2015 CANNON ESTATE PLANNING TELECONFERENCE SERIES

Participant Packet

Protecting an Inheritance From Spousal and Creditor Claims

FEBRUARY 24, 2015

PRESENTED BY:

Protecting an Inheritance From Spousal and Creditor Claims

Cannon Financial Institute, Inc.

Presents

The 2015 Estate Planning Teleconference Series

Tuesday, February 24, 2015

By

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Protecting an Inheritance From Spousal and Creditor Claims

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A. Spendthrift Trust Limitations

1. *In re Castellano*, 514 B.R. 555 (Bankr. N.D. Ill. 2014)

In re Castellano serves as a precautionary tale to all beneficiaries relying upon spendthrift provisions for asset protection in the event of bankruptcy.

a. <u>Facts</u>. On February 18, 1997, Faith Campbell, mother of Linda Castellano (the "Debtor"), established a revocable trust (the Campbell Trust"). The Campbell Trust was to be divided into equal shares among the settlor's four children upon the settlor's death and distributed outright to each beneficiary. The Campbell Trust contained a spendthrift provision for the protection of the trust beneficiaries, which stated:

> [I]f by reason of bankruptcy or insolvency or any attempted execution, levy, attachment, or seizure of any assets remaining [in this trust] . . . under claims of creditors or otherwise, all or any part of the income or principal might fail to be enjoyed by any beneficiary or might vest in or be enjoyed by some other person, then the interest of that beneficiary shall immediately terminate. *Thereafter, the [] Trustee shall pay to or for the benefit of that beneficiary only those amounts that the [] Trustee, in its sole and absolute discretion, deems advisable for the education and support of that beneficiary* . . . (emphasis in original).

The settlor died in February 2011, and J.T. Del Alcazar was appointed Trustee of the Campbell Trust. Del Alcazar was related by marriage to the trust beneficiaries. Del Alcazar had not made the required distributions to the settlor's children as of October 2011.

On October 5, 2011, the Debtor's lawyer sent a letter (the "Letter") to Del Alcazar stating that the Debtor and the Debtor's husband were insolvent and would be filing for bankruptcy. Accordingly, the Debtor believed it Del Alcazar's duty to exercise his authority under the spendthrift provision regarding distributions to the Debtor. Following receipt of the Letter, Del Alcazar then transferred the Debtor's share of the Campbell Trust into an account with Merrill Lynch "named the Faith F. Campbell *Spendthrift Trust* f/b/o Linda Castellano" (the "Spendthrift Trust") (emphasis in original).

The Debtor filed for Chapter 7 bankruptcy on November 18, 2011. Subsequently, on November 21, 2011, the Debtor executed a receipt of trust assets and release of Trustee (the

"Receipt") acknowledging, *inter alia*, that she was no longer a "named beneficiary" of the Campbell Trust as of October 5, 2011 pursuant to the Letter and that she was now classified as a "life-time, limited beneficiary" of the Spendthrift Trust.

The Bankruptcy Trustee filed a complaint against the Debtor seeking to avoid the transfer from the Campbell Trust to the Spendthrift Trust under the United States Bankruptcy Code, 11 U.S.C. § 548(e), and seeking turnover of the assets pursuant to Sections 543 and 550. Section 548(e) states that a Bankruptcy Trustee may avoid transfers made within ten years of a debtor's filing for bankruptcy if: (1) a debtor transfers an interest in property; (2) into a "self-settled trust or similar device"; (3) of which the debtor is a beneficiary; (4) with actual intent to defraud creditors. The Bankruptcy Trustee must prove each element by a preponderance of the evidence.

b. Transfer by Debtor of Interest in Property. The Debtor claimed she merely provided direction to Del Alcazar but never made an actual transfer of property. The Bankruptcy Trustee argued that the Letter, the Receipt, the Debtor's familial relationship with Del Alcazar and the timing of the transfer "enabled the Debtor to effectuate a 'transfer' of her share" of her mother's trust. A transfer of assets may be indirect or conditional. *See* Section 101(54)(D). Consequently, the court said that the Debtor "recruited" Del Alcazar to transfer the assets on her behalf through the Letter, which was effectively the same as receiving the funds outright and transferring them on her own accord. The Debtor confirmed this indirect transfer by executing the Receipt that stated that the effect of the transfer would be to terminate her status as beneficiary of the Campbell Trust and bestow upon her a new status as lifetime beneficiary of the Spendthrift Trust. Accordingly, the court said, the Debtor indirectly transferred her interest in the Campbell Trust.

c. Self-Settled Trust or Similar Device. The court reasoned that Congress' failure to define "similar device" requires broad interpretation of the term, leaving discretion to the court to "effectuate its terms." State law formalities regarding the creation and validity of trusts are not required under Section 548(e) because such formality would run counter to the broad interpretation required by the "similar device" language. The Spendthrift Trust was created indirectly by the Debtor to protect the Debtor's inheritance from her creditors and to preserve the Debtor's ability to receive distributions during her lifetime. Ultimately, these factors were sufficient to constitute a "similar device" because the Spendthrift Trust exhibited many of the same traits as a self-settled trust. *But see In re Porco*, 447 B.R. 590 (S.D. Ill. 2011).

d. Debtor as Beneficiary. The court had little trouble determining that the Debtor was, in fact, a beneficiary of the Spendthrift Trust. The Spendthrift Trust account was titled, in part, "f/b/o Linda Castellano," and the Debtor consistently referred to herself as a "beneficiary" in the Receipt she signed in November 2011. In addition, the spendthrift provision in the Campbell Trust document refers to the Debtor as a beneficiary.

e. Actual Intent to Defraud. The court looked negatively upon the timing of the Letter, asset transfer and Receipt in relation to the Debtor's bankruptcy petition. The court found the Letter to be the trigger for all the other events, including distributions to the other beneficiaries of the Campbell Trust. Del Alcazar was aware of the Debtor's financial trouble in

March 2011, one month after the Debtor's mother's death, but Del Alcazar did not make any distributions to the Debtor at that time. It was not until Del Alcazar received the Letter that any action was taken with regard to the Debtor's share of the Campbell Trust. The Debtor was already insolvent by the time the assets were transferred. Furthermore, the Debtor testified during trial that the purpose of the transfer was to protect those assets from creditors. The Debtor's actions clearly indicated that "the Debtor and [Del Alcazar] actively planned and structured the creation of the Spendthrift Trust with the explicit purpose of shielding those assets from creditors . . ."

