The Florida Senate

BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Committee on Commerce and Tourism

BILL: CS/SB 102

INTRODUCER: Banking and Insurance Committee and Senator Detert

SUBJECT: Charitable Contributions

DATE: March 29, 2013 REVISED:

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Oh	Burgess	BI	**Fav/CS**
2.	Siples	Hrdlicka	CM	**Pre-meeting**
3.			RC	
4.				
5.				
6.				

Please see Section VIII. for Additional Information:

A. COMMITTEE SUBSTITUTE.....	X	Statement of Substantial Changes
B. AMENDMENTS........................		Technical amendments were recommended
		Amendments were recommended
		Significant amendments were recommended

I. Summary:

CS/SB 102 amends the Florida Uniform Fraudulent Transfer Act (FUFTA) to provide protection against creditors' clawback actions for charitable contributions received in good faith by qualified religious or charitable organizations. A charitable contribution made by a natural person, however, is subject to clawback actions if received within 2 years of the commencement of an action under FUFTA, a bankruptcy petition, or an insolvency proceeding, unless the transfer was consistent with the debtor's practices in making charitable contributions or the transfer did not exceed 15 percent of the debtor's gross annual income. The bill defines "charitable contribution" and "qualified religious or charitable entity" consistent with how those terms are defined in the Internal Revenue Code.

This bill substantially amends ss. 213.758, 718.704, 721.05, 726.102, and 726.109, F.S.

II. Present Situation:

Florida Uniform Fraudulent Transfer Act

According to the National Conference of Commissioners on Uniform State Laws, the Uniform Fraudulent Transfer Act (UFTA) has been enacted by 43 states, as well as the District of Columbia and the U.S. Virgin Island.[1] Florida adopted UFTA in 1987.[2] The Florida Uniform Fraudulent Transfer Act (FUFTA) provides a creditor with a means to reach assets that a debtor has transferred to another person to keep the assets from being used to satisfy a debt to the creditor, and defines the circumstances for application of the law. Under FUFTA, a transfer made or an obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

- With actual intent to hinder, delay, or defraud any creditor of the debtor; or
- Without receiving a reasonably equivalent value in exchange of the transfer or obligation, and the debtor:
    - was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
    - intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.[3]

In the situations described above, FUFTA provides a statutory remedy for creditors, primarily through a "clawback" action, whereby a prevailing creditor may have a debtor's fraudulent transfer or obligation made to a third party voided and surrendered back to the creditor. This remedy is subject to a 4 year statute of limitations, unless otherwise specified in s. 726.110, F.S.

FUFTA also provides protection for an innocent third party transferee, by specifying that a transfer is not voidable when the transferee is "a person who took in good faith and for a reasonably equivalent value or against any subsequent transferee or obligee."[4] However, FUFTA does not provide a specific exception for transfers received by charitable organizations, which generally do not give value in exchange for contributions. As a result, a charitable organization can be subject to a clawback action under FUFTA, even when it has already spent the contribution to provide its charitable service. Under an Illinois law that is similar to Florida's, the U.S. Court of Appeals for the Seventh Circuit ruled in favor of a creditor in a clawback action, even though the charitable organization received the contribution in good faith.[5]

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[1] Uniform Law Commission, Legislative Fact Sheet – Fraudulent Transfer Act, *available at* http://uniformlaws.org/LegislativeFactSheet.aspx?title=Fraudulent%20Transfer%20Act (last visited Mar. 28, 2013).
[2] Chapter 87-79, L.O.F. The short title for ch. 726, F.S., is the "Uniform Fraudulent Transfer Act."
[3] Section 726.105, F.S.
[4] Section 726.109, F.S.
[5] *Scholes v. Lehmann,* 56 F.3d 750, 761 (7th Cir. 1995).

Federal Bankruptcy Code

Like the UFTA, the Federal Bankruptcy Code[6] (code) allows certain fraudulent transfers made by a debtor to be voided. However, unlike the FUFTA, which relies on individual creditors to bring actions to void the transfer, the code empowers the bankruptcy trustee to bring the action to void the transfers for the benefit of all the debtor's creditors. The three most important sections of the Bankruptcy Code dealing with fraudulent transactions are ss. 548, 544, and 727.

