AMERICAN BANKRUPTCY INSTITUTE

2017 Caribbean Insolvency Symposium

Part I: I Ain't Afraid of No Laws! Legal Issues for Attorneys When Creating, Defending or Chasing Offshore Assets

C.R. Bowles, Moderator
Bingham Greenebaum Doll LLP; Louisville, Ky.

Sabrina Foster
Maples Fiduciary; Grand Cayman, Cayman Islands

Jonathan E. Gopman
Akerman LLP; Naples, Fla.

Ira L. Herman
Blank Rome LLP; New York

Carlos de Serpa Pimentel
Appleby; George Town, Grand Cayman, Cayman Islands

CONCURRENT SESSION

2017

WEALTH PROTECTION

DOMESTIC

&

INTERNATIONAL PLANNING

By: **Jonathan E. Gopman, Esquire**
Akerman LLP
9128 Strada Place, Suite #10205
Naples, Florida 34108
Telephone: **(239) 449-5600**
Cell Phone: **(561) 306-4599**
jonathan.gopman@akerman.com
Direct Dial: **(239) 449-5560**
E-Fax: **(866) 254-3207**

Anna Els, Esquire
Akerman LLP
9128 Strada Place, Suite #10205
Naples, Florida 34108
Telephone: (239) 449-5600
Cell Phone: (941) 735-1628
anna.els@akerman.com

Michael Sneeringer, Esquire
Akerman LLP
9128 Strada Place, Suite #10205
Naples, Florida 34108
Telephone: (239) 449-5564
E-Fax: (866) 896-5022
michael.sneeringer@akerman.com

www.akerman.com

TABLE OF CONTENTS

I. INTRODUCTION. 1

II. FLORIDA EXEMPTIONS. 1

A. Homestead Generally. 1

B. Life Insurance & Annuities. 62

C. Retirement Accounts. 75

D. Wages 79

E. Disability Benefits. 84

F. Tax Advantaged Savings Accounts. 84

G. Miscellaneous. 85

H. Tenancy by the Entireties. 85

I. Workers' Compensation Benefits. 95

J. Fraudulent Asset Conversions. 96

K. Florida is an Opt-Out State. 97

III. SELF-SETTLED TRUSTS. 97

IV. SELF-SETTLED TRUSTS IN FLORIDA. 99

A. Common Law 99

B. New Florida Trust Code - Part V Creditors' Claims 103

V. NEVIS TRUST LAW. 111

VI. COOK ISLANDS TRUST LAW. 131

VII. BELIZE TRUST LAW. 134

VIII. BERMUDA TRUST LAW. 136

IX. BAHAMAS TRUST LAW. 139

X. DELAWARE LAW. 141

XI. ALASKA LAW. 153

XII. OKLAHOMA LAW. 168

XIII. UTAH LAW. 172

XIV. RHODE ISLAND LAW. 176

XV. NEVADA LAW. 180

XVI. MISSOURI LAW. 185

XVII. COLORADO LAW. 187

XVIII. SOUTH DAKOTA LAW. 187

XIX. TENNESSEE LAW. 192
XX. WYOMING LAW. 197
XXI. NEW HAMPSHIRE LAW. 202
XXII. HAWAII LAW. 207
XXIII. ARIZONA LAW. 212
XXIV. FLORIDA LAW. 213
XXV. VIRGINIA LAW. 213
XXVI. MICHIGAN LAW. 217
XXVII. NORTH CAROLINA LAW. 217
XXVIII. OHIO LAW. 218
XXIX. SOUTH CAROLINA LAW. 231
XXX. MARYLAND LAW. 231
XXXI. OREGON LAW. 232
XXXII. KENTUCKY LAW. 232
XXXIII. TEXAS LAW. 233
XXXIV. MISSISSIPPI LAW 234
XXXV. FEDERAL TAX ISSUES WITH ASSET PROTECTION TRUSTS. 243
A. Incomplete Gift Trusts. 243
B. Completed Gift Trusts. 248
C. Income Tax Issues. 295
D. Tax Compliance for a Foreign Trust. 297
1. Definition of Foreign Trust. 297
2. Compliance Related to Foreign Trust. 298
XXXVI. Third Party (Non-Self Settled) Trusts. 306
A. Spendthrift Trusts. 306
1. Florida Common Law 306
2. New Florida Trust Code - Part V Creditors' Claims 307
3. Florida Case Law 309
4. Uniform Trust Code (the "UTC") 313
5. Restatement of Trusts 314
6. Other Case Law 314
7. Bankruptcy Proceedings 319
8. Federal Tax Liens 324
B. Discretionary Trusts. 327
C. Designing a Third Party Trust to be More Debtor Friendly 337
XXXVII. DESIGNING A QTIP TRUST TO BE MORE DEBTOR FRIENDLY. 355
XXXVIII. FRAUDULENT TRANSFERS. 363

A. Historical Background. 363
1. Statute of 13 Elizabeth (1571) 363
2. Uniform Fraudulent Conveyance Act (1918) 364
3. Uniform Fraudulent Transfer Act (1984) 364

B. General. 365
1. Present creditors. 365
2. Future creditors. 365

C. Florida Uniform Fraudulent Transfer Act 365

D. Uniform Fraudulent Transfer Act (1984). 373

E. Fraudulent Transfers under the Bankruptcy Code. 382

F. Ethics 415
1. Applicable Model Rules of Professional Conduct 415
2. State Ethics Opinions 416
3. Aiding and Abetting Liability for a Fraudulent Transfer 419
4. *Grupo Mexicano de Desarrollo, S.A. de C.V. v Alliance Bond, 527 U.S. 308 (1999)* 420
5. *Morganroth & Morganroth v. Norris, McLaughlin & Marcus, P.C.*, 331 F.3d 406 (3rd Cir. 2003) 421

