Asset Protection
Part 1

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On behalf of:

Peak Trust Company

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Subject: Alan Gassman and Adriana Choi: Creditor Protection During the Virus Crisis:

22 Definitions, 33 Strategies, and 26 Traps for the Unwary

"While the world and even the United States has been through much tougher times, the present cash crunch, financial devastation, and social disorder that businesses and self-employed individuals find themselves in today is unprecedented in our generation, and poses a significant challenge to advisors who care about clients and businesses and want to do what we can to help save them.

There is no doubt that there will be years of litigation, tens of thousands of bankruptcies and countless horror stories that result from this terrible financial and business tsunami, but there are things that we can do to help clients, and to prevent them from making terrible mistakes that in many cases will result in significant personal and business losses that will not have had to have happened, but for misinformed or unfortunate decisions and actions or inactions. Many of these will be caused by well-meaning but erring advisors, or will occur under their watch, unnecessarily.

While bankruptcy lawyers may today be the second most in demand professionals, behind intensive care personnel and people who make medical equipment and protective supplies, many of the basic and not so basic concepts and situations may need to be handled in large part by business lawyers and advisors. Hopefully, they will work with debtor creditor law specialists to the extent feasible, and learn as much as possible about this area in order to be able to assure that the client has a sound connection with legal and financial counsel beyond the typically dangerous 30 minute phone call that does not provide the advisors with full information about the situation. Those of us working from home have additional challenges but need to assure that we have high quality uninterrupted time to think and work steadily, and without undue interruptions to give our clients the help they need.

We hope that readers will make a list of clients who may need a good discussion of where they are with things and what to do about it and reach out to them, employing the strategy that what we do for others is much more important than what we do for ourselves and that clients do not always know that they need advice, let alone what advice is needed."

Alan Gassman and **Adriana Choi** provide members with commentary that examines creditor protection issues that can arise during the virus crisis. The authors thank **Michael Markham, Esq.** of the Tampa and Clearwater law firm of **Johnson Pope** for his guidance and advice with respect to the terms of this newsletter and from years of practicing together. Mr. Markham can be reached at MikeM@jpfirm.com

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Here is their commentary:

EXECUTIVE SUMMARY:

While the world and even the United States has been through much tougher times, the present cash crunch, financial devastation, and social disorder that businesses and self-employed individuals find themselves in today is unprecedented in our generation, and poses a significant challenge to advisors who care about clients and businesses and want to do what we can to help save them.

and contractors, and whether to risk going into default on leases, mortgages and contracts in order to do so.

“Anything that can go wrong, will – at the worst possible moment.”[i] While we may not believe that things will continue to get worse for much longer, we do believe that it is our job to make sure clients are prepared for what further problems may come.

We recommend that all of our clients engage in an “asset protection stress test” as soon as possible, to determine, if the worst-case scenario happens, what will remain to be absolutely protected from creditors, and what will be potentially exposed. A stress test entails reviewing all expenses and liabilities and walking through a worst-case scenario with experienced advisors.

While President Trump would like to see lockdowns and the closure of commerce be over by Easter, and CARES Act moneys in businesses pockets by May, it is possible that this may be by Easter of 2021, and that money spent in the next four to eight weeks will wipe out businesses and professional practices that would have otherwise survived for several months or years, if they had not used their precious powder naively in the beginning of the crisis.

Our experience from 2008 is that a great many clients who own and operate businesses do not fully appreciate the dangers facing them, and do not take the necessary steps to save their businesses or investments. Instead, they sit back and hope for the best as they become completely overwhelmed with anxiety or compartmentalizing problems, and refuse to make decisions while there is still cash or credit available.

Please do not get caught like a deer in headlights in your own practice, like many clients do, and make sure that you have done your own cash flow planning, and have a basic understanding of bankruptcy and what it means for clients who will need a “fresh start,” so that you can help explain this and let clients know what it costs in money, time and effort to go into bankruptcy to start anew, since this will be the last resort for many. Whether we like it or not, businesses are going to go bankrupt during this recession.

