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Avoid Pulling the UVTA Hand Grenade Pin on Your Private Retirement Trust

Properly funding a Private Retirement Trust ("PRT") is crucial to preserving the exemption protection provided to private retirement plans under Cal. Code Civ. Proc. § 704.115(b), which allows you to re-characterize nonexempt personal assets *(assets that can be taken by creditors)* into exempt retirement assets *(assets that cannot be taken from you except in limited circumstances)*. In order to take advantage of this exemption, California residents must ensure that their retirement plan is primarily designed and used for retirement purposes, which is evaluated by courts based on the totality of the circumstances.[1] For purposes of this article, we will assume the retirement plan was primarily designed and used for retirement purposes and instead focus our inquiry on potential challenges to the exemption that may arise under the Uniform Voidable Transfers Act ("UVTA").

The natural consequence of playing the retirement plan exemption card is that a competent creditor will scrutinize the direct transfers funding the PRT as well as the underlying transfers involving the assets used to fund the PRT. If any of the transfers appear questionable, the creditor may seek to avoid one or more under UVTA. Avoiding a transfer means the transaction never occurred and the asset remains titled as it was before the attempted transfer.

Under UVTA, any transfer within the applicable statute of limitations period which ranges from four to seven years, can be avoided under certain circumstances. Of course present and future creditors can seek to avoid a transfer that is made with actual intent to hinder, delay, or defraud any creditor.[2] Not so obvious, however, is that present and future creditors can seek to avoid a transfer if you made the transfer without receiving a reasonably equivalent value in exchange for the transfer and (A) your remaining assets were unreasonably small in relation to the business or transaction in which you were engaged or about to engage, or (B) you intended to incur, or believed or reasonably should have believed that you would incur, debts beyond your ability to pay as they became due.[3] Present creditors are also provided with the additional avenue of avoiding a transfer that is lacking an exchange of reasonably equivalent value *if* you were insolvent at the time of the transfer or became insolvent as a result of the transfer.[4]

With UVTA in mind, now imagine this scenario:

> You own a small corporation in which you are the sole shareholder and you have one employee. Your one employee quits and files a lawsuit against the corporation seeking to recover $1 million based on employment law claims. Since you are the only other person at the corporation, you know the claims are frivolous but you make a reasonable offer to settle in order to avoid the high cost of litigation.
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> With your settlement offer pending, you also decide to implement the retirement planning you have been contemplating for years. You are solvent, your corporation is solvent, and there are no lawsuits or claims against you or the Company except for the employee claim.

[1] See O'Brien v. AMBS Diagnostics, LLC (2019) 38 Cal.App.5th 553, 561.
[2] Cal. Civ. Code § 3439.04(a)(1).
[3] Cal. Civ. Code § 3439.04(a)(2).
[4] Cal. Civ. Code § 3439.05(a).

> Your corporation sets up a retirement plan and sponsors a PRT for your benefit. The PRT is funded with a small contribution by the corporation and your contribution of 50% non-voting membership interests (valued at $5 million) in a limited liability company. The LLC is a holding company with a single commercial property asset, which is the commercial property you transferred a year prior from yourself to the LLC for free.
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> Eventually your offer to settle the employment claims was rejected, you were added to the lawsuit as an individual, and one year later the employee obtains a judgment against you for $1 million. You only have $100,000 in the bank so the employee's only chance at recovering the money is to avoid the transfer of the LLC interests to your PRT and expose the $5 million. *Will the employee be able to reach the PRT asset or will the exemption stand?*

Scrutinizing a transfer under UVTA requires numerous considerations including the time of funding, amount of funding, the exchange value, the type of asset used to fund, as well as any underlying transfers involving the asset that was used to fund the PRT. In the above scenario, the direct funding of the PRT consists of the employer contribution and your contribution. The employer contribution is relatively small and will not be problematic since the corporation was solvent at the time of the transfer. Your contribution of $5 million worth of LLC interests, however, may require defending on two levels. The first level involves a challenge to the direct funding of the PRT *(the transfer of the LLC interests from you to the PRT)*. The second level involves a challenge to the indirect funding of the PRT *(the transfer of the commercial property from you to the LLC)*.

Regarding the first level, although the direct funding of the LLC interests to the PRT did not render you insolvent, the fact that your remaining asset is only $100,000 provides a clears path for creditors to seek to avoid your transfer of the LLC interests to the PRT under UVTA. Under these circumstances, a creditor can seek to avoid this transfer if it can be shown that your remaining assets were unreasonably small in relation to the business or transaction in which you were engaged or about to engage, or that you intended to incur (or believed or reasonably should have believed that you would incur) debts beyond your ability to pay as they became due.

Regarding the second level, the PRT asset is the LLC interest and the underlying transaction involving the LLC interest is the transfer of the commercial property to the LLC. When a creditor examines this transaction, immediate red flags will be raised due to the lack of consideration for the transfer. A transfer that is made for no consideration can be avoided if you made the transfer when you were insolvent, about to become insolvent, entering transactions for which your remaining assets are unreasonably small in relation to the transaction, or you cannot pay your debts as they become due. Thus, the mere lack of consideration opens the door for a creditor to invade your financial privacy and attempt to avoid the transfer on grounds that you were not financially capable of entering the transaction. If a creditor is successful, and the transfer of the commercial property to the LLC is avoided, the LLC interests would be held by you personally and thus subject to collection by your creditor.

It is important to make certain that the direct transfers funding the PRT as well as the underlying transfers involving the assets that are used to fund the PRT can withstand scrutiny under UVTA. If the creditors are successful, your assets will lose their exempt status and be subject to collection. And, even if you prevail, ultimately you still lose after incurring the high cost of defending against such claims. To save time and money in the future, invest time and money now to ensure your PRT is properly funded.