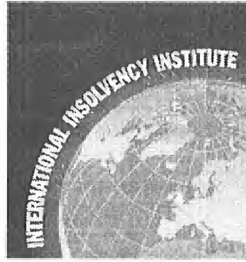


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## *Tithing and Bankruptcy*

**Kenneth N. Klee**

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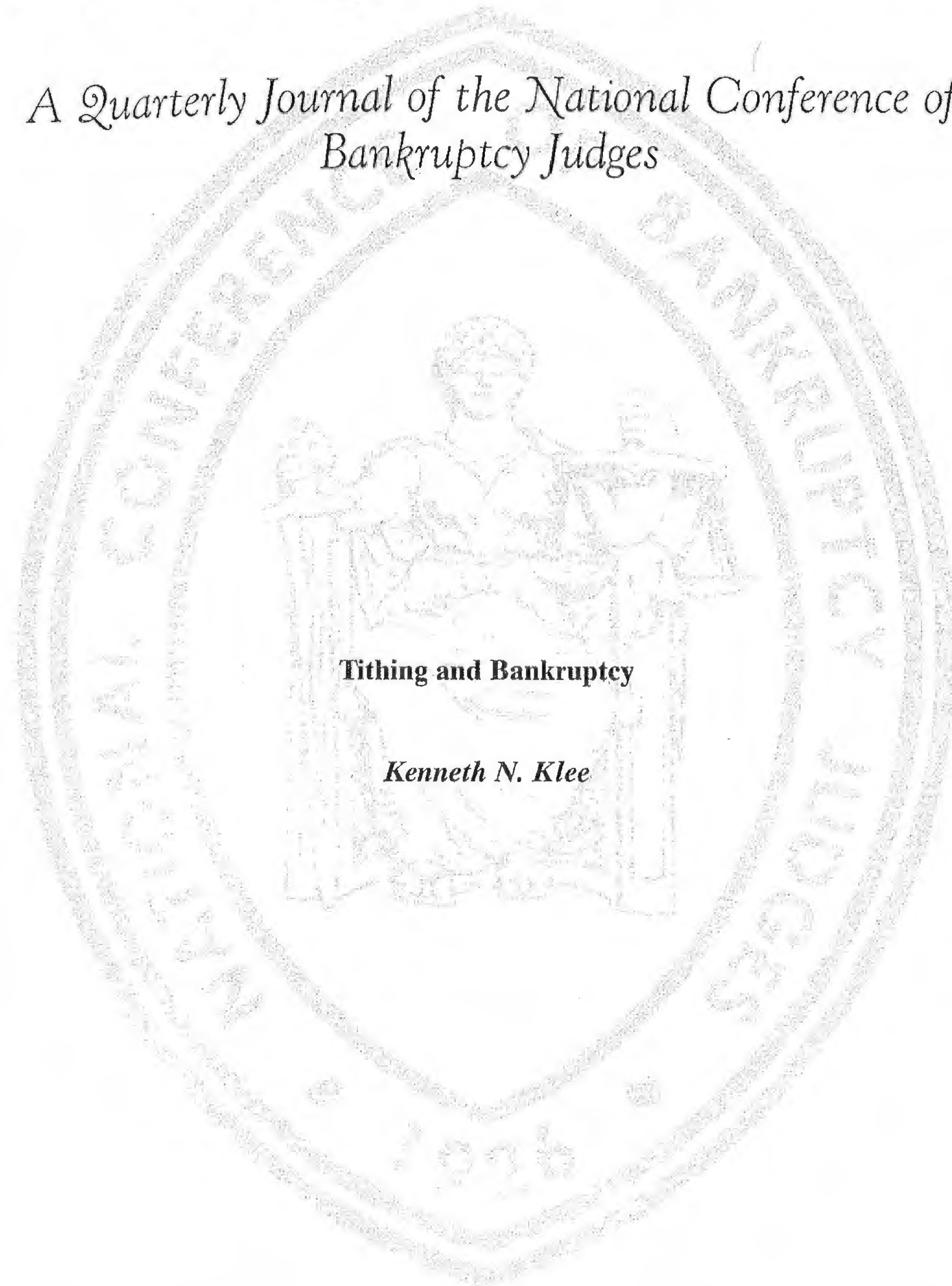

# Tithing and Bankruptcy

*Kenneth N. Klee*

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# Tithing and Bankruptcy

*by*

*Kenneth N. Klee**

If the Bankruptcy Code were a Country and Western song, its refrain would be "Equity is Equality." At its core, the bankruptcy system embodies the principle that creditors with similar rights are treated equally. Debtors are not permitted to prefer their friends at the expense of other creditors. Nor may insolvent debtors tithe[1] or make gifts of their property, giving something away that could have been used to pay their creditors. The principle ranking creditors ahead of gift recipients is so deeply engrained that it dates back to English Law in 1570.[2] A debtor must be just before she is generous.[3]

To implement this policy, for 427 years the law required recipients of an insolvent debtor's donations to return the donated money or property so that it could be distributed to creditors. In 1998, however, with little fanfare and surprising speed, Congress responded to pressure from religious groups to insulate churches from disgorging donations.[4] By inserting fewer than 200 words into the Bankruptcy Code, Congress let churches and charities[5] keep gifts that otherwise could be reclaimed for distribution to creditors. In mak-

