



**Fraudulent Transfer Provision Of The Bankruptcy Code Defined More Narrowly Than
Similar Provisions In Other Statutes**

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Introduction

The fraudulent conveyance provision of the Bankruptcy Code, (“the Code”), Section 548, is an “elemental and ancient provision of debtor-creditor relations.”¹ It provides that “[t]he trustee may avoid any transfer ... of an interest of the debtor in property ... that was made ... within two years before the date of the filing of the petition . . .” where the transfer involved actual or constructive fraud.²

But the ability to avoid fraudulent transfers is not limited to the bankruptcy context; parallel provisions are found in several areas of the federal legislation. For instance, there is a fraudulent transfer provision in the federal tax laws (“If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount ... shall be a lien in favor of the United States upon all property and rights to property . . .”³), and the Fair Debt Collection Practices Act (“FDCPA”) (“a transfer made or obligation incurred by a debtor is fraudulent as to a debt to the

¹ 5 COLLIER ON BANKRUPTCY ¶ 548.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2017).

² 11 U.S.C. § 548(a)(1) (2012).

³ 26 U.S.C. § 6321 (2012).

United States . . .”⁴), the statute that governs the collection of debts owed to the federal government.

A central issue in interpreting these provisions is how broadly to define “property.” Recent decisions addressed this point in a situation where the debtor disclaimed assets that were coming to a debtor from another source, typically money receivable upon the death of a wealthy relative. The effect of the disclaimer would be to fully renounce the debtor’s interest in the property and the assets would pass to the next beneficiary. The courts considered whether such a renunciation amounts to a fraudulent transfer of “property” that can be avoided by the creditor as a fraudulent conveyance.

The courts have applied different standards to the same transaction, depending on the statute involved. Specifically, the courts have drawn a distinction between the Bankruptcy Code and other statutes. This memorandum will explore this distinction in a three-fold approach. Part I will demonstrate that courts adopt a broad interpretation of property in the tax lien context. Part II will establish that a similarly broad definition has been embraced under the FDCPA. And Part III discusses the narrow definition of property followed by the courts in the bankruptcy context and the rationale for a different standard under the Code.

I. A Disclaimer Is A Fraudulent Transfer Under The Federal Tax Laws

Section 6321 of the Internal Revenue Code provides: “If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount ... shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to

⁴ 28 U.S.C. § 3304(a) 2012).

such person.”⁵ The language in section 6321 “is broad and reveals on its face that Congress meant to reach every interest in property that a taxpayer might have.”⁶

The question of whether a taxpayer’s asset constitutes “property” or “rights to property” is a matter of federal law.⁷ However, “property” and “right to property” are not defined in the tax code.⁸ Instead, the Supreme Court announced a two-prong test to determine if an asset is property under the tax code.⁹ First, we look to state law to determine what rights the taxpayer has in the property. *Id.* The Court reasoned that we should look to state law—not federal law—to determine his right in the property because “[s]tate law creates legal interests and rights” while the federal tax law merely “designate[s] what interests or rights, so created, shall be taxed.”¹⁰ Having determined the extent of the power of the taxpayer in the property, we then look to federal law to determine whether the taxpayer’s state-delineated rights qualify as “property” or “rights to property” within the compass of the federal tax lien legislation.¹¹

The Supreme Court did not delineate what state rights are property under federal law but did emphasize that control over the property is central. “The important consideration is the breadth of the control the [taxpayer] could exercise over the property.”¹² Several appellate courts have held that property would encompass any “state-law rights or interests that have pecuniary value and are transferable.”¹³ Accordingly, to satisfy a tax delinquency, the federal government may collect property as long as the taxpayer had control over it or it had pecuniary value and is

⁵ 26 U.S.C. § 6321.

⁶ *United States v. Nat’l Bank of Commerce*, 472 U.S. 713, 719–20 (1985) (internal citations omitted).

⁷ *Drye v. United States*, 528 U.S. 49, 58 (1999) (quoting *Nat’l Bank of Commerce*, 472 U.S. at 727).

