guaranteed by the owners, the corporate release will not affect the owners' personal liability under the guarantee. *See* 11 U.S.C. § 524(e).

II. FRAUDULENT CONVEYANCES

A. General Rule. Courts look for “badges of fraud,” which provide circumstantial evidence of fraudulent intent, to find a fraudulent conveyance. The existence of any one or more badges is not necessarily determinative of the presence of fraud, although a very strong finding of one badge of fraud can establish intent to hinder, delay or defraud creditors. Similarly, the absence of several very significant badges may disprove fraudulent intent. Fraud is never presumed; it must be proven by clear and convincing evidence. The burden of proving fraud is upon the party asserting it.

B. Bankruptcy Code on Fraudulent Conveyances

1. 11 U.S.C. § 544. A transfer is not “made” until it becomes known or discoverable by the exercise of reasonable diligence. *See Butler v. Lomas & Nettleton Co.*, 862 F.2d 1015 (3rd Cir. 1988). The bankruptcy trustee may avoid any transfer by a debtor which would be avoidable by an unsecured creditor of the debtor under applicable state law. The court looks to the “badges of fraud” applicable in the state where the debtor resides. In the case of a transfer alleged by the trustee to be fraudulent under the state Uniform Fraudulent Transfer Act (K.S.A. §§ 33-201 *et seq.* [as discussed *infra*]), the trustee’s “reach-back” authority is extended to four years (see Section II, C, 3).

2. 11 U.S.C. § 548. The trustee can avoid any transfer by a debtor made within two years preceding the filing of the bankruptcy petition, if such transfer was made with either actual or constructive intent to defraud the creditors. Section 548(b), which applies to partnership debtors, does not require proof of actual intent; constructive intent is sufficient to void the transfer. A transfer is fraudulent if: (a) the debtor was insolvent at the time of transfer or intended to incur debts beyond the debtor’s ability to pay; and (b) the transfer was made for less than reasonably equivalent value.

3. 11 U.S.C. § 727(a)(2). A court will deny the debtor a discharge if within one year before the date of filing bankruptcy the debtor transfers assets with actual intent to hinder, delay, or defraud creditors. The badges of fraud under this section include the following:

- a. Conversion on the eve of filing or shortly after entry of a large judgment against the debtor;
- b. The debtor's intent to materially mislead or deceive a creditor about the debtor's financial position;
- c. Concealment of the transfer;
- d. Pending legal action;
- e. The debtor's use of credit to purchase exempt property;
- f. The debtor's retention of possession, benefit, or use of the property in question;
- g. Value of the sheltered assets;
- h. The debtor was insolvent or the conversion rendered the debtor insolvent;
- i. Transfer of all assets;
- j. Absconding;
- k. Removing assets from the jurisdiction of the court;
- l. Hiding assets;
- m. Receiving inadequate consideration;
- n. Engaging in a pattern of sharp dealing;
- o. The transfer was simultaneous with significant debt;
- p. Transfer to straw persons;
- q. Transfer to an insider.

4. 11 U.S.C. § 547(b). The trustee may avoid as preferential transfers, transfers to creditors within ninety days of the bankruptcy petition if the debtor was insolvent at the time of the transfer. This period is extended to one year if the transfer is to an "insider." The debtor is presumed to have been insolvent on or during the 90 days immediately preceding the date of the filing of the petition.

C. State Law: The Uniform Fraudulent Transfer Act

1. K.S.A. § 33-201 - 212; R.M.S. §§ 428.005 – 428.090. Both Kansas and Missouri have enacted the Uniform Fraudulent Transfer Act (K.S.A. §§ 33-201 - 212; V.A.M.S. §§ 428.005 - 428.090), which states that a transfer made or an obligation incurred by a debtor is fraudulent, whether the creditor's claim arose before or after the event, if the debtor acted with actual intent to hinder, delay or defraud. Whether a debtor acted with the actual intent to defraud is determined by applying the "Badges of Fraud." See *State ex rel. Graeber v. Marion County Landfill*, 276 Kan. 328 (2003).

2. Badges of Fraud Under the Uniform Fraudulent Transfer Act (K.S.A. § 33-204(b); V.A.M.S. § 428.024):

- a. The transfer was to an insider;
KS: *In re Wills*, 2008 WL 4498802 (D. Kan. 2008); "insider" is defined at K.S.A. § 33-201(g).

MO: *Fischer v. Brancato*, 147 S.W.3d 794 (Mo. Ct. App. 2004);
 “insider” is defined at V.A.M.S. § 428.009(7).

- b. The debtor retained possession or control of the property after the transfer;
 KS: *Citizens State Bank of Hiawatha v. Rogers*, 155 Kan. 478 (1942).
 MO: *Fischer v. Brancato*, 147 S.W.3d 794 (Mo. Ct. App. 2004).
- c. The transfer was concealed;
 KS: *McCain Foods USA, Inc. v. Central Processors, Inc.*, 275 Kan. 1 (2002).
 MO: *In re Moss*, 258 B.R. 405 (W.D. Mo. 2001).
- d. Before the transfer was made, the debtor had been sued or threatened with suit;
 KS: *McCain Foods USA, Inc. v. Central Processors, Inc.*, 275 Kan. 1 (2002).
 MO: *Behr v. Bird Way, Inc.*, 923 S.W.2d 470 (1996).
- e. The transfer was of substantially all of the debtor’s assets;
 KS: *McCain Foods USA, Inc. v. Central Processors, Inc.*, 275 Kan. 1 (2002).
 MO: *U.S. v. Easley* 1996 WL 303352.
- f. The debtor absconded;
 MO: *In re Moss*, 258 B.R. 405 (Bkrtcy. W.D. Mo. 2001).
- g. The debtor removed or concealed assets;
 KS: *In re Taylor*, 133 F.3d 1336 (10th Cir. 1998).
 MO: *In re Moss*, 258 B.R. 405 (W.D. Mo. 2001).
- h. The insufficiency of consideration;
 KS: *Dodson v. Cooper*, 50 Kan. 680 (1893).
 MO: *Mark Twain Bank v. Riccardi*, 865 SW2d 425 (W.D. Mo. 1993).
- i. The debtor was insolvent or became insolvent shortly before the transfer was made;
 KS: *Dodson v. Cooper*, 50 Kan. 680 (1893); “insolvency” is defined at K.S.A. § 33-202.
 MO: “Insolvency” is defined at V.A.M.S. § 428.014.
- j. The transfer occurred close in time to a substantial debt being incurred;
 MO: *In re Moss*, 258 B.R. 405 (W.D. Mo. 2001).

- k. The transfer was a sham transfer to a lienor who transferred the property to an insider.

3. Judicially Recognized Badges of Fraud. In addition to the statutory enumerated Badges of Fraud, courts have recognized other circumstances as Badges of Fraud. See *In re Kopp*, 383 B.R. 179 (D. Kan. 2008)[interpreting Missouri law] and *In re Agnew*, 355 B.R. 276 (Bankr. D. Kan. 2006). These court-recognized Badges of Fraud include:

- a. Transfer to a relative;
- b. Transactions are different from the usual method of transacting business;
- c. Transfers made in anticipation of a lawsuit or execution on a judgment;
- d. Transfer of all or nearly all of the debtor's property;
- e. Failure to produce rebuttal evidence when the circumstances surrounding the transfer are suspicious;
- f. The debtor obtained credit in order to purchase exempt property;
- g. The debtor had engaged in a pattern of sharp dealing prior to bankruptcy.

4. Constructive Fraud. In certain cases, the trustee or other party challenging the transfer can prevail without demonstrating actual intent to defraud. The trustee does not have to demonstrate actual intent, but may establish constructive fraud by demonstrating that the transfer was not made for sufficient consideration and that another factor is present. These other factors include:

a. Where the debtor was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction. V.A.M.S. § 428.024.1(2)(a); K.S.A. § 33-204(a)(2)(A).

b. Receiving inadequate compensation for a transfer made by a debtor who reasonably should have believed that he or she would incur debts beyond the ability to pay as they became due. See V.A.M.S. § 428.024.1(2)(b); K.S.A. § 33-204(2)(b). The trustee or party challenging the transfer must show that the debtor knew of a liability or reasonably believed that he or she would incur a liability which he or she would be unable to pay. *In re Van Vleck*, 211 B.R. 689, 693-95 (Bankr. E.D. Mo. 1997).

c. Note Missouri common law provides that constructive fraud is present regardless of a transferor's actual intent where a transfer is made for insufficient consideration and the debtor is unable to pay his debts after the transfer. *Citizen's Nat'l Bank Maryville v. Jerry*, 857 S.W.2d 502 (Mo. Ct. App. 1993) (citing *Bostonian v. Bono*, 323 S.W.2d 813 (Mo. 1959)). However, the *Van Vleck* court in applying V.A.M.S. § 428.024.1(2)(b) required that for constructive fraud to lie, the

debtor at least must subjectively know of his outstanding debt before making the transfer. 211 B.R. at 693.

5. Conclusive Fraud. A transfer is conclusively considered fraudulent as to existing creditors if the creditor's claim arose before the transfer was made, the debtor made the transfer without receiving a reasonably equivalent value in exchange and the debtor was either insolvent at the time of the transfer or became insolvent as a result. K.S.A. § 33-205; R.M.S. § 428.029.

6. Statute of Limitations. The Kansas UFTA statute of limitations for actions challenging fraudulent transfers is four years after the transfer was made or, if later, within one year after the transfer was or could reasonably have been discovered. K.S.A. § 33-209. In the case of a transfer made to an insider (as defined by K.S.A. § 33-201(g)) which is fraudulent as to an existing creditor, the statute of limitations is one year. K.S.A. §§ 33-205(b) and 33-209(c). The Missouri statutes of limitations are the same. M.R.S. § 428.049.