Consequently, the Bankruptcy Trustee was able to avoid the transfer to the Spendthrift Trust, and Del Alcazar was obligated to turn over the property to the Bankruptcy Trustee.

2. Exceptions to Spendthrift Provisions

Spendthrift provisions are intended to keep trust assets out of the reach of a beneficiary's creditors. Spendthrift provisions are not fail-safe, however. Many states have created statutory exceptions to spendthrift trusts, which allow certain creditors to reach income and/or principal of a trust irrespective of the trust's spendthrift protections. The most common exceptions exist for former spouses (alimony; separate maintenance) and children (child support). *See, e.g.*, Section 456.5-503.2, RSMo.; La. Rev. Stat. Ann. § 9:2005; Okla. Stat. tit. 60, § 175.25. Other states, like Arkansas, have enacted such exceptions through case law. *See Council v. Owens*, 770 S.W.2d 193 (Ark. Ct. App. 1989) (permitting children and spouses to access spendthrift trust assets; finding public policies favoring discharge of child support and alimony obligations outweigh right to dispose of property as one sees fit); *see also Ventura Cty. Dep't of Child Support Serv. v. Brown*, 117 Cal. App. 4th 144 (Cal. Ct. App. 2004) ("the beneficiary should not be permitted to have the enjoyment of the interest under the trust while neglecting to support his or her dependents").

Several other states have expanded their list of creditor exceptions to include individuals or entities other than spouses and children. Georgia, for example, allows tort creditors to access the assets of a spendthrift trust. Ga. Code Ann. § 53-12-80(d)(3). California and Louisiana allow trust assets to be accessed if the trust beneficiary is convicted of a felony resulting in damages. *See* Cal. Prob. Code § 15305.6; La. Rev. Stat. Ann. § 9:2005. A restitution creditor in California is not automatically entitled to invade the spendthrift trust, however.

In *Young v. McCoy*, 147 Cal. App. 4th 1078 (Cal. Ct. App. 2007), Richard Young brought an action against the Trustee of his brother's trust seeking to compel a distribution to satisfy a judgment against his brother. Richard and his brother Steven were involved in an argument that resulted in Steven shooting Richard. Steven was convicted of premeditated attempted murder and sentenced to life in prison. Richard subsequently brought a personal injury action against Steven and was awarded $1,250,000. Richard sought to recover this amount from Steven's spendthrift trust. The trust instrument provided for distributions, in the Trustee's discretion, for Steven's health, education, support and maintenance. The Trustee determined Steven's needs were met by the State of California while he was in prison and did not see a need to make trust distributions. Cal. Prob. Code § 15305.5(b) permits the court to

compel payment to a restitution creditor when the trust instrument mandates distributions to the beneficiary. When distributions are subject to a Trustee's discretion, however, Cal. Prob. Code § 15305.5(c) permits the court to compel payment to a restitution creditor only when the Trustee has exercised its discretion and determined a distribution should be made. Thus, the court reasoned it lacked statutory authority to compel the Trustee to make a distribution to Richard as a restitution creditor.

As noted above, Oklahoma is one of several states that allow children and former spouses of the beneficiary to reach income of a spendthrift trust. In addition, the statute provides creditors rendering "necessary services" or providing "necessary supplies" to the beneficiary the same access as children and spouses. Okla. Stat. tit. 60, § 175.25. The comparable Louisiana statute allows access to both income and principal by all the same "exception creditors." La. Rev. Stat. Ann. § 9:2005. In Oklahoma, *all* creditors may access income from a beneficiary's spendthrift trust to the extent the income exceeds $25,000 in a calendar year. Okla. Stat. tit. 60, § 175.25.

B. Asset Protection Through Discretionary Trusts

1. Introduction

Even in circumstances in which a trust is not a self-settled trust and a spendthrift provision is not operative or not made a part of the trust instrument, other types of provisions can be used to protect a non-self-settled trust beneficiary's interest on the basis that the beneficiary's interest is sufficiently tenuous such that it does not qualify as a property right that is subject to attachment by creditors. In light of the discussion above, in some circumstances discretionary trusts may provide even greater protection from creditors than the spendthrift provision.

If the Trustee has the right to accumulate income and has complete discretion over distributions of principal, because the beneficiary cannot compel payment to him or herself for his or her benefit, the beneficiary's creditors cannot compel the Trustee to pay out any part of the income or principal. *See, e.g.*, *Kolpack v. Torres*, 829 S.W.2d 913 (Tex. App. 1992). The protection can be so pervasive that in some jurisdictions it cannot be undermined to pay claims for taxes or spousal support. *See, e.g.*, RESTATEMENT (SECOND) OF THE LAW, TRUSTS, Section 157, cmt. b and e for cases where the beneficiary's interest could not be reached.

If the governing instrument of a discretionary trust does not contain a valid spendthrift provision or the beneficiary's interest is not otherwise restricted under state law, the beneficiary can generally assign his or her interest in the trust. Even if the beneficiary's interest in a discretionary trust is determined to be alienable, however, a creditor that seizes the interest of the beneficiary can still only hope that the Trustee will exercise the Trustee's discretion to make a distribution. The creditor cannot force the Trustee to do so. Thus, if asset protection for a beneficiary is an issue, the income should be accumulated and added to principal to be held in trust for the lifetime of the beneficiary (or at least until the creditor risk subsides), and the governing instrument of the trust should not mandate a distribution of income or principal to the beneficiary at any time.

