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RE: Bankruptcy Reform & Asset Protection Update

Dear Clients & Friends:

We would like to take this opportunity to explain and provide current information relating to the Bankruptcy Reform Act of 2001 and recent Asset Protection case law.

BANKRUPTCY REFORM ACT UPDATE – H.R. 333

As of April 23, 2002, Federal House and Senate committee members had decided all but one issue regarding The Bankruptcy Reform Act (H.R. 333). The remaining issue is a Senate passed amendment to bar the discharge of debts incurred as a result of acts of violence directed at abortion clinics and other targets (the "Abortion Issue"). The conference seems to be gridlocked on the Abortion Issue and no further progress has been made between committee members. House and Senate conferees will meet May 22 to reconcile the bankruptcy reform legislation and to negotiate a compromise on the Abortion Issue. However, there is some good news to report. The committee appears to have reached an agreement regarding the cap on the Homestead exemption.

HOMESTEAD COMPROMISE

Florida is one of the few states that allows an unlimited Florida Homestead exemption. House and Senate committee members debated whether to cap the Homestead exemption at \$125,000. The final compromise appears favorable toward Florida Homestead law. It appears that the new law will cap the Homestead exemption at \$125,000 only if the debtor: 1) cannot meet a residency requirement of 40 months in a particular state before filing for bankruptcy; 2) is shown to have committed fraud or other criminal acts, such as violations of State or Federal securities regulations, which appears to be aimed at situations like Enron; or 3) is subject to pending criminal charges. The Bankruptcy Court can also look back 10 years for instances of fraud associated with a Homestead exemption claim.

What this means for you. It appears that, as proposed, the new Homestead exemption cap of \$125,000 would only apply to limited situations. The uncapped Homestead exemption would still protect debtors who are subject to creditor's claims for negligent acts, as long as the debtor can fulfill the 40 month residency requirement in Florida (or other states with lenient homestead provisions) and show that he/she has not committed fraud or any criminal acts. For example, if a creditor's claim arose from a car accident or medical malpractice lawsuit, the debtor's current homestead should be protected from creditors claims under Article X, Section 4 of the Florida Constitution if: 1) the residence is situated on 160 acres or less outside of a municipality or on one-half acre or less within a municipality; and 2) the debtor resided in Florida for more than 40 months and the debtor has not committed fraud or any criminal act.

ASSET PROTECTION UPDATE

The following recent decisions address asset protection issues.

FOREIGN TRUSTS

In Re: Stephen J. Lawrence, 279 F.3d 1294 (11th Cir.) (January 23, 2002). Bankruptcy Judge ruled that if a Debtor did not hand over \$7 million in an offshore trust, the Debtor would be held in contempt of court. The Debtor, a securities options trader, lost a significant amount in the October 1987 crash. An arbitration judgment for \$20 million was rendered against the Debtor in March, 1991. The Debtor reflected no assets other than his \$400,000 homestead on his bankruptcy petition. The \$7 million held in the foreign trust was placed there two months before his arbitration case was ruled upon. The Judge issued a Turn Over Order for the assets held in the foreign trust. The Debtor argued that it was impossible to comply with the Bankruptcy Judge's Order and failed to comply. The Debtor was held in contempt of court for failure to turn over the assets of the foreign trust. He was subsequently incarcerated. The Debtor appealed and the 11th Circuit Court held that the Bankruptcy Court did not err in holding that the Debtor failed to establish his defense of impossibility because, as settlor and prospective beneficiary, he retained de facto control over the offshore trust through his ability to appoint trustees who could, in their absolute discretion, reinstate the Debtor as a beneficiary and assign the entire proceeds to him. The defense of inability to comply with the Turn Over Order was held to be invalid because the asserted impossibility was self-created. The opinion stated that the Debtor's last minute appointment of the bankruptcy trustee as trustee of the offshore trust did not demonstrate that the Debtor made all reasonable efforts to meet the terms of the court order, and none of his actions appear to have been made in good faith. The ruling stated that if the Bankruptcy Court determines that, although the Debtor has the ability to turn over the trust res, he will steadfastly refuse to do so, the Judge will be obligated to release the Debtor because incarceration would no longer serve civil purpose of coercion.

BANKRUPTCY

In Re: Financial Federated Title & Trust, Inc., 273 B.R. 706 (Bankr. S.D. Fla.) (November 16, 2001). Financial Federated Title & Trust, Inc. ("FinFed"), its alter egos and its principal, were indicted on Federal charges alleging they fraudulently obtained investor funds exceeding \$115,000,000 through the sales of investments in viatical settlement policies. The Debtor purchased real property in Florida with funds received from defrauding investors. The Debtor asserts that the property is considered Homestead and exempt from forced sale pursuant to the Florida Constitution. The property was sold and placed in a separate escrow account. John Kozyak, Bankruptcy Trustee, imposed an equitable lien and constructive trust on proceeds from the sale of certain property on the grounds that most, if not, all of the funds used to purchase the property could be traced directly back to fraud. The imposition of an equitable lien is necessary to prevent the Debtor from using homestead exemption as an instrument of fraud and to prevent his unjust enrichment at the expense of defrauded investors. Lack of knowledge or involvement in the Debtor's massive fraudulent activity does not exonerate the co-owner of the property from liability, as it is the fraudulent nature of the funds used to purchase the property which is of the utmost importance. The Bankruptcy Trustee satisfied the elements necessary for a constructive trust by tracing, directly or indirectly, over 90% of the funds used to purchase the property to the Debtor's fraud. The Court held that the Bankruptcy Trustee was entitled to an equitable lien and a constructive trust in the amount of the funds held in the escrow account from the sale of the property because it was necessary to prevent the Debtor from using the homestead exemption as an instrument of fraud.