Your client may rely on their customers, clients or patients to pay the client, and those payers may hoard cash or have other problems that are not foreseen. Clients, no matter how smart they are, no matter how well they have done historically, are emotional and often overly optimistic or naïve and really need a conversation with their lawyer, their CPA, their hairdresser, or whomever they rely on, to think things through and make the right decisions.

The following definitions and comments therein are arranged in progressive order to help those who are familiar with debtor creditor law and bankruptcy to familiarize themselves, and to help those with little background to get their feet wet and begin to familiarize. Please read these carefully because many strategies and choices are contained therein. Please note that while most debtors will not need to file bankruptcy, the ultimate settlement with creditors will usually take into account how the parties would come out in bankruptcy.

Bankruptcy	–	The federal law and process that permits debtors to adjust creditor situations and receive a “fresh start” under the separate bankruptcy court system.
Chapter 7 Bankruptcy	–	A process that provides for the appointment of an independent trustee to liquidate the non-protected assets of a debtor as pre-bankruptcy debts are discharged if certain requirements are met. In an individual Chapter 7 Bankruptcy all debts may be discharged (eliminated) while exempt assets are retained, and businesses may be sold at arm’s-length to related parties in court approved sales. This will be a home run for many unfortunate, but well-advised, debtors. No payment plan is required if the debt is mostly “business debt,” as opposed to being mostly consumer debt. You can advise clients of the importance of this ratio. Further discussion of the implications of Chapter 7 Bankruptcy planning is provided below.
Chapter 11 Bankruptcy	–	A reorganization bankruptcy that will typically apply for bankruptcy businesses, investment entities, and individuals having large amounts of indebtedness or

otherwise not qualifying for a Chapter 13 bankruptcy. The CARES Act has raised the amount of debt that a small business debtor can have while filing a Chapter 11 to $7,500,000. There were many changes in the Chapter 11 laws in 2019 and 2020. These are discussed in detail below.

Prepackaged Chapter 11 – A Chapter 11 bankruptcy where there is an advance agreement between the debtor and a sufficient number of creditors to allow for debt to be reduced and/or paid over time in a bankruptcy proceeding in order to have the ability to avoid federal income tax on debt discharge or adjustment, and state law documentary, intangible and other transfer taxes that may not apply when transitions and transactions occur in bankruptcy.

Chapter 13 Bankruptcy – A payment plan arrangement that individual debtors in bankruptcy meeting certain requirements must comply with under payment plan rules in order to adjust their debts. Normally, this applies when there is mostly consumer debt and results in a five-year payment plan.

Chapter 13 is only available to individuals (not corporations or other business entities). To be eligible to receive a Chapter 13 payment plan in 2020, an individual or married couple must have unsecured debt of less than $419,275, and secured debt of less than $1,257,850. Chapter 13 repayment plans are for three to five years and are funded by the debtor's disposable income. Once the plan is approved by the court, the Chapter 13 trustee receives and administers payments. In exchange for compliance with a Chapter 13 plan, the debtor can keep his or her assets and a discharge of all debts is received when all payments have been made.

Bankruptcy Estate – Upon filing bankruptcy, non-exempt assets (assets not immune from creditors under state or Bankruptcy law) of a debtor become property of the bankruptcy estate, and are then under the control of the trustee in bankruptcy or the debtor in possession, pursuant to 11 U.S.C. § 541. For example, an individual filing bankruptcy who owns a creditor-exempt annuity contract and a bank account will retain ownership of the annuity and lose the bank account. The bank account will become part of the bankruptcy estate.

Discharge, Fiduciary Duty Concerns, and Assignments for the Benefit of Creditors.

