



Agricultural Law Press

Publisher/Editor

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Agricultural Law Digest

Volume 30, No. 8

April 12, 2019

ISSN 1051-2780

Does a Debtor Need to Receive Contemporaneous Value for a Pre-petition Transfer to Avoid Recapture?

-by Robert P. Achenbach, Jr., J.D.

A recent bankruptcy case¹ examined several parameters of the rules governing avoidance of pre-petition fraudulent transfers.

Avoidance of Fraudulent Transfers

A bankruptcy trustee may avoid transfers made or obligations incurred, voluntarily or involuntarily, by a debtor within two years prior to the filing of the bankruptcy petition with actual intent to hinder, delay, or defraud a past or future creditor.² The trustee's power of avoidance extends to transfers made or obligations incurred where an interest of the debtor in property was voluntarily or involuntarily transferred within two years of filing bankruptcy where the debtor received less than reasonably equivalent value and debtor was insolvent at the time of the transfer or became insolvent as a result thereof.³

A 2019 case looked primarily at the issue of whether the debtor received "reasonably equivalent value" for a pre-petition rent payment and whether such value had to be received at the same time as the payment in question was made.

*In re McMartin*⁴

The debtor was a member of a family partnership which leased farmland from an unrelated family trust under a written lease for 2013 through 2018. The debtor's partnership had the right to sublease the farmland so long as the trust agreed to the sublease and the sublease terms matched the main lease agreement. The debtor personally made the annual lease payment of \$22,000 for 2017 on February 10, 2017. The debtor then began forming a new partnership on February 16, 2017 and sublet the farmland to the new partnership on March 22, 2017. The new entity then reimbursed the debtor with a check for \$22,500 on April 26, 2017. The debtor filed for Chapter 7 bankruptcy on September 11, 2017.

The court found that the Chapter 7 trustee had established all the requirements for avoidance under Section 548 except the requirement that the debtor had received less than a reasonably equivalent value for the debtor's payment of the annual rent on February 10, 2017.

The court examined three factors in analyzing reasonably equivalent value: whether (1) value was given; (2) it was given in exchange for the transfer; and (3) what was transferred was reasonably equivalent to what was received. Section 548(d)(2)(A) defines "value"

* Publisher and editor of the Agricultural Law Press.

as property in satisfaction of or securing of a present or antecedent debt of the debtor.

The debtor first argued that the debtor had received a direct benefit for the rent payment because the debtor received the right to farm the rented land. However, the court found that the lessee was the initial family partnership; therefore, the debtor did not receive a direct benefit from payment of the rent.

The debtor next argued that the debtor received reasonably equivalent value through the indirect benefit of the \$22,500 rent reimbursement payment from the new partnership which sublet the farmland. The trustee responded that any benefit received by the debtor for the rent payment must be a contemporaneous exchange at the time of the rent payment. The trustee noted that the new partnership did not even exist at the time of the debtor's rent payment.

Contemporaneous Exchange

The trustee argued that the determination of whether the debtor received reasonably equivalent value had to be made at the time of the debtor's transfer of the funds in issue. The trustee cited *BFP v. Resolution Trust Corp.*,⁵ and following cases which held that the determination of reasonably equivalent value received from a foreclosure sale had to be made at the time of the sale. However, the court found that the U.S. Supreme Court did not require that a reasonably equivalent benefit be received by a debtor at the time of the transfer. In addition, the court noted that the *BFP*-following cases allowed post-transfer repayments where the debtor received an indirect benefit at the time of the transfer.

The court noted that in this case there was no dispute that the debtor actually received from the reimbursement more than the debtor paid for the rent. The question was whether the debtor received an indirect benefit from payment of the rent. The court found that as part of the series of transactions, it was clear that the debtor's payment of the rent for the first partnership gave rise to the debtor's right to receive reimbursement from the new partnership. The court noted that much of the delay in making the reimbursement was caused by the time needed to form the second partnership and that the payment of the rent was made at

the same time as the debtor expressed to the landlord the desire to sublease the farmland to the new partnership. Thus, the court held that the debtor's payment of the 2017 rent for the first partnership was not an avoidable fraudulent transfer.

In Conclusion

In many ways, this was an easy case in that (1) the debtor paid money and received money in reimbursement, relieving the court of any need to value the property received by the debtor for the payment; (2) the debtor was involved with all the parties, as a member of both partnerships; and (3) the reimbursement left the debtor, and the debtor's bankruptcy estate, in the same position as to the ability to pay creditors. Since the purpose of the reasonably equivalent value requirement is the protection of creditors, the court might have simply ruled against the trustee on that last fact. Indeed, where a debtor's estate is not reduced by the pre-petition transfer and later reimbursement, the case opens up some pre-bankruptcy planning for the debtor, so long as the debtor receives a reasonably equivalent value that will be available to pay creditors.

ENDNOTES

¹ *In re* McMartin, 2019 Bankr. LEXIS 908 (Bankr. D. N.D. 2019).

² 11 U.S.C. § 548(a)(1). See Harl and Achenbach, *Agricultural Law*, § 120.04[2][e] (2019).

³ *See, e.g., In re* Janz, 140 B.R. 256 (Bankr. D. N.D. 1991) (debtors' conveyance of most of farm to son for cash, promissory note, and lifetime interest in one-third of crops avoidable as fraudulent conveyance because consideration received for land substantially less than fair market value of land and debtors made insolvent by transaction); *In re* Stevens, 112 B.R. 175 (Bankr. S.D. Tex. 1989) (debtor's disclaimer and renunciation of inheritance within three months before filing bankruptcy when debtor insolvent was avoidable fraudulent transfer).

⁴ *In re* McMartin, 2019 Bankr. LEXIS 908 (Bankr. D. N.D. 2019).

⁵ 511 U.S. 531 (1994).

CASES, REGULATIONS AND STATUTES

FEDERAL ESTATE AND GIFT TAXATION

IRA. The decedent owned an IRA and had received the required minimum distributions for the year of death. The decedent's estate was the sole beneficiary of the IRA and the decedent's will bequeathed the decedent's interest in the IRA to beneficiaries. The executor divided the IRA into separate IRAs for each beneficiary by making trustee-to-trustee transfers. The IRS ruled that (1) The

division of the IRA as of the decedent's date of death by means of trustee-to-trustee transfers into inherited IRAs for the benefit of the beneficiaries will not result in taxable distributions or payments under I.R.C. § 408(d)(1) to the estate. (2) Because the estate was listed as the designated beneficiary of the IRA, the IRA is treated as having no designated beneficiary. Because the IRA had no designated beneficiary and the decedent died after the required distribution beginning date, the beneficiaries can take required minimum distributions from each of their inherited IRAs for the remaining life expectancy of the decedent. The amount required to be distributed each year is determined using the decedent's age in the calendar year of death and the applicable actuarial table. The life expectancy factor is reduced by one each subsequent calendar