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A disadvantage of this approach to asset protection is that the beneficiary is completely subject to the Trustee's judgment to withhold or distribute trust income and principal. Thus, a discretionary trust is appropriate if the beneficiaries are subject to a high degree of creditor risk and the settlor is comfortable that the Trustee will act honorably, responsibly and in accordance with the settlor's wishes.

2. Extent of Discretion

Depending on the jurisdiction, a discretionary trust may or may not afford protection against claims of the beneficiary's creditors where the Trustee's discretion is subject to a standard and the standard is itself subject to the absolute and uncontrolled discretion of the Trustee. For example, in *United States v. Taylor*, 254 F.Supp. 752 (N.D. Cal. 1966), the trust instrument provided that the Trustees "shall pay" to the beneficiary so much of the income from the trust as the Trustees deem necessary for the proper care, maintenance and support of the beneficiary. The court held that, because the "shall pay" language is mandatory, it conveyed an intent of the decedent that his son was to receive support payments from the net income of the trust if he needed such support. Thus, the court found that the trust was not discretionary because the Trustee could be compelled to make distributions. In contrast, in *First of America Trust Co. v. United States*, 72 A.F.T.R.2d 5296 (C.D. Ill. 1993), a district court held that a trust was discretionary with respect to the principal notwithstanding language that the Trustee "shall pay" the "income and so much of the principal as the Trustee may in its sole discretion deem necessary or appropriate for the support, comfort and welfare" of the beneficiary.

Uniform Trust Code ("UTC") § 504 provides that whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the Trustee's discretion, even if: (a) the discretion is subject to a standard; or (b) the Trustee has abused the discretion. However, if the Trustee has not complied with a standard or has abused a discretion: (a) a court may order a distribution for support or maintenance of the beneficiary's child, spouse or former spouse; and (b) the court shall direct the Trustee to make an equitable distribution to the beneficiary's child, spouse or former spouse, but only up to the amount that the Trustee would have distributed to the beneficiary if the Trustee had complied with the standard or had not abused its discretion.

UTC § 504 has been modified by several jurisdictions that have enacted the UTC, in most cases resulting in greater protections for beneficiaries against creditors. *See, e.g.*, 18-B M.R.S.A. § 504; Section § 456.5-504, RSMo.; Tenn. Code Ann. § 35-15-504.

UTC § 506 also provides that a creditor or assignee of a beneficiary may reach a mandatory distribution of income or principal, whether or not the trust contains a spendthrift provision, if the Trustee has not made the distribution to the beneficiary within a reasonable time after the date set for distribution. This Section does not apply to discretionary distributions, including such distributions that are provided for in the form of a standard and distributions that are described in language of discretion with language of direction. The comment to this Section explains that, after a reasonable time after the designated distribution date has passed, "payments

mandated by the express terms of the trust are in effect being held by the trustee as agent for the beneficiary and should be treated as part of the beneficiary's personal assets."

A discretionary trust does not comprehensively protect the beneficiary's interest where the dispositive discretion of the Trustee is merely as to the time of payment and the beneficiary is ultimately entitled to the whole or to a part of the trust property. In *In re Nicholson's Estate*, 50 A.2d 283 (Pa. 1947), the court held that a will providing that the trust property must be held for the decedent's sons to be "given them at [Trustee's] discretion," conferred discretion in the Trustee only as to the time and manner of payment.

As the above discussion illustrates, to maximize protection for trust beneficiaries from creditors' claims, distributions to or for such beneficiaries should not be subject to any identifiable or ascertainable standard.

3. Specific Drafting Techniques to Facilitate Asset Protection for Trust Beneficiaries

- The trust instrument could give the Trustee the power to "spray" trust principal and income among more than one beneficiary, such as the beneficiary and the beneficiary's descendants, rather than limiting the Trustee's discretion to a single beneficiary.
- The instrument could provide for at least one independent Trustee or trust protector whose consent is required for the distribution of trust property to the beneficiary.
- The trust instrument could also encourage the Trustee to acquire assets for the use of the beneficiary in lieu of making distributions of trust property to the beneficiary. The Trustee could also be empowered to make loans to the beneficiary or to make equity investments in business entities managed by the beneficiary rather than distributing trust property outright to the beneficiary.
- When the trust instrument confers powers on beneficiaries to withdraw principal, the practitioner should consider also providing the Trustee (or a trust donor) with the power to exclude trust beneficiaries from holding such powers with respect to future contributions to the trust.
- The trust instrument may provide that the beneficiary's interest terminates in favor of another beneficiary in the event that the first beneficiary is at any time deemed insolvent, or the trust instrument may provide that an attempted alienation by the trust beneficiary, or an attempted attachment by the beneficiary's creditors, will cause the beneficiary's interest to be forfeited in favor of another beneficiary. *See, also*, RESTATEMENT (THIRD) OF THE LAW, TRUSTS ("Restatement 3d"), Section 57 (allowing for an interest to terminate or become discretionary upon an attempted voluntary or involuntary alienation of the interest or the beneficiary's bankruptcy).
- Another alternative involves the conversion of an absolute trust interest

into a discretionary trust interest. *See* Restatement 3d § 57 (stating that a trust instrument may provide that a beneficiary's mandatory income interest may become discretionary upon a creditor's attempt to reach such interest).

- The trust instrument could provide the Trustee with the power to withhold otherwise mandatory distributions if the Trustee, in the exercise of the Trustee's sole and absolute discretion, should deem the distributions to be adverse to the beneficiary's interest because there exists a creditor problem at the time that the distribution would otherwise be made. The beneficiary's interest is reinstated after the disqualifying event has passed or has been resolved.

C. Trusts With Tenancy by the Entireties Characteristics

Under most states' laws, spouses can hold property in a tenancy by the entirety, which treats the property so owned as being held not by the spouses but by the marital unit. Orth, "Presumed Equal: Shares of Cotenants," 38 ACTEC LAW JOURNAL 463 (Winter 2011). Generally, one spouse cannot terminate a tenancy by the entirety without the consent of the other. Similar to joint tenancies with rights of survivorship, on the death of the first spouse to die, the surviving spouse automatically receives an interest in the entire tenancy by the entirety by operation of law. Orth, "The Paradoxes of Joint Tenancies," 46 REAL PROP. TR. & EST. L.J. 483 (Winter 2012).