– The actual order that results in debt being cancelled under a Chapter 7 bankruptcy, or upon completion of a successful Chapter 11 or Chapter 13 bankruptcy plan. Certain liabilities are generally not dischargeable in bankruptcy. These can include government backed federal student loans, trust fund tax liability, hazardous waste liability, breach of fiduciary duty liability, child support and alimony, Medicare penalty refunds, and Medicaid penalty refunds.

Liabilities generally not covered by insurance include civil rights violations committed by employees or others, environmental liabilities, criminal acts, charitable and religious board activities, and acts of terrorism. Avoid conduct that causes such liabilities and consider paying them first if they arise.

No discharge is issued to non-individual entities (such as corporations and partnerships) under the Bankruptcy Code. Oftentimes, corporations are put into Chapter 7 without realizing that there will be no discharge of debt. One good reason to file a Chapter 7 is for a corporation is to relieve the officers and directors of the entity from having the state law responsibility to properly administer assets and situations for the benefit of creditors. The officer, director or manager of an insolvent business or investment entity has a fiduciary duty to act in the best interests of creditors. An alternative way to avoid personal liability for the conduct of an insolvent entity is to file a state court action called an Assignment for the Benefit of Creditors ("ABC") wherein by state statute a debtor entity can request that the court appoint a fiduciary "Assignee" who acts like a receiver by receiving the assets of the entity and liquidating them and then paying what is available to the creditors after all parties have had notice and the right to object to the process.

Loss of Discharge – What occurs when a debtor in bankruptcy is denied the right to discharge debt by reason of pre-bankruptcy or post-bankruptcy conduct which causes the debtor to never be entitled to receive a discharge of debt then existing, leaving the debtor in "debtor purgatory." This can occur when the debtor is not truthful about assets, or makes a "fraudulent transfer" within one year before filing bankruptcy. Get any "fraudulent transfers" over well before needing to file bankruptcy, if they are legal to make in the first place (which is one reason that many debtors move to Florida—others are discussed below).

Exempt Assets

– An asset that will not be accessible to creditors and may be retained by a debtor under state or federal law, such as homestead, IRAs, 401(k) plans and 529 plans where law permits. State exemptions do not apply unless the debtor satisfied the 730-day or 180-day rule described below. Obviously, we want clients to own as many of these as possible, and to own them before they are or may become insolvent so that the purchase is not a “fraudulent transfer” that may be set aside. Sometimes it is best to remain optimistic and to put reasonable assets into reasonable categories of assets well before disaster strikes. Every planner should be familiar with what

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assets are exempt from creditors in the state where the client resides, and under the Bankruptcy Code.

Non-Exempt Assets – Assets which are subject to creditor claims and become assets of the bankruptcy estate upon the filing of a bankruptcy petition. Non-exempt assets cannot be converted into an exempt asset because it may be considered to be a fraudulent transfer. A debtor who files bankruptcy within one year of making a fraudulent transfer risks permanent loss of the ability to discharge any and all debts then existing. Some non-exempt assets are nevertheless difficult for a creditor to reach into, such as multi member LLCs in states where a charging order is the sole remedy and the LLC agreements are executory contracts under the bankruptcy law.


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730 Day or 180 Day Rule

– A debtor will need to reside in the state where the bankruptcy is filed (to have the exemption laws of that state apply) for at least 730 consecutive days before filing. If the debtor does not meet the 730-day requirement, then the Bankruptcy Court will apply the exemptions of the state where the debtor resided for a majority of the 180 days immediately preceding the 730-day period. For example, if a debtor moves to Florida and has been living there for 729 days and someone forces them into bankruptcy, then the law of the state where the debtor resided for most of the 180 days before the 730 days will apply. Given that litigation often lasts over two years, those considering a move to Florida may wish to do so sooner rather than later to protect annuities, life insurance, homestead, 529 plans, tenancy by the entireties assets (if one spouse is not liable), assuming that moving to Florida is not itself a "fraudulent transfer" that causes loss of exemptions that do not exist in the state the person came from.