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*Acting Professor, UCLA School of Law. © 2001 Kenneth N. Klee, all rights reserved. The author gratefully appreciates and acknowledges comments of Professors Daniel Bussel, Ann Carlson, Caroline Gentile, Robert Goldstein, Lynn LoPucki, Eugene Volokh, Elizabeth Warren, Jay Westbrook, and the UCLA School of Law Junior Faculty on previous drafts of this Article. The author gratefully appreciates and acknowledges valuable technical assistance by Joseph Doherty, Associate Director for Research, Empirical Research Group, UCLA School of Law, and research assistance by Harden Fisch and David Lassen of the UCLA School of Law Class of 2002 and Christopher Casamassima of the UCLA School of Law Class of 2000. The author appreciates and acknowledges valuable funding from the American Bankruptcy Institute Endowment Fund and the UCLA Academic Senate.

[1]"Tithing is the ancient practice of giving one-tenth of one's annual income to a church." *See* Steven Hopkins, *Is God a Preferred Creditor? Tithing as an Avoidable Transfer in Chapter 7 Bankruptcies*, 62 U. CHI. L. REV. 1139, 1139 & n.1 (1995). *See also* Mary Jo Newborn Wiggins, *A Statute of Disbelief?: Clashing Ethical Imperatives in Fraudulent Transfer Law*, 48 S.C. L. REV. 771, 772 n.6 (1997). Tithing has its origins in the Old Testament of the Bible where it has different applications that are "confused, inconsistent, and complex." *See* Oliver B. Pollack, *"Be Just Before You're Generous": Tithing and Charitable Contributions in Bankruptcy*, 29 CREIGHTON L. REV. 527, 531 (1996). In Pollack's article, a "tithe" is defined as a debtor's donation of one-tenth of her gross income to a religious organization. *See id.*

[2]*See* Statute of 13 Elizabeth, 13 Eliz., ch. 5 (1570).

[3]*See* Boston Trading Group, Inc. v. Burnazos, 835 F.2d 1504, 1508 (1st Cir. 1987) ("'be just before you are generous'") (quotation omitted).

[4]This pressure should persist in other areas since the President of the United States continues to urge a more intertwined relationship between government and faith-based organizations. *See, e.g.*, *Bush's Call to Church Groups To Get Untraditional Replies*, N.Y. TIMES, Feb. 20, 2001, at A1.

[5]Congress added charities to the protected class to make it "religion neutral" and therefore constitu-

ing that change, Congress unwittingly disturbed multiple other sections of the Bankruptcy Code, changing the law in odd and peculiar ways. For example, surprisingly, instead of reducing returns to creditors, the data show that the congressional enactment might increase returns by providing more flexibility in the budgets of Chapter 13 debtors who tithe. Also, somewhat unexpectedly, Congress failed to insulate from attack religious or charitable pledges or the payment of pledges.

The Religious Liberty and Charitable Donation Protection Act of 1998[6] offers an early warning of the tangle that can be created when faith-based groups lobby for economically helpful legislation that must, of constitutional necessity, be neutral on its face and therefore affect many other institutions and transactions. The Act also raises the question whether Congress collectively has the will to scrutinize such legislation lest any member be accused of being unsympathetic to religious interests, raising the specter that such legislation poses far more serious problems than have been identified in the usual discussions of separation of church and state. It is too soon to tell whether congressional behavior capitulating to religious interests in passing the Act is limited to bankruptcy legislation, where no meaningful lobby opposed the process, or will be applied in broader contexts when powerful lobbyists weigh in on the other side.

The formal legislative history of the Act is unremarkable. On June 19, 1998, President Clinton signed the Act into law. It had passed the House and Senate unanimously,[7] taking only 262 days from introduction to enactment.[8]

But Congress passed the Act without testing competing empirical assertions underlying these policy issues. As a result, creditors may contend that the Donation Protection Act is little more than unjustified congressional over-reaction to a handful of lawsuits under the Bankruptcy Code. Most debtors have neither the desire nor the income or resources shortly before they tumble into bankruptcy to tithe major sums to churches. And without threatening their religious mission, most churches could disgorge small tithes or contributions in the rare instances when a trustee sued to avoid them as

tional, but charities were not the ones who lobbied for the bill or who were the obviously intended beneficiaries. *See infra* note 19.

[6]Pub. L. No. 105-183, § 1, 112 Stat. 517 (1998) (hereinafter the "Donation Protection Act" or "Act").

[7]On May 13, 1998, S. 1244 originally passed the Senate 99-1, 144 Cong. Rec. S 4772 (daily ed. May 13, 1998), but the dissenting Senator received unanimous consent to change his vote later that day. 144 Cong. Rec. S 4814 (daily ed. May 13, 1998). S. 1244 passed the House by voice vote on June 3, 1998, after consideration of H.R. 2604, a companion bill. 144 Cong. Rec. H 4005 (daily ed. June 3, 1998).