Perhaps the most significant benefit for spouses' holding property in a tenancy by the entirety (as opposed to in a joint tenancy) is that, with rare exceptions, creditors of only one spouse cannot reach property held in tenancy by the entirety. Gary, "Transfer-on-Death Deeds: The Nonprobate Revolution Continues," 41 REAL PROP. PROB. & TR. J. 529 (Fall 2006). Creditors of both spouses, however, can reach such property. In addition, the administration and establishment of tenancies by the entirety involves very little expense or complication. One disadvantage of tenancies by the entirety is that the property cannot be transferred without the consent of the other. Kirkland, "The Good, The Bad and the Innovative: The Evolution of Joint Spousal Trusts in Today's Estate Planning," AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL, Fall 2013.

In most states, the asset protection advantages of a tenancy by the entirety ownership is lost if the assets so held are transferred into a trust. Eight states (Virginia, Delaware, Hawaii, Illinois, Indiana, Missouri, Wyoming and Tennessee) have enacted spousal trust statutes that essentially provide that tenancy by the entirety property transferred to a special type of trust established by the spouses will retain the asset protection advantages of tenancy by the entirety ownership. The trust may be able to be split into two separate shares or trusts while both spouses are alive. Upon the death of the first spouse to die, usually the portion of the joint spousal trust deemed to be "owned" by the predeceased spouse can be further divided into a marital trust and a credit shelter trust or otherwise pass in a trust format providing protection against claims of the surviving spouse's creditors. Kirkland, *supra*.

Some states provide additional flexibility or conditions. In Wyoming, for example, property can be conveyed to joint or separate trusts, and those trusts can be revocable or irrevocable. Wyo. Stat. Ann. § 4-10-402(c). The Hawaii, Illinois and Indiana statutes limit using tenancy by the entirety trusts to real estate only. Illinois further limits the application of its statute to "homestead" property. Haw. Rev. Stat. § 509-2; 765 ILCS 1005/1c; Ind. Code Ann. 30-4-3-35.

The Delaware statute provides additional asset protection benefits. If tenancy by the entireties property is contributed to an asset protection trust under Delaware law, such property will not only maintain its character as tenancy by the entirety property, but if a creditor of either spouse *or both* spouses prove that a fraudulent transfer occurred, the creditor's only remedy is an order directing the Trustee to transfer such property to both spouses, who will continue to hold the property as tenants by the entirety. In addition, the Delaware statute explicitly places the burden of proof on the creditor to prove by clear and convincing evidence that the immunity provided by the statute is not available. 12 Del. Code Ann. §§ 3572(b), 3574(f); Ruben & Gopman, "Delaware Statutory Tenancy By the Entireties Trusts: Potentially Powerful Asset Protection for Couples Across the Country," 39 ESTATES, GIFTS & TRUSTS JOURNAL 123 (May 9, 2014).

D. Important Differences in State Law and U.S. Bankruptcy Code Standards

1. Domicile

The Bankruptcy Code, 11 USCA 101, *et. seq.*, grants an individual debtor the option to elect the federal exemptions provided in Section 522(d), exemptions provided under other federal law (*e.g.*, social security payments and Veterans' benefits, H.R. Rep. No. 595, 95th Cong., 1st Sess. 360 (1977), U.S. Code Cong. & Admin. News 1978, p. 5787) or the exemptions available under the law of the debtor's domicile. Section 522(b). However, under Section 522(b), states may opt out of making the federal exemptions available to debtors and require residents to utilize the state exemption scheme. *See, e.g.*, Fla. Stat. § 222.20; Ariz. Rev. Stat. Ann. 33-1133. Thus, a debtor's domicile is often an important issue in bankruptcy cases. The Bankruptcy Code makes it difficult for a debtor to change his or her domicile in order to utilize more beneficial exemptions. Section 522(b)(3).

2. Retirement Plans

Section 522(d)(10)(E) exempts distributions from certain retirement plans to the extent reasonably necessary for the support of a debtor and his or her dependents. It further provides, in pertinent part, that a debtor may exempt from the bankruptcy estate the debtor's "right to receive…a payment under a stock bonus, pension, profit sharing, annuity or similar plan or contract on account of illness, disability, death, age or length of service," unless: (a) such plan or contract was established by an "insider"; (b) the payment is on account of age or length of service; and (c) such plan or contract was not qualified under Internal Revenue Code ("IRC") §§ 401(a), 403(a), 403(b) or 408.

The Bankruptcy Code provides, in addition to the exemption under Section 522(d)(10)(E), an express exemption for IRAs (both traditional and Roth) and other tax-exempt plans owned by debtors who elect either state exemptions or federal exemptions. Section 522(b)(3)(C), (b)(4) and (d)(12). This exemption, however, is limited for IRAs described in IRC §§ 408 and 408A (other than a simplified employee pension under IRC § 408(k) or a simple retirement account under IRC § 408(p)) to $1,245,475 exclusive of amounts attributed to rollover contributions. A court can increase this limit in specific cases in "the interests of justice." Section 522(n). The exemption is not available to an IRA beneficiary, as contrasted with an IRA owner. *Clark v. Rameker*, 573 U.S. ____ (2014); 134 S.Ct. 2242 (2014).

In addition, the majority of courts to consider the issue have ruled that IRAs are not exempt under state law. Rosen and Rothschild, 810-2nd T.M., Asset Protection Planning. In contrast, and by way of example, Missouri, Florida and Illinois have statutes providing an exemption for IRAs. Section 513.430.1(10)(f) RSMo.; Fla. Stat. Ann § 222.21(2)(a); Illinois, 735 ILCS 5/12-1006(a); *see also* N.Y. C.P.L.R. 5205(c); Ohio Rev. Code 2329.66(A)(10) (providing an exemption for both retirement plans and IRAs).