Automatic Stay – This prohibits creditors from taking action to collect on debts owed by a debtor once the bankruptcy has been filed. The creditor may petition the court to have the stay "lifted." The automatic stay will not apply to certain federal agencies, such as the EPA. For example, it does not prevent certain federal agencies from taking action against a debtor.

Fraudulent Transfer – These have nothing to do with fraud, and are also now known in many states as "voidable transfers". These can be set aside in bankruptcy if the filing is within the later of two years from the date of the bankruptcy or the applicable state law period, which is four years in most states (including Florida), and six years in some (including New York).

In some states, it violates state law and/or ethical rules to assist a client in making such a transfer, and in others it does not.

There are two types of fraudulent transfers. An "actual" fraudulent transfer is a transfer of an interest or obligation that is made with the intent to hinder, delay, or defraud any creditor. A "constructive" fraudulent transfer is a transfer of an interest or obligation by an insolvent or soon-to-be insolvent entity, without receiving reasonably equivalent compensation in exchange.

Such transfers may cause loss of the ability to receive a bankruptcy discharge, if it has occurred within one year before the debtor files bankruptcy, or may be set aside or subject a transferee to liability if it has occurred within two years before the filing of bankruptcy under the federal Bankruptcy Code, or for whatever longer period of time may apply under state law.

Preferential Transfer – A transfer that occurs when a corporation or other entity favors a creditor by making a payment or other transfer of property during the 90-day period prior to the bankruptcy filing to one or more unsecured creditors not within the "ordinary course of business" and not to others of the same class. Such transfers are deemed voidable by the Bankruptcy Code. If the creditor is an "insider" (e.g., a family member, friend, business partners, or person or entity with a special connection to the debtor), the 90-day lookback period increases to one year.

State law Preferential Transfer rules should be considered as well and may be for one (1) year or more.

Insider – Under the Preferential Transfer rules, the one (1) year set aside law will apply, if the debtor is an "Insider". An Insider is a (i) relative of the debtor or of a general partner of the debtor; (ii) partnership in which the debtor is a general partner; (iii) general partner of the debtor; or (iv) corporation of which the debtor is a director, officer, or person in control.

If the debtor is a corporation, an "insider" is a (i) director of the debtor; (ii) officer of the debtor; (iii) person in control of the debtor; (iv) partnership in which the debtor is a general partner; (v) general partner of the debtor; or (vi) relative of a general partner, director, officer, or person in control of the debtor.

If the debtor is a partnership, an "insider" is a (i) general partner in the debtor; (ii) relative of a general partner in, general partner of, or person in control of the debtor; (iii) partnership in which the debtor is a general partner; (iv) general partner of the debtor; or (v) person in control of the debtor.

All transfers made to "insiders" within one year of filing Bankruptcy should be for contemporaneous value to avoid having the Preferential Transfer statute apply.

Involuntary Bankruptcy – A creditor can force a debtor to a Chapter bankruptcy by filing a petition, but it generally takes three creditors to join in the petition if there are at least twelve creditors. For this reason, many debtors are well advised to have at least twelve creditors, and to make sure that no three of them are "unfriendly". This is particularly important for debtors who have made fraudulent transfers within one year before they may be forced into bankruptcy, who debtors who have put significant moneys into a Florida homestead that will be protected from creditors unless and until the debtor is forced into bankruptcy within ten years after making a "fraudulent transfer" into a Florida homestead.

Doctrine of Successor -- Liability State law, which provides that the successor owner of a business or investment arrangement, will be responsible for the liabilities of the previous owner if there is a commonality of related ownership, business identity, customers, and business assets. An arm's-length Bankruptcy Court approved sale by a Trustee in Bankruptcy in a Chapter 7 or Chapter 11 Bankruptcy can avoid imposition of the doctrine. In some states the doctrine may be avoided by engaging in a non-Bankruptcy Assignment for the Benefit of Creditors.