[8]Senator Grassley introduced S. 1244 on October 1, 1997 and Representative Packard introduced H.R. 2604 on October 2, 1997. *See* 143 Cong. Rec. S 10294-95 (remarks of Sen. Grassley Oct. 1, 1997); H 8320 (Oct. 2, 1997); E 2037 (remarks of Rep. Packard Oct. 21, 1997).

fraudulent transfers.[9]

On the other hand, churches and charities might contend that the Act justifiably protects both a debtor's right to tithe (or donate) and churches and charities from undergoing the serious financial hardship of disgorging money already spent. Just as Congress designed the Internal Revenue Code in part to protect charities and churches from losing donations and tithes through income taxation,[10] so did Congress design the Donation Protection Act in part to prevent bankruptcy trustees from recovering charitable donations and tithes. At first blush it might appear that the Act overturned 427 years of fraudulent conveyance doctrine[11] by insulating recipients of insolvent debtors' gifts from disgorging those gifts to the donor's creditors. In fact, the Donation Protection Act did little to change bankruptcy practice; actual practice for most of those 427 years had not involved attacks on churches and charities.[12]

To appreciate these competing views of the issues, a brief review of bankruptcy practice and lore is useful. Under the predecessor to the 1978 Bankruptcy Code, trustees and debtors in possession employed attorneys who specialized in bankruptcy law.[13] Based on their own consciences and their perceptions of judicial preferences, these attorneys and the trustees they represented were reluctant to sue charities and churches.[14]

The 1978 Bankruptcy Code changed this custom by enticing large, mainstream firms to enter bankruptcy practice. Not all of these newcomer firms had the same inhibitions that their predecessor small firms and specialists had about suing charities or churches. During the 1980s some of these large firms represented debtors in possession or trustees in cases where debtors had fraudulently transferred millions of dollars to charities.[15] The attorneys analyzed the amounts at stake and raised fraudulent transfer statutes from their

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[9]*See* Pollack, *supra* note 1, at 560 ("These parties can bear the expenses of litigation and appeal in pursuit of money and principle.").

[10]*See* I.R.C. § 501(c)(3) (1994) (exempting religious and charitable corporations from income taxation).

[11]Modern fraudulent conveyance law traces its roots back 427 years to the English Statute of 13 Elizabeth, 13 Eliz., ch. 5 (1570). *See* Hyman L. Asamow, Note, *Fraudulent Conveyances—Steps Necessary Before Creditor Can Set Aside*, 6 N.Y.U. L. REV. 469 (1929). Fraudulent conveyance law had its origins in Roman bankruptcy law. *See* Robert J. Bein, *Robbing Peter to Pay Paul: Charitable Donations as Fraudulent Transfers*, 100 DICK. L. REV. 103, 107-08 (1995).

[12]*See infra* notes 13-16, 97-100 and accompanying text.

[13]*See* REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137 pt. I, 93d Cong., 1st Sess. 4 (1973) ("law firms which do receive business tend to monopolize the proceedings in a particular area").

[14]Telephone interview with Leon Forman (Aug. 10, 2000); telephone interview with Lawrence P. King (Sept. 13, 2000); telephone interview with Harvey R. Miller (Aug. 13, 2000); telephone interview with Leonard M. Rosen (Sept. 13, 2000); telephone interview with Bernard Shapiro (Aug. 6, 2000); and telephone interview with George M. Treister (Aug. 5, 2000).

[15]Some noteworthy recoveries occurred in unreported opinions. *See infra* note 16 and accompanying text.

dormancy to recover substantial dollar amounts of charitable donations and tithes. For example, in bankruptcy proceedings involving scam artist J. David Dominelli, the law firm Gibson, Dunn & Crutcher represented the estate and recovered thousands of dollars from charities and churches that were the recipients of Dominelli's donations.[16] Smaller firms and bankruptcy specialists soon followed suit. Churches began to pressure Congress to reform the law, but their efforts achieved little success until the 1990s.

During the 1990s, the religious right gained new clout with the 1994 election of a Republican majority in the House of Representatives. Even before 1994, churches started a campaign to enact or amend various laws to protect their interests. Early on, Congress passed a broadly drafted Religious Freedom Restoration Act; but in 1997, the Supreme Court declared it unconstitutional, at least as applied to the states, but not with respect to federal bankruptcy law.[17] Churches increased lobbying pressure on Congress to enact more narrowly focused legislation that would pass constitutional muster across the board. In addition, numerous churches demanded an amendment to the Bankruptcy Code to return to practice before the 1980s when trustees did not attack religious donations or tithes.[18] In response, the Republican leadership in Congress joined in introducing, and Congress considered, legislation to insulate churches from returning charitable donations and tithes.[19] During congressional hearings only one organization, the National Bankruptcy Conference, opposed it.[20] The opposition was based on the bank-

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[16]Telephone interview with Bennett Silverman (Dec. 11, 2000).

[17]*See infra* note 25.