D. Fraudulent Transfers: A Summary of Do's and Don'ts. Navigating the turbulent seas of the federal and state laws regarding fraudulent transfers might seem daunting, but there are reliable do's and don'ts in protecting assets and preventing both unexpected and self-inflicted losses. The mere fact that a transaction occurred shortly before the filing of bankruptcy does not support the finding of fraud, as the circumstances of the transaction must be examined and a legitimate purpose for the transfer supports the finding of no fraudulent intent. See *In re Brown*, 108 F.3d 1290 (10th Cir. 1997).

Additionally, all creditors are not treated equally under the various laws regarding fraudulent transfers. According to common law principles, there are three types of creditors: present and existing creditors, whose interests against the debtor exist at the time the transfer is made; sequential creditors, whose interests might not have existed as choate judgments at the time of the transfer but against whom the debtor acted in a fraudulent or reckless manner; and potential creditors, whose interests were not known or discoverable by the debtor at the time the transfer was made. It is important to determine the status of the creditor in determining the legal rights afforded the debtor.

There are still substantial opportunities for prebankruptcy planning to transfer non-exempt assets into exempt assets, provided that none of the bright lines demarcated by the statutes and the case decisions are not blatantly crossed. Evidence alone of prebankruptcy planning to convert non-exempt assets into exempt assets is not sufficient to deny discharge, as actions to hinder, delay or defraud creditors require "something more." See *In re Agnew*, 355 B.R. 276 (Bankr. D. Kans. 2006); *In re Holt*, 894 F.2d 1005 (8th Cir. 1990). That "something more" can be evidenced by the Badges of Fraud discussed in this article. See *In re Carey*, 938 F.2d 1073 (10th Cir. 1991).

It is also important to note the interaction of the pertinent "look-back" periods under both federal and state law. Although the federal statute permits a two-year period for the trustee to challenge any prebankruptcy transfer (see 11 U.S.C. § 548(a)(1)), pursuant to 11 U.S.C. § 544(b)(1) the trustee is also given the rights of a creditor under state fraudulent transfer laws. See *In re Jones*, 184 B.R. 377 (Bankr. N.M. 1995). Furthermore, the applicable state limitations period also applies to actions brought under § 544 (b) challenging fraudulent transfers under state law. See *In re Verco*

Indus., 704 F.2d 1134 (9th Cir. 1983). As noted *supra*, at Section II, C, 5, the state statute of limitations for challenging a transfer under the UFTA is four years; consequently, the federal two-year period of limitations in § 544 (b)(1) probably does not establish the deadline for challenging transfers as fraudulent since the trustee can use the four-year period from the state UFTA. Consequently, debtors should be cautioned that any transfer made within four years of filing the petition in bankruptcy may be challenged as fraudulent. Therefore, debtors are advised to heed the following recommendations when engaging in transfers involving property of their estate made within four years of filing a petition in bankruptcy:

1. Document the transfer, such as recording a transfer involving real estate with the Recorder of Deeds;
2. Refrain from becoming insolvent as a result of the transfer;
3. Follow the standard course of business in making the transfer;
4. Actually transfer the asset being sold (*e.g.*, don't continue using the car);
5. Do not use credit to acquire the asset;
6. Do not transfer all non-exempt assets;
7. Appraise or properly evaluate the asset to be sold or transferred;
8. Listen to your attorney.

III. ASSET PROTECTION DEVICES

A. General Rule. The basic premise behind asset protection planning lies in understanding the maxim “it is not what I *own*, it is what I *control* that counts.” The best way to avoid losing assets when being sued is to be devoid of any control over those assets. The object of asset protection planning is twofold:

1. Discourage Litigation. The practical solution to the “lawsuit epidemic” in the U.S. is to stop being an easy target. If your assets are adequately protected, you will not be an attractive target.

2. Post-lawsuit Savings. If you do get sued and lose, your asset protection plan should allow you to start over with some assets that are beyond the reach of potential creditors.

B. Kansas Exemptions: K.S.A. § 60-2301, et seq.

1. Homestead and Home Improvements. 160 contiguous acres of farming land or one acre within the limits of an incorporated town or city or a mobile home occupied as a residence by the owner or by the family of the owner, together with all the improvements on the same, are exempt from creditors, with the exception of tax creditors, mechanic's lien

holders or persons holding mortgages thereon. The homestead exemption was formerly not limited in amount or value. K.S.A. § 60-2301. However, the changes to the Bankruptcy Code in 2005 placed important limits on the homestead exemption in opt-out states such as Kansas and Missouri. 11 U.S.C. § 522(o) extends the “look-back” period for determining the value of the homestead exemption to ten years; and 11 U.S.C. § 522(p) restricts to \$136,875 the homestead exemption if the homestead was acquired within three-and-a-half years of filing for bankruptcy. For a further discussion of these provisions, see Section IV, *infra*.

2. Household Goods. Furnishings, equipment and supplies, including fuel and clothing for the person in the person’s present possession and “reasonably necessary” at the principal residence of the person for a period of one year are exempt from claims of creditors other than taxing authorities or persons to whom the debtor owes wages. The courts have ruled that “reasonably necessary” is based on the debtor’s customary standard of living. The exemption is not limited in amount or value. K.S.A. 60-2304(a); see *Nohinek v. Logsdon*, 6 K. App. 342, 628 P.2d 257 (1981).

3. Means of Conveyance. One means of conveyance regularly used for the transportation of the debtor, limited to \$20,000.00. However, the value limitation does not apply when the means of conveyance is a vehicle designed or equipped for handicapped persons. A handicapped person is any individual with a severe visual or physical impairment or condition which limits walking ability and results in an inability to travel, unassisted, more than 200 feet without the use of a wheelchair, crutch, walker, prosthetic, orthopedic or other device. K.S.A. 60-2304(c).

4. Jewelry. Ornaments of the person, having a value not to exceed \$1,000.00. K.S.A. 60-2304(b).

5. Tools of the Trade. Books, documents, furniture, instruments, tools, implements and equipment, the breeding stock, seed, grain or growing plant stock or other tangible means of production necessary to carry on one’s trade, profession, business or occupation in an aggregate value not to exceed \$7,500.00. Items exempted under this section must be both reasonably necessary to and regularly used in the debtor’s business or trade. Automobiles are generally not allowed under this exemption unless the debtor’s employment is uniquely dependent on the automobile or the automobile is modified to render it especially suited to the debtor’s trade. K.S.A. § 60-2304(e).

6. Burial plot or crypt. No limit in amount. K.S.A. § 60-2304(d).

7. Statutory Exemptions. Any personal property exempt from process under the following three statutes:

a. K.S.A. § 36-202. Permits an innkeeper, hotelkeeper, boardinghouse keeper, apartment-house keeper or rooming-house keeper to detain baggage and other property belonging to a non-paying guest or boarder until the charges are paid.

During such time, the detained property shall be exempt from attachment or execution by any creditor not already holding a valid existing lien of record.

b. K.S.A. § 48-245. Exempts from suits, distresses, executions or sales for debt all uniforms, arms and equipment required by law or regulations to be worn or maintained by every officer and soldier of the Kansas National Guard.

c. K.S.A. § 84-2-326(2). Provides that goods held on approval of sale are not subject to the claims of the buyer's creditors until accepted if the goods are delivered primarily for use (see K.S.A. § 84-2-326(1)(a)). Goods held on sale or return (goods delivered primarily for resale) are subject to creditors' claims while in the buyer's possession. A consignor desiring protection from creditors should comply with the filing provisions of Article 9 of the Uniform Commercial Code as codified in K.S.A. 84-9-505.

8. Pension Money. K.S.A. § 60-2308(a) permits debtors to exempt pension moneys received within three months next preceding the issuance of an execution, attachment or garnishment to the extent the funds are necessary for the maintenance of the debtor or the debtor's family. K.S.A. § 60-2312 extends this exemption to pension funds that would be exempt under 11 U.S.C. § 522(d)(10). Pursuant to 11 U.S.C. § 522(d)(10) the following are exempt to the extent they are reasonably necessary for the support of the debtor or the debtor's dependents: social security benefits, unemployment compensation, local public assistance benefits, veteran's benefits, disability benefits, illness benefits and unemployment benefits. In addition, alimony, support and separate maintenance are exempt as well as payments under a pension, profit sharing, annuity or similar plan or contract on account of illness, disability, death, age or length of service.

9. Qualified Retirement Plans. Qualified plans under §§ 401(a), 403(a), 403(b), 408, 408A, or 409 of the Internal Revenue Code are exempt under K.S.A. § 60-2308(b). This includes corporate retirement plans, KEOGH's and IRAs.

The Supreme Court in *Patterson v. Shumate*, 504 U.S. 753 (1992), held that all retirement plans subject to the anti-alienation provisions of ERISA are excluded from the bankruptcy estate pursuant to § 541(c)(2) of the bankruptcy code because the phrase "applicable nonbankruptcy law" in § 541(c)(2) is not limited to state law and ERISA's anti-alienation provision is an enforceable transfer restriction under the section. Thus, qualified retirement plans subject to ERISA's anti-alienation provision are excluded from bankruptcy estate without regard to state exemptions.

The Bankruptcy Reform Act of 2005 includes an express exemption for retirement accounts that are tax exempt pursuant to I.R.C. §§ 401, 413, 408, 408A, 414, 457 or 501(a). 11 U.S.C. § 522(d)(12). This includes ERISA plans and both IRAs and Roth IRAs. The exemption applies whether or not the debtor elects state exemptions, but is limited to \$1,095,000.00 with respect to Roth IRAs and traditional IRAs, except in the case of an IRA funded through qualified rollovers. 11 U.S.C. § 522(n).