Attorney-Client Work Product Privileges – The two common privileges which prevent a lawyer's file and work product from being accessible to parties who are adverse to a client. These privileges are often lost in bankruptcy to the surprise of many.

Crime Fraud Exception – Federal and state laws which prevent the assertion of the attorney/client privilege if the lawyer's actions

constitute the perpetration of a crime, committing fraud or in some situations communications with respect to a planned transfer to avoid creditors or concealment of assets.

Super Creditors	– These are creditors that can break through the exemptions. Super Creditors presently consist of the IRS, the Federal Trade Commission, the Securities Exchange Commission, Medicare (for penalties), federal agencies for penalties, restitution owed to the government as the result of criminal conduct, and the Federal Deposit Insurance Company in some circumstances. The Small Business Administration also has special collection rights, as discussed in Chapter 9 of our book on Bankruptcy law and planning.

Further Discussion and Strategies

In general, there are two primary types of bankruptcy that will be used by debtors, or forced upon them by aggressive creditors. These are as follows:

- Chapter 7, which enables a debtor to eliminate debt and keep creditor exempt assets.
- Chapters 11 and 13, which contemplate a full or partial repayment plan based upon ability to pay and statutory requirements.

Before it gets to this point, though, it is critical to practice sound creditor protection planning when this is possible.

We have a chart that we commonly use for our Florida clients that summarizes which assets creditors can and cannot reach under normal circumstance.

Aside from exempt assets, it is imperative to analyze which assets are exposed, and to make adjustments as appropriate. One important rule to keep in mind is that, other than a protected homestead, any assets that are

exempt from creditor claims that the client purchases or transfers into for the purpose of avoiding a creditor may be set aside by the creditor.

And even with a move towards homestead like paying off the mortgage, if the purpose of that was to avoid the creditor and the client ends up in bankruptcy within ten years of making the transfer, then that may be backed out in bankruptcy, although under Florida law a transfer to homestead that avoids creditors cannot be set aside under the Florida fraudulent transfer statute, except that under the 2005 Bankruptcy Act a debtor who has made a fraudulent transfer into bankruptcy within ten years before filing bankruptcy can have such transfer set aside in bankruptcy, which is a good reason to stay out of bankruptcy.

From the above it is obvious that now is the time to encourage clients to share the facts of their situation with you, so that you can make suggestions as to what normal business and estate planning changes might be made to best address their situation, taking into account tax, financial, estate planning, and other considerations. An example of this includes the need to save for college using 529 plans, the advantages of putting assets under the name of a spouse or a spousal limited access trust for estate and estate tax planning, and the tax and practical advantages of using permanent life insurance and variable annuities for tax and investment planning.

There are bankruptcy court decisions which have found that engaging in sound and clearly called for planning that moves assets out of the debtor's hands may be permitted and not considered to be a "fraudulent transfer" that can be set aside, even if the transfer resulting from that planning will clearly keep the asset out of the hands of a creditor, and occurred after the creditor was known to be in existence under dire circumstances.[ii] This type of planning should not be taken lightly, but may put the debtor in a better negotiating position than would otherwise be the case.

Chapter 11 Bankruptcy and the new Small Business Reorganization Act of 2019

Chapter 11 bankruptcy is an interesting and complicated topic for discussion, but some background may be of interest. While a Plan of Reorganization may be blessed by the court and a vote of each class of creditors, as is normally required, this is not always the case, and clients should reserve at least $25,000, or possibly much more, to pay for the legal and accounting fees, which must usually be paid to the bankruptcy lawyer as a retainer before the bankruptcy is filed. A Chapter 11 bankruptcy may provide a client with many benefits, depending on the situation. The client's corporation will normally receive 90 days of safe time when they do not have to pay past bills, and they can still collect their accounts receivable and put together a plan to pay the creditors over time. Any debt that they discharge in the process of negotiation and settlement will normally be income tax free under Section 108 of the Internal Revenue Code, whether the shareholders are the partners of the entity and are insolvent or not. This tax-free rule also applies to debt that is discharged or negotiated down in a Chapter 7 proceeding. Debt planning is crucial, in order to have the best chance of each class of creditors approving a Plan of Reorganization, and best positioning the shareholders and others to be repaid from available assets by having liens and being in first position if this is possible.