3. Homestead Exemption

The provisions in the Bankruptcy Code dealing with state law homestead exemptions seek to prevent debtors from engaging in abusive transactions that defraud creditors.

a. **522(o)**. For debtors choosing state law exemptions, Section 522(o) reduces the value of the exemption for the value of a homestead to the extent that: (1) such value is attributable to any portion of any property that the debtor "disposed of" in the ten-year period preceding the petition date; (2) such property or portion of property would not have been exempt ("nonexempt property") on the petition date if the debtor had not so disposed of it; and (3) the debtor disposed of the nonexempt property with the intent to hinder, delay or defraud a creditor.

b. **522(p)**. Under Section 522(p), the value of the homestead exemption is limited to $155,675 if the debtor acquired the homestead in the 1,215-day (*i.e.*, three years and four months) period preceding the filing of the petition. A family farmer's principal residence is not subject to the $155,675 limit. This homestead limitation does not apply to any amount transferred from the debtor's prior principal residence into the debtor's current principal residence if the prior principal residence was acquired before the 1,215-day period and if the prior residence is located in the same state as the current residence.

Most states provide for only a very limited homestead exemption. *See, e.g.*, Conn. Gen. Stat. § 52-352b(t) (value of exempt homestead limited to $75,000); Ind. Code § 34-55-10-2(c)(1) (value of exempt homestead limited to $15,000 per owner). Six states (Florida, Iowa, Kansas, Oklahoma, South Dakota and Texas) provide unlimited exemptions, but typically provide exceptions for federal tax liens, support obligations and fraudulent transfers. Rosen and Rothschild, *supra*. For debtors who might contemplate relocating to one of these six states to take advantage of an unlimited homestead exemption, Section 522(b)(3), in general, requires a debtor to be domiciled in a state for 730 days before the debtor can take advantage of the state's

homestead exemption, or if the debtor's domicile has not been located in a single state for such 730-day period, the place in which the debtor's domicile was located for 180 days immediately preceding the 730-day period.

4. Fraudulent Transfer Statutes

The main potential impediment to transfers made for the purpose of asset protection is a fraudulent transfer claim. If a transfer is considered fraudulent under applicable state or federal law, it will be voidable by the creditor or Bankruptcy Trustee, subject to the applicable statute of limitations. Forty-three states and the District of Columbia have adopted the Uniform Fraudulent Transfer Act ("UFTA"). Note that the UFTA was amended in 2014 and renamed the Uniform Voidable Transactions Act. Some states are currently considering the latest amendments. *See* http://www.uniformlaws.org.

The Bankruptcy Code has fraudulent transfer provisions. Section 548. A "transfer" generally refers to any means of disposing of property, regardless of the amount of consideration received. *See* UFTA § 1(12).

a. Statute of Limitations. Section 9 of the UFTA provides that a cause of action relating to a fraudulent transfer is extinguished unless an action is brought:

- To void a transfer made with actual intent to delay, hinder or defraud creditors, within four years after the transfer was made, or if later, within one year after the transfer was or could reasonably have been discovered by the claimant;
- To void a transfer of property made with constructive fraud, within four years after the transfer was made; and
- To void a transfer made to an insider for an antecedent debt, within one year after the transfer is made.

The Bankruptcy Code provides that a fraudulent transfer is voidable, and the court can refuse to discharge the debtor's debts, if the fraudulent transfer claim is commenced, in general, within two years of the filing of a bankruptcy petition. Section 548(a). Thus, a Bankruptcy Trustee may wish to bring a fraudulent transfer claim under state law rather than under the Bankruptcy Code. Russell, et. al., "Practical Asset Protection Planning Concepts and Ideas," ESTATE PLANNING, November 2012, at 7.

b. Actual Fraud. A transfer made with actual intent to hinder, delay or defraud creditors may be voidable by a present or future creditor or a Bankruptcy Trustee. UFTA § 4; Section 548(a)(1). Since direct testimony regarding the intent to defraud creditors will usually be impossible to obtain, the UFTA provides a non-exhaustive list of factors that may be considered in determining actual intent. UFTA §§ 4(b); 5(b). The most significant of these "badges of fraud" include:

- Transfer made when the transferor is insolvent. *See e.g.*, *Rosenberg v. Aamel Funding Corp.*, 575 So.2d 753 (Fla. App. 3d Dist. 1991).

- Transfer after the transferor has been sued or threatened with suit. *See, e.g.*, *Durrant v. Kelly*, 588 N.Y.S.2d 196 (2d Dept. 1992).
- Transfer with retention of possession or control of the property. *See e.g.*, *In re Vidro*, 497 B.R. 678 (Bankr.E.D.N.Y. 2013).

Other important "badges of fraud" include:

- Transfer to an "insider." An insider is a relative of the debtor; a partnership in which the debtor is a general partner; a general partner of such a partnership; or a corporation in which the debtor is a director, officer or control person.
- Transfer of substantially all of the debtor's assets.
- Removal of assets from the jurisdiction of the court.
- Omission of assets from a financial statement given to a creditor or Bankruptcy Trustee.
- Transfer for inadequate consideration.
- Transfer shortly before or after a substantial debt is incurred.

The Bankruptcy Code provides a list of fraudulent transfers or obligations that are similar to the above-listed "badges of fraud." Section 548(a)(1).

Needless to say, it is not helpful to a settlor's case if a trust's governing instrument contains language reciting the purpose of the trust as "to maximize the protection of the trust estate or estates from creditors' claims of the Grantor or any beneficiary…" *See Battley v. Mortensen*, 2011 Bankr. LEXIS 5004 (Bankr.D. Alaska 2011).

c. **Constructive Fraud**. Some transfers are voidable regardless of the transferor's intent. The UFTA allows present creditors (not future creditors) to establish constructive fraud solely based on objective criteria. UFTA § 5. In practice, counsel for creditors often prefer striving to meet objective criteria for a constructive fraud rather than trying to meet the subjective requirements for actual fraud. Stein, "Practical Primer and Radical Approach to Asset Protection," ESTATE PLANNING, June 2011, at 21.

