

Fraudulent Conveyances Disguised as Legitimate Estate Planning: How to Recognize the Difference

By Gregory T. Reagan and Stephanie Daniel



When someone faces a significant liability or the threat of a significant liability, it may be tempting to transfer assets to shield them from creditors' claims. After-the-fact estate planning can be an attempt to legitimize the transfer. However, if such planning is not executed carefully, these transfers can be deemed fraudulent conveyances. We have observed this type of transfer in family law (divorce) and commercial damages matters. This article explains how to recognize whether asset transfers are actually fraudulent conveyances.¹

What is Fraud?

According to *Black's Law Dictionary*, "fraud consists of a deceitful practice or willful device, resorted to with intent to deprive another of a right, or to cause injury." In a civil lawsuit, only the trier of fact can make a determination that fraud has occurred. What is a fraudulent conveyance? It is an illegal transfer of property by a debtor with the purpose of moving assets outside the reach of a creditor or other claimant. If proven fraudulent, a conveyance may be reversed, set aside, or invalidated by the courts.

Efforts to protect assets from the reach of existing or foreseeable creditor claims can be disguised as legitimate estate planning. The federal government and many states have adopted the Uniform Fraudulent Transfer Act (UFTA) or a version of the Uniform Voidable Transactions Act (UVTA) to protect creditors from being deprived of access to assets to satisfy claims against debtors. Fraudulent or voidable transfers can arise in many cases, including divorce and civil litigation.

¹ Fraudulent conveyances may also occur in connection with bankruptcy matters. However, those situations are beyond the scope of this article.

Alaska's statutes provide that a "fraudulent conveyance can only be set aside if a creditor can prove actual fraud as to that creditor."

Asset protection is the goal of these schemes and evidence that conveyance of an asset may be fraudulent may include any combination of the following:

- Forming new entities domiciled in Delaware, where owners cannot be identified,
- Transferring equity ownership rights to the new entities,
- Creating post-transfer estate planning,
- Forming self-settled asset protection trusts in asset protection states,
- Transferring equity ownership rights to these entities or trusts,
- Maintaining control after the transfer, and
- Withdrawing funds from the trusts, often to the point of exhausting the trust assets.

What is an Asset Protection Trust?

An asset protection trust is an estate planning tool used to protect an individual's assets from potential creditors. These trusts are typically self-settled trusts, meaning that the individual funding or transferring assets to the trust is also a beneficiary of the trust. Once assets are placed in an asset protection trust the beneficial interest generally cannot be attached by the beneficiary's creditors unless they were fraudulently transferred. These trusts are often established by individuals in highly litigious professions, such as the medical and legal fields, but when used improperly, they can render the individual insolvent and shield the individual's assets from the claims of legitimate creditors.

Currently, 20 states offer some form of domestic asset protection trust (DAPT):

Alabama	Alaska	Arizona
Arkansas	Connecticut	Delaware
Hawaii	Indiana	Michigan
Mississippi	Missouri	Nevada
New Hampshire	Ohio	Oklahoma
Rhode Island	South Dakota	Tennessee
Utah	Virginia	

Alaska is widely regarded as a favorable jurisdiction for establishing asset protection trusts in the U.S., though transfers intended to hinder, delay, or defraud creditors may be subject to challenge. Under Alaska law, to breach an asset protection trust and gain access to assets fraudulently conveyed to the trust, a creditor must present evidence of actual fraud in court. Alaska's statutes provide that a "fraudulent conveyance can only be set aside if a creditor can prove actual fraud as to that creditor." A few other states' statutes, including Nevada, provide that a transfer can be set aside upon proof of constructive fraud to a creditor (for example, if the transfer was not made for reasonably equivalent value and rendered the debtor insolvent).

A review of Alaska Code sections 13 and 34 is beneficial if you are analyzing transfers made to Alaska trusts.