It is therefore necessary to be sure that your clients hold on to enough cash or enough collateral so that they can make sure they can pay to file a Chapter 11 bankruptcy if they need to do so.

The Small Business Reorganization Act (SBRA) of 2019, enacted what is now known as a Subchapter V, which changed the bankruptcy law to be more debtor friendly by increasing the amount of debt that a small business debtor can have while qualifying in a Chapter 11 bankruptcy, and making the further change described below.

Effective February 2020 a small business debtor could have had up to $2,725,625 in debt and qualify to file a Subchapter V bankruptcy.

The CARES Act increased the threshold from $2,725,625 to $7,500,000, effective for cases filed after Friday, March 27, 2020.

In addition, the CARES Act eliminated the former requirement that any class or classes of unsecured creditors would have to vote on a plan in order to have the court approve the reduction or restructuring of debt.

After the CARES Act, unsecured creditors cannot vote, and secured creditors will be required to be subject to bankruptcy plan terms approved by the court, which will generally provide that a secured creditor's claim cannot exceed the value of collateral secured by the applicable debt on the date that a Chapter 11 bankruptcy petition is filed.

This will make it much easier and cost effective for debtors to successfully reorganize under a Chapter 11 bankruptcy.

When to File

Typically, a Chapter 11 bankruptcy should not be filed immediately before any creditor may act or refuse to act in any way that would have a catastrophic impact on the business.

In addition, a Chapter 11 bankruptcy should typically not be filed unless a plan of reorganization and a source of future revenue and income will be identifiable and in place within approximately 90 days of the filing of the Chapter 11 bankruptcy petition.

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But on the other hand, if the collateral that secures the debt that is held by a creditor who will not be cooperative is lower now than it will be later, it can make sense to file a bankruptcy petition sooner than would otherwise be the case.

For example, where the collateral is accounts receivable and the Coronavirus business shutdown is still in effect, the value of such accounts receivable may be much lower than what it will be once the virus freeze lifts and things hopefully go back to some semblance of "business as normal."

File Proper Liens Without Delay – Reach out to Clients Who are Owed Moneys by Their Business or Investment Entities

It can be crucial that any loans or advances from shareholders or related parties be documented with appropriate promissory notes, and also be secured by liens that are properly recorded against real estate (as mortgages) against tangible and intangible non-real estate assets (by Uniform Commercial Code UCC-1 filings), and against any valuable automobiles or other motor vehicles that would be liened by proper registration with applicable State Division of Motor Vehicles and the U.S. Coast Guard with respect to large boats. Failure to have this completed more than one year before the filing of a bankruptcy or a state court creditor action could be catastrophic.

Funding Negative Cash Flow

If the client needs to put money into a possibly insolvent entity it will normally be best to document this as a loan to the entity and to take a lien on any and all assets that may be liened. If the client will pay off debt owned by the entity, it may be best to "buy the paper" from a previous existing creditor that has a lien on assets in order to "step into the shoes" of that creditor.

Many well meaning family members and others may advance moneys for a company without protecting themselves, and end up not only losing what they put in, but also becoming parties to nasty litigation. Having independent legal counsel for separate family members is often advisable, and throwing bad money after bad in unrealistic situations to keep a dying business on its death bed longer without real hope of recovery is not at all unusual. By the same token, many parents and others will guarantee obligations of a faltering business and later lose significant moneys when guarantees are called in or when the Preferential Transfer rules cause a guarantor to have to put in an amount equal to all payments made by the debtor on the guaranteed loan, lease or other arrangement under the theory that each payment benefited the guarantor going back one year before the filing of a bankruptcy petition.