[18]*See generally The Religious Liberty and Charitable Donation Protection Act of 1997: Hearing on S. 1244 Before the Subcomm. on Administrative Oversight and the Courts of the Senate Comm. on the Judiciary*, 105th Cong. (1997) (on file with author); *The Religious Liberty and Charitable Donation Protection Act of 1997: Hearing on H.R. 2604 Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary*, 105th Cong. 1-139 (Feb. 12, 1998) (on file with author and *available at* <http://commdocs.house.gov/committees/judiciary/hju51375.000/hju51375_of.htm>); *Religious Fairness in Bankruptcy Act of 1997: Hearings on H.R. 2611 Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary*, 105th Cong. 1-139 (1997) (on file with author and *available at* <http://commdocs.house.gov/committees/judiciary/hju51375.000/hju51375_of.htm>).

[19]Although many Members of Congress introduced bills to remedy this problem, Senators Grassley, Sessions, and Gramm and Representatives Packard, Chenoweth, and Traficant took the lead. One of the bills introduced in the House of Representatives had sixty-seven co-sponsors, including members of the Republican leadership such as Newt Gingrich and Dick Armey. *See* H.R. 2604, 105th Cong. (1997). Although H.R. 2611 only protected religious donees, in order to avoid a possible problem under the Establishment Clause, Congress adopted legislation protecting both secular and religious charities.

[20]*See generally The Religious Liberty and Charitable Donation Protection Act of 1997: Hearing on S. 1244 Before the Subcomm. on Administrative Oversight and the Courts of the Senate Comm. on the Judiciary*, 105th Cong. (1997) (statement of Donald S. Bernstein, National Bankruptcy Conference) (on file with author); *The Religious Liberty and Charitable Donation Protection Act of 1997: Hearing on H.R. 2604 Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary*, 105th Cong. 1-139 (Feb. 12, 1998) (statement of Stephen Case, National Bankruptcy Conference) (on file with author and *available at* <http://commdocs.house.gov/committees/judiciary/hju51375.000/hju51375_

ruptcy principle of maximizing distributions to creditors: A trustee may recover money that an insolvent debtor donates, even if the donation is charitable or religious in nature. The Conference pointed out that the issue appeared only rarely, and that most churches could disgorge small tithes or contributions in the rare instances when a trustee sues to avoid them as fraudulent transfers without threatening their religious mission or financial security.[21] Congress, however, thought otherwise and quickly passed the Act.

The Donation Protection Act was hastily written and enacted to respond to claims of serious and widespread problems: Bankruptcy judges were granting the requests of bankruptcy trustees to prevent debtors from tithing postpetition and recover from churches the debtor's prepetition tithes. But Congress never conducted systematic research or took evidence on the magnitude of the problems. The legislative record is devoid of systematic data about the scope of the problem. It is not surprising that certain problems anticipated by Congress would fail to materialize and that unanticipated problems would arise following such hasty enactment.

The Donation Protection Act was thinly justified, and although specialists in the field were reluctant to antagonize churches and their political supporters by deriding the Act publicly, many quietly expressed their concerns. While some shared the view of the National Bankruptcy Conference that the Act was a bad idea in principle because it sharply deviated from the fundamental notion that insolvent debtors should not give away their property before satisfying their creditors, many others objected on far more practical grounds: The Act opened up a loophole that would permit debtors to divert substantial assets away from their creditors. Even the Act's most vigorous supporters could say little more than that they doubted that most people would make such gifts.

Both those who supported the Act and those who worried about its effects made essentially empirical assertions, each predicting how debtors would or would not respond to the change in law. This Article presents the results of a survey of bankruptcy trustees that measures the incidence of debtors' use of the new provisions.[22] The data show that two years into the

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of.htm>); *Religious Fairness in Bankruptcy Act of 1997: Hearings on H.R. 2611 Before the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary*, (1998) (on file with author and *available at* <http://www.house.gov/judiciary/5232.htm)>. At the time of this testimony, the author was Chair of the National Bankruptcy Conference's Committee on Legislation.

[21]*See* Pollack, *supra* note 1, at 560 ("These parties can bear the expenses of litigation and appeal in pursuit of money and principle.").

[22]A consumer bankruptcy case generally is one of two types. First, a consumer debtor may file for relief under Chapter 7. *See* 11 U.S.C. §§ 109(b), 701-766 (1994). In a Chapter 7 case, the debtor surrenders all property into a bankruptcy estate that is administered by a trustee. *See* 11 U.S.C. §§ 541, 701 (1994). The debtor exempts certain property out of the estate, but the rest is sold and distributed to

Act's life, a substantial number of debtors are making donations protected by the Act but few debtors are "abusing" it in the sense of making last-minute donations that reduce their estates substantially. A few debtors, however, have diverted meaningful dollars to charities and churches instead of leaving them in their bankruptcy estates for distribution to creditors. In addition, the data contain important lessons about regional variations in application of theoretically uniform federal law, using the treatment of tithing in bankruptcy cases as an example. Finally, the data suggest that the Act might have unintended consequences that demonstrate the complex and interdependent nature of the consumer bankruptcy system. Although these findings do not resolve the question of principle at issue, they do help frame it and provide the context essential for further discussion.