(1) **Transfer While Insolvent**. The Bankruptcy Code and many state laws provide that a transfer is voidable by a Bankruptcy Trustee or existing creditors if: (a) the transferor does not receive reasonably equivalent value in return; and (b) the transferor is insolvent at that time or becomes so as a result of the transfer. Section 548(a)(2); UFTA § 5(a). The Bankruptcy Code and the UFTA generally define "insolvent" as the debtor's liabilities exceeding the fair market value of the debtor's assets. UFTA § 2(a); Section 101(32). Moreover, under the UFTA, a debtor is presumed insolvent if the debtor is generally not paying his or her debts as they become due. UFTA § 2(b).

(2) **Transfer by Person Intending to Incur Debt**. The Bankruptcy Code provides that a transfer made by a person who intended to incur or believed he or she would incur debts beyond his or her ability to pay, and who received less than a reasonably

equivalent value in return, is voidable by creditors or the Bankruptcy Trustee. Section 548(a)(2)(B)(ii)(III).

(3) Other Voidable Transfers. A transfer of real property can be voided under the Bankruptcy Code if the transfer has not been acknowledged or proved and filed for record as required by law. Section 548(d)(1). The Bankruptcy Code and some state laws provide that a transfer for less than reasonably equivalent value by a person engaged in business is voidable if the transferor's capital remaining after the transfer is unreasonably small in relation to the business. Section 548(a)(2)(B)(ii); UFTA § 4(a)(2)(i).

d. Asset Protection Trusts. The rules expressly address self-settled, asset protection trusts. The fraudulent transfer rules grant a Bankruptcy Trustee a ten-year period within which to avoid a debtor's transfer to a "self-settled trust or similar device." Section 548(e). The ten-year period is measured from the date of the filing of a bankruptcy petition. A self-settled trust presumably includes any trust created by and for the benefit of the settlor, including irrevocable trusts and typical revocable trusts. For the Bankruptcy Trustee to avoid a transfer, the transfer must have also been made with the actual intent to hinder, delay or defraud present or future creditors. Such intent must exist when the debtor makes the transfer. *See, e.g.*, *Battley v. Mortensen*, 2011 Bankr. LEXIS 5004 (Bankr.D. Alaska 2011) (transfer of real property into an Alaska Asset Protection Trust set aside as a fraudulent transfer). As the language indicates, Section 548(e) is intended to reach transfers not only to asset protection trusts, but transfers to other undefined devices as well. Creditors will certainly attempt to stretch the language of this provision to cover other estate planning arrangements.

E. IRS Claims Against Trusts and Tenancy by the Entirety Property

IRC § 6321 permits the IRS to attach a lien to "all property and rights to property, whether real or personal" of a delinquent taxpayer. Rev. Rul. 55-210, 1955-1 CB 544, clarified that the lien also attaches to a trust beneficiary's right to future trust distributions, not just those distributions due at the time the lien has attached. *See also United States v. Canfield*, 29 F. Supp. 734 (1939) (holding that notice of levy served on Trustee of spendthrift trust attaches to distributions to beneficiary even if not due at time levy is served). This lien is a general lien for all taxes owed, and arises automatically after the period for payment of tax has expired. The terms of the trust instrument, as interpreted through state law, will determine whether the lien attaches to the income and/or the principal of the trust. A spendthrift provision, however, does not serve to avoid a lien on trust property. *See generally United States v. Bess*, 357 U.S. 51 (1958).

In *United States v. Craft*, 535 U.S. 274 (2002), the Supreme Court held that the federal tax lien that arises under IRC § 6321 attaches to a taxpayer's rights in property held as a tenancy by the entirety, notwithstanding that local law exempts entirety property from the claims of only one spouse. State law determines what rights an individual has in property, but federal law determines whether state law-defined rights are property or rights to property to which the IRC § 6321 may attach. IRS Notice 2003-60, IRB 2003-39.

Special rules for estate and gift tax liens are addressed in IRC § 6324. Estate tax liens attach upon the date of death to the decedent's gross estate regardless of whether the executor ever takes possession of the property. Treas. Reg. § 301.6324-1(a)(1). Gift tax liens attach to gifts made during the period for which a gift tax return was filed. Treas. Reg. § 301.6324-1(b). In the case of unpaid estate tax, a transferee, Trustee or beneficiary who receives property included in the gross estate is personally liable for the unpaid tax to the extent of the value of the property received. Treas. Reg. § 301.6324-1(a)(1). Similarly, a donee of a gift becomes personally liable for the tax to extent of value of gift received. Liens under IRC §§ 6321 and 6324 may exist simultaneously and are cumulative. *See* Treas. Reg. § 301.6324-1(d).

The IRS may levy the taxpayer's property for unpaid taxes. *See* IRC § 6331-32. The IRS must give thirty days' notice of intent to levy in most situations. IRC § 6331. The IRS cannot seize the property unless the net proceeds are expected to pay off the debt owed. *See* IRS Pub. 594.

Virginia MCLE Board

CERTIFICATION OF ATTENDANCE (FORM 2D)

MCLE requirement pursuant to Paragraph 17, of Section IV, Part Six, Rules of the Supreme Court of Virginia and the MCLE Board Regulations.

INSTRUCTIONS

Certify Your Attendance Online at www.vsb.org see Member Login

Complete this Certification. Retain for two years.

MCLE Compliance Deadline - October 31. MCLE Reporting Deadline - December 15.

A $100 fee will be assessed for failure to comply with either deadline.

