Are you familiar with fraudulent transfer laws?

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A primary goal of your estate plan is to transfer wealth to your family according to your wishes and at the lowest possible tax cost. However, if you have creditors, be aware of fraudulent transfer laws. In a nutshell, if your creditors challenge your gifts, trusts or other strategies as fraudulent transfers, they can quickly undo your estate plan.

2 fraud types

Most states have adopted the Uniform Fraudulent Transfer Act ("UFTA"). The act allows creditors to challenge transfers involving two types of fraud that you should be mindful of as you weigh your estate planning options:

1. Actual fraud. This means making a transfer or incurring an obligation "with actual intent to hinder, delay or defraud any creditor," including current creditors and probable future creditors.

Just because you weren't purposefully trying to defraud creditors doesn't mean you're safe from an actual fraud challenge. Because a court can't read your mind, it will consider the surrounding facts and circumstances to determine whether a transfer involves fraudulent intent. So before you make gifts or place assets in a trust, consider how a court might view the transfer.

2. Constructive fraud. This is a more significant risk for most people because it doesn't involve intent to defraud. Under UFTA, a transfer or obligation is constructively fraudulent if you made it without receiving a reasonably equivalent value in exchange for the transfer or obligation *and* you either were insolvent at the time or became insolvent as a result of the transfer or obligation.

"Insolvent" means that the sum of your debts is greater than all of your assets, at a fair valuation. You're presumed to be insolvent if you're not paying your debts as they become due.

Generally, the constructive fraud rules protect only *present* creditors — that is, creditors whose claims arose before the transfer was made or the obligation was incurred.

Know your net worth

By definition, when you make a gift — either outright or in trust — you don't receive reasonably equivalent value in exchange. So if you're insolvent at the time, or the gift renders you insolvent, you've made a constructively fraudulent transfer, which means a creditor could potentially undo the transfer.

To avoid this risk, analyze your net worth before making substantial gifts. Even if you're not having trouble paying your debts, it's possible to meet the technical definition of insolvency.

Fraudulent transfer laws vary from state to state, so please consult an attorney about the law in your specific state.

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