Part I of this Article describes the substance of the Donation Protection Act and explores doctrinal issues that can be expected to arise. Part II examines recently collected data, assessing two years of experience since enactment of the Donation Protection Act. In particular, it analyzes the results of questionnaires, circulated to every Chapter 7 and Chapter 13 trustee, that sought to elicit the trustees' experiences with charitable and religious contributions in bankruptcy cases during the Act's first two years. After recapitulating the trustees' answers to the questionnaires, Part II explores the data for further lessons and consequences of the Act. Part III examines additional effects of the Donation Protection Act, some of which Congress did not anticipate. Consequences include abuse of the bankruptcy system, more prepetition contributions, postpetition tithing, objections to discharge, denials of discharge, suits for malpractice, lawyer disciplinary actions, and refusal by courts and trustees to enforce the law as enacted. Following the conclusion, an Appendix contains the form of questionnaires sent by the author to Chapter 7 and 13 trustees.

## I. DESCRIPTION OF THE DONATION PROTECTION ACT

The Donation Protection Act contains five essential parts. First, it limits §§ 548 and 544(b) of the Bankruptcy Code to preclude the trustee's ability to make a constructive fraudulent transfer attack on most charitable and re-

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creditors. *See* 11 U.S.C. §§ 522 (1994 & Supp. IV 1998), 726 (1994). The honest debtor gets a fresh start through the discharge of prebankruptcy debts. *See* 11 U.S.C. §§ 524(a) (1994), 523(a) (1994 & Supp. IV 1998), 727 (1994). Second, a consumer with regular income and limited debts can file for relief under Chapter 13. *See* 11 U.S.C. §§ 109(e), 1301 *et seq.* (1994). In a Chapter 13 case, a debtor retains physical possession of all property but surrenders disposable income to a Chapter 13 trustee for distribution over a three- to five-year period under a repayment plan. *See* 11 U.S.C. §§ 1306(b), 1322(d), 1325 (1994 & Supp. IV 1998), 1326 (1994). The debtor is discharged from most kinds of debts if all payments are completed under the plan. *See* 11 U.S.C. § 1328(a) (1994).

ligious contributions made by individuals or natural persons.[23] Second, it preempts creditors' abilities to use state law to attack these contributions. Third, it limits the relevance of most contributions to the court's determination whether it should dismiss the bankruptcy case as an abuse of Chapter 7 or deny confirmation of a Chapter 13 plan based on insufficient distribution of the debtor's disposable income.[24] Fourth, it applies retroactively. Fifth, it provides that the Donation Protection Act is not a limitation on the Religious Freedom Restoration Act,[25] so churches may assert RFRA to attempt to insulate transfers that are not protected by the Donation Protection Act.

As a general proposition, the Donation Protection Act purports to preclude the trustee from avoiding a natural person's charitable contributions or religious donations as constructive fraudulent transfers. The preclusion also covers attacks by a debtor in possession or other estate representative.[26] Furthermore, the preclusion applies whether the attack is made as a matter of federal law under § 548 of the Bankruptcy Code[27] or state law, as incorpo-

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[23]The Donation Protection Act defines "charitable contribution" to limit its scope to contributions made by debtors who are natural persons. *See* 11 U.S.C. § 548(b)(3)(A) (Supp. IV 1998), *amended by* Donation Protection Act, § 2, 112 Stat. 517 (1998).

[24]Section 1325(b)(2) of the Bankruptcy Code defines "disposable income" as follows:

> (2) For purposes of this subsection, "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended—
>
> (A) for the maintenance or support of the debtor or a dependent of the debtor, including charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to a qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)) in an amount not to exceed 15 percent of the gross income of the debtor for the year in which the contributions are made; and
>
> (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

*See* 11 U.S.C. § 1325(b)(2) (1994 & Supp. IV 1998).

[25]Religious Freedom Restoration Act ("RFRA"), 42 U.S.C. §§ 2000bb to 2000bb-4 (1994). The Supreme Court declared that RFRA is unconstitutional, at least as applied to state laws. *See* City of Boerne v. Flores, 521 U.S. 507 (1997) (holding that RFRA exceeds the scope of Congress' enforcement power under section 5 of the Fourteenth Amendment as applied to a state zoning law).

[26]In a Chapter 11 case, when a trustee is not serving, the debtor represents the estate as a debtor in possession with the same power to avoid fraudulent transfers that a trustee would have. *See* 11 U.S.C. §§ 1101(1), 1107(a) (1994). Under a confirmed Chapter 11 plan, a representative of the estate may be appointed to retain or enforce claims. *See id.* § 1123(b)(3)(B) (1994). Most courts hold the avoiding power causes of action, including actions to avoid fraudulent transfers, to be claims that may be pursued postconfirmation by a creditors' committee or other duly appointed representative of the estate. *See, e.g.*, Nordberg v. Sanchez (*In re* Chase & Sanborn Corp.), 813 F.2d 1177, 1180 n.1 (11th Cir. 1987); Creditor's Comm. v. Parks Jaggers Aerospace Co. (*In re* Parks Jaggers Aerospace Co.), 129 B.R. 265 (M.D. Fla. 1991). *But see* Foster Dev. Corp. v. Morning Treat Coffee Co. (*In re* Morning Treat Coffee Co.), 77 B.R. 62, 66-68 (Bankr. M.D. La. 1987) (holding trustee's avoidance rights are not property of the estate, and, therefore, cannot be transferred under a plan of reorganization).