Member Name: ______________________________ **VSB Member Number:** ____________________

Address: ______________________________ **Daytime Phone:** ____________________

______________________________ **E-mail Address:** ____________________

____

City **State** **Zip**

Course ID Number: **NCC0565**

Sponsor: **Cannon Financial Institute**

Course/Program Title: **Protecting an Inheritance from Spousal and Creditors' Claims**

Live Interactive *Approved CLE Credits (Ethics Credits): **1.5** **(0.0)**

Date of telephone/webcast:____________________ **Location(s):** ____________________

By my signature below I certify

___ I attended a total of _____________ (hrs/mins) of **approved CLE**, of which (______) (hrs/mins) were in **approved Ethics**. Credit is awarded for actual time in attendance (0.5 hr. minimum) rounded to the nearest half hour. (Example: 1hr 15min = 1.5hr)

___ The sessions I am claiming had written instructional materials to cover the subject.

___ I participated in this program in a setting physically suitable to the course.

___ I was given the opportunity to participate in discussions with other attendees and/or the presenter.

___ I understand I may not receive credit for any course/segment which is not materially different in substance than a course/segment for which credit has been previously given during the same completion period or the completion period immediately prior.

___ I understand that a materially false statement shall be subject to appropriate disciplinary action.

* NOTE: A maximum of 8.0 hours from pre-recorded courses may be applied to meet your yearly MCLE requirement. Minimum of 4.0 hours from live interactive courses required.

____________________ ______________________________

Date Signature

Questions? Contact the MCLE Department at (804) 775-0577 or E-mail questions to mcle@vsb.org

If not certified online, this form may be mailed to:

Virginia MCLE Board
Virginia State Bar
1111 East Main Street, Suite 700
Richmond, VA 23219-3565
Web site: www.vsb.org

[Office Use Only: Teleconference]

Pennsylvania Continuing Legal Education Board
601 Commonwealth Avenue, Suite 3400 • P.O. Box 62495 • Harrisburg, PA 17106-2495
(800)497-2253, (717)231-3250 • FAX (717)231-3251
www.pacle.org
E-mail: pacleb@pacle.org

CREDIT REQUEST FORM

BA_____

This form is to be used when you have attended a course that is not sponsored by an AccreditedProvider. Lawyers seeking Pennsylvania CLE credits must complete Section B of this form and return it to PACLE, along with a Uniform Certificate of Attendance, if available, and a check made payable to PACLE for the $1.50, per credit hour attendance fee payment. Please refer to Section C to calculate the correct attendance fee payment.

SECTION A : Course Information

Provider: **1854** Cannon Financial Institute

Course: **208124** Protecting an Inheritance From Spousal and Creditors' Claims (450766)

Date: 02/24/2015 13:00 **Location:** Alternate Delivery

Total CLE Credit Hours: Maximum: 1.50 = 1.50S

SECTION B : Lawyer Information

Lawyer Name ______________________________ PA Lawyer ID __________

Address ____

City ___________________________________ State _________ Zip ____________

By signing below, I certify that I attended the activity described above and am entitled to claim:
_____ Substantive

______________________________ ____________________
Signature Date

I am enclosing check #_________________ for $__________

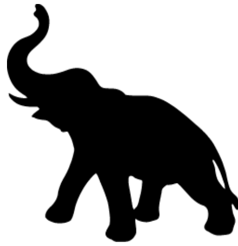
NOTE: If you attended the maximum 1.50 credit hours for this course, please enclose $3.00 attendance fee payment. See Section C below for calculation.

SECTION C : Attendance Fee Calculation

Pennsylvania grants one (1) CLE credit for each 60 minutes of attendance at an approved course. Pennsylvania requires a $1.50 per credit hour attendance fee payment. This $1.50 fee is also required for any portion of a credit hour. We accredit only programs that are at least one hour long; in addition, we accredit only in half hour increments. Please refer to the example below when calculating your attendance fees.

1 hour = 1.50	1.5 to 2 hours = $3.00	2.5 to 3 hours = $4.50	3.5 to 4 hours = $6.00
4.5 to 5 hours = $7.50	5.5 to 6 hours = $9.00	6.5 to 7 hours = $10.50	7.5 to 8 hours = $12.00

etc...



Certificate of Attendance

____

(Participant Name)

____

(Colorado Attorney Registration #)

Has successfully completed the Cannon Financial Institute, Inc. course:

Protecting an Inheritance from Spousal and Creditor Claims

(745675)

February 24, 2015

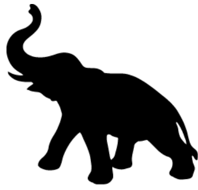
Laurie Frye
Professional Education Coordinator

Continuing Legal Education Credits for this course are as follows:

Colorado – 2 General Credits

****As required by the State of Colorado, attorneys must submit their own credits.

Any questions regarding CE credit, please contact Laurie Frye at (706) 353-3346.
Fax (706) 353-3994, Email lfrye@CannonFinancial.com
PO Box 6447, Athens, Georgia 30604



Certificate of Attendance

____
(Participant Name)

____
(Attorney Bar # or Social Security #)

Has successfully completed the Cannon Financial Institute, Inc. course:

Protecting an Inheritance from Spousal and Creditors' Claims
February 24, 2015

Laurie Frye
Professional Education Coordinator

Continuing Legal Education Credits for this course are as follows:
The following states have been approved for 1.5 hours of General Credit: (Course number is indicated in parenthesis): Alabama, Arkansas (TWE48103), California, Delaware, Georgia, Idaho, Illinois, Iowa (161322), Kentucky (151757), Louisiana, Maine (036024), Minnesota (199855), Mississippi, Montana (25833), Nebraska(101872), Nevada (6503), New Mexico, New York, North Carolina, North Dakota, Oregon (1048* 224), Pennsylvania, South Carolina, Tennessee (Distance Ed), Texas (901306270), Utah , Vermont, Virginia, Washington, Wisconsin , & Wyoming.