NONDISCHARGEABLE DEBTS

In re: DONALD HANFT, M.D., P.A., 274 B.R. 917 (Bankr. S.D. Fla.) (March 20, 2002). Medical malpractice judgment is nondischargeable under 11 U.S.C. section 523(a)(2)(A) which prevents discharge from liability arising from fraud. Debtor misrepresented status of his medical license when he treated plaintiff. Plaintiff justifiably relied on Debtor's representation that he was a licensed doctor, and plaintiff sustained a loss as a result of the representation. Debtor's failure to disclose that he was practicing with an inactive and terminated license, coupled with his failure to disclose that he neither had insurance nor assets set aside in an escrow account to satisfy a malpractice judgment, satisfy the elements of Section 523(a)(2)(A). Florida law does not allow one who holds himself out as a doctor to claim that he did not know his license was inactive or terminated. Medical malpractice judgment against Debtor is nondischargeable under 11 U.S.C. section 523(a)(4), which exempts from discharge debts resulting from fraud or defalcation while Debtor was acting in fiduciary capacity, and where the Debtor failed to fulfill his statutory obligation to maintain an escrow account or post a letter of credit to satisfy a malpractice judgment.

FRAUDULENT TRANSFERS

George G. Levin, Gayla S. Levin, & Georgetown Manor, Inc. v. Ethan Allen, Inc., 27 Fla. L. Weekly D894a (Fla. Dist. Ct. App. 4th Dist.) (April 17, 2002). Levin, through Georgetown Manor, Inc., had a prior business relationship with Ethan Allen furniture stores. Ethan Allen discontinued distributing furniture to Georgetown Manor and placed an advertisement in several South Florida newspapers stating the Georgetown Manor was behind on its debts to Ethan Allen and asking customers to contact new Ethan Allen stores. Ethan Allen obtained a judgment against Georgetown Manor on the amounts due for furniture delivered. Georgetown Manor owned property which was encumbered with a \$500,000 first mortgage and a \$125,000 second mortgage. A third mortgage was placed on the property in favor of GGL Industries which was a company owned by George Levin. Georgetown Manor was insolvent at time it gave the mortgage, as it had not been paying its debts as they became due. The Levins acquired the first mortgage, which was in default, and foreclosed on the mortgage. Ultimately, the Levins acquired the property free and clear and for less than the first mortgage. The court held that a fraudulent transfer occurred when Georgetown Manor executed a third mortgage on the property without receiving reasonably equivalent value in exchange.

NationsBank, N.A. v. Coastal Utilities, Inc., et. al., 27 Fla. L. Weekly D982a (Fla. Dist. Ct. App. 4th Dist.) (May 1, 2002). Creditor seeking to recover funds transferred by non-debtor wife from account which was opened with debtor as a joint tenancy with right to survivorship. The Court ruled that it was in error to enter a motion for summary judgment against creditor based on conclusion that the non-debtor wife had an undivided possession and ownership of funds at issue and, accordingly, could dispose of assets as she saw fit. Because account was joint tenancy, creditor could have attached debtor's portion of the account. A transaction in which one joint tenant parts with his or her interest in a joint account by directing or allowing the other joint tenant to withdraw all or a disproportionate part of the funds is encompassed by the Uniform Fraudulent Transfers Act's definition of a "transfer". Issues of fact exist regarding the extent that a fraudulent transfer may have occurred and debtor's proportionate interest in the joint funds. The Court held that there was no error in denying creditor's cross-motion for summary judgment where there are issues of fact as to extent of debtor's interest in the withdrawn funds and the application of the several "badges of fraud" evidencing intent.

TENANTS BY ENTIRETY PROPERTY

U.S. v. Craft, 122 S. Ct. 1414 (April 17, 2002). The Internal Revenue Service assessed unpaid income tax liabilities against the husband for failure to file Federal income tax returns. When the husband failed to pay, a Federal tax lien attached to all property and rights to property, whether real or personal, belonging to him. At the time the lien attached, the couple owned a piece of real property in Michigan as

tenants by the entirety. The government claimed that its lien had attached to the husband's interest in the tenancy by the entirety. The United States Supreme Court determined that Michigan law granted the husband, inter alia, the right to use the property, the right to receive income produced by it, the right to exclude others from it, the non-unilateral right to alienate the property, and the right of survivorship. The Court determined that the rights Michigan law granted to the husband as a tenant by the entirety qualified as "property" or "rights to property" under 26 U.S.C.S § 6321. Therefore, the Federal tax lien could attach to the husband's interest in the entireties property.

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I hope this information is helpful for you. We will continue to track the Bankruptcy Reform Bill.

Should you have any questions, please feel free to contact me.

Very truly yours,

Barry A. Nelson

BARRY A. NELSON
For the Firm

BAN/dl
Enclosures