10. Individual Retirement Accounts. An IRA is a trust or custodial retirement account for the exclusive benefit of an individual or his beneficiaries, whether or not they participate in a qualified plan. IRAs, which are not subject to ERISA, are protected in Kansas by the state exemption, but are limited to \$1,095,000.00 by the federal exemption.

11. Life Insurance. K.S.A. 40-414 provides that life insurance policies or beneficiary certificates, their reserves or the present value thereon (cash surrender value) are exempt from the claims of the insured or the insured's creditors and representatives, from tax claims and from claims and judgments of the creditors and representatives of any person named as beneficiary in the policy of insurance. The proceeds from life insurance policies or beneficiary certificates continue to be exempt to the beneficiary as long as they remain on deposit in a bank, but they lose their exempt character when invested in non-exempt property. K.S.A. 40-414(b)(1) provides that if a debtor obtains an insurance policy within one year of the date of filing a bankruptcy petition, the nonforfeiture value of that policy will not be exempt.

12. Miscellaneous Exemptions (see K.S.A. § 60-2313):

- a. Crime Victims Reparation Award;
- b. Liquor License;
- c. Club License or Cereal Malt Beverage Wholesaler's or Distributor's License;
- d. Fraternal Benefit Society Benefit;
- e. Charity;
- f. Relief or Aid;
- g. Trust funds held in Cemetery Merchandise Trust;
- h. Prearranged Funeral Agreements;
- i. Police and Fireman's Retirement and Pension Benefits;
- j. Public Employees Retirement;
- k. Foreign Service Retirement and Disability Payments;
- l. Injury or Death Compensation Payments from War Risk Hazards;
- m. Wages of Fishermen, Seamen and Apprentices;
- n. Civil Service Retirement Benefits;
- o. Longshoremen's and Harbor Worker's Compensation Act Death and Disability Benefits;
- p. Railroad Retirement Act Annuities and Pensions;
- q. Veteran's Benefits;
- r. Special Pensions paid to Winners of the Congressional Medal of Honor;
- s. Federal Homestead Lands on Debts Contracted before Issuance of the Patent.

C. Missouri Exemptions: V.A.M.S. § 513.427 et seq.

1. Note on Limitations. Property does not qualify for exempt status in the following circumstances: seizure and sale for taxes, § 513.465; property encumbered by a

voluntary lien, § 513.436; debts for personal services of house servants or common laborers not exceeding \$90 if suit by such creditor is instituted within six months after the last services are rendered, § 513.470; attachment or execution of money or assets in a qualified retirement plan under Section 408A of the Internal Revenue Code in satisfaction of a valid judicial or administrative order for the payment of child support or maintenance. § 513.430.2.

2. Homestead. Dwelling house, appurtenances, land used in connection therewith, together with rents, issues and products thereof, up to the value of \$15,000 are exempt from attachment and execution under V.A.M.S. § 513.475. 11 U.S.C. § 522(o) extends the “look-back” period for determining the value of the homestead exemption to ten years. For a further discussion of this provision, see Section IV, *infra*.

3. Household Goods. Furnishings, household goods, wearing apparel, appliances, books, animals, crops or musical instruments held primarily for personal, family or household use of such person or a dependent of such person, up to the aggregate value of \$3,000. V.A.M.S § 513.430.1(1).

4. Motor Vehicle. Any motor vehicle up to an aggregate value of \$3,000. V.A.M.S § 513.430.1(5)

5. Mobile Home. Any mobile home used as the principal residence but not on or attached to real property in which the debtor has a fee interest up to the value of \$5,000. V.A.M.S § 513.430.1(6).

6. Jewelry. Wedding ring up to \$1,500 and other jewelry held primarily for the personal, family or household use of such person or a dependent of such person up to the aggregate value of \$500. V.A.M.S § 513.430.1(2).

7. Miscellaneous Property. Property of any other kind up to an aggregate value of \$600. V.A.M.S § 513.430.1(3).

8. Tools of the Trade. Implements, professional books, or tools of the trade of such person or the trade of a dependent of such person up to the aggregate value of \$3,000. V.A.M.S § 513.430.1(4).

9. Health Aids. Professionally prescribed health aids for the debtor or a dependent of the debtor. V.A.M.S. § 513.430.1(9).

10. Head of a Family. Each head of a family may exempt any other property, debts, or wages up to the value of \$1,250 plus \$350 for each unmarried dependent child under the age of 18 or dependent as defined by the Internal Revenue Code of 1986, as amended, determined to be disabled by the Social Security Administration. This exemption does not apply to 10% of such Head of Family’s debt, income, salary or wages. V.A.M.S. § 513.440.

11. Statutory Exemptions. Any personal property exempt from process under the following statutes:

a. V.A.M.S. § 419.060 Permits the keeper of an inn, hotel, or boardinghouse to detain baggage and other property of non-paying guests or boarders until charges due have been paid. During such time, the detained property shall be exempt from attachment or execution.

b. V.A.M.S. § 400.2-326(2). Provides that goods held on approval of sale are not subject to the claims of the buyer's creditors until accepted if the goods are delivered primarily for use (see V.A.M.S. § 400.2-326(1)(a)). Goods held on sale or return (goods delivered primarily for resale) are subject to creditors' claims while in the buyer's possession. A consignor desiring protection from creditors should comply with the filing provisions of Article 9 of the Uniform Commercial Code as codified in V.A.M.S. § 400.9-505.

12. Pension Money. Payments reasonably necessary for the support of the debtor and dependents under a stock bonus plan, pension plan, disability or death benefit plan, profit-sharing plan, nonpublic retirement plan or any plan described defined, or established pursuant to V.A.M.S. § 456.072, any deferred compensation program offered by the state of Missouri or any of its political subdivisions, or annuity or similar plan or contract on account of illness, disability, death, age or length of service. V.A.M.S. § 513.430.1(10)(e). The exemption does not apply if the plan or contract was established by or under the auspices of an insider that employed the debtor when the debtor's rights under the plan or contract arose, the payment is on account of age or length of service, and the plan or contract is not a qualified plan or contract. § 513.430(10)(e)(a)-(c).

Section 513.430.1(10) additionally exempts:

1. Social Security benefits, unemployment compensation or local public assistance benefits;
2. Veteran's benefits;
3. Disability, illness or unemployment benefits;
4. Alimony, support or separate maintenance up to \$750 per month.

Payments listed in this section are also subject to attachment and execution pursuant to a qualified domestic relations order, defined by § 414(p) of the Internal Revenue Code, issued by a court in any dissolution of marriage or legal separation proceeding or proceeding for disposition of property following dissolution of marriage. V.A.M.S. § 513.430.1(10)(e).

13. Qualified Retirement Plans. Money or assets payable to a participant or beneficiary from, or interests in qualified plans under §§ 401(a), 403(a), 403(b), 408, 408A, or 409 of the Internal Revenue Code are exempt under V.A.M.S. § 513.430.1(f). Such funds are not exempt from claims of alternate payees under a qualified domestic relations order. Claims of alternate payees are exempt from all claims, except from claims of the state

of Missouri through its division of family services. *Id.* The exemption does not apply to funds conveyed fraudulently within three years of a proceeding under Title 11. *Id.*

The Supreme Court in *Patterson v. Shumate*, 504 U.S. 753 (1992), held that all retirement plans subject to the anti-alienation provisions of ERISA are excluded from the bankruptcy estate pursuant to § 541(c)(2) of the bankruptcy code because the phrase “applicable nonbankruptcy law” in § 541(c)(2) is not limited to state law and ERISA’s anti-alienation provision is an enforceable transfer restriction under the section. Thus, qualified retirement plans subject to ERISA’s anti-alienation provision are excluded from bankruptcy estate without regard to state exemptions.

The Bankruptcy Reform Act of 2005 includes an express exemption for retirement accounts that are tax exempt pursuant to I.R.C. §§ 401, 413, 408, 408A, 414, 457 or 501(a). 11 U.S.C. § 522(d)(12). This includes ERISA plans and both IRAs and Roth IRAs. The exemption applies whether or not the debtor elects state exemptions, but is limited to \$1,095,000.00 with respect to Roth IRAs and traditional IRAs, except in the case of an IRA funded through qualified rollovers. 11 U.S.C. § 522(n).

14. Individual Retirement Accounts. An IRA is a trust or custodial retirement account for the exclusive benefit of an individual or his beneficiaries, whether or not they participate in a qualified plan. IRAs, which are not subject to ERISA, are protected in Missouri by the state exemption, but are limited to \$1,095,000.00 by the federal exemption.

15. Life Insurance. V.A.M.S. § 377.090 and § 377.330 provide that money, or other benefit, charity, relief or aid to be paid under a life insurance contract is exempt from attachment to pay debts of a certificate holder or a beneficiary. Section 513.430.1(7) exempts accrued dividends, interest, and loan value of all life insurance contracts owned by the debtor other than a credit life insurance contract. Section 513.430.1(8) limits the exemption to \$150,000 in the aggregate less any property transferred by the life insurance company to itself in good faith to pay a premium or carry out an automatic nonforfeiture insurance option under a life insurance contract entered into before the proceedings. The exemption does not apply to any claim for child support or an insurance contract purchased within one year prior to the commencement of proceedings under Title 11. *Id.*

16. Cemeteries/Burial Funds: V.A.M.S. § 214.190 exempts land or property set apart as burial grounds either recorded or used for burial for ten years. The exemption is limited to one acre and a value of \$100.