Protection for Creditors

The UFTA and UVTA provide relief for creditors and potential creditors. The purpose of the UFTA is to prevent defendants from divesting themselves of assets while claims are pending or in anticipation of future claims. A creditor is a person holding a claim, matured or unmatured, liquidated or unliquidated. The victim of a fraud scheme or embezzlement is a creditor within the meaning of the UFTA. A person who is obligated to return money or property to its rightful owner is considered a debtor. The UFTA was initially adopted by 26 states in 1918 as the Uniform Fraudulent Conveyance Act, which was replaced by the UFTA in 1984. The UFTA was revised in 2014 and renamed the UVTA. Currently, 43 states and the District of Columbia have adopted the UFTA or the UVTA. Jurisdictions that previously adopted the UFTA but have not yet adopted the UVTA continue to follow the UFTA.

The adoption of the UVTA resulted in four significant changes to the UFTA:

- A choice of law provision was included, requiring the voidable transaction law of the debtor's "location" to govern the voidable transaction claim.



- The UVTA clarifies that the creditor’s burden of proving intent to hinder, delay, or defraud is by a “preponderance of the evidence” as opposed to “clear and convincing evidence”—a standard used in some jurisdictions.
- The UVTA identifies “series” LLCs and clarifies that transactions between a series and another series can be viewed as voidable transactions.
- The term “fraudulent” is replaced with “voidable,” reflecting the fact that intent to defraud is not a requirement for setting aside a transfer.

debtor’s jurisdiction, a transfer to a self-settled asset protection trust is voidable per se.

The Badges of Fraud

If you encounter an engagement in which a potential fraudulent transfer has occurred:

- Carefully review choice of law provisions in contracts and other agreements.
- Engage an attorney experienced with the laws of any jurisdiction affecting the transaction or the parties.
- Be aware that states that have not adopted the UVTA present planners with a greater danger of being associated with a “fraud.”
- Review the badges of fraud for the transactions in question. The legal roots of the badges of fraud stretch back over 450 years to England. The foundational law was the Statute of 13 Elizabeth, enacted in 1571. This act was designed to prevent debtors from making “feigned, covinous and fraudulent feoffments, gifts, grants, or alienations ... which are devised and contrived of malice, fraud, covin, collusion or guile, to the end, purpose and intent, to delay, hinder or defraud creditors.” Badges of fraud have been identified and adopted in U.S. federal and state statutes.

States that have adopted the UVTA include:

California	Colorado	Florida
Georgia	Idaho	Indiana
Kentucky	Massachusetts	Michigan
Minnesota	Nevada	New Mexico
North Carolina	North Dakota	Wyoming

The UVTA is important because it added Section 10 to the UFTA, which is a jurisdictional statute. The Official Comments explain that if a debtor changes jurisdictions to take advantage of a benefit that is not available in the

The Badges of Fraud are:



Badge #1—Transfer was to an insider.

- Who is an insider?
 - An insider can be an individual, partnership, corporation, trust, estate, LLC, or other legal entity.
- If the debtor is an individual, an insider can be:
 - A relative
 - A general partner
 - A relative of a spouse
- If the debtor is a corporation, the insider can be:
 - An officer
 - A director
 - A person in control
 - A relative of an officer, director, or person in control



Badge #2—Debtor retains control over the transferred property.

- Debtor retains effective control over the property despite the transfer.
 - Example: Debtor transfers stock in company to a DAPT but remains the president of the company.
 - Example: Debtor transfers real property to DAPT and continues to live in the property rent-free.



Badge #3—Transfer was concealed.

- While there can be many reasons to protect one's financial privacy, when a debtor is threatened or under pressure from creditors, concealing of transactions appears more suspect.



Badge #4—Recent or threatened lawsuit.

- Transfers occurring after a creditor threat has arisen are inherently more subject to challenge.
- Debtors should be prepared to provide plausible explanations for transfers in such situations.



Badge #5—Transfer was of substantially all the debtor's assets.

- A transfer that leaves the debtor with little to no assets is wide open to challenge by a creditor.
- Establishing a business purpose other than protecting assets and avoiding creditors becomes difficult when the debtor has nominal value in the remaining assets.



Badge #6—The debtor absconded.

- Absconded means to go in a clandestine manner out of the jurisdiction of the courts or to lie concealed in order to avoid due process.
- This is an obvious badge of fraud—when a debtor skips town immediately after transferring assets.
- This badge of fraud involves a facts and circumstances determination.