These states have been approved for the following General Credit:
Colorado – 2 hours, Florida - 2 hours (1407634N), Missouri –1.8 hours, Oklahoma – 2 hours, West Virginia – 1.8 hours

The following states either do not require/do not accept outside CLE Credit/or do not accept teleconference calls for CLE Credit: District of Columbia, Hawaii, Maryland, Massachusetts, Michigan & South Dakota

The following states have special circumstances:
Alaska-Attorneys can use this certificate to submit to Alaska State Bar
Arizona-On honor system
Indiana & Ohio-Site Coordinators must apply for credit as the sponsor in order for participants to receive credit
Kansas–Attorney or Site may apply 30 days prior to program
New Hampshire- *NHMCLE does not approve or accredit CLE activities for the NH Minimum CLE requirement. NH attendees must self-determine whether a program is eligible for credit, and self-report their attendance.*
New Jersey-Attorneys can use this certificate to submit to New Jersey State Bar for 1.5 General credits (Reciprocity Rule)
New York–Attorneys may use this certificate to report their attendance as it is accredited by Approved NY Jurisdictions: AL, AR, CO, DE, GA, KY, LA, MS, NM, NC, ND, OK,. Type of credit: Areas of Professional Practice, 1.5 Credits

* In order for PA attorneys to receive credit they must listen to the teleconference in a live classroom setting. The teleconference site must also be listed on the PACLE website and the site must be open to any PA attorney who desires to listen to the program. Call PACLE at 1-800-497-2253 with questions on website listing.
****As required by the following State Bars, and in order to obtain CLE in these states, Cannon will submit the mandatory attendance rosters for the attorneys seeking CLE credits **ONLY** in the following states: Alabama, Delaware, Georgia, Idaho, Louisiana, Montana, Nebraska, Nevada, New Mexico, North Carolina, Oklahoma, Oregon, Rhode Island, South Carolina, Tennessee, Texas, Utah, West Virginia and Washington. ****

Any questions regarding CE credit, please contact Laurie Frye at (706) 353-3346.
Fax (706) 353-3994, Email lfrye@CannonFinancial.com
PO Box 6447, Athens, Georgia 30604

Certificate of Attendance

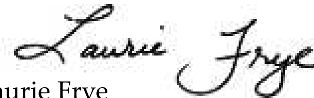
____

(Participant Name)

Has successfully completed the Cannon Financial Institute, Inc. course:

Protecting an Inheritance from Spousal and Creditors' Claims

February 24, 2015



Laurie Frye
Professional Education Coordinator

Continuing Education Credits for this course are as follows:

- **Certified Public Accountant** **1.5 total credit hours**
  In accordance with the National CPE Registry of CPE sponsors, CPE credits have been granted based on a 50-minute hour. For information regarding available CPE credits please visithttp://cpemarket.nasbatools.com/index".
  Instructional delivery method: Group-Live
  NASBA #103655; Field of Study –Specialized Knowledge & Application

- **Enrolled Agent (IRS)** **2.0 total credit hours**
  Cannon is designated as a qualified education sponsor by the IRS and can offer continuing education credit to Enrolled Agents. Cannon's agreement with the IRS' Office of Professional Responsibility does not constitute an endorsement by the IRS as to the quality of the programs or their contribution to the professional competence of the enrolled individual.
- **Certified Financial Planner (CFP™)** **1.5 total credit hours**
  Course #199069
- **Accredited Fiduciary Investment Manager (AFIM™)** **1.5 total credit hours**
- **Certified Wealth Strategists (CWS®)** **2.0 total credit hours**
- **Certified Investment Management Analyst (CIMA®)** **1.5 total credit hours**
  Course #14CFI008
  If you hold the CIMA®, CIMC® or CPWA® certification, you may report this pre-accepted CE program online by logging into your My IMCA account at www.imca.org/user

- **Certified Trust Financial Advisor (CTFA™)** **2.0 total credit hours**

Fiduciary Law	2
Taxes	0
Investments	0
Financial Planning	0
Ethics	0

- **Fiduciary Investment Risk Management Association (FIRMA®)** **2.0 total credit hours**
- **Chartered Life Underwriter & Chartered Financial Consultant** **1.5 total credit hours**
  (**No Individual State Insurance Credit Available)

Any questions regarding CE credit, please contact Laurie Frye at (706) 353-3346.
Fax (706) 353-3994, Email lfrye@CannonFinancial.com
PO Box 6447, Athens, Georgia 30604

CERTIFICATE OF ATTENDANCE FOR CALIFORNIA MCLE

To be Completed by the Provider

Provider: Cannon Financial Institute

Subject Matter/Title: Protecting an Inheritance from Spousal and Creditor Claims

Date and Time of Activity: February 24, 2015 1:00-2:30 PM ET, 12:00-1:30 PM CT, 11:00AM-12: 30 PM MT, 10:00AM- 11:30 AM PT

Location: Teleconference

Length of Presentation: 1.5 Hours

ELIGIBLE CALIFORNIA MCLE CREDIT:

TOTAL HOURS: 1.5

Legal Ethics: 0

Elimination of Bias in the Legal Profession:

Prevention, Detection and Treatment of Substance Abuse:

To Be Completed by the Attorney after Participation in the Above-Name Activity

By signing below, I certify that I participated in the activity described above and am entitled to claim the following California MCLE credit hours:

TOTAL HOURS: ________________________

(You may not claim credit for the following sub-fields unless the provider is granting credit in these areas as listed above.)

Legal Ethics:_______________________________

Elimination of Bias in the Legal Profession:_______________________________

Prevention, Detection and Treatment of Substance Abuse: _______________________________

Attorney Signature:

REMINDERS: Keep this record of attendance for four years. In the event that you are audited by the State Bar, you may be required to submit this record of attendance. Send this to the State Bar only if you are audited. You must sign in on the Official Record of Attendance for California MCLE maintained by this provider in order for these hours to qualify for California MCLE credit.

Thank you for attending this event.

Today's event features an online, post-event evaluation form. To send us your feedback, please click on the link below, or type the URL into your web browser's address bar.

http://eval.krm.com/eval.asp?id=21890

Your feedback and comments are very important to us. Thank you in advance for taking the time to complete this evaluation!