XXXIX. GOVERNING LAW & SITUS. 423

XL. IS A FOREIGN TRUST A VIABLE WEALTH PROTECTION STRATEGY - ABSOLUTELY!!!! 426
1. *Riechers v. Riechers*, 178 Misc.2d 170, 679 N.Y.S.2d 233 (1998) 429
2. *Eulich v. United States*, 2004 WL 1844821 (N.D. Tex. 2004) 430
3. *Duttle v. Bandler & Kass*, 1992 WL 162636 (1992 SDNY) 434
4. *In re Portnoy*, 201 B.R. 685 (SDNY 1996) 434
5. *In re Brooks*, 217 B.R. 98 (Bankr.D.Conn. 1998) 435
6. *Federal Trade Commission v. Affordable Media, LLC*, 179 F.3d 1228 (9th Cir. 1999) 436
7. *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002) 437
8. *Braswell v. Ryan Investments, Ltd.* (No. 3D06-2827, Fla. App. 3 Dist., July 9, 2008) 441
9. *Dahl v. Dahl*, Civil No. 090402989 (2011); 779 Utah Adv. Rep. 13 (Jan. 30, 2015). 446
10. *United States v. Grant,* 2008 WL 2894826 (May 27, 2008) 449
11. *S.E.C. v. Solow*, 682 F.Supp.2d 1312 (S.D. Fla. 2010) 452
12. *Advanced Telecommunication Network, Inc. v. Allen*, 2011 WL 3585827 (Bkrtcy. M.D. Fla.) .. 455
13. *Tasarruf Mevduati Sigorta Fonu v. Merrill Lynch Bank and Trust Company, et al.*, Privy Council of the Cayman Islands, Appeal No. 0036 of 2010, decided June 21, 2010 455
14. *Goldberg v. Rosen* (*In re Niroomand*), 11th Cir., No. 12-11231, Oct. 17, 2012 457
15. *Rush University Medical Center v. Sessions*, 2012 WL 4127261 (Illinois) 465
16. *U.S. Bank v. Rose*, 4 N.E.3d 601 (Ill. App. 3d 2014) 468
17. *Branch Banking & Trust Co. v. Hamilton Greens*, *LLC*, 2014 WL 1603759 (S.D. Fla. Feb. 26, 2014). 472
18. *TrustCo Bank v. Mathews*, C.A. No. 8374-VCP (Del. Ch. Jan. 22, 2015). 473

XLI. CREDITOR RIGHTS ISSUES WITH CRUMMEY POWERS & OTHER WITHDRAWAL RIGHTS. 478

A. Crummey Power 478
1. Restatement of the Law 478
2. *Irwin Union Bank and Trust Company v. Long* 479

B. Statutory Changes to the Common Law Rule 480
1. The First Type of Statute 480
2. The Second Type of Statute 480
3. The Third Type of Statute 481

4. Analysis 481

C. Statutory Protection for Lapsing Crummey Powers within Annual Exclusion Limits or 5 and 5 Exemption 482

1. Hanging Powers 483
2. Unintentionally Tolling Withdrawal Period 488
3. Period of Withdrawal 489
4. Failure to Qualify for Annual Exclusion 489
5. Power Exercisable Only with Consent of a Non-Adverse Party 489
6. Fraudulent Transfers 490
7. Income Tax Consequences 490
8. How Much Does Reference to Section 2503(b) Include? 492

D. Reversion to Common Law Rule & More (Alaska & Delaware) 494

E. Bankruptcy 495

XLII. BUSINESS AND TAX PLANNING 495

A. Liability and Tax Considerations 495

1. Choice of Entity 495

B. Business Operations 538

1. Cash 538
2. Human Capital 538
3. Equipment 539
4. Intellectual Property 539
5. Real Estate 539
6. Accounts Receivable 540

I. INTRODUCTION.

Wealth protection planning is a method of arranging access, control, management and ownership of assets to preserve value for an individual, family or business because of the risk of potential claims by creditors. The strategies a person utilizes in arranging a wealth protection plan will depend on residence, desired mobility, investment objectives, tax and estate planning, necessity of access to wealth and present circumstance. There are numerous reasons why an individual or business should develop a wealth protection plan, including, but not limited to the following:

A. We live in one of the most litigious societies in the world. The contingency fee in our legal system promotes litigation (and the threat of litigation).

B. Many individual's work in a high risk profession such as physicians, real estate investors and developers, engineers and lawyers.

C. Wealth creates a target.

D. Personal security and mobility protection.

E. Numerous family issues, such as divorce and alcohol and drug addiction, create a need for wealth protection planning.

F. The personal life of an individual may create a need to develop a wealth protection plan.

G. The unknown, that is, each year a number of cases percolate through our legal system creating new theories of liability for potential plaintiffs.

An individual resident of Florida has a constitutional right to protect property. See Section 2 of Article I of the Constitution of the State of Florida, which provides in relevant part:

> All ***natural persons***…are equal before the law and have inalienable rights, among which are the right to enjoy and defend life and liberty, to pursue happiness, to be rewarded for industry, ***and to acquire, possess and protect property***. [Emphasis added.]

II. FLORIDA EXEMPTIONS.

A. Homestead Generally.

1. Section 4 of Article X of the Florida Constitution provides that a portion of an individual's homestead is exempt from forced sale by process of any court. Furthermore, no judgment, decree or execution is permitted to constitute a lien on a homestead other than for the payment of:

a. taxes and assessments related to such property;

b. obligations contracted for the purchase, improvement or repair of such property; or

c. obligations contracted for house, field or other labor performed on such property.

2. The homestead must be owned by a "**natural person**."

3. The portion of a homestead protected by this exemption will vary depending upon the location of the property. If the homestead is located in an unincorporated area, the exemption will protect up to one hundred sixty (160) acres of contiguous land and improvements on such land. If the homestead was originally acquired in an unincorporated area that later incorporates or is annexed by an existing municipality, the protected acreage cannot be reduced without the owner's consent. Except as previously mentioned, if the homestead is located within a municipality, the exemption will only protect up to one-half (1/2) acre of contiguous land and the exemption is limited to the residence of the owner or the owner's family.

4. The homestead exemption also protects the value of up to one thousand dollars ($1,000) of personal property.

5. The homestead exemption also inures to the benefit of a surviving spouse or heirs of the owner.

6. Important homestead cases:

a. In *Havoco of America, Ltd. v. Hill*, 790 So.2d 1018 (Fla. 2001), the United States Court of Appeals for the Eleventh Circuit certified the following question concerning Florida law to the Supreme Court of Florida:

> Does Article X, Section 4 of the Florida Constitution exempt a Florida homestead, where the debtor acquired the homestead using non-exempt funds with the specific intent of hindering, delaying or defrauding creditors in violation of Fla. Stat. § 726.105 [Florida's Fraudulent Transfer Act] and Fla. Stat. § 222.29 [related to Florida's Fraudulent Transfer Act] and 222.30 [Florida's Fraudulent Conversion Statute]?

Despite egregious facts, the court held that the homestead exemption applies to protect the equity of the debtor ("**D**") in his Florida home.