Badge #7—The debtor removed or concealed assets.

- Like concealing the transfer, concealment of assets will draw similar scrutiny.
- Debtors facing lawsuits, default, or other liabilities make drastic removals of assets.



Badge #8—Lack of consideration.

- Debtor transfers property for an amount that bears no reasonable resemblance to the value of the property.
- This is strong evidence the debtor had an ulterior motive for the transfer.
- An example is gifts to one or more trusts.



Badge #9—Insolvency.

- In essence, liabilities are greater than the assets remaining after the transfer.
- Transfers are suspect when the debtor had serious financial problems leading up to the transfer.
- The transfer will draw scrutiny if not made in the ordinary course of business.
- The transfer will draw scrutiny when the debtor is struggling financially.
- Be suspicious of a transfer that creates insolvency.



Badge #10—Timing of the transfer.

- Occasionally, a debtor will make anticipatory fraudulent transfers.
- Determine whether substantial debt was taken on by debtor shortly before or shortly after transfer.
- Significant new debt that raises a solvency issue should be suspect.



Badge #11—Debtor transferred essential business assets.

- Can be a combination of other badges of fraud.
- Debtor transfers property to an insider or close associate.
- Example: transfer of property to a brother-in-law or other relative around the time a lawsuit is threatened or filed.



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Be aware that states adopting the UVTA have their own statutes, and the badges of fraud can vary. For example, North Carolina's statutes identify 13 badges of fraud. Always talk with retaining counsel to understand your particular state's statutes and relevant case law precedents.

Each badge is evidence of a possible fraudulent conveyance. Violating only one can be enough to "sink the ship." When a scheme is implemented, however, often several badges of fraud are evident. The key is to follow the money.

Fraud vs. Legitimate Estate Planning

So, how do you know if the transfers you are examining constitute badges of fraud or legitimate estate planning? There are a variety of legitimate estate planning tools, including revocable trusts. These trusts are used primarily as a probate avoidance tool to:

- Avoid court involvement/oversight,
- Avoid delays in the court system,
- Avoid probate fees,

- Protect and maintain privacy/confidentiality for the grantor and his or her family, and
- Ease the administrative burden following the death of the grantor.

The trust document can easily be amended during the grantor's lifetime. Assets can easily be transferred in or out of the trust during the grantor's lifetime. The trust becomes irrevocable upon the grantor's death. A revocable trust typically remains subject to claims by the grantor's creditors.

Irrevocable trusts can also be used as legitimate estate planning tools. With an irrevocable trust, the grantor relinquishes control over the trust assets to an independent trustee. Depending on the selection of the trustee, the grantor may retain indirect control over the assets. If the grantor is a beneficiary of the trust, the trust provisions cannot allow the grantor to compel distributions.

Additionally, irrevocable trusts typically provide for an ascertainable standard, limiting distributions to those that are necessary for the grantor's health, education,

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Determining whether the estate planning you are reviewing is legitimate or is merely a tool to disguise a fraudulent conveyance requires some digging into the facts and circumstances.

maintenance, and support. Irrevocable trusts are often used for federal estate tax planning but can also be used for asset protection purposes.

Examples of irrevocable trusts include:

- Grantor retained annuity trust (GRAT)
- Irrevocable life insurance trust (ILIT)
- Charitable remainder annuity trust (CRAT)
- Spousal lifetime access trust (SLAT)
- Qualified personal residence trust (QPRT)
- Special needs trust (SNT)
- Generation-skipping trust (GST)
- Beneficiary defective irrevocable trust (BDIT)

Limited liability companies (LLCs) can be used to transfer fractional shares of assets, such as investments, real property, or closely held business interests. These entities allow the bifurcation of ownership interests into voting and nonvoting interests. The use of LLCs allows the application of valuation discounts to better leverage estate and gift tax exemptions. Examples of discounts include:

- Lack of marketability
- Lack of control
- Minority share
- Future interest

Determining whether the estate planning you are reviewing is legitimate or is merely a tool to disguise a fraudulent conveyance requires some digging into the facts and circumstances. Things to consider include:

- Choice of jurisdiction
- Solvency (consider performing a solvency analysis)
- Timing of the estate planning
- Relationship of the parties involved

Example 1

Here is one example of illegitimate estate planning. In a civil litigation matter, Company received a cease and desist notice from a manufacturer alleging that Company violated the manufacturer's licensing requirements.