⁸ *See Drye Family 1995 Trust v. United States*, 152 F.3d 892, 895 (8th Cir. 1998).

⁹ *Drye*, 528 U.S. at 49.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Dyre*, 528 U.S. at 61 (citing *Morgan v. Commissioner*, 309 U.S. 78, 83 (1940)) (holding that the right to disclaim inheritance under state law was “right to property” under federal law because the disclaimant could use that power to channel the inheritance to a known heir).

¹³ *Drye Family 1995 Trust*, 152 F.3d at 895 (citing decisions from the 3rd., 6th, 9th, and 11th circuits).

transferrable regardless if under state law other creditors would not be able to reach that property. Thus, the federal government and the ordinary creditor have different standards regarding which transferred out property they are able to reach.

For example, in *Nat'l Bank of Commerce*, the Supreme Court held that a taxpayer's right under state law to withdraw all of the funds in a joint bank account constitutes "property" or the "righ[t] to property" subject to levy for unpaid federal taxes, although state law would not allow ordinary creditors to deplete the account.¹⁴ Similarly, the Court held that a taxpayer's right under a life insurance policy to compel his insurer to pay him the cash surrender value qualifies as "property" or a "righ[t] to property" subject to attachment for unpaid federal taxes, although state law shielded the cash surrender value from creditors' liens.¹⁵

II. Disclaimed Assets Are Not Shielded From Collection By The United States

The FDCPA, the statute governing the collection of debt owed, allows the government to void a fraudulent transfer by a debtor owing a debt to the United States.¹⁶ The FDCPA is similar to the federal tax lien statute because it "create[s] a comprehensive statutory framework for the collection of debts owed to the United States government," which parallels the aims of the tax code.¹⁷ Further, like the federal tax lien statute, the FDCPA "itself creates no property rights but merely attaches consequences, federally defined, to rights created under state law."¹⁸

To determine what is a fraudulent transfer under the FDCPA—and by extension, what is property under the FDCPA—courts apply the *Drye* standard announced by the Supreme Court in

¹⁴ *Nat'l Bank of Commerce*, 472 U.S. at 723–27.

¹⁵ *United States v. Bess*, 357 U.S. 51, 56–57 (1958).

¹⁶ *See* 28 U.S.C. § 3304(a).

¹⁷ *United States v. Bensal*, 853 F.3d 992, 994 (9th Cir. 2017) (citing *United States v. Gianelli*, 543 F.3d 1178, 1183 (9th Cir. 2008)).

¹⁸ *United States v. Craft*, 535 U.S. 274, 278 (2002).

the tax lien context.¹⁹ Under this framework, for example, the Ninth Circuit held that the disclaimer of an inheritance by a debtor who owed money to the federal government was a fraudulent transfer under the FDCPA because under state law he could channel that money to a known heir, just as it would have been reachable under the tax lien statute.²⁰ In another case, the Second Circuit held that the government cannot collect money that was being held by an intermediary bank in an electronic fund transfer when the originator or the intended beneficiary owed a debt the government.²¹ Since neither party at either end of the transaction could control or direct those funds, neither had an interest or right in it under state law and was therefore not a fraudulent transfer under the FDCPA.²²

III. Disclaimed Assets Under Section 548 Of The Bankruptcy Code

Under the Bankruptcy Code, “[t]he trustee may avoid any transfer ... of an interest of the debtor in property ... that was made ... within two years before the date of the filing of the petition . . .” where the transfer involved actual or constructive fraud.²³ The Code does not define “property” or “an interest ... in property.”²⁴ Rather, “Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law,”²⁵ meaning that “[i]n the absence of any controlling federal law, ‘property’ and ‘interests in property’ are creatures of state law.”²⁶

¹⁹ See *Bensal*, 853 F.3d at 1000; *Export-Import Bank of U.S. v. Asia Pulp & Paper Co., Ltd.*, 609 F.3d 111 (2d. Cir. 2010).

²⁰ *Bensal*, 853 F.3d at 1000.

²¹ *Export-Import Bank*, 609 F.3d at 122.