17. Wrongful Death: payment on account of the wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor. V.A.M.S § 513.430.1(11)

18. Miscellaneous Exemptions

- a. Crime Victims Reparation Award, V.A.M.S § 595.025.6
- b. Police and Fireman’s Retirement Pension and Medical Benefits, V.A.M.S. §§ 86.190; 86.353; 86.1040; 86.1430; 87.090; 87.485.
- c. County Employees’ Retirement Benefits, V.A.M.S § 50.1175.
- d. Local Government Employees’ Retirement Benefits, V.A.M.S. §§ 70.695; 71.207.
- e. Public School Retirement Benefits, V.A.M.S. §§ 169.090; 169.520; 169.690.
- f. Judicial Retirement Benefits, V.A.M.S. § 476.688.

D. Family Transfers and Gifts

1. General Rule. Outright gifts to family members are an effective way to protect assets from creditors, provided that the transfer passes the “fraudulent conveyance” test. The following are some rules of thumb to use when making family transfers:

- a. The donor should not transfer so much that it would render him insolvent.
- b. The donor should be sure that the assets are being transferred to a “safe” party (i.e., you should analyze the risk of liability of both the transferor and transferee).
- c. The donor should not keep transfers abnormally secret or take any steps that are fraudulent by themselves. For example, if the donor is transferring real estate, he should execute a normal deed and record it with the appropriate Recorder of Deeds office.
- d. The donor should clearly document the transfer. For example, when transferring tangible personal property, the donor should sign a deed of gift or other assignment form and make sure that possession is actually transferred.
- e. There should always be a reason for the transfer other than avoiding creditors, such as transferring assets to maximize estate planning efficiency.

The maximum annual gift tax exclusion is \$13,000.00 per donee, or \$26,000.00 per donee if the grantor’s spouse agrees to “split” the gift with the grantor. IRC § 2503(b). The maximum gift tax exemption is \$1,000,000.00. In addition, qualified transfers paid on behalf of an individual as tuition to an educational organization or to any person who provides medical care for such individual are not included in the donor’s total amount of gifts. IRC § 2503(e).

2. Gifts To Spouse. Once the asset leaves the control of the donor, the donor's creditors cannot reach it. Married couples enjoy a special marital deduction for gifts made between spouses. Under IRC § 2523, gifts between spouses may be deducted from the donor's annual taxable gifts. Under Kansas fraudulent conveyance law a transfer to a spouse within two years of the transferor filing for bankruptcy is generally construed to be a fraudulent transfer.

3. Gifts To Children: The IRC § 2503(c) Trust and the Crummey Trust. Gifts to minors are subject to the \$13,000.00 annual gift tax exclusion under IRC § 2503. Income distributed to or for the benefit of a child will be taxable to the child, and the "kiddie tax" will apply in the year of distribution if the child is under 14 and the income exceeds approximately \$1,000.00. The tax on the net unearned income of a child under the age of 14 is computed at the marginal rate of the child's parent.

a. Prerequisites of § 2503(c) trust. The principal and the income of the trust may be expended in the discretion of the trustee for the benefit of the child/donee before his attaining age 21. To the extent the principal and income is not so expended, then such property must pass to the child upon his attaining age 21. If the child dies prior to age 21, the property must be distributed to his estate or be subject to the child's general power of appointment. The IRS has ruled that the "passing" requirement upon the child's reaching age 21 is satisfied if the trust agreement gives the child the right to withdraw such property at age 21, such right to exist for a specified time (i.e., 30-60 days).

b. Crummey Trusts. This technique involves an irrevocable trust wherein assets are contributed to the trust, followed by a notice from the trustee to the children (or their guardian, other than the donor of the property) notifying the children of the contribution and the fact that they have a specified time period in which to withdraw the money. This power of withdrawal creates a "present interest" on behalf of the child in the trust property, and, therefore, the contribution is eligible for the \$13,000.00 annual exclusion from income tax. If the child does not withdraw the money within the specified period of time, then the money is left in the trust for whatever period is desired and governed by the remaining terms of the trust. If the instrument provides that the right of withdrawal is automatically forfeited should the party with power file for bankruptcy or enter into an assignment for the benefit of a creditor, then creditors of that party, and in any event, creditors of the grantor, should not be able to reach the trust assets.

4. 529 Higher Education Savings Accounts. A 529 plan is an educational savings plan operated by a state (both Kansas and Missouri authorize 529 plans) and designed to set aside funds for future higher education. The beneficiary of such a plan must be a child, stepchild or grandchild of the debtor. In Kansas, the assets of such plans are exempt from attachment. See K.S.A. § 75-647(q). In Missouri, the assets are not exempt from attachment, but under federal Bankruptcy law, in certain circumstances the funds invested in the plan are not considered "assets" of the estate and are therefore beyond the reach of a debtor who funds such a plan. See 11 U.S.C. § 541(b)(6).

Those circumstances are set forth in the Bankruptcy Reform Act of 2005 (BAPCPA), which established restrictions on the exclusion of the funds invested in a 529 plan from the estate of the debtor. Essentially, all funds invested in a 529 plan **more than two years prior** to the filing of a petition in bankruptcy are excluded from the estate of the debtor; and any funds contributed **more than one year but less than two years prior** to filing are excluded from the property of the estate to the amount of \$5,475 only (this amount is adjusted every three years to reflect the cost of living; the next adjustment is due on April 10, 2010). Any funds contributed to the plan **within one year** of filing for bankruptcy are not excluded from the property of the estate.

529 plans are also subject to the gift tax laws. Although the gift tax exclusion for 2009 is \$13,000 per recipient (married couples can give \$26,000 to each recipient), there is an exception for 529 plans. The donor can make five years' accumulated contribution (if made in 2009, for a total of \$65,000) without becoming liable for any gift tax, provided that no other funds are given to the recipient within the five years.

Finally, each state has set a maximum contribution per beneficiary in a qualified savings plan. In Missouri, the maximum contribution per beneficiary is \$235,000; in Kansas, the maximum contribution per beneficiary is \$290,000.

E. Trusts

1. Irrevocable. A trust is irrevocable if the trust property is permanently transferred out of the settlor's hands and is therefore exempt or insulated from the claims of the settlor's creditors. If properly set up, the beneficiaries will also be free of the creditors' claims. The trust should contain a discretionary distribution provision and the settlor cannot be a beneficiary of the trust.

2. Revocable. The grantor is the beneficiary and trustee for lifetime, retaining the power to revoke the trust. Revocable trusts are useless as an asset protection tool because the grantor's creditors can attach the trust funds to the full extent of the grantor's retained beneficial interest as established by the provisions of the trust instrument.

3. Spendthrift. A spendthrift trust imposes a restraint on the voluntary and involuntary transfer of the beneficiary's interest in the trust property under state law. The trust agreement contains a special "spendthrift clause" which vests in the trustee the legal title to the trust assets, as well as the sole discretion to control the trust assets free from all claims, attachments, judgments, executions and liens of every nature by creditors against the settlor. Since the settlor does not have an assignable interest in the trust, most creditors of either the settlor or the beneficiaries are unable to attach the trust assets. *Everitt v. Haskins*, 102 Kan. 546, 171 P.2d 632 (1918); *In re Hayes*, 168 B.R. 717 (D. Kan. 1994).

a. Exceptions to the spendthrift exemption:

i. Spendthrift law may not be applicable with respect to two types of creditors: family creditors seeking support; and medical providers. Restatement (Second) of Trusts § 157 (1957). *See: Watts v. McKay*, 160 Kan. 377 (1945) (ex-wife seeking child support); and *Pond v. Harrison*, 96 Kan. 542, 152 P. 655 (1915) (court implied that a creditor might reach a beneficiary's interest in a spendthrift trust if, with the trustee's knowledge, the creditor had provided necessary medical services to an improvident beneficiary).

ii. Spendthrift provisions may not be effective as to any creditor if the beneficiary is given broad rights to reach the trust property. *See In re Threewitt*, 24 B.R. 922 (D. Kan. 1982) (trust provision giving debtor/beneficiary certain withdrawal rights and rights to borrow against the trust principal deemed a voluntary right of alienation which gave creditors a right to reach the trust).

4. Self-Settled or Domestic Asset Protection Trusts. A self-settled trust is a trust created by an individual for his or her own benefit. The majority of states, including Kansas, currently have laws which allow creditors to reach the assets of self-settled trusts. *See* K.S.A. § 33-101. Therefore, in such states the self-settled trust is not a viable asset protection device.

Missouri law, on the other hand, provides that a self-settled irrevocable spendthrift trust can be valid as an asset protection device under certain circumstances. These trusts are often called "Domestic Asset Protection Trusts" (DAPT). In order to be valid against creditors, a Missouri DAPT must meet the following requirements:

- a. The funding of the trust must not be fraudulent under the Uniform Fraudulent Transfer Act;
- b. The grantor is not able to amend or revoke the trust;
- c. There must be other beneficiaries in addition to the grantor;
- d. The grantor's interest in the trust is entirely discretionary;
- e. The trust must include a spendthrift clause.

There are also bankruptcy restrictions on a self-settled trust valid under state law. 11 U.S.C. § 548(e) provides that the trustee may avoid a transfer made to a "self-settled trust" if the transfer was "made on or within 10 years before the date" of the filing of the petition if the transfer was made by the debtor with the actual intent to hinder, delay or defraud any entity to which the debtor was or would become indebted.

5. Insurance. An irrevocable trust which is created to hold an insurance policy, as with insurance policies, is subject to a one year look-back period. The nonforfeiture value of a life insurance policy shall not be exempt from: (1) claims of the creditors of a policyholder who files for bankruptcy on or within one year after the date the policy is issued; or (2) the claim of any creditor of a policyholder if execution on judgment for the claim is issued on or within one year after the date that the policy is issued. K.S.A. § 40-414(b).