- Months passed with no reply to the manufacturer.
- The Company's owners initiated post-notification estate planning, in which the stockholders formed a second class of nonvoting stock—and obtained a valuation of voting and nonvoting stock for gift tax purposes, which contained deep valuation discounts.
- A few months later, the stockholders sold substantially all of Company's assets to a third party for substantially more than the valuation amount.
- The stockholders then transferred the nonvoting stock to newly formed asset protection trusts, transferred the sales proceeds to the trusts, and immediately began withdrawing funds from the trusts.

The badges of fraud seen in this example include:

- The transfer or obligation was to an insider.
- The debtor retained possession or control of the property after the transfer.
- The transfer or obligation was undisclosed or concealed.
- Before the transfer was made or the obligation was incurred, the debtor had been sued or threatened with suit.
- The transfer was of substantially all the debtor's assets.
- The debtor absconded.
- The debtor removed or concealed assets.
- The value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred.
- The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred.
- The transfer occurred shortly before or shortly after a substantial debt was incurred.

- The debtor transferred the essential assets of the business to a lienor that transferred the assets to an insider of the debtor.

Example 2

Another example of illegitimate estate planning involved a divorce litigation matter in which the following facts existed:

- One party in the divorce was a general partner in a private equity firm using a typical limited partnership (LP) structure, under which the LP invested in a fund or funds that held portfolio company investments.
- The business owner party held a greater than 50 percent ownership interest in the general partnership (GP).
- The business owner party held individual ownership interests as a limited partner.
- The same party controlled the LP pursuant to the terms of the limited partnership agreement.
- The same party owned a 100 percent ownership interest in the funds’ management company.

Figure 1 illustrates the private equity firm structure and the flow of money during the life of the fund. The bags of money on the left represent the portfolio investments made by the limited and general partners. The bags of money on the right represent the return on investment received by the investors.

Three business entities existed:

- A limited partnership,
- A general partnership, and
- A management company.

Just after divorce became apparent, a “shell game” ensued:


- A new management company was formed, which mirrored the former management company. The new management company essentially “stepped into the shoes” of the former management company with a new name.
- A DAPT was also formed.
- The new management company’s ownership interest was transferred to the trust.
- Several new Delaware LLCs were formed.
- The GP’s ownership interests in the GP and LP were transferred to the new LLCs; ownership in the new LLCs was bifurcated, so that the equity ownership interests were all transferred to the new LLCs, but the terms of those LLCs’ operating agreements permitted the GP to maintain control over the transferred interests.
- The newly formed trust was managed by a family member (an insider), enabling the divorcing GP to retain an indirect interest in the trust through the family member.

The badges of fraud seen in this example include:

- The transfer or obligation was to an insider.

Figure 1: Limited Partnership Private Equity Capital Model



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Possible fraudulent conveyances can occur in nonbankruptcy situations.

- The debtor retained possession or control of the property after the transfer.
- The transfer or obligation was undisclosed or concealed.
- Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit.
- The transfer was of substantially all the debtor's assets.
- The debtor absconded.
- The debtor removed or concealed assets.
- The value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred.
- The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred.
- The transfer occurred shortly before or shortly after a substantial debt was incurred.
- The debtor transferred the essential assets of the business to a lienor that transferred the assets to an insider of the debtor.

Be aware: Possible fraudulent conveyances can occur in nonbankruptcy situations. If you encounter circumstances where you are concerned that a fraudulent conveyance may have occurred, we offer the following observations:

- The threat of litigation or just incurring a new debt obligation is enough to trigger a fraudulent conveyance scheme.
- Follow the money.
- Follow control of the money after the transfer.
- The truth is always in the numbers ... you may just have to dig for it.
- Recognize the badges of fraud that indicate purported estate planning may not be legitimate.

Finally, as noted above, always consult an experienced attorney to understand the laws of any jurisdictions that apply to the transaction or the parties. **VE**



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