[27]Section 3(a) of the Donation Protection Act amends § 548 of the Bankruptcy Code to move constructive fraudulent transfer provisions in former § 548(a)(2) to renumbered § 548(a)(1)(B). *See* Donation

rated by reference under § 544(b)[28] of the Bankruptcy Code.

To fully appreciate the scope of the Act's preemptive effect, a brief review of state fraudulent transfer law is in order. As a matter of general fraudulent transfer law,[29] a creditor may avoid a constructive fraudulent transfer without proving the debtor's state of mind[30] or the state of mind of

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Protection Act, § 3(a)(3)-(6). Section 3(a)(7) of the Donation Protection Act adds new § 548(a)(2) of the Bankruptcy Code as follows:

> A transfer of a charitable contribution to a qualified religious or charitable entity or organization shall not be considered to be a transfer covered under paragraph (1)(B) in any case in which—
>
> the amount of that contribution does not exceed 15 percent of the gross annual income of the debtor for the year in which the transfer of the contribution is made; or
>
> the contribution made by the debtor exceeded the percentage amount of gross annual income specified in subparagraph (A), if the transfer was consistent with the practices of the debtor in making charitable contributions.

[28]Section 3(b) of the Donation Protection Act amends § 544(b) of the Bankruptcy Code to incorporate the same limitations on the trustee's avoiding powers in asserting the rights of actual unsecured creditors that the Donation Protection Act imposes on the trustee's federal avoiding powers under § 548 of the Bankruptcy Code. Section 3(b) of the Donation Protection Act provides as follows:

> TRUSTEE AS LIEN CREDITOR AND AS SUCCESSOR TO CERTAIN CREDITORS AND PURCHASERS.—Section 544(b) of title 11, United States Code, is amended—
>
> by striking "(b) The trustee" and inserting "(b)(1) Except as provided in paragraph (2), the trustee"; and by adding at the end the following:
>
> (2) Paragraph (1) shall not apply to a transfer of a charitable contribution (as that term is defined in section 548(d)(3)) that is not covered under section 548(a)(1)(B), by reason of section 548(a)(2). Any claim recovered by any person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case.

[29]Today, states have three basic kinds of fraudulent transfer laws. Some states rely on common law. "The English statute was enacted in some form in many states, but whether or not so enacted, the voidability of fraudulent transfer was part of the law of every American jurisdiction." Uniform Fraudulent Transfer Act Prefatory Note (1993) (copy on file with author). Other states have adopted the Uniform Fraudulent Conveyance Act ("UFCA"), and it is currently the law in four states and the Virgin Islands. *See* MD. CODE ANN., COM. LAW §§ 15-201 to 15-214 (2001); N.Y. DEBT. & CRED. LAW Art. 10 §§ 270 to 281 (McKinney 2001); TENN. CODE ANN. §§ 66-3-301 to 66-3-315 (2001); WYO. STAT. ANN. §§ 34-14-101 to 34-14-113 (Michie 2001); V.I. CODE ANN. §§ 201 to 212. Other states have adopted the Uniform Fraudulent Transfer Act ("UFTA"), and it is currently the law in Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, the District of Columbia, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Maine, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Texas, Utah, Vermont, Washington, West Virginia, and Wisconsin.

[30]*See, e.g.*, Muhl v. Tiber Holding Corp., 18 F. Supp. 2d 514, 518 (E.D. Pa. 1998) (noting that under New York law, "it is not necessary to prove intent to establish a claim of constructive fraud"); Metropolitan Steel Fabricators, Inc. v. Michalski (*In re* Metro. Steel Fabricators, Inc.), 191 B.R. 150, 153 (Bankr. D. Minn. 1996); Asleson v. West Branch Land Co., 311 N.W.2d 533, 544 (N.D. 1981); Doughty v. Birkholtz, 964 P.2d 1108, 1112 (Or. Ct. App. 1998).

the transferee.[31] As long as the transfer is made, or the obligation is incurred, for less than a reasonably equivalent value or fair consideration, a creditor can attack the transfer successfully if, at the time the transfer was made, the debtor was insolvent or rendered insolvent, left with an unreasonably small capital, or intended to incur debts beyond its ability to repay.[32] The theory is that when the debtor is in financial difficulty, the debtor's assets essentially belong to the creditors.[33] Stated differently, the insolvent or financially-distressed debtor loses the autonomy to make gifts of her assets and should not be at liberty to give away assets for less than a reasonable economic equivalence.[34] As a corollary of this, the donee is not entitled to retain the donation at the expense of the donor's creditors, regardless of the donee's knowledge.[35]

But debtors do give away assets. Some make regular gifts to spouses and

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[31]*See, e.g.*, Fisher v. Sellis (*In re* Lake States Commodities, Inc.), 253 B.R. 866, 879 (Bankr. N.D. Ill. 2000) ("the state of mind of the transferee is not an element of either of the two causes of action [to avoid an actual intent or constructive fraudulent transfer]").