6. Charitable Remainder Trust. A CRT is similar to a life income annuity with an insurance company, with a few distinctive features and greater tax benefits. Under the CRT provision of I.R.C. § 664, a CRT may be set up to make payments to non-charitable beneficiaries for life or a term of years, not to exceed 20 years, as long as the remainder goes to a charity. Payments to non-charitable beneficiaries can be made either in the form of a fixed annuity amount or a fixed percentage amount. The Charitable Remainder Annuity Trust (CRAT) pays a fixed annual annuity amount of not less than 5% of the initial fair market value of property placed in trust. The Charitable Remainder Unitrust (CRUT) pays the beneficiary in the form of a fixed percentage, not less than 5%, of the fair market value of the trust as valued annually during the lifetime of the beneficiary or for a term of years. With either a CRAT or a CRUT the remainder goes to charity. The CRT offers the following benefits:

- a. Avoids capital gains tax. By transferring some highly appreciated investments to the CRT, they can be sold at a profit without incurring capital gains tax.
- b. Income tax deduction. Transfers made to a CRT are tax deductible for the donor. The value of the deduction is illustrated by example: According to the IRS mortality tables, the remaining life expectancy of a person at age 65 is 20 years. If you contribute \$200,000.00 to a CRT in exchange for a 5% annual payment of \$10,000.00 per year, the amount of your tax deduction will be about \$100,000.00. That's the value of the gift minus the present value of the 20 years of income.
- c. Assets held by a CRT are generally not subject to attachment by creditors of the donor or creditors of the beneficiary until the funds are distributed. If the CRT is construed to be an annuity the assets may be subject to attachment by creditors.

7. Bankruptcy Law on Trusts. Section 541(c)(2) of the Bankruptcy Code states that “a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable non-bankruptcy law is enforceable in a case under this title.” Thus, since under Kansas law a creditor is precluded from reaching a beneficiary’s discretionary or spendthrift trust interest, a bankruptcy trustee also would be precluded from including the interest in the debtor’s bankruptcy estate. 4 Collier on Bankruptcy ¶ 541.01; *accord, In re Kragness*, 58 B.R. 939 (D. Or. 1986).

F. Family Limited Partnership

1. General Rule. An FLP is an entity which allows parents to control the family's assets without subjecting the assets to the claims of the parents' creditors. In order to qualify for special tax treatment, the FLP must lack two of the following four attributes: centralization of management; limited liability; continuity of life; and free transferability of interests. FLPs offer flow-through taxation like a partnership, and are therefore tax-neutral. Transfers of assets to the partnership are considered neutral transactions, resulting in no gain to the transferor. However, gain may be realized if the transferor is compensated for the transfer within five years of the transfer, as that is then considered a "sale" of the property under IRC § 704(c)(1)(B).

2. Structure. The FLP closely resembles a limited partnership and shares many of its legal attributes. In a typical FLP, the children are 99% owners of the limited partnership interest, and the parents are 1% owners of the general partnership interest. A corporation may be formed to hold the 1% general partner interest, with the parents as the officers. If this structure is chosen the corporation should not be controlled by the parent, or else a creditor or a bankruptcy trustee of the parent could accede to the controlling interest in the corporation's stock. Another alternative is to place the general partner's interest in a trust with the parent retaining some control over the trust, but not acting as the trustee. In the event of the parent's bankruptcy, the bankruptcy trustee should not be able to step into the shoes of the trustee of the trust (which holds the general partner interest). However, courts may not allow the 99% to 1% division, construing it as '*de minimis*' or a sham, thereby treating the entire interest as owned by the parent. Rev. Proc. 74-17 suggests that the general partner should have no less than a 1% interest.

3. Estate Planning. The FLP can be used as a vehicle to dramatically reduce or eliminate estate taxes. The parents could make gifts to the children in the form of limited partnership interests. In subsequent years, the parents as general partners could gift limited partnership interests equal to the amount of the annual gift tax exclusion of \$26,000.00 per child (\$13,000.00 exclusion per parent - IRC § 2503). Once all of the family's assets are held by the FLP, title would transfer to the children upon the death of the parents as general partners without incurring estate taxes.

4. Asset Protection. The FLP can afford excellent asset protection. Although creditors have three non-bankruptcy remedies to pursue the parent's assets in an FLP - (1) assignment of the parent's FLP interest, (2) a charging order, and (3) foreclosure - for reasons discussed below, these remedies fall short of providing the creditor meaningful access to the debtor's assets.

a. Ordinarily, an assignment will not dissolve an FLP, and it will be able to continue its existence provided that the remaining limited partners elect a new general partner according to the terms of the partnership agreement. A creditor-assignee will ordinarily not accede to the rights and powers of the general partner. Therefore, the creditor-assignee will be unable to compel distributions from the FLP, sell partnership assets, or dissolve the partnership. K.S.A. § 56-1a402.

b. A creditor that obtains a charging order acquires only the right to receive the parent's entitlement to distributions as a partner. K.S.A. § 56-1a403. The charging order will not dissolve the FLP. The limited partners can refuse to make income distributions, thereby denying the creditor any money. However, the creditor is still liable for taxes on this "phantom income" which it will never receive. IRC § 1398(b)(2) & (c)(1). During this time the parent ex-general partner can continue to receive money from the FLP as a form of "salary" pursuant to an employment contract.

c. If a creditor forecloses on a partnership interest, the interest will be treated as having been assigned to the creditor. The creditor will encounter the same difficulties as if it were assigned the general partnership interest in the FLP.

5. Bankruptcy Rules for FLPs. There is a risk that the FLP may dissolve if the general partner (parent) files for bankruptcy. The bankruptcy trustee may be able to succeed to the general partner's power to order a dissolution of the FLP. Such power would allow the trustee to obtain a distribution of the parent's interest. However, in Kansas, the bankruptcy of the parent will not necessarily result in a dissolution of the FLP. Pursuant to K.S.A. § 56-1a451(b), a partnership is dissolved by the withdrawal of a general partner *unless* there is at least one remaining general partner and the partnership agreement permits the partnership to continue, or all partners agree in writing, within 90 days of the withdrawal, to continue the business and to appoint one or more new general partners as necessary. As long as the general partner position remains filled, it appears that the bankruptcy of the parent will not necessarily dissolve a Kansas FLP.

If the partnership agreement does not prohibit a limited partner from withdrawing and receiving the fair market value of the interest, a bankruptcy trustee holding a limited partnership interest may be able to do just that. Therefore, the partnership agreement should provide that no partner will receive the value of his share upon any event of withdrawal until the partnership is dissolved. Practitioners should be sure that this provision is not triggered solely by changes in a partner's financial condition or a partner's bankruptcy, as such a provision may be attacked as an unenforceable *ipso facto* clause.

If the trustee succeeds to a limited partner's interest, the Trustee may be able to compel the general partner to make income distributions to it under a theory that the general partner owes a fiduciary duty to the limited partners. The general partner in this situation is not permitted to make distributions to other limited partners, to the exclusion of the trustee.

6. FLP Fraudulent Conveyance Concerns. A parent may not organize a FLP in order to defraud its creditors. If fraud is found, a court will order the general partner to make distributions of the FLP assets to satisfy the parent's creditors. Subject to the applicable statute of limitations, a transfer to an FLP will be voidable by a present or future creditor or bankruptcy trustee if it is made with actual intent to hinder, delay, or defraud creditors. Courts look for the presence of "badges of fraud" as extrinsic evidence by which they may infer fraud in the transfer. These badges include the following:

- a. Transfer of only bare legal title, where parent retains control;
- b. Concealment of transfer - The limited partner should be registered and hold the transferred property out to the public as property of the partnership;
- c. Transfer of substantially all of parent's assets;
- d. Inadequately compensated use of transferred assets by the parent;
- e. Value of partnership interest received by parent is not reasonably equivalent to the value of the property transferred;
- f. Partnership made when parent insolvent, or shortly after parent becomes insolvent; after parent is sued or threatened with suit; or shortly before or after parent incurs a substantial debt;
- g. Transfer to an insider;
- h. Transfer that removes assets from the jurisdiction;
- i. Transfer to a straw person;
- j. Transfer not in the ordinary course of business; and
- k. "Transfer and lease-back" to parent, or transfer and employment/salary contract with parents; where parent retains actual control of the transferred assets.

The following transfers to FLPs are voidable even absent proof of fraudulent intent by the parent:

- a. Transfer of tangible personal property without adequate consideration, unless a deed of gift is recorded or actual possession of the property is surrendered;
- b. Any transfer if a bona fide purchaser's interest in the transferred property can be perfected against the partnership;
- c. A transfer without reasonably equivalent consideration if parent is insolvent at the time or parent becomes insolvent as a result of the transfer;
- d. Any transfer if parent is engaged, or about to be engaged, in business and parent's capital remaining after the transfer is unreasonably small; and

- e. Any transfer of property to the partnership within two years of the transferor filing for bankruptcy. 11 U.S.C. § 548(a).

G. Offshore Asset Protection Trusts An OAPT is a trust which the settlor establishes under the laws of a foreign jurisdiction. An OAPT is governed internally by its contract provisions and externally by the laws of the situs jurisdiction. The trust agreement delineates how much control the settlor has over the assets, the timing and manner of or constraints on the trustee, and how the trustee is to act in certain situations, (*e.g.*, when a U.S. court proceeds against the foreign trust corpus, the trustee is often directed by the trust instrument to take the trust assets and move to another location).