In July of 1992, D filed a bankruptcy petition claiming his residence in Destin, Florida as exempt homestead property. Havoco of America, Ltd. ("**P**"), a creditor of D, filed an objection claiming that D had converted non-exempt assets into an exempt asset with the intent to hinder, delay or defraud his creditors. In an action commenced ***in 1981***, P obtained a jury verdict for $15,000,000 against D for acts of fraud, conspiracy, tortuous interference with contractual relations and breach of fiduciary duty. The trial court entered a judgment on the

verdict on ***December 19, 1990*** and the judgment became enforceable on ***January 2, 1991***. D purchased his home in Destin, Florida on ***December 30, 1990***. D, a long time resident of Tennessee, paid approximately $650,000 in cash for his Florida home.

The court recognized that the homestead exemption should be liberally construed "in the interest of protecting the family home." See *e.g.*, *Milton v. Milton*, 58 So. 718, 719 (1912).

The court recognized that it has engrafted a narrow non-constitutional exception to the homestead exemption granting a limited class of creditors relief when funds are converted from non-exempt assets to homestead. This exception is referred to as the "**equitable lien and equitable subrogation exception**." It applies only where an individual obtains funds and uses those funds to acquire a homestead or pay a mortgage on a homestead or the individual procures services that directly benefit the homestead. In *Havoco*, no exception was present. In holding for D, the court stated:

> In sum, we conclude that we must answer the certified question in the affirmative. The transfer of non-exempt assets into an exempt homestead with the intent to hinder, delay or defraud creditors is not one of the three exceptions to the homestead exemption provided in Article X, section 4. Nor can we reasonably extend our equitable lien jurisprudence to except such conduct from the exemption's protection. We have invoked equitable principals to reach beyond the literal language of the excepts [*sic*] ***only where funds obtained through fraud or egregious conduct were used to invest in, purchase, or improve the homestead***.

See also *Republic Credit Corporation, Inc. v. Upshaw*, 4th Dist. Case No. 4D08-1591 (March 25, 2009); *Palm Beach Savings & Loan Ass'n. v. Fishbein*, 619 So.2d 267 (Fla. 1993); *Jones v. Carpenter*, 106 So. 127 (Fla. 1925); *Craven v. Hartley*, 135 So. 899 (Fla. 1931); *LeMar v. Lechlider*, 185 So. 833 (Fla. 1939); *Sonneman v. Tuszynski*, 191 So. 18 (Fla. 1939); *In re: Gosman*, 382 B.R. 826 (S.D.Fla. 2007) (equitable lien denied); & Kolcon, Common Law Equity Defeats Florida's Homestead Exemption, 68 Fla. B.J. 54 (Nov. 1994).

Bank Leumi Trust Co. v. Lang, 898 F. Supp. 883 (S.D. Fla. 1995), was cited favorably in *Havoco*. It provides in relevant part:

> The homestead does not contain an exception for real property which is acquired in the state of Florida for the sole purpose of defeating the claims of out-of-state creditors. In light of the Supreme Court's admonition in Caggiano that the three exceptions to the homestead exemption should be read narrowly, this court is unwilling to graft another exception.

The court also noted that the application of Florida's fraudulent transfer and fraudulent conversion statutes could not affect the validity of D's claim of homestead exemption because it is a right granted under the state constitution. According to the court, "The legislature is powerless to affect the rights provided by the homestead exemption through statutory enactments." *Ostendorf v. Turner*, 426 So.2d 539 (Fla. 1982). See also, *Sparkman v. State ex*

rel. Scott, 58 So.2d 431 (Fla. 1952), providing "Express or implied provisions of the Constitution cannot be altered, contracted or enlarged by legislative enactments."

b. In *In re Bosonetto*, 271 B.R. 403 (2001), the debtor ("**D**") was an eighty-nine (89) year old widow who moved to Florida from Michigan. When living in Michigan in 1994 D was sued for injuries sustained by a plaintiff while visiting her property. In 1995, D sold her home in Michigan for $320,000, receiving $60,000 in cash and a contract for deed for the balance. In 1997, D established a revocable trust transferring all of her tangible and intangible property to it. According to the court D transferred all of the foregoing property to her revocable trust:

> even though record ownership or title, in some instances, may presently or in the future, be registered in [the debtor's] individual name, in which event such record ownership shall hereafter be deemed held in trust even though such trusteeship remains undisclosed.

D specifically assigned the contract for deed to her revocable trust.

In September of 1998, D received the balance of the purchase price from the sale of her home in Michigan and invested the proceeds in two life insurance policies and two Putnam funds. Title to the Putnam account was held in D's revocable trust.

In February of 1999, the personal injury case against D went to a jury trial and in late February of 1999 the trial court entered a final judgment against D for $161,199.36. The case was appealed by D and an appellate court reversed the trial court based on a faulty jury instruction. During the time that post-trial motions were pending D sold all of her investments and moved to Florida where she purchased a home paying $248,000 in cash for it. **D took title to the new home in her name and her daughter's name as joint tenants with right of survivorship**. **D's daughter did not pay anything for her interest in the home**.

The court noted that D depleted most of her investments and cash to acquire her home. It also noted that D had monthly expenses of $1,435.40 and the home would be subject to approximately $4,100 per year in *ad valorem* tax. Nevertheless, the court noted that D only receives $1,000 per month in social security benefits and $62.40 per month in other retirement benefits. The court also seemed intrigued because D had less than $1,400 in furnishings for a 3,200 square foot home.

The judgment on the personal injury claim from Michigan was domesticated in Florida in late December of 1999 and D filed for bankruptcy in late January of 2001.

The bankruptcy trustee objected to D's claim that the Florida property was her homestead and sought to avoid the purchase of the home as a fraudulent transfer and avoid the transfer of an interest in the home to D's daughter as a joint tenant. According to the court, the fraudulent "conversion" claim was abandoned by the trustee because of the *Havoco* decision. Nevertheless, the trustee continued to pursue D's transfer of an interest in the home to her daughter as a fraudulent transfer and D's claim that the property was homestead.

The trustee argued that D's home was owned by her trust even though it was titled in her name and the name of her daughter as joint tenants. According to the trustee the property was not eligible for the benefit of the homestead if it was owned by the trust. The trustee noted that the cash used to purchase the home in Florida was originally derived from the contract for deed that was "owned by the Trust" and investments from the proceeds of that contract. According to the court:

> Defendant Bosonetto established the trust in 1997 and conveyed all of her tangible and intangible property to it 'even though record ownership or title, in some instances, may presently or in the future, be registered in [her] individual name, in which event such record ownership shall hereafter be deemed held in trust even though such trusteeship remains undisclosed.'

