

Making Sure a Bequest Benefits the Intended Recipient

By Todd E. Duffy

It is an unfortunate reality that bankruptcy filings continue to rise. Indeed, business bankruptcies are up approximately 66% from this time last year. While no one wants to be forced to seek bankruptcy protection, in this economy it is simply unrealistic to believe that anyone is immune. This especially is true for people with high incomes, high value assets, and high levels of debt. In order to minimize its long-term financial impact, anyone contemplating a bankruptcy filing should meet with an attorney to discuss the many planning possibilities presented by such a filing.

One frequently arising issue is whether or not it is appropriate to renounce an inheritance so that other family members, rather than a beneficiary's creditors, can enjoy the proceeds of a decedent's estate. A recent bankruptcy court decision held that renunciation of an inheritance was permissible. As a result of that debtor's proper planning and renunciation, his wife and other family members received the fruits of his mother's estate, instead of his creditors.

The William Alesius Case

Prior to filing his bankruptcy petition, in or around 1993, William Alesius ran a business that failed and, as is common in these types of situations, the failed business left William with a significant amount of debt, including federal and state tax debt. At roughly the same time, William, his brother and mother discussed plans regarding the disposition of his mother's assets upon her death. During this discussion, William stated that until his tax problems were resolved, he would not want to have any assets in his name. In 1998, William's mother transferred title to her home to William's brother and William's future wife, Joyce Bennett.

William's mother died in 1999. In compliance with William's wishes, his mother's will

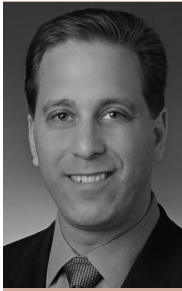
left nothing to him. As a result of the previous transfer, the house was immediately sold and Joyce used her share of the proceeds to purchase a home to live in with William.

In May 2006, William filed his voluntary bankruptcy petition. His bankruptcy documents showed more than \$100,000 of tax debt as well as other debts. Approximately two years after filing his bankruptcy petition, William's Chapter 7 trustee sued him in bankruptcy court asserting, among other things, that William's refusal to accept his inheritance was a fraudulent conveyance. The trustee's analysis was that the home purchased with the inheritance that would have belonged to William should be considered property of William's bankruptcy estate.

In examining this question, the bankruptcy court first determined whether William had any interest in the home purchased by Joyce. To do that, the court looked to applicable New York State law. The court determined that there were two ways to look at this situation: (1) the mother by her own act excluded William from her will, or (2) William renounced his interest in his mother's will. Because New York law permits a parent to exclude descendants from a will for any reason, if the transfer was as a result of William's mother's decision to exclude him, the exclusion was proper and therefore not a fraudulent transfer. Moreover, here, the home was transferred outside the decedent's estate. William never received an interest in the property and therefore there could be no fraudulent conveyance. Even if William had

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who's who

Todd E. Duffy is a shareholder in the New York office of Anderson Kill and is chair of the firm's

bankruptcy and restructuring group. For nearly two decades, Mr. Duffy has helped businesses work through financial difficulties to get their affairs back on track. Leveraging many approaches — including the protections offered by the bankruptcy process — he restores order to situations that may seem out of control. With extensive experience on both debtor and creditor sides of the equation, Mr. Duffy has a uniquely strategic perspective and an ability to maneuver skillfully and quickly, both of which are essential to businesses facing restructuring.

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been given an interest, the court opined that he would have been allowed to renounce his interest in the property, even to the detriment of his creditors. Thus, the fraudulent transfer claims were defeated.

Practical Applications of Alesius

These considerations are even more pertinent in the context of any client preparing to leave assets to a financially challenged beneficiary. When an individual who earns a large salary and has debt in excess of \$500,000 files a bankruptcy petition, he or she will be required to file under Chapter 11 of the Bankruptcy Code. In a Chapter 11 bankruptcy, a debtor is required to propose a plan to pay his or her creditors some portion of their claims.

In order for a plan to be approved by a court, a debtor must show that creditors will receive more under the plan than they would have if the debtor simply liquidated all his or her assets.

Let's make this even more concrete. Dorothy Decedent leaves her home to her son, David. The home has a net worth of \$500,000. David, however, has more than \$500,000 of unsecured debt from a failed business and cannot figure out how he will ever climb out of this massive debt hole. Over the last three years, David has drawn significant compensation from his failed business. Currently, David has no significant assets. Although he collected a significant draw on his salary from his previous business, once that business disappeared, so too did his income. Without any assets of significant value, David's bankruptcy attorney could make a good argument that he should be entitled to file a Chapter 7 bankruptcy petition despite his history of significant income.

Now, let's assume that Dorothy dies either just prior to or within six months of David's bankruptcy filing. If Dorothy has not spoken to David about her will and bequeaths her home to him, David will be forced to sell the property and most, if not all, of the proceeds would be used to pay creditors. However, if Dorothy and David spoke about her will and, after that discussion she decided not to leave her home to David, and left it to David's wife instead, his wife (and presumably David, too) would be entitled to enjoy the benefits of the bequest. Moreover, if David were to renounce the bequest to him, the renunciation would keep the proceeds of Dorothy's home away from David's creditors.▲

Helpful Tip: *Clients drafting a will should be aware of the financial health of those receiving their assets. If not, they could face the situation in which assets that they worked hard all of their lives to acquire could be taken from the intended beneficiary to pay the beneficiary's creditors.*

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