OAPTs offer the primary benefits of giving greater effect to favorable spendthrift provisions for the settlor, and shielding beneficiaries from future potential tort liability. Ancillary benefits of OAPTs include: probate avoidance; confidentiality; vehicle for global investing; ease in transferring assets; avoidance of potential monetary exchange controls; will substitute; avoidance of multiple wills; privacy; facilitating the handling of affairs in the event of disability or unavailability; flexibility; and tax-neutral status under the Internal Revenue Code.

1 Internal OAPT Provisions. The flexibility of OAPT agreements allows the debtor to further protect his assets by inserting debtor-favorable language into the contract. The following is a list of provisions that are commonly incorporated into OAPT contracts:

- a. Discretionary/Spendthrift clause. OAPTs offer the same basic protections as a domestic spendthrift trust. The settlor/beneficiary relinquishes legal title to the trust assets, and does not have the power to compel any re-conveyancing of transferred assets. Furthermore, if the OAPT is properly drafted as a discretionary/spendthrift trust, the settlor/beneficiary may not compel distributions. Thus, the creditors of the settlor/beneficiary will be unable to reach the trust assets until they are distributed.

Nevertheless, the OAPT allows the settlor/beneficiary to retain certain powers, such as limited powers of appointment (both inter vivos and testamentary) and the ability to remove and replace the trustees. These powers give the settlor/beneficiary considerable control over the trust assets, without violating the trust's spendthrift clause.

- b. Anti-duress clause. Prohibits the trustee from complying with orders issued by a court, or other involuntary mandate imposed upon the settlor, a domestic trustee or the foreign trustee. When an OAPT becomes the object of a court order contrary to the settlor's intent, the foreign trustee may be instructed to discharge the U.S. co-trustees, ignore the decisions of others to discharge or replace trustees and, when the trust owns the stock of a U.S. corporation that is under attack, liquidate the corporation and expatriate the assets.

- c. Establish a "trust protector". A trust protector is a person appointed by the settlor to ensure that the trustee governs the trust assets in a manner consistent

with the settlor's best interests. The trust protector serves as an advisor or ombudsman to the trustee, and may be given the authority to remove the trustee, change the jurisdiction of the trust or even change the beneficiaries of the trust. By serving in a quasi-fiduciary status to the settlor, the trust protector provides the settlor with indirect control over the trust assets.

d. Blind trust provision. The blind trust provision prevents the trustee from disclosing information concerning the trust to the settlor. Thus, the settlor will be unable, even under court order, to disclose information about the trust's activities because he will lack such knowledge. The blind trust provision provides a defense to a charge of contempt since a person cannot be held in contempt for not failing to disclose information that one truly does not know, and makes it virtually impossible for creditors to locate the trust assets. However, as discussed *supra*, some courts have rejected the "impossibility" defense, ruling that it has been self-created by the settlor. See *In re Lawrence*, 227 B.R. 907 (S.D. Fla. 1998).

e. Flight clause. A flight clause in an OAPT allows the trustee to move the assets of the trust upon the occurrence of events that may pose a threat to the trust. The flight clause protects against threats such as nationalization, expropriation orders or political or social instability of the foreign situs.

2 Laws of Foreign Situs. The laws of the foreign jurisdiction that govern an OAPT are more debtor-favorable than the corresponding U.S. laws. Foreign situs laws generally feature short statutes of limitation for bringing actions against the trust and fraudulent conveyance laws that require the claimant to prove that the trust was established by the debtor with the specific intent to defraud the creditor - an extremely high burden to meet.

In those cases when the laws of the situs jurisdiction and the laws of the U.S. conflict, the debtor will be able to claim the protection of the favorable laws of the former jurisdiction to the exclusion of the latter. Because most foreign situs jurisdictions do not give full faith and credit to decisions of U.S. courts, a foreign court in the jurisdiction of an OAPT may not grant comity to a U.S. court's judgments and may ignore demands to repatriate the trust assets.

3 Combine OAPT With Other Asset Protection Tools. An OAPT can easily be integrated into a more comprehensive asset protection scheme to provide greater asset protection. The following example illustrates how an OAPT can be combined with a Limited Partnership.

a. The debtor transfers assets to a Limited Partnership in which the debtor retains a 1% interest and acts as general partner, retaining control over the assets. The OAPT is the limited partner with a 99% interest.

b. If a lawsuit threatens the debtor the Limited Partnership will initially continue to operate. Creditors will, at best, receive a charging order. They will not

receive income distributions, but will be forced to pay taxes on the “phantom income.”

c. If a persistent creditor succeeds in obtaining an equitable remedy in court that threatens the Limited Partnership interest, the Limited Partnership will dissolve. The debtor will receive his 1% share, which the creditor may attach. However, the OAPT trustee will take the remaining 99% of the assets and leave the country. If the creditor is lucky enough to find the OAPT a lawsuit must be brought in the foreign jurisdiction, since the foreign court will not grant comity to U.S. courts’ decisions. The foreign jurisdiction will require retention of local counsel (often, the creditor must pay the foreign attorneys up-front), the creditor will face an uphill battle with the decidedly debtor-favorable laws, and the foreign situs may even pose a language barrier to the creditor.

4 Potential Issues Regarding OAPTs. As noted, courts have been chipping away at the protections afforded by OAPTs. As in the case of all trusts, if it was created for the purpose of defrauding creditors or at a time when the settlor was insolvent, then the validity of the trust will not be recognized by the court, and the assets will not be protected from creditors. See *In re B.V. Brooks*, 217 B.R. 98 (D. Conn. 1998).

Additionally, creditors are mounting innovative challenges to the validity of OAPTs. Specifically, courts have found troublesome the issues of the “anti-duress” clause and the blind trust provision leading to the impossibility of the settlor to provide information about the OAPT. As noted, the “anti-duress” clause prohibits the trustee from complying with orders issued by a court, or other involuntary mandates imposed upon the settlor, a domestic trustee or the foreign trustee. The terms of the trust will mandate the removal of the trustees in order to insure that the assets of the trust will not be repatriated. However, if the settlor is either a co-trustee or the protector of the trust, vesting the settlor with such powers may expose the settlor to a contempt order. See *FTC v. Affordable Media LLC, et al.*, 179 F.3d 1228 (9th Cir. 1999).

Furthermore, even though the blind trust provision can prevent the trustee from disclosing information to the settlor and thereby insulate the settlor from disclosing information about the trustee’s activities, courts have rejected the ignorance of the settlor and found the settlor in civil contempt if the settlor created the trust for the purpose of defrauding a potential creditor. See *In re Lawrence*, 227 B.R. 907 (S.D. Fl. 1998).

H. Payment of Nondischargeable Debts (Pre-Bankruptcy) A debtor may reduce his nondischargeable debts before the assets of the bankruptcy estate are applied to satisfy nondischargeable debts.

1 Nondischargeable Tax Debts. Income tax; withholding tax; property tax; the 100% penalty tax; and interest.

2 Nondischargeable Non-Tax Debts. Debts for money, property, services, or extension, refinancing or renewal of credit obtained by fraud or misrepresentation;

unscheduled debts; debts resulting from certain crimes involving dishonesty; debts for child or spousal support, and other debts incurred in connection with divorce or separation; debts for malicious injury to another or another's property; debts for certain government-assisted educational loans; debts resulting from driving a motor vehicle while intoxicated; and certain debts arising in prior bankruptcies or with respect to bank regulatory agencies. 11 U.S.C. § 523(a)(2-15).

3 Caution. Combining payment of nondischargeable debts with other forms of pre-bankruptcy planning (e.g., conversion of non-exempt assets) may, if taken to excess, lead to the denial of the debtor's discharge on the grounds that transfers and dispositions were made with the intent to hinder, delay or defraud creditors. *See In re Swift*, 3 F.3d 929, 931 (5th Cir. 1993).

IV. CHECKLISTS

A. Exemptions

1 Kansas Homestead and Home Improvements

a. The land must contain the debtor's residence. *In re Gray*, 45 B.R. 437, 439 (D. Kan. 1984); *Peak v. Lenora State Bank*, 58 Kan. 485, 489, 49 P. 613 (1897).

b. The land must be occupied and used as a residence. *Belcher v. Turner*, 579 F.2d 73 (10th Cir. 1978)(only the portion of a duplex occupied as a residence can qualify for exemption); but see *In re McCambry*, 327 B.R. 469 (D. Kan. 2005)(occupancy is only one factor to consider in determining whether duplex qualifies as homestead).

c. Limited to one acre within an incorporated town or city, or 160 acres of farming land not within an incorporated town.

d. Parcels must be contiguous. *Slafo v. Jarvis*, 477 F.2d 369 (10th Cir.), cert. denied, 414 U.S. 944 (1973); *Linn County Bank v. Hopkins*, 47 Kan. 580, 28 P. 606 (1892)(parcels are not contiguous if they merely corner on each other); *Meech v. Grigsby*, 153 Kan. 784, 113 P.2d 1091 (1941)(parcel cannot be divided by alley dedicated to the public use); *In re Grey*, 45 B.R. 437 (D. Kan. 1984)(debtor cannot select the one-acre parcel by carving out his tract so as to impair the value of the remainder portion).