As a result of the foregoing language, the trustee asserted that the Florida home was titled in the name of the trust or alternatively, held in a resulting trust.

The court cited Section 4 of Article X of the Florida Constitution which provides in relevant part:

> There shall be exempt from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon, except for the payment of taxes and assessments thereon, obligations contracted for the purchase, improvement or repair thereof, or obligations contracted for house, field or other labor performed on the realty, the following property owned by *a natural person*: a homestead, if located outside a municipality, to the extent of one hundred sixty acres of contiguous land and improvements thereon, which shall not be reduced without the owner's consent by reason of subsequent inclusion in a municipality; or if located within a municipality, to the extent of one-half acre of contiguous land, upon which the exemption shall be limited to the residence of the owner or the owner's family; (Emphasis added.)

The court held that the Florida home was owned by D's revocable trust or alternatively through a resulting trust. According to the court a trust is not *a natural person*, therefore, D could not claim the benefit of the homestead exemption.

The court also held that D's transfer of a fifty percent (50%) interest in home to her daughter could be avoided as a fraudulent transfer.

Bosonetto is a terrible decision in which the court was unable to cite any authority to support its holding. In fact, the court ignored the great weight of authority in reaching its decision. See *Callava v. Feinberg*, 2003 WL 22336421 (Fla. App. 3 Dist.) discussed *infra*. In *In re Ballato*, 318 B.R. 205 (Brankr. M.D. Fla. 2004) the court noted that the "homestead exemption makes no distinction between the types of ownership interests in land that qualify for the exemption, and has been interpreted as applying to any interest in land." See *e.g.*, *Bessemer Properties v. Gamble*, 158 Fla. 38, 27 So.2d 832 (1946) (held to apply to an equitable interest in real estate); *Milton v. Milton*, 63 Fla. 533, 58 So. 718 (Fla. 1912) (held to

apply to a fractional interest in real estate); *Southern Walls, Inc. v. Stilwell Corp.*, 810 So.2d 566 (Fla. 5th DCA 2002) (held to apply to a life estate in real estate).

c. In *Callava v. Feinberg*, 2003 WL 22336421 (Fla. App. 3 Dist.), the defendant ("**D**"), a Florida resident, appealed a judgment of foreclosure of an equitable lien against her homestead. The lien was granted to D's former attorney ("**P**") to satisfy P's fees for representing D during the course of "a long and tortured" divorce. In 1993, as part of the divorce proceedings the trial court ordered a residence located in Florida to be transferred to D to satisfy child support and alimony owed to D by her former spouse. During a hearing relating to the transfer of the residence it was also discussed that D would be able to use the equity in the residence to pay her legal fees. The residence was not marital property and title was transferred to D only during the divorce proceeding.

In April of 1995, D sold the residence she received in the divorce and purchased a less expensive home. **The new home was actually purchased in the name of a trustee for D's benefit**. A portion of the proceeds from the sale of the first home were used by D to pay her counsel fees, however, none of the proceeds were used to satisfy legal fees owed by D to P.

In June of 1995, P commenced an action to collect her unpaid legal fees and obtained a judgment against D in the amount of $168,301.71, plus costs. Following the entry of the judgment the trial court imposed a lien on D's residence for payment of the judgment because it determined that "D had been awarded a 'distinct marital asset' from which she was to pay her attorney's fees." D did not appeal this order. Thereafter, the trial court entered a judgment of foreclosure on D's residence that D appealed. The appellate court reversed, finding that the property was D's homestead and therefore protected from forced sale to satisfy P's judgment pursuant to Section 4 of Article X of the Florida Constitution, that is, the Florida homestead exemption.

P argued that D could not claim the benefit of the Florida homestead exemption because the legal title to the residence was not in her name, rather it was held in trust for her benefit. The court rejected this argument holding:

> The constitutional provision "does not designate how title to the property is to be held and it does not limit the estate that must be owned…" [Citation omitted.] "[T]he individual claiming homestead exemption need not hold fee simple title to the property." [Citations omitted.] Thus, even if [D] owns only a beneficial interest in the property, she is entitled to claim a homestead exemption to the forced sale of the property and the trial court erred in foreclosing her interest in the property.

P also made other arguments in support of her foreclosure judgment which were all rejected by the court. One of these arguments suggested that D's conduct in claiming the homestead exemption was egregious and amounted to fraud because she was supposed to use the equity in the home that the court awarded her to pay her legal fees. The court noted that the primary intent of the court in awarding D the residence in the divorce proceeding was to provide support for her child. Payment of legal fees was secondary. The court also noted that

D sold the original residence and moved into a less expensive residence consistent with the intent of the trial court's order.

P's final argument claimed that D waived her right to claim the homestead exemption because it was only raised as a defense to the foreclosure of the property in a post-judgment motion. Rejecting this argument, the court stated:

> As a matter of public policy, the purpose of the homestead exemption is to promote the stability and welfare of the state by securing to the householder a home, so that the homeowner and his or her heirs may live beyond the reach of financial misfortune and the demands of creditors who have given credit under such law." [Citations omitted.] That being so, the defense of homestead exemption may first be offered at the time that a creditor attempts foreclose on the homestead.

As mentioned, Section 4 of Article X of the Florida Constitution provides in relevant part:

> There shall be exempt from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon, except for the payment of taxes and assessments thereon, obligations contracted for the purchase, improvement or repair thereof, or obligations contracted for house, field or other labor performed on the realty, the following *property owned* by a natural person: a homestead, if located outside a municipality, to the extent of one hundred sixty acres of contiguous land and improvements thereon, which shall not be reduced without the owner's consent by reason of subsequent inclusion in a municipality; or if located within a municipality, to the extent of one-half acre of contiguous land, upon which the exemption shall be limited to the residence of the owner or the owner's family. (Emphasis added.)

As previously discussed, *Bosonetto*, *supra*, reached a different conclusion from *Callava*. Under an odd set of facts, *Bosonetto* held that real property located in Florida that was held by the trustee of a revocable trust and used as the primary residence of the grantor did not qualify for the homestead exemption. The grantor held the retained power of revocation and served as the trustee of her revocable trust. The *Bosonetto* decision was never appealed.