²² *Id.*

²³ 11 U.S.C. § 548(a)(1).

²⁴ *In re Costas*, 555 F.3d 790, 793 (9th Cir. 2006).

²⁵ *id.* (citing *Butner v. United States*, 440 U.S. 48, 54 (1979))

²⁶ *Barnhill v. Johnson*, 503 U.S. 393, 398 (1992).

Unlike the tax lien statute and the FDCPA, courts do not look to the *Drye* standard to determine “property” under section 548.²⁷ Rather, courts apply the *Butner* rule under which not only is the definition of property governed by state law, but the “determination of property rights in the assets of a bankrupt’s estate” is controlled by state law as well.²⁸ In other words, even if an asset is “property” under state law and that property was transferred out of the bankrupt’s estate, if state law shields that property from creditors, it will not be a fraudulent transfer under section 548.

This standard to evaluate fraudulent transfers has been adopted by other courts as well. See *In re Laughlin*, 602 F.3d 417 (5th Cir. 2010) (holding that a Chapter 7 petitioner’s pre-petition renunciation of an inheritance was shielded from creditors under state law and therefore was not a fraudulent transfer under section 548 of the Code as well); *In re Atchison*, 925 F.2d 209 (7th Cir. 1991); *In re Sanford*, 369 B.R. 609 (B.A.P. 10th Cir. 2007).

For example, in *Costas*, Rachel Costas disclaimed a \$34,000 interest in her father’s trust.²⁹ Three weeks later, she filed a voluntary petition for relief under Chapter 7 of the Code.³⁰ The Chapter 7 trustee sought to avoid the disclaimer as a fraudulent transfer under section 548.³¹ The court held that since Arizona law provided that disclaimed assets are protected from creditors (“Az.Rev.Stat. § 14-2801(G) . . . is a legal fiction that retroactively eliminates any property interest that a disclaimant previously held in the disclaimed property,” *id.* at 793-94),

²⁷ *Costas*, 555 F.3d at 795-96.

²⁸ See *Costas*, 555 F.3d, at 797 ([i]nstead, we apply the principles of *Butner* and hold that a disclaimer, properly executed under Arizona law, is not a “transfer . . . of an interest of the debtor in property” for purposes of section 548).

²⁹ *Id.* at 792.

³⁰ *Id.*

³¹ *Id.*

the disclaimer was not a fraudulent transfer under section 548 even though the right to disclaim is a property interest under state law.

In drawing a distinction between the Bankruptcy Code and other federal statutes, the *Costas* court emphasized several considerations. First, it noted that the policy underlying the tax lien statute and the FDCPA—to facilitate the collection of debt owed to the government—contrasts sharply with the policy of the code.³² The Bankruptcy Code “largely respects substantive state law rights, neither granting a creditor new rights in the debtor's property nor taking any away.”³³ Therefore, while it may be justified that the government can collect its debt from funds that state law would otherwise protect, no such compulsion exists in the bankruptcy context.

Further, the court identified a goal of achieving “[u]niform treatment of property interests by both state and federal courts within a State....”³⁴ Extending the *Drye* rule to the bankruptcy context creates different standards of protection from creditors under state and federal law. Disparate treatment of creditors would undermine this goal of uniformity.³⁵

Finally, the court noted that while the tax lien statute only permits a narrow range of exemptions from “property,” indicating that that term should be interpreted broadly, the Code delineates a broad range of exceptions³⁶, suggesting an intent of allowing a debtor to take advantage of all available state law exemptions.³⁷

³² *Id.* at 797.

³³ *Id.* (citing *Raleigh v. Ill. Dep't of Rev.*, 530 U.S. 15, 20 (2000)).

³⁴ *Id.* (citing *Butner*, 440 U.S. at 55).

³⁵ *Id.*

³⁶ *See* 11 U.S.C. § 522 (2012).

³⁷ *Id.*

IV. Conclusion

While courts have adopted an expansive view of fraudulent conveyance provisions of several federal statutes, they have interpreted the same provision of the Bankruptcy Code more narrowly, affording the debtor all the protections that he would have received under state law.