2 Missouri Homestead

a. Property must be occupied or debtor must exhibit both an intent to occupy such property, and an ability to control or strongly influence the time of occupation. *In re Schissler*, 250 B.R. 697 (Bankr. W.D. Mo. 2000) (citing *In re Dennison*, 129 B.R. 609, 611 (Bankr.E.D.Mo.1991)).Parcels need not be contiguous as long as the land is used in connection with the dwelling and its

appurtenances. *Brune v. Rathbun*, 204 S.W.2d 705 (Mo. 1947); *Overfield v. Overfield*, 326 S.W.2d 1073 (Mo. 1930); *Haggard v. Haggard*, 233 S.W. 18 (Mo. 1921);

b. Tenancy By The Entirety – Under the bankruptcy code, Missouri residents can exempt property interests held jointly or by the entirety to the extent such interests are exempt from process under applicable nonbankruptcy law. 11 U.S.C. § 522(b)(3)(B). While Missouri nonbankruptcy law does not exempt entirety property to the extent the owners are jointly indebted, the Eighth Circuit has held that when such property is liquidated in a bankruptcy proceeding against one, but not the other entirety-holding spouse, the nonfiling spouse’s share of the proceeds from the sale are to be returned to her before payment of the joint creditors. *In re Garner*, 952 F.2d 232, 236 (8th Cir. 1991). The joint creditors can then proceed against the nonfiling spouse once the filing spouse has been discharged. *Id.* However, in situations in which joint creditors are not going to be paid in full, the filing spouse’s homestead exemption is limited to half the full amount, or \$4,000. *In re Van Der Heide*, 164 F.3d 1183, 86 (8th Cir. 1999). In *Van Der Heide* the court reasoned that a strict application of *Garner* would hinder the federal interest of preventing debtors from exploiting the tension between bankruptcy and state property law. *Id.* A filing spouse could claim the full \$8,000 homestead exemption for the entirety property. After his discharge the joint creditors would not be able to pursue the nonfiling spouse’s share of the entirety property as the debt would no longer be joint. *Id.* Federal limitations – two provisions of the Bankruptcy Reform Act of 2005 affect the homestead exemption. These provisions both apply even in opt-out states such as Kansas and Missouri. These provisions are:

i. 11 U.S.C. § 522(o) – this section extends the “look-back” period for determining the homestead exemption to ten years, and states that the homestead exemption shall be reduced to the extent that the value of the homestead is attributable to any property that the debtor disposed of during that ten-year period with the intent to hinder, delay, or defraud a creditor. The section only applies to the disposition of non-exempt property.

ii. Recent case law regarding 11 U.S.C. § 522(o) - on August 7, 2008, the Eighth Circuit decided *In re Addison*, 540 F.3d 805 (8th Cir. 2008), which addressed the issue of § 522(o)’s application to a case involving prebankruptcy transfer of nonexempt assets into an exempt homestead. In another case decided on April 11, 2008 – *In re Anderson*, 386 B.R. 315 (2008) - the Kansas Bankruptcy Court addressed similar issues.

In re Addison, 540 F.3d 805 (8th Cir. 2008) – *Addison* involved pre-bankruptcy planning: shortly before he filed his petition, the debtor converted \$11,500 in nonexempt funds to make a voluntary principal payment on his home mortgage. Even though the debtor’s domicile, Minnesota, is an opt-out state, the Eighth Circuit held that state homestead

exemptions are subject to 11 U.S.C. § 522(o), which reduces the amount of the state homestead exemption to the extent that the value of the exemption is attributable to nonexempt property which the debtor converted into the homestead within 10 years of filing for bankruptcy, if the conversion was made “with the intent to hinder, delay, or defraud a creditor.” In other words, debtors seeking the protection of a state homestead exemption will find that state homestead exemption limited by 11 U.S.C. § 522(o).

In deciding then what was necessary to demonstrate “the intent to hinder, delay or defraud a creditor,” the Eighth Circuit looked at cases interpreting §§ 548(a)(1) and 727(a)(2). The Court rejected the argument that § 522(o) created a new standard for determining what evidence met this standard, noting that § 522(o) merely established a 10 year look-back period within which such evidence may be considered.

The trustee sought to set aside the transfer of nonexempt property into the homestead since the transfer was made on the eve of bankruptcy. However, the Court rejected that argument. The Court noted that “It is well settled that the mere conversion of non-exempt assets into exempt assets is not in itself fraudulent” and that “a debtor’s conversion of property on the eve of bankruptcy for the express purpose of placing that property beyond the reach of creditors, without more, will not deprive the debtor of the exemption to which he otherwise would be entitled.”

The lower court had voided Addison’s transfer, noting that several of the traditional badges of fraud were present in the transfer (the transfer was made to an insider; Addison retained control of the property after the transfer; the transfer was made after Addison was sued on a personal guaranty; Addison was insolvent at the time of the transfer). However, the Eighth Circuit concluded after analyzing the traditional “Badges of Fraud” that **for fraudulent intent to be found there must appear in the evidence some facts or circumstances which are *extrinsic* to the mere facts of conversion of non-exempt assets into exempt and which are indicative of such fraudulent purpose** (emphasis added).

In other words, in the Eighth Circuit, the conversion of non-exempt assets into exempt assets (in this case, into the homestead) by itself is not probative of fraud, even if done at the penultimate moment, and any badges of fraud arising from the facts of the transfer are also not in and of themselves indicators of fraud. To that point, the Court in *Addison* noted that the debtor’s conversion of nonexempt property into exempt could be viewed as a transfer to an insider; that after the transfer the debtor would continue to control the property; and that a debtor converting nonexempt assets on the eve of bankruptcy is usually insolvent; and concluded that these “badges of fraud,” without more, could not support a finding of intent to defraud.

The Court did give examples of the sort of evidence which would be necessary to find fraud. Among the examples were:

- 1 Conduct intentionally designed to materially mislead or deceive creditors about the debtor's position;
- 2 Use of credit to buy exempt property;
- 3 Converting a very great amount of the debtor's property (the Court noted that Addison had not transferred all of his non-exempt assets to the homestead); and
- 4 The existence of conveyances for less than adequate consideration.

In re Wilmoth, 397 B.R. 915 (8th Cir. 2008) - the Court affirmed that 11 U.S.C. § 502(o) did not establish a new evidentiary standard for pre-bankruptcy homestead exemption planning, but only extended the look-back period to 10 years. The Court further held that **there must be extrinsic evidence of fraud, other than the badges of fraud themselves, to support a finding of intent to defraud.** Apparently this extrinsic evidence would consist of deeds such as those referenced by the court in *Addison*. This was precisely the point made in *In re Montaro*, 398 B.R. 688, a case which was decided on Dec. 10, 2008.

In re Anderson, 386 B.R. 315 (D. Kan. 2008) - This recent Kansas case used a similar analysis in deciding what must be demonstrated to set aside a transfer under §522(o). In *Anderson* the Court also looked to the case law interpreting §§ 548(a) and 722(a) in determining what evidence would be necessary to demonstrate an intent to defraud under § 522(o). *Anderson* had paid down his mortgage obligation with non-exempt assets within a few months of filing a petition in bankruptcy. The decision in *Anderson* was based in its particular set of facts, and after weighing all of the evidence the Court concluded that although it was a close question, in the absence of direct evidence demonstrating fraudulent intent by a preponderance of the evidence based on the presence of the badges of fraud, it would not sustain the objection to the transfer. In reaching this decision, the Court concluded that “Substantial evidence of prebankruptcy planning to pay down a mortgage on a homestead using nonexempt assets is not sufficient [to] deny discharge, as actions to hinder, delay, or defraud creditors require something more.”

However, where *Addison* explicitly set forth examples of that “something more,” *Anderson* was reticent as to what would constitute evidence of intent to defraud. The Court did reference the “Badges of Fraud” analyses under both §§ 548(a) and 722(a), but repeated that “Substantial evidence of prebankruptcy planning to pay down a mortgage on a homestead using nonexempt assets is not sufficient [to] deny discharge, as actions to hinder, delay, or defraud creditors require *something more*” (italics added). In *Anderson*, that “something more”

could be found in the facts and circumstances of the transfer itself; unlike the Eighth Circuit's decision in *Addison*, in which the Court determined that the "something more" to demonstrate an intent to defraud must be found in circumstances extrinsic to the transfer.

Finally, it is important to note that both *Addison* and *Anderson* were cases interpreting 11 U.S.C. § 522(o) in the context of the prebankruptcy conversion of nonexempt assets into an exempt homestead asset. Efforts to extend the reasoning and conclusions of *Addison* and *Anderson* into other areas of bankruptcy law should be cautiously and thoroughly articulated.

iii. 11 U.S.C. § 522(p) – this section restricts any homestead acquired within 1,215 days (three-and-a-half years) of filing the petition to \$136,875 (this amount is adjusted every three years to reflect the cost-of-living). Rollover equity from the disposition of a prior homestead put in a new homestead acquired within the time limit is exempted, provided that both homesteads are located in the same state.

2 Kansas Household Goods

- a. Must be "reasonably necessary" to maintain debtor's customary standard of living.
- b. Must be in person's present possession. *In re Ferguson*, 67 B.R. 246 (D. Kan. 1986) (goods repossessed by creditor holding a nonpossessory, nonpurchase money security interest were not considered to be in the debtor's present possession, and thus were not exempt).
- c. Must be at the principal residence.
- d. Must be owned for at least one year.
- e. There is no monetary limit on the exemption. *In re Noland*, 13 B.R. 766 (D. Kan. 1981); *Nohinek v. Logsdon*, 6 Kan.App.2d 342, 628 P.2d 257 (1981).