As mentioned in *Callava*, Florida courts hold that the homestead exemption should be liberally construed in favor of protecting the family home. See *Southern Walls, Inc. v. Stilwell Corporation*, 810 So.2d 566 (Fla. App. 5 Dist. 2002); *Havoco of Am. Ltd. v. Hill*, 790 So.2d 1018 (Fla. 2001); *Snyder v. Davis*, 699 So.2d 999 (Fla. 1997); and *Milton v. Milton*, 63 Fla. 533, 58 So. 718 (1912). Seemingly ignoring this mandate, however, the court in *Bosonetto* focused on the fact that the property was not owned by a *natural* person. Thus, the debtor, an elderly woman, could not claim the benefit of the Florida homestead exemption. In *Callava*, the court focused on the meaning of the word "owned." Arguably, this approach is more consistent with construction of the homestead exemption in a liberal manner. Other courts in Florida have reached a similar conclusion. For instance, in construing the application of the homestead exemption the court in *Southern Walls, Inc. v. Stilwell Corporation* stated:

> Although this definition [of a homestead] quantifies the amount of the real property that may encompass a homestead, it does not define "owned." *In other words, it does not designate how title to the property is to be held and it does not limit the estate that must be owned, i.e., fee simple, life estate, or some lesser interest*. (Emphasis added.)

Furthermore, other courts have held that the homestead exemption is applicable to a life estate in a residence. See *Hill v First Nat'l. Bank*, 73 Fla. 1092, 75 So. 614 (1917); and *Anemaet v. Martin-Senour Co.*, 114 So.2d 23 (Fla. App. 2 Dist. 1959). It is certainly beyond argument that a residence held in a revocable trust and used as the primary residence of the person who holds the power of revocation is superior in legal rights to a life estate.

Callava appears to reach the correct result; that is, a result that is consistent with the historical mandate of the application of the Florida's homestead exemption. In theory, *Callava* should also constitute stronger precedent than *Bosonetto* because it is the decision of a state appellate court. Nevertheless, practitioners should continue to advise a Florida resident to hold title to his or her primary residence in the individual's name. Wealth protection should deal with certainty rather than speculation and the stakes are too high to advise clients in any other manner. It is possible that another Bankruptcy Court could follow the *Bosonetto* court while it is clear that the homestead exemption will be applied in a consistent manner in a Florida state court **and** a Federal Bankruptcy Court when title to such property is held in an individual's name.

d. **The Bankruptcy Court Gets It Right**: In *In re Merry Alexander*, 346 B.R. 546 (Bankr.M.D.Fla. 2006), on the day the debtor ("**D**") filed her bankruptcy petition her primary residence was held in her revocable trust, that is, a realty trust called "the Arthur Realty Trust." D was the sole trustee and the sole primary beneficiary of her revocable trust. The sole issue in the case was whether D could claim the homestead exemption for her residence that was held in her revocable trust and not titled in a the name of a natural person. The court noted that D had:

i. "legal control" of the trust as the sole trustee;
ii. the right to revoke the trust;
iii. the right to the exclusive possession and use of the residence held in the trust as the primary beneficiary; and
iv. the intent to reside in the residence held in the trust as her primary residence and had in fact resided in the home since 1995.

Accordingly, the court held that the property qualified as D's homestead and was exempt from the claims of her creditors in bankruptcy. The court noted:

> As a general rule, the individual claiming the exemption need not hold fee simple title to the property. Rather, in order to claim the property in which the individual resides as exempt, it is sufficient that: (1) the individual has a legal or equitable interest which gives the individual the legal right to use and possess the property as a residence; (2) the individual have the intention to make

> the property his or her homestead; and (3) the individual actually maintain the property as his or her principal residence.

D asserted that as the sole trustee and sole primary beneficiary she maintained the equivalent of absolute ownership of the residence held in the trust and was entitled to claim the protection of the homestead exemption. The bankruptcy trustee asserted that D was not entitled to the exemption because the homestead was not owned by a natural person. The trustee cited the *Bosonetto*, *supra*, as authority to support its position. The court, however, refused to follow *Bosonetto*, stating:

> The court, however, declines to follow the reasoning in *Bosonetto*. *Bosonetto* does not cite to any Florida cases in support of its ruling nor does it account for the contrary holdings of several courts in the cases cited above. Further, it appears that subsequent cases have not followed the reasoning of *Bosonetto*. (Citations omitted.)

Holding that D was entitled to claim the homestead exemption for her residence held in her trust, the court noted:

> the Florida Constitution, which has been interpreted as applying to a variety of interests in land, does not distinguish different types of ownership interests that qualify for the homestead exemption. *In re Ballotto*, 318 B.R. 205, 209 (Bankr. M.D. Fla. 2004) (citing *Bessemer Properties v. Gamble*, 158 Fla. 38, 27 So.2d 832 (1946); *Milton v. Milton*, 63 Fla. 533, 58 So. 718 (Fla. 1912) ; *Southern Walls, Inc. v. Stilwell Corp.*, 810 So.2d 566 (Fla. 5th DCA 2002)).

The court noted that courts have held the Florida homestead exemption applies to lease hold estates. See *In re Dean*, 177 B.R. 727 (Bankr. S.D. Fla. 1995); *In re McAtee*, 154 B.R. 346 (Bankr. N.D. Fla. 1993). It also noted that *Bessemer Properties* v. Gamble, 27 So.2d 832 (Fla. 1946), the debtor purchased land with a deed executed in favor of his spouse. Following the acquisition of the land the debtor built a home on it and paid other expenses related to maintenance, insurance and taxes. The court noted that the court in Bessemer Properties held:

> There is no question that [debtor] was the head of a family and that his contributions to his wife's separate property gave him an equitable interest on the basis of which he could claim his homestead exemption. It was not essential that he hold the legal title to the land. This court has also held that a one-half interest, the right of possession, or any beneficial interest in land gave the claimant a right to exempt it as his homestead.

The court also cited *Callava*, *supra*, and *Engelke*, *infra*, cases favorably in reaching its decision. These two cases are Florida appellate court decisions holding that the homestead exemption applies to a residence held in a realty trust (*Callava*) and a revocable trust (*Engelke*).

