

30th Annual Tax Symposium

OH, THE THINGS YOU SHOULD KNOW!

IMPORTANT TIPS FOR THE ACCOUNTANT WHEN ADDRESSING INSOLVENCY RELATED MATTERS

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TRANSFERRING REAL ESTATE AND OTHER ASSETS – EXEMPTIONS AND IMPLICATIONS

- Transferring assets when addressing creditor concerns requires careful consideration of exemptions and the implications of any transfer.
- An initial reaction to addressing creditor concerns of a client may trigger the immediate thought of “Let’s just get it out of your name.”

EXEMPTIONS

- Michigan law provides that certain property is beyond the reach of creditors. This is commonly known as “exemptions.”
- Exemptions can protect assets from creditor claims, thereby eliminating any consideration of transferring the asset.
- Any transfer of assets, and in particular assets owned by a husband and wife, must be carefully evaluated in light of protections afforded by entireties exemptions available under Michigan and/or Federal Law.

ENTIRETIES PROPERTY IN MICHIGAN

- **REAL PROPERTY** – Real property titled in the name of husband and wife as tenants by the entirety is entirety property. (Tenants by the entirety is only available to spouses.) A judgment lien does not attach to such property unless the creditor's claim is against both husband and wife (ie, joint debt).
- **REAL PROPERTY AND BANKRUPTCY** – State of Michigan bankruptcy exemptions, if elected, exempts property owned by H&W as tenants by the entirety as property of the bankruptcy estate if a creditor's claim is only against one spouse. It does not apply to joint debt.

ENTIRETIES PROPERTY – CERTAIN EVIDENCES OF INDEBTEDNESS

- May be owned by H&W as T by E and afforded same protections as real property from the reach of creditors of only one spouse.
- Examples:
 1. a debenture (bond or other debt instrument),
 2. promissory note payable to H&W,
 3. brokerage accounts,
 4. limited liability membership interests.

FRAUDULENT CONVEYANCES/VOIDABLE TRANSACTIONS, IMPLICATIONS, RAMIFICATIONS

Michigan has enacted the Uniform Voidable Transaction Act, Act 434 of 1988, MCL 566.31, *et seq* (the “Act”), which is:

“An Act to provide for the setting aside and modification of certain transfers of conveyances, and obligations; to make uniform the law of fraudulent transfers and to provide remedies.”

DEFINITIONS UNDER THE ACT

- “Asset” – Property of a debtor
- “Creditor” – A person who has a claim
- “Claim” – A right to payment
- “Transfer” – Disposing of, or parting with, an asset or an interest in an asset or creating a lien.
- “Insolvent” – Debtor’s debts are greater than assets, or debtor cannot pay debts as they become due.
- “Transfer with Intent to Defraud” – A transfer made with actual intent to hinder, delay or defraud any creditor.

FRAUDULENT CONVEYANCES/VOIDABLE TRANSACTIONS (WITH OR W/O INTENT TO DEFRAUD)

- Transfers can be problematic/subject to being set aside as a fraudulent conveyance or a voidable transaction under Michigan law.
- Careful consideration should be given to any potential transfer of assets by a client who has financial difficulties and/or creditors.
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- The first reaction under certain circumstances should not immediately be to simply “transfer the asset.”

IMPORTANT CONSIDERATIONS

- Your client has existing creditor claims. Note: “claim” has a very broad definition.
- Your client has been sued, or is about to be sued.
- Your client is insolvent (debts exceed assets), or might be rendered insolvent by making the asset transfer.
- Your client has an intent to hinder, delay or defraud a creditor.

RAMIFICATONS UNDER MICHIGAN LAW

- The Act provides a mechanism for avoiding a transfer, for attachment or other provisional remedy against the transferred asset and against the recipient of the transferred asset, such as:
- Injunction against further disposition of the asset or other property
- Appointment of a receiver to take charge of the transferred asset or other property of the transferee
- Any other relief the court determines appropriate

IMPLICATIONS/CONSEQUENCES OF TRANSFER OF ENTIRETIES PROPERTY AND FRAUDULENT CONVEYANCES/VOIDABLE TRANSACTIONS

If a creditor of just one spouse is pursuing a fraudulent transfer/voidable transaction claim in the Michigan courts, the transfer of entireties property to a third party or to the non-debtor spouse will not rise to the level of a voidable transfer due to the so-called “no harm, no foul” rule. This is because the entireties asset was not previously reachable.

“NO HARM, NO FOUL” IN BANKRUPTCY

- In a bankruptcy scenario, if a bankruptcy trustee seeks to avoid the transfer, the “no harm, no foul” rule may not insulate the transfer, but it depends on the timing of the transfer.
- Under the Bankruptcy Code, a trustee can avoid a transfer made within 2 years of the bankruptcy filing. The property would come back to the bankruptcy estate to be administered by the trustee.
- If a trustee seeks to avoid the transfer under the Act, the “no harm/no foul” rule may come back into play.

RAMIFICATIONS IN BANKRUPTCY

To the extent that a transfer of entireties property to a third party or the non-bankrupt spouse is avoided pursuant to Section 548 of the Bankruptcy Code, it could result in a denial of the bankrupt spouse's discharge.

OTHER CONSIDERATIONS

- The transfer of property held initially by only one spouse to both spouses as T by E is a voidable transaction as to a creditor of the initial spouse/owner.
- This is, of course, because such a transfer acts to transform an otherwise non-exempt asset into an exempt asset.

PREFERENCES – IDENTIFYING, TENDERING, DISGORING

- Section 547(b) of the Bankruptcy Code permits a trustee or a debtor in possession to recover, under certain defined circumstances, payments made by a debtor to a creditor within 90 days prior to the date of a bankruptcy filing (or 1 year for insiders).
- The purpose of a preference action is to (i) ensure a fair and equal distribution of assets; and (ii) discourage aggressive collection action at the expense of other creditors.

PREFERENCES, CONTINUED

- Typically, preference actions are preceded by a demand letter from the debtor or the trustee.
- A preference action must be pursued by the trustee or debtor in possession as an adversary proceeding in the Bankruptcy Court to recover the “preference” payment.
- Many preference demands are settled prior to litigation.
- Affirmative defenses are available, such as: 1) contemporaneous exchange for new value, 2) subsequent new value, 3) ordinary course.
- Always consult experienced bankruptcy counsel to evaluate any preference demand and defenses to same.

KEY CONSIDERATIONS – PREFERENCES

- Try to know the true financial condition of what appears to be a financially distressed individual or entity and proceed with caution when accepting payment or extending credit.
- If a customer is or may be having financial problems, or if you receive notice of a bankruptcy filing, maintain all records and halt any automatic removal or destruction of any records.
- Always accept the payments but be aware of the risks and potential for disgorgement if there is a preference demand or action.
- Always respond promptly to a preference demand and seek the advice of experienced bankruptcy counsel.

CONCLUSION

The considerations addressed herein are a starting point for any analysis of the propriety of a transfer of assets or the evaluation of a potential preference issue. However, even the most “innocent” transfer can have significant consequences to not only the transferor, but also to the transferee. Likewise, the proper analysis of a preference demand is critical to the ultimate outcome of the preference issue.

Insolvency counsel should always be consulted to evaluate the impact of any transfer in light of the debtor’s entire creditor and asset picture, and to properly address any potential preference issue.

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THANK YOU



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