Published on *The National Law Review* https://natlawreview.com

Seizing Assets Hidden In A Sham Trust

Article By:

Eric (Rick) S. Rein

The Bankruptcy Appellate Panel for the 9th Circuit in Chantel v. Pierce, 2015 Bankr. Lexis 2174, recently explained what can constitute a sham trust to enable creditors to reach assets transferred to that trust. A California trust had been created with the Chantels as co-trustees. After a judgment had been entered against them, they filed a Chapter 13 bankruptcy, which was converted to a Chapter 7. In their schedules, the Chantels claimed they owned no real property and had not made any transfers to their self-settled trust within the previous 10 years. The Chantels did claim that they leased farmland from the Trust, but stated they had no other income and did not claim any income from the trust.

The Bankruptcy Trustee brought an adversary complaint alleging that the trust was a sham and that the Chantels had fraudulently transferred assets to the trust. At trial, the Chantels admitted that a) a group of people who could not be identified had approached the Chantels about creating a trust and had given them two parcels of real estate to create the trust; b) they had declared income from property purportedly owned by the trust on their personal income tax returns; c) they had used the trust property as collateral for loans made to them personally; d) the trust's funds were used to pay their personal expenses; e) silver bullion purchased by the trust had been sold for money lost in gambling; f) a cash inheritance had been transferred to the trust which was then used to make improvements to the property in the trust; and g) trust funds had purchased jewelry stored in a jewelry box and worn by Mrs. Chantel.

The Court determined that the trust was the alter ego of the Debtors because there was no substantive existence separate from the Debtors and the property purportedly held by the trust was considered the Debtors' own property. The finding was based on Arizona law where a court may find a trust is an alter ego where (1) the individual treats the trust property as his own; (2) the trust paid minimal or no consideration for the property; (3) the individual has expressed the intent to shelter assets via the trust mechanism; (4) the individual maintains active or substantial control over the operations and decisions of the trust; and (5) a family or close relationship exists between the individual and the holding entity.

In view of this decision, for creditors to set aside a trust on an alter ego theory, they should consider factors such as:

- The primary beneficiary uses the trust to directly pay person bills, pay off credit cards or personal loans.

- Property is passed back and forth between the beneficiary and the trust without a great deal of legal consideration.
- There is evidence in the trust file that it is used for asset protection purposes, especially where documents name it as an "Asset Protection Trust."
- The beneficiary essentially controls the trust assets by the artifice of acting as the "investment advisor."
- The trustee is either a family member or a trust company that really isn't acting as a trustee so much as a nominee for the beneficiary.

Thus, the issue is not how a trust is set up, but how it is operated. It is apparent as years pass that parties get careless in how they handle the affairs of their trust and mishandle the operations of the trust for immediate personal needs.

National Law Review, Volume V, Number 213