Spend What Is Exposed and Save What Is Protected

In some situations, it may be risky to try to move exposed assets to exempt categories, but still planners should advice clients as to what to save and what to spend.

An example that most planners do not think about is that if the client is a wage earner and earns a wage that would be protected from creditors under the state wage statute, such as in California, then those moneys can be moved into a variable annuity, cash value life insurance policy, homestead, or even a tenancy by the entireties account if both clients are not going to be sued, and therefore be creditor protected while the client may spend down assets that are otherwise exposed. This would not be considered to be a fraudulent transfer, because transferring an otherwise protected asset to another protected asset class is normally not considered a transfer that can be set aside, but would have significant benefits.

As another example, if your client works for themselves, or has a medical practice or other professional practice of their own, their wages and what they invest them in may be protected under state law. The California wage statute has been found by the 9th Circuit Court of Appeals to protect wages paid by a company owned by its working owner, but Florida courts have not been very kind to the owners of companies who employ themselves through the company, even though the Florida and California statutes are almost identical. This may eventually be resolved by the Florida Supreme Court or a legislative clarification. It helps to have a written employment agreement in place that sets the wages to be paid, and to assure that the amounts set forth therein are paid in equal amounts each pay period, and reported as wages.

Cut Personal Spending

This is a time to discuss lifestyle levels and why anyone needs to spend more than they can afford to for living. Many Americans are “hooked” on a high standard of living that includes drinking $100 bottles of wine, eating only gourmet foods, burning thousands of dollars of fuel in boats and airplanes and spending hundreds of dollars a day on Amazon and other websites for fashions and accessories that far from “necessary” from a practical standpoint. It may be time to stop those patterns. An excellent video that is very revealing and has stopped rampant spending for many families is Professor Sut Jhally’s YouTube video “Advertising and the Perfect Storm” and “Advertising and the End of the World” which can be seen on YouTube and has had a strong impact on the author and others who have seen it. Another impactful and fiscally responsible YouTube video we recommend is “Killing Us Softly” by Professor Jean Kilbourne, which was directed by Professor Jhally. Please watch these and tell us if they do not change your view of what is necessary and appropriate to spend money on in this day and age. Professor Srikumar Rao's book Happiness at Work and his TED Talk titled Plug into your hard-wired happiness are also required reading and viewing for those who believe that they need significant worldly possessions and cash flow in order to be happy.

Studies have shown that happiness and contentment is increased with income up to a certain level, which would presently be approximately $135,000 per year for a typical household, but does not go up further even when income skyrockets. This may be of interest to those who are supporting multiple households of children and others who seem to need many times more than the above amounts. The author often tells new professionals that if they think they need more than 3,500 feet of housing to raise 2 children they need to see a psychologist as opposed to a realtor.

In addition, although the “medium home” in a given area may be increasing in value by 3.5% a year, a real home is getting older every year and losing on average approximately 1/65th of the value of the structure each year, assuming a 65 year life, not to mention the need to pay taxes, insurance, utilities, new roofs and new air conditioning based upon the size of the structure and value. Many families believe that their home has been a very good investment until they run the numbers and discover that putting more money away in a conservative well allocated stock and bond based portfolio, which can be creditor protected by being held in tenancy by the entireties if only one spouse is high risk, under variable annuities that may offer both tax deferral and creditor protection, under pension accounts, in 529 college savings plans and in other ways.

Given the above, the author would sell the vacation home sooner rather than later if its value may be needed to pay for expenses to save or restart a business or profession. The value of vacation homes may plummet when the virus crisis thaws.