What can you recommend to a client following the holding in *Alexander*? Importantly, *Alexander* did not overrule *Bosonetto*. It merely reaches a different conclusion.

i. In advising clients on the preferred method of structuring ownership of a homestead it is important to note that as the line of cases in the bankruptcy court provide, the door has been ever so slightly left open for another bankruptcy court to rule that property held in a revocable trust will not qualify as homestead. Thus, planners should continue to advise a client who is a Florida resident to own his or her principal residence in the client's individual name and not in his or her revocable trust.

ii. The importance of this issue is magnified by certain provisions found in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (discussed *infra*). If a court finds that the holding in *Bosonetto* is applicable to a particular case, a debtor may find the limitation periods in §§ 522(o) and 522(p) of the Bankruptcy Code (discussed *infra*) may be tolled. This could be a disastrous trap for the unwary.

iii. Section 736.0505(1)(a) of the Florida Statutes also seems to contain language that is helpful to claiming the homestead exemption for a residence titled in the name of a revocable trust. This statute provides that the assets held in a revocable trust are subject to the claims of the creditors of the settlor, however, only to the extent such assets would be subject to such claims if owned directly by the settlor.

Furthermore, the court in *In re Edwards*, 356 B.R. 807 (Bankr. M.D. Fla. 2006), followed the holding in *Alexander*. Thus, two bankruptcy court cases issued by judges in the Middle District of Florida now conflict with the holding in *Bosonetto*. Also, in *In re Cocke*, 371 B.R. 554 (Bankr. M.D. Fla. 2007), discussed *infra*, the decision of Judge Proctor (the same judge who presided over the *Bosonetto* case) was overturned on appeal in a case involving substantially similar issues, that is a homestead held in a trust.

e. In *In re Edwards*, the debtor ("**D**") filed bankruptcy on September 14, 2005. On December 30, 1994, D purchased a residence located at 4517 Pacer Court, Orlando, Florida (the "**Orlando Property**"). She used the Orlando Property as her personal residence until May of 2003. D also purchased a property located at 365 Wilmette Circle, Ormond Beach, Florida 32174 (the "**Volusia Property**"). D purchased the Volusia Property with her daughter on February 18, 1998, however, until May of 2003 she continued to maintain the Orlando Property as her personal residence. D executed a declaration of trust on June 7, 2000 (the "**Trust**"). Under the terms of the Trust D was permitted to revoke it at any time without the consent of any other party. D transferred all of her right, title and interest in the Volusia Property to the Trust on the same date the Trust was established by her. On May 13, 2003, D sold the Orlando Property and moved into the Volusia Property making it her primary residence. D claimed the Volusia Property as exempt homestead property in her bankruptcy proceeding and the trustee ("**T**") objected to the claim.

T contended that the Volusia Property did not constitute homestead property because it was held in the Trust and not owned by a natural person. T claimed that D had no ownership interest in the Volusia Property and ownership of the real estate is a requirement to claim the homestead exemption.

The court recognized that T's objection was inconsistent with applicable case and statutory law regarding the homestead exemption. According to the court, D had an ownership

interest in the Volusia Property as the grantor and trustee of the Trust. Thus, the Volusia Property constituted D's homestead. The court noted that the Florida homestead exemption must be liberally construed in favor of protecting the family home. It also noted that D and T disagreed regarding the definition of the phrase "owned by a natural person" set forth in Section 4 of Article X of the Florida Constitution. T argued that a trust is not a natural person, therefore, D could not claim the homestead exemption in this case. According to T, D did not have the proper ownership interest in the Volusia Property to claim the homestead exemption protection because that property was held in the Trust.

The court in *Edwards* properly noted that the Florida homestead exemption does not make a distinction between the kind of ownership interests in land which can constitute a homestead for purposes of the exemption. To the contrary, the court noted that the exemption has been construed to apply to any interest in real estate. According to the court, the most significant consideration is the owner's intent to use the residence as the owner's homestead and the his or her use of the residence as a primary residence. In this case the Volusia Property was D's primary residence and had been used as her primary residence two years before her petition was filed. The court concluded that D intended this property constitute her homestead. T had not provided any evidence to dispute the use of the Volusia Property as D's homestead.

T relied on *In re Bosonetto,* 271 B.R. 403 (Bankr.M.D.Fla.2001) as authority to support his position. Noting T's error in relying on *Bosonetto* to support his position, the court provided:

> The great weight of the relevant case law holds to the contrary. Fee simple title of the property is not required, and an equitable or legal interest should afford protection pursuant to the provision. The Florida Appellate Court ruled in *Engelke v. Estate of Engelke,* 921 So.2d 693, 696 (Fla. 4th DCA 2004) a revocable trust was constitutionally protected homestead property and could not be used to pay claims and expenses of the grantor's estate. The grantor of the trust retained an ownership interest in the property since the trust was revocable. The trust, due to its revocable nature, was owned by a "natural person" within the meaning of the Florida homestead exemption. The revocable trust only held title to the property, while the grantor retained ownership. A recent case decided in the Middle District of Florida, *In re Alexander,* 346 B.R. 546 (Bankr.M.D.Fla.2006) is in agreement holding fee simple title to the property is not necessary to qualify for the homestead exemption. '...[I]n order to claim property in which the individual resides as exempt it is sufficient that: (1) the individual have a legal or equitable interest which gives the individual the legal right to use and possess the property as a residence; (2) the individual have the intention to make the property his or her homestead; and (3) the individual actually maintain the property as his or her principal residence.' The Bankruptcy Court ruled homestead property titled in a revocable trust can be exempt from a debtor's bankruptcy estate in a Chapter 7 case.

Interestingly, T argued that *Alexander* was distinguishable on its facts because there the debtor resided in the disputed homestead property for seven years before she transferred it to her revocable trust. In this case T argued that D transferred the home to the Trust only three years

before the property became her primary residence. Thus, T argued the Volusia Property could not constitute a homestead for purposes of the homestead exemption since D did not live in the residence when she possessed legal title to it. The court concluded that T's argument had no merit and did not impinge upon D's ability to claim the homestead exemption. D owned the Volusia Property in the Trust and lived there prior to filing for bankruptcy. She possessed the intent to use the Volusia Property as her principal residence. According to the court, "The timing of the Debtor's transfer of title to the Trust does not alter her ownership interest of the Volusia Property." Hence, the court found no reason to reach a conclusion that was not consistent with the court in *Alexander*.

f. In *In re Cocke*, John L. Cocke and his spouse, Judy D. Cocke ("**Ds**"), filed bankruptcy on November 22, 2004. Ds claimed their residence located in Jacksonville, Florida (the "**Residence**") as exempt homestead property. The residence was held in a trust referred to as Trust No. 17296 (the '**Trust**'). Judy Cocke was the trustee of the Trust. Ds and their minor granddaughter were listed as the grantors and beneficiaries of the Trust. (Ds were the legal guardians of their granddaughter.) The terms of the Trust gave Ds (in their capacity as beneficiaries) the same rights that any person owning fee simple title to property would possess. For example, such rights included the authority to exclude other parties from the property and to alienate the Residence. Nevertheless, the Trust prohibited the beneficiaries from dividing the Residence amongst the beneficiaries. According to the terms of the Trust:

> [t]he interests of the Beneficiaries shall consist of the following rights respecting the Trust Property:
> a. The right to direct the Trustee to convey or otherwise deal with the title to the Trust Property hereinafter set out.
> b. The right to manage and control the Trust Property.
> c. The right to receive the proceeds and avails from the rental, sale, mortgage, or other disposition of the Trust Property.