3 Kansas Tools of the Trade K.S.A. § 60-2304(5):

- a. Exemption is limited in amount to \$7,500.00.
- b. Tool must be reasonably necessary, convenient, or suitable for the production of work (need not be indispensable). *In re Frierson*, 15 B.R. 157 (D. Kan. 1981); *In re Currie*, 34 B.R. 745 (D. Kan. 1983). Tool must also be tangible means of production. *In re Lampe*, 278 B.R. 205 (10th Cir. 2002); *In re Kobs*, 163 B.R. 368 (D. Kan. 1994).
- c. Exemption only pertains to debtor's principal business. *In re Oetinger*, 49 B.R. 41 (D. Kan. 1985); *In re Meckfessel*, 67 B.R. 277 (D. Kan. 1986).

d. Does not include automobiles unless the debtor's business is uniquely dependent on the auto. *In re Meaney*, 35 B.R. 3 (D. Kan. 1982); *In re Currie*, 34 B.R. 745 (D. Kan. 1983); *In re Bondank*, 130 B.R. 586 (D. Kan. 1991) (held vehicle used by debtor in his business as real estate appraiser, to travel to and from properties appraised, was not exempt as tool of trade).

e. Where one spouse is employed and the other is not, both spouses are entitled to the tool of trade exemption. *In re Currie*, 34 B.R. 745, 748 (D. Kan. 1983).

f. Cattle are usually exempt. See *In re Heape*, 886 F.2d 280 (10th Cir. 1989).

4 Missouri Tools of the Trade

a. Item is exempt if reasonably necessary to the debtor's trade or business even if it could be exempt under a different exemption. *In re Gray*, 303 B.R. 632 (Bkrtcy. W.D. Mo. 2003) (horses and heifers used in teaching others to rope and ride exempt as tools of the trade); *In re Baker*, 139 B.R. 468, 71 (Bankr. W.D. Mo. 1992) (van used in business of transporting passengers exempt as tool of the trade for lien avoidance purposes); but see *In re Eakes*, 69 B.R. 497 (Bkrtcy. W.D. Mo. 1987) (holding that the tools of the trade exemption does not apply to livestock, but rather inanimate devices such as an instrument or apparatus that augments or extends the limits of human physical ability or power).

5 Kansas Pensions and Qualified Retirement Plans

a. Any money or interest in a qualified plan under sections 401(a), 403(a), 403(b), 408, 408A, or 409 of the Internal Revenue Code are exempt and treated as spendthrift trusts. K.S.A. § 60-2308(b).

b. Proceeds must have been received within three months of the issuance of an execution, attachment, or a garnishment, and must be necessary for the support of debtor or debtor's family in order to be exempt.

c. IRAs are exempt under K.S.A. § 60-2308(b). They are exempt under federal law to the amount of \$1,095,000.00.

d. Exemption does not apply to execution for past-due maintenance owed former spouse. *In re Marriage of Schoneman*, 13 Kan.App.2d 536, 775 P.2d 194 (1989).

6 Missouri Pensions and Qualified Retirement Plans

a. A right to receive any payment under a stock bonus plan, pension plan, disability or death benefit plan, profit-sharing plan, nonpublic retirement plan or any plan under V.A.M.S. § 456.072, any deferred compensation program offered

by the state of Missouri or any of its political subdivisions, or annuity or similar plan or contract on account of illness, disability, death, age or length of service, to the extent reasonably necessary for the support of the debtor and any dependents. V.A.M.S. § 513.430.1(10)(e). The exemption does not apply if the plan or contract was established by or under the auspices of an insider that employed the debtor when the debtor's rights under the plan or contract arose, the payment is on account of age or length of service, and the plan or contract is not a qualified plan or contract. § 513.430(10)(e)(a)-(c).

b. There are no bright line rules in determining whether or not funds are reasonably necessary, but the court is to balance the interests of creditors in obtaining some repayment on their claims with the debtor's legitimate interest in obtaining a fresh start. *In re Bonuchi*, 327 B.R. 428 (Bkrcty. W.D. Mo. 2005). Factors relevant to the determination are: debtor's present and anticipated living expenses, debtor's present and anticipated income, age of debtor and her dependents, debtor's health, debtor's ability to work and earn a living, debtor's job training and skills, debtor's other assets, liquidity of debtor's assets, debtor's ability to save for retirement, debtor's special needs, and debtor's other financial obligations. *In re Guentert*, 206 B.R. 958 (Bkrcty. W.D. Mo. 1997).

c. Any money, assets, or interest of a participant or beneficiary in a qualified plan under sections 401(a), 403(b), 408, 408A, or 409 of the Internal Revenue Code are exempt except from claims of an alternate payee under a qualified domestic relations order. V.M.A.S. § 513.430.1(f). Interests of alternate payees are exempt from creditor claims except for the state of Missouri through its division of family services. *Id.*

d. IRAs are exempt under V.M.A.S. § 513.430.1(f). They are exempt under federal law to the amount of \$1,095,000.00.

7 Kansas Life Insurance

a. The nonforfeiture value of the policy shall not be exempt from: (a) the claims of creditors of a policyholder who files for bankruptcy within one year after the date the policy was issued and (b) claims of creditors of a policyholder if execution on judgment for the claim is issued on or within one year after the date the policy is issued. K.S.A. 40-414. Creditors must also show that the conversion of property into a life insurance policy as fraudulent. The badges of fraud which are considered in determining whether the conversion of property into a life insurance policy is fraudulent include:

i. Whether there was a fair consideration paid for the life insurance policies;

ii. Whether the debtor was solvent or insolvent as a result of the transfer or whether he was insolvent at the time of the transfer;

iii. The amount of the policy;

iv. Whether the debtor intended, in good faith, to provide by moderate premiums some protection to those he has a duty to support;

v. The length of time between the purchasing of a life insurance policy and the filing of the bankruptcy;

vi. The amount of non-exempt property which the debtor had after purchasing the life insurance policy; and

vii. The debtor's failure to produce available evidence and to testify with significant preciseness as to the pertinent details of his activities shortly before filing the bankruptcy petition. *In re Mueller*, 71 B.R. 165, 168 (D. Kan. 1987).

b. If a debtor "re-issues" term insurance policies into universal life policies, the "conversion" does not relate back to the original date the term policies were issued. The conversion of the policy merits a re-setting of the one year period preceding the debtor's filing for bankruptcy. *People's State Bank & Trust Co. v. Saylor*, 68 B.R. 111 (D. Kan. 1986), *rev'd*, 98 B.R. 536 (D. Kan. 1988), *aff'd*, 98 B.R. 542 (D. Kan. 1989).

c. It is unclear in Kansas how much money the debtor can put into a policy within one year of bankruptcy if the policy was purchased more than one year before. In *In re Beckman*, 104 B.R. 866 (S.D. Ohio 1989), the court found fraud where, three days before bankruptcy, the debtor invested an additional \$200,000.00 into a life insurance policy that had existed for more than a year before the petition. The court reasoned that this went far beyond "providing in good faith ... by moderate premiums some protection to those to whom ... [debtors] had a duty to support."

d. Once the insurance policy is cashed, it loses its exempt status. *Emmert v. Schmidt*, 65 Kan. 31 (1902); *Independence Savings & Loan Association v. Sellars*, 149 Kan. 652 (1939). The same is true if the policy is payable to the debtor as beneficiary. *In re Douglas*, 59 B.R. 836 (D. Kan. 1986).

6 Missouri Life Insurance

a. Money or other benefit, charity, relief or aid to be paid under a life insurance contract is exempt from attachment to pay debts of a certificate holder or a beneficiary. V.A.M.S. §§ 377.090, 377.330.

b. Any accrued dividend or interest under, or loan value of an unmaturing life insurance contracts, other than credit life insurance contracts, are exempt up to \$150,000 in the aggregate less property transferred by the life insurance company to itself in good faith to pay a premium or carry out an automatic nonforfeiture insurance option under a life insurance contract entered into before the proceedings. V.A.M.S. §§ 513.430.1(7), (8).

c. Any amount included in b. *supra* is not exempt if the insurance contract was purchased within one year prior to the commencement of proceedings under Title 11. *Id.*

d. Once the life insurance contract matures into a right to receive proceeds, it loses its exempt status. *In re Pettigrew*, 115 B.R. 214, 15 (Bkrcty. E.D. Mo. 1990). This is true whether the debtor is the policyholder or beneficiary. *Reinecke v. C.I.R.*, 220 F.2d 406, 411 (8th Cir. 1955) (citing *Kansas City v. Halvorson*, 180 S.W.2d 710 (Mo. 1944)).

B. Gifts

1 General Rule

- a. \$1,000,000.00 maximum exemption from gift tax.
- b. \$13,000.00 exclusion from donor's annual gifts (for tax year 2009).
- c. Tuition and medical payments excluded from donor's annual gifts.
- d. Gifts to a political organization for its use excluded from donor's annual gifts.
- e. Gifts to charities excluded from donor's annual gifts.

2 Gifts to Spouse

- a. If donee spouse is U.S. citizen, the gift is excluded from the donor's annual taxable gifts.
- b. If donee spouse is not a U.S. citizen, there is no marital deduction. 26 U.S.C. § 2523(i). Instead, the donor's annual gift tax exclusion under IRC § 2503(b) applies with respect to the alien spouse and is increased to \$100,000.00 (plus the tax year's cost of living adjustment). *Id.*; 26 U.S.C. § 2503(b).

3 Gifts to Children and Grandchildren

- a. Gifts made to children and grandchildren are treated like gifts made to third parties. The \$1,000,000.00 maximum exemption, and the \$13,000.00 annual exclusion apply to the donor for gift tax purposes.
- b. Gifts made within the debtor's family are scrutinized more closely by courts. In order to avoid accusations that the transfer was fraudulent, the donor should establish a long-time pattern of giving.
- c. When making a gift, select assets that the transferor does not intend to continue using. Transfer of possessions to the children that the parent continues to use, such as antiques, automobiles and home furnishings, may constitute continuing concealment and may result in a denial of discharge on the basis of fraud. *In re Sanders*, 128 B.R. 963 (W.D. La. 1991).