Planes, Trains and Automobiles (that are not needed)

Yes, many clients also have expensive sports cars, boats and airplanes that may be sold now at 75% or less of what they were worth before the virus when this thaws. Will they be smart enough to take the 25% loss, or will they hold on to these assets and use them to run down their value and eventually sell them for 35% of the present value, which is what happened many times in 2009 and 2010. The human mind has a funny way of holding on to investments until they recover their value, even when it is obvious that taking the value of a failed investment and shifting it to cash or other investment classes will be a more logical and safer move. “I cannot live without my boat” is a sad thing to hear and see when children have to drop out from college because Dad cannot sell the boat to pay for their tuition, but these things happen.

Clients With Leveraged Investment Real Estate

With respect to clients who have leveraged real estate that may or more not be upside down once the virus lockdown defrosts, the best question may be how much in other assets can they safely take off of the table so that if the real estate goes upside down, or there are no or fewer paying tenants to service mortgages, they have creditor exempt assets that lenders cannot touch.

When the bank comes to them and asks for a refinancing or a substantial pay down, can the client look the bank in the eye and say, “well wait a minute, I have a lot of assets that are exempt from creditor claims, so I am not going to use them in my refinancing.” This will be a sound strategy if the creditor exempt assets were acquired before there was a high risk of insolvency, and for good tax, estate planning and business reasons.

After 2008, banks appraised real estate and gave borrowers the choice of putting more equity in by paying the loan down, giving additional collateral, or having the loan called in if the borrower could not find a new lender. The CARES Act may provide some help to landlords in the form of being able to borrow moneys to keep employees of the landlord employed and to pay mortgage interest and certain other expenses, but this is not going to go very far in keeping landlords afloat for the number of years it may take to recover economic turmoil.

A separate LISI newsletter is in progress to discuss making an S election for LLC's and other entities now taxed as partnerships or disregarded, if this can be done without triggering income tax, so that loan work outs and foreclosures are less likely to result in taxable income from the discharge of indebtedness being sprayed onto LLC owners who will already have enough economic burdens if things do not go well for their leveraged real estate.

Conclusion

Whatever your client's situation is, it should be looked at to help them think through what is going on and what move they can make to update their planning and safeguard what they have.

Another consideration discussed above is how much cash the client has and what their "burn rate" is. If banks do not extend lines of credit, and you never looked into your client's burn rate, your client might not realize that they will be out of money before it's too late. As such, it is essential to examine a client's financial and contractual positions and the burn rate, and to help reduce the burn rate and increase revenues, while keeping in mind what risks they might have.

If you think your client may go into bankruptcy, make sure you understand that your attorney-client privilege may be lost on the date of filing. As with other proceedings, privilege can be asserted or waived in a bankruptcy case, but the question of who or what entity or entities own the privilege, and whether creditors or a trustee in bankruptcy can take it over to waive it, is crucial to pre-bankruptcy planning, and is much different than what applies under state law in many jurisdictions.

A bankruptcy court appointed trustee in bankruptcy may get to see all of your legal documents and all your legal letters and may be able to depose the debtor and lawyers if there is no attorney-client privilege anymore. As such, you might want to be careful about what you put in writing. Also, there is no CPA client privilege in bankruptcy or other Federal Court Proceedings, so a lawyer who may have attorney-client privilege can consider hiring the CPA who helps with strategy to be a contractor for the lawyer under a "Kovel-Type Letter" or agreement.

Please do not "try this at home" with any difficult situation without the active assistance of a lawyer who will be there in the event of litigation that may call to question whether you properly advised your client, and whether you and your client took all of the right steps in this thorny area.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Alan Gassman

Adriana Choi

TECHNICAL EDITOR: DUNCAN OSBORNE

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[i] *Murphy's Law*, *The Oxford Dictionary of Phrase and Fable*, https://www.oxfordreference.com/view/10.1093/oi/authority.20110803100217459 (last visited March 30, 2019).

[ii] See *In re Montgomery*, 475 B.R. 742 (DC Kansas 2011), where the Bankruptcy court concluded that the look-back period 90 days is only counted once, not once for each such event.

Asset Protection
On To Part 2

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