Section 548

Section 548 of the code deals exclusively with fraudulent transfers and allows a bankruptcy trustee to void transactions involving actual or constructive fraud.[7] The elements that must be proved to void a fraudulent transfer under this provision are substantially similar to those that are required under the FUFTA. Section 548 also parallels the FUFTA by providing a "value" defense which is virtually identical to the defense provided by FUFTA, and is available to a transferee that takes in good faith for a reasonably equivalent value.[8] A transfer or contribution to a charitable or religious organization is not voidable if it does not met the "value" defense when:

- The transfer was consistent with the practices of the debtor; or
- The transfer did not exceed 15 percent of the debtor's gross annual income.[9]

Unlike the FUFTA, however, a bankruptcy trustee may void only fraudulent transfers that occur within 2 years (1 year for cases commenced before April 20, 2005) from the date of the filing of the bankruptcy petition. A bankruptcy trustee seeking to void a transfer that occurred more than 1 year before a debtor's petition must rely on Section 544 of the code.

Section 544

Section 544 of the code is commonly referred to as the "strong-arm clause" and generally allows a bankruptcy trustee to set aside pre-bankruptcy transfers that are voidable under applicable state law.[10] The strong-arm clause is primarily designed to protect unsecured creditors against unrecorded or unperfected interests and secret liens or any other prepetition claims against the debtor's assets at the time the case is commenced. The trustee has the rights and powers of a hypothetical creditor or purchaser, whether or not such a creditor or purchaser exists, to avoid certain transfers or obligations of the debtor.[11]

The statute of limitations that applies to actions under Section 544, which also applies in Florida, would allow a transfer to be voided up to 4 years after it was made. Moreover, for actions based on actual fraud, the limitation period is the longer of 4 years or 1 year after the transfer reasonably could have been discovered.[12]

Section 727

[6] 11 U.S.C. s. 101 et. seq.
[7] 11 U.S.C. s. 548.
[8] 11 U.S.C. s. 548(c).
[9] 11 U.S.C. s. 548(a)(2)
[10] 11 U.S.C. s. 544
[11] 8A C.J.S. *Bankruptcy* s. 705
[12] See s. 726.110(1), F.S.

Under Section 727, a bankruptcy debtor may be denied a discharge from debts if the debtor transferred property either within 1 year before the bankruptcy petition or during the bankruptcy case with actual intent to hinder, delay, or defraud a creditor. The effect of this penalty is to deny the debtor the benefits of bankruptcy and to allow creditors to continue to pursue the debtor even after bankruptcy. Some courts have interpreted this 1-year period broadly and denied a discharge based on transfers before the 1-year period if there is proof of "continuing concealment" by the debtor.[13]

III. Effect of Proposed Changes:

Section 1 amends s. 726.102, F.S., to create definitions for the terms "charitable contribution" and "qualified religious or charitable entity or organization consistent" with the definitions in the IRC. Charitable contributions are limited to cash or financial instruments.

Section 2 amends s. 726.109, F.S., to provide that the transfer of a charitable contribution received by a qualified religious or charitable entity or organization in good faith is not a fraudulent transfer.

The bill, however, provides that a charitable contribution from a natural person is a fraudulent transfer if it was received within 2 years of the earlier of the commencement of an action under FUFTA, the filing of a bankruptcy petition, or the commencement of an insolvency action. The bill then provides an exception for a transfer from a natural person if:

- The transfer was consistent with the practices of the debtor; or
- The transfer was received in good faith and the contribution did not exceed 15 percent of the gross annual income of the debtor.

Sections 3, 4, and 5 amend ss. 213.758, 718.704, and 721.05, F.S., respectively, to correct cross-references.

Section 6 provides an effective date of July 1, 2013, and specifies that it will apply to all charitable contributions made on or after that date.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

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[13] An example of "continuing concealment" is when a debtor nominally transfers an asset before the 1-year period prior to bankruptcy, but retains an interest in it even after the bankruptcy filing (8B C.J.S. *Bankruptcy* s. 1035). See, *e.g.*, *In the Matter of Hazen*, 37 B.R. 329 (M.D. Fla. 1983), denying debtor discharge because it failed to list in its bankruptcy schedules its remaining interest in assets fraudulently transferred to trust, even though fraudulent transfer occurred more than one year before bankruptcy.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

Under the bill, creditors would not be able to void certain transfers that they currently are able to void. Thus, fewer assets may be available to make creditors whole. However, charities may feel more secure about transfers they receive.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes:
(Summarizing differences between the Committee Substitute and the prior version of the bill.)

CS by Banking and Insurance on March 14, 2013:
The CS makes the following changes:

- The original bill provided that a transfer of a charitable contribution received in good faith by a qualified religious or charitable entity is not a fraudulent transfer under ch. 726, F.S.; the CS specifically identifies s. 726.105(1)(b), F.S., rather than the entire chapter generally.
- The CS provides technical conforming changes, replacing the original bill's use of the term "transferor" with the term "debtor."
- The CS amends the effective date to July 1, 2013, and provides that bill applies prospectively to all charitable contributions made on or after that date.

B. Amendments:

None.