The terms of the Trust also provided that:

i. the rights of the beneficiaries are considered personal property;

ii. such rights can be assigned and transferred as personal property;

iii. no beneficiary possesses any legal or equitable right, title or interest to any real property held in the Trust; and

iv. no beneficiary possesses the power to demand partition of any real property held in the Trust because such rights are treated as an interest in personal property.

Importantly, the terms of the Trust also provided that it "may be terminated at any time by the Beneficiaries and with thirty (30) days written notice of termination delivered to the Trustee."

In the original bankruptcy proceeding the trustee ("**T**") objected to Ds' claim that the Residence was protected by the homestead exemption arguing that Ds' interest in the Trust that

owned the Residence was not an interest in real property. Therefore, according to T, the interest could not qualify for the homestead exemption. The bankruptcy court agreed with T holding that Ds and their granddaughter did not possess a beneficial or equitable interest in the Residence because of the terms of the trust.

Ds appealed the decision of the bankruptcy court and the appellate court reversed. The appellate court held that in deciding if Ds' interest in the Residence is exempt homestead property, the bankruptcy court needs to determine whether:

> (1) the Debtors have a legal or equitable interest which gives [them] the legal right to use and possess the [Real] [P]roperty as a residence;
> (2) the Debtors have the intention to make the [Real] [P]roperty their homestead; and
> (3) the Debtors actually maintain the [Real] [P]roperty as their principal residence.

The appellate court's ruling provided that the bankruptcy court must hold that Ds' possessed a legal or equitable interest in the Residence held in the Trust "if the Debtors were the [grantors] and the [T]rust is revocable." The appellate court stated that if the Ds possessed the power to revoke the Trust "then that interest alone *may be* a sufficient interest to satisfy the requirement that Debtors have an equitable or legal interest in the [Real] [P]roperty." (Emphasis added.) The parties stipulated that factors (2) and (3) were present in this case. Thus, the only open issue related to whether the first requirement was met by Ds, that is, did Ds possess a legal or equitable interest which gives them the legal right to use and possess the Residence as a residence. The record in the bankruptcy proceeding contained ample evidence to support Ds' contention that the Residence was used as their homestead.

On remand the bankruptcy court recognized that "Florida courts have consistently emphasized that the homestead exemption is to be liberally construed in the interest of protecting the family home against the claims of creditors." (Citations omitted.)

The bankruptcy court recognized that if the Trust was found to be revocable by Ds, the *Engelke* case would determinative of the first factor. *Engelke* held that the authority to revoke a trust constituted a sufficient interest in a residence held in the trust to permit an individual to claim such property as exempt homestead. Thus, if Ds possessed the authority to revoke the Trust, that right by itself could be adequate to satisfy the first requirement that Ds possess an equitable or legal interest in the Residence.

T also argued that Ds were not the lone grantors and beneficiaries of the Trust and did not solely hold the authority to revoke the Trust. As such T argued that Ds did not possess an adequate legal or equitable interest in the Residence to claim it as homestead property. T argued that the terms of the Trust provided that it could only be terminated by the beneficiaries acting together. The bankruptcy court disagreed with this argument and held that the Residence was Ds' homestead and protected by the homestead exemption.

g. In *Cutler v. Cutler*, 32 Fla. L. Weekly D583 (Fla. 3d Dist. Ct. App., February 28, 2007) the court held that the Florida homestead protection applied to a

residence that was held in an irrevocable land trust. The decedent ('**D**") established the Cutler Irrevocable Land Trust for estate planning purposes (the "**Trust**"). The Trust was established eight months before D's death. D named herself and her two children as co-trustees of the Trust. and transferred two parcels of property into the Trust before her death. By the terms of the Trust, D retained a life estate in the properties transferred to the Trust and the Trust provided that she had the "right to use, possess and occupy said property during [her] lifetime." The parcels D transferred to the Trust were D's primary residence located at 10979 South West 77th Avenue (the "**Residence**") and an adjacent vacant lot (the "**Vacant Lot**"). D had resided in her Residence many years prior to the transfer to the Trust. Upon D's death, any remaining trust property was to be distributed to D's estate to be administered as part of D's estate.

D's son ("**S**") appealed the circuit court's ruling that the Residence was homestead property exempt from being sold to pay the debts of D's estate. S challenged this ruling because under the terms of D's will, the Residence was specifically devised to S's sister. D's will devised the Vacant Lot to S. However, because homestead property is exempt from the claims of creditors, the debts and expenses of D's estate would be paid from the Vacant lot devised to S and the residence devised to S's sister would pass free of any of D's estate's debts and expenses.

As a result, S argued that the Residence should not qualify as homestead property under Article X, Section 4(b) of the Florida Constitution because at the time of D's death the Residence was titled in the Trust. The court set forth the four requirements for property to qualify as homestead property under the Florida law:

(1) the property must be owned by a natural person;

(2) the person claiming the exemption must be a Florida resident who establishes that he or she made or intended to make the real property his or her permanent residence;

(3) the person claiming the exemption must establish that he or she is the owner of the real property; and

(4) the property claimed as the homestead must satisfy the size and contiguity requirements of the constitution.

S challenged the trial court's ruling that the Residence was homestead property on the basis that D was not the owner of the Residence and that the Residence was not owned by a natural person because legal title of the Residence was held by the Trust during D's lifetime. The court held that D was the owner of the property under Florida law because D retained both a life estate in the Residence and occupied it continuously before her death pursuant to her retained right in the Trust. Additionally, D had resided in the property for numerous years prior to the transfer of the Residence to the Trust.