[32]*See* 11 U.S.C. § 548(a) (1994 & Supp. IV 1998); UFCA § 4 (rendered insolvent); UFCA § 5 (unreasonably small capital); UFCA § 6 (intended to incur debts); UFTA § 4(a)(2)(i)-(ii) (unreasonably small assets and intention to incur debts beyond ability to repay); UFTA § 5(a) (rendered insolvent). Intention to incur debts beyond one's ability to repay is different than actually intending to make a fraudulent transfer. The former is a constructive fraudulent transfer that focuses on the transferor's actions after the transfer is made whereas the latter focuses on the transferor's intent in making the transfer itself.

[33]*See* Marsh v. Kaye, 61 N.E. 177, 177 (N.Y. 1901) ("it may be said that every man's property is a trust fund for the payment of his debts") (*dictum*); Candee v. Lord, 2 N.Y. 269, 274 (N.Y. 1848) (the debtor is a "quasi trustee for his creditors" and his assets are "the fund upon which they must depend for payment"). *But see* GARRARD GLENN, THE LAW OF FRAUDULENT CONVEYANCES §§ 10, 227 (1931) ("in no sense of the word can it be said that a debtor holds his general estate in trust for his creditors"). Whether an insolvent debtor holds property in trust for his creditors is an essential component to resolve the tension between the insolvent debtor's freedom to tithe and his creditors' rights to payment. At least in the corporate context, when the debtor is in the vicinity of insolvency the directors owe primary fiduciary duties to creditors rather than shareholders. *See* Miramar Res., Inc. v. Schultz (*In re* Schultz), 208 B.R. 723, 729-30 (Bankr. M.D. Fla. 1997); Brandt v. Hicks, Muse & Co. (*In re* Healthco Int'l, Inc.), 208 B.R. 288, 300 (Bankr. D. Mass. 1997); Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991). *See generally*, Christopher L. Barnett, *Healthco and the "Insolvency Exception": An Unnecessary Expansion of the Doctrine?*, 16 BANKR. DEV. J. 441 (2000). Such a corporation holds its assets in trust for creditors. *See, e.g.*, Wood v. Dummer, 30 F. Cas. 435, 436-37 (D. Me. 1824) (No. 17,944). It remains to be seen whether courts will extend this trust fund doctrine to partnership and individual debtors. Only individuals may be debtors in Chapter 13 cases. *See* 11 U.S.C. § 109(e) (1994).

[34]*See* Boston Trading Group, Inc. v. Burnazos, 835 F.2d 1504, 1508 (1st Cir. 1987) ("'be just before you are generous'"). The original proposition was stated by Blackstone in his commentaries on distributing a decedent's estate. *See* 1 WILLIAM BLACKSTONE, COMMENTARIES *511-512, which states as follows:

> [I]t is [the executor's] business first of all to see whether there is a sufficient fund left to pay the debts of the testator: the rule of equity being, that a man must be just, before he is permitted to be generous.

[35]Just as a donee may not retain stolen property against the claim of the true owner, so should the donee disgorge an insolvent donor's tithe to the donor's creditors as the beneficial owners of the property.

children.[36] Some make regular charitable or religious donations, contributions or tithes.[37] And some make irregular gifts.[38] The Donation Protection Act insulates most charitable and religious gifts, whether or not part of a regular history of giving or tithing, from attack as constructive fraudulent transfers.

By preempting the field, the Donation Protection Act goes much farther than simply limiting the acts of trustees in seeking to avoid charitable and religious contributions and donations.[39] Creditors of individual debtors also are precluded from commencing or continuing litigation against charitable or religious institutions even though they could have done so under state law in the absence of bankruptcy.[40] True, bankruptcy law preempts state law in other contexts by precluding creditors from pursuing avoiding power causes of action.[41] But the purpose for this preemption is to permit the trustee to pursue those causes of action for the benefit of the entire creditor body.[42] That rationale is specifically repudiated by the Donation Protection Act, which extinguishes all specified creditors' causes of action and precludes their revival against the debtor even after the bankruptcy case concludes.[43] Thus, bankruptcy policy is turned on its head. Instead of maximizing returns to creditors, the Donation Protection Act uses preemption to diminish returns to creditors.

There are limits, however, on this protection. The Donation Protection

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[36]*See, e.g.*, Jacobson v. Church of Manalapan, Inc. (*In re* Jackson), 249 B.R. 373 (Bankr. D.N.J. 2000); *In re* Buxton, 228 B.R. 606 (Bankr. W.D. La. 1999).

[37]*See, e.g.*, Christians v. Crystal Evangelical Free Church (*In re* Young), 82 F.3d 1407 (8th Cir. 1996), *vacated by* 521 U.S. 1114 (1997), *remanded to* 141 F.3d 854 (8th Cir. 1998) (reinstating 82 F.3d 1407); Weinman v. World of Life Christian Ctr. (*In re* Bloch), 207 B.R. 944 (D. Colo. 1997); Morris v. Midway S. Baptist Church (*In re* Newman), 203 B.R. 468 (D. Kan. 1996); *In re* Bien, 95 B.R. 281 (Bankr. D. Conn. 1989).

[38]*See, e.g.*, Murray v. La. State Univ. Found. (*In re* Zohdi), 234 B.R. 371 (Bankr. M.D. La. 1999); Rimmel v. Goldman (*In re* Goldman), 111 B.R. 230 (Bankr. E.D. Mo. 1990).

[39]The Donation Protection Act, 112 Stat. 517, amended Bankruptcy Code § 544(b)(2) to read as follows:

> Any claim by any person to recover a charitable contribution described in the preceeding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case.

[40]*See* Miller v. Grace Fellowship, Inc. (*In re* Witt), 231 B.R. 92, 98 (Bankr. N.D. Okla. 1999).

[41]*See, e.g.*, Glenny v. Langdon, 98 U.S. 20, 29-30 (1878) (action for fraudulent conveyance may only be brought by creditors in trustee's name with leave of court if trustee refuses to act); Koch Ref. v. Farmers Union Cent. Exch., Inc., 831 F.2d 1339, 1342-43 (7th Cir. 1987) ("The trustee's single effort eliminates the many wasteful and competitive suits of individual creditors.").

[42]*See, e.g.*, Buncher Co. v. Official Comm. of Unsecured Creditors, 229 F.3d 245, 250 (3d Cir. 2000) ("[A]ny recovery is for the benefit of all unsecured creditors, including those who individually had no right to avoid the transfer.").

[43]*See* 11 U.S.C. § 548(a)(1)(B) & (2) (Supp. IV 1998). Ordinarily, if the trustee or debtor does not pursue or settle a fraudulent transfer cause of action during the bankruptcy case, creditors are free to pursue it after bankruptcy. *See, e.g.*, Knapp v. Seligson (*In re* Ira Haupt & Co.), 398 F.2d 607, 612-13 (2d Cir. 1986) (Bankruptcy Act case).

Act does not preclude the trustee from attacking a fraudulent transfer made with actual intent to hinder, delay, or defraud creditors (referred to as an "actual intent fraudulent transfer").[44] Moreover, it allows the trustee to attack certain constructive fraudulent transfers in excess of fifteen percent of the individual debtor's gross annual income.[45] Without requiring proof of the debtor's fraudulent intent, the Donation Protection Act permits the trustee to avoid transfers exceeding fifteen percent of the individual debtor's gross annual income unless "the transfer was consistent with the practices of the debtor in making charitable contributions."[46] The Donation Protection Act fails to define "practices," leaving courts to figure out whether the identity of the donee, frequency of contribution, amount of contribution, or other factors are relevant.[47] One case involved a debtor who donated $20,000 after his income increased shortly before bankruptcy: Rejecting the donation as inconsistent with the debtor's "past practices," that court compared the challenged transfer as a percentage of the debtor's income with prior transfers as a percentage of income.[48]

The Donation Protection Act provides a safe harbor, protecting from attack as a constructive fraudulent transfer each transfer not exceeding fifteen percent of the individual debtor's gross annual income.[49] On its face, the Donation Protection Act has no provision to aggregate transfers before application of the fifteen percent of gross income test.[50] Thus, a court might allow a debtor to tithe all of her disposable income to various charities as long as no particular charity receives more than fifteen percent.[51] Courts, however,

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[44]The Donation Protection Act does not limit the trustee's attack under § 548(a)(1)(A) of the Bankruptcy Code to avoid transfers made with the actual intent to hinder, delay, or defraud creditors. *See* 11 U.S.C. § 548(a)(1)(A) (Supp. IV 1998).

[45]The trustee may avoid constructive fraudulent transfers in excess of fifteen percent of the individual debtor's gross income unless the debtor shows that the transfer was consistent with the practices of the debtor in making charitable contributions. 11 U.S.C. § 548(a)(2)(B) (Supp. IV 1998).

[46]*See* § 3(a)(7) of the Donation Protection Act, 112 Stat. 527, amending § 548(a) of the Bankruptcy Code to incorporate this standard.

[47]*See* Jacobson v. Church of Manalapan, Inc. (*In re* Jackson), 249 B.R. 373, 377 (Bankr. D.N.J. 2000) (even though debtor made donations to church each year, $20,000 donation from windfall bequest made five months before bankruptcy was not consistent with debtor's past practices).

[48]*See id.*

[49]*See* 11 U.S.C. § 548(a)(2) (Supp. IV 1998).

[50]Since § 548 of the Bankruptcy Code examines transfers made in the year before the commencement of the bankruptcy case, presumably a court would aggregate charitable donations and tithes made during the one year period. *See* 11 U.S.C. § 548(a)(1) (Supp. IV 1998). The aggregation issue is complicated because the trustee also might be able to use § 544(b) of the Bankruptcy Code to assert the rights of an actual unsecured creditor to avoid the transfer under nonbankruptcy law. *See* 11 U.S.C. § 544(b) (Supp. IV 1998). Under nonbankruptcy law the reach-back period over which a creditor may attack transfers often exceeds one year. *See, e.g.,* UFTA § 9 (four years). Therefore, a court might aggregate the debtor's transfers over a period that exceeds one year.

[51]*See* Murray v. La. State Univ. Found. (*In re* Zohdi), 234 B.R. 371, 386 (Bankr. M.D. La. 1991) ("the ultimate effect of this ruling is arguably to insulate all transfers from avoidance under § 548(a)(2) that are