The court held that the Residence was owned by a natural person. The court cited *Callava v. Feinberg* stating that it as well as other courts have consistently held that properties held in trust can be characterized as homestead. The court recognized that these prior cases all involved revocable trusts; however, the court did not find any reason to limit the holdings of these cases to revocable trusts. As a result, the court held that it is immaterial that legal title to

the Residence was held in an irrevocable trust during D's lifetime and the Residence met all the requirements of homestead property under Florida law.

On rehearing, *Cutler*, 994 So.2d 341, 2008 WL 4057751 (Fla. App. 3 Dist. 2008), the court affirmed the panel's holding regarding the qualification of the residence as homestead, however, it overturned the ruling regarding the availability of the homestead to satisfy the expenses and debts of D's estate because of the express intent set forth by D in her will.

h. In *Conseco Servs, LLC v. Cuneo*, 904 So.2d 438 (Fla. 3d Dist. Ct. App. 2005), a court has again upheld the benefit of the Florida homestead exemption even though it was used solely as a shield to protect wealth from the claims of a known creditor and as a tool to hinder, delay and defraud such creditor. The Cuneos (collectively "**D**"), a husband and wife, participated in a loan program for certain employees, directors and officers of Conseco, Inc. ("**Conseco**"). The loan program was offered through a subsidiary of Conseco. Under the program, D borrowed close to $40,000,000 from certain banks which D used to purchase Conseco stock. As part of the loan transaction D signed notes and guaranties in favor of the subsidiary for $15,000,000. The subsidiary paid the interest on the bank loans for D. Following the loans Conseco declared bankruptcy and its stock become worthless. D defaulted on their obligations under the loans.

The subsidiary sued D in Indiana to obtain repayment of the loans. In the Indiana case the subsidiary alleged D made certain fraudulent transfers to family members. Subsequent to the filing of this action D sold $8,000,000 of securities and obtained a mortgage for $2,450,000 on their residence in Connecticut. D used these funds (that is, the proceeds from the sale of the securities and the mortgage) to purchase a residence in Florida for $10,200,000 and established it as their primary home during the course of this litigation. The Indiana court refused to issue an injunction to stop D from shielding wealth by moving to a home in Florida. The Indiana court also held that it did not have jurisdiction over real property located in Florida.

Following the Indiana court's ruling Conseco's subsidiary filed an action in Florida against D alleging:

1. The "transfer" of funds by D into a Florida homestead constituted a fraudulent transfer because D used the Florida homestead exemption to hinder, delay and defraud their creditors.

2. It was entitled to an equitable lien on the new residence because the D had:

> 'committed a fraudulent or otherwise egregious act by fraudulently transferring $10,200,000, all during the pendency of another fraudulent transfer action,' and '[t]he funds used to purchase the Florida Property can be directly traced to at least two fraudulent conveyances, a $2.45 million mortgage taken out on [Ds'] Connecticut home, and the sale of $8 million in securities, the proceeds of which were used to purchase the $10.2 million home in Florida.'

The subsidiary filed a notice of *lis pendens* on the homestead based on the foregoing claim which was eventually dissolved by the trial court because there was "no fair nexus between [Ds'] Florida home and the dispute set forth in the complaint."

The court affirmed the trial court's holding because the subsidiary failed to demonstrate the nexus between the home and the dispute. The court noted that it is not sufficient that D transferred non-exempt funds to an exempt asset to preclude a creditor from reaching such funds. Even though a debtor may acquire homestead property in Florida with the explicit intent to hinder, delay or defraud creditors, such property will still benefit from the homestead protection granted under the Florida Constitution.

As previously noted, Section 4 of Article X of the Florida Constitution provides that a portion of an individual's homestead is exempt from forced sale by process of any court and that no judgment, decree or execution is permitted to constitute a lien on a homestead other than for payment of: (i) taxes and assessments related to such property; (ii) obligations contracted for the purchase, improvement or repair of such property; or (iii) obligations contracted for house, field or other labor performed on such property. The foregoing exceptions are the only exceptions to the Florida homestead exemption and these exceptions are narrowly construed. The equitable lien exception is closely related to, and in reality merely an extension of, the second exception. It is not an additional exception. It is tool that can be used by a court to prevent a grossly inequitable result.

The identical issue in *Conseco Servs., LLC v. Cuneo* was answered in the debtor's favor in several prior cases, including the recent case of *Havoco of America, Ltd. v. Hill*, 790 So.2d 1018 (Fla. 2001). In *Havoco*, the court also recognized that it has engrafted a narrow non-constitutional exception to the homestead exemption granting a limited class of creditors relief when funds are converted from non-exempt assets to homestead. This exception is referred to as the "**equitable lien and equitable subrogation exception**." The plaintiff in *Cuneo* argued that this exception was applicable, however, the plaintiff failed to recognize that the exception only applies where an individual obtains funds and uses those funds to acquire a homestead or pay a mortgage on a homestead or the individual procures services that directly benefit the homestead. In *Cuneo*, as in *Havoco* this exception was not present.

It is also important to note that the sky was not as blue as it may first have seemed for the defendants in *Cuneo*. They faced a long road ahead of them unless they were able to settle on favorable terms to them. Without advance planning done under appropriate circumstances and a sound wealth protection plan in place, the defendants may have found it difficult to maintain a residence with a fair market value in excess of $10,000,000. Expenses and property tax on a residence of this value in Florida will be astronomical. This is a good example of the need for planners to counsel clients on advance planning and establishing a wealth protection plan that is practical and flexible. For instance, if the defendants had implemented a plan that included a properly structured offshore wealth protection trust established under appropriate circumstances, the trustee of that trust could pay the annual property tax bill on this residence and other maintenance expenses. Of course, the defendants could obtain a credit line or mortgage the residence to raise funds to pay such expenses, however, prudent counsel representing a creditor in this type of case should be able to find away to attach such funds

before the funds are used to pay these taxes and expenses or prevent the foregoing from occurring altogether.

i. *Cuneo* demonstrates that the Florida homestead exemption remains a viable planning tool to protect wealth when no other strategy is appropriate because of failure to do sufficient advance planning. However, care must be taken when using this strategy because of the bankruptcy rules applicable to the homestead exemption (discussed *infra*). Use of this exemption is only available to a debtor who invests in a homestead during the debtor's life. If the homestead is not acquired during the debtor's lifetime, the debtor's estate will be unable to acquire a homestead to protect wealth. Thus, should a debtor die while a claim is pending, the debtor's estate will be unable to avail itself of the Florida homestead exemption if the debtor did not use such strategy during the debtor's life. This is an important concern because the Florida homestead exemption inures to the benefit of a debtor's spouse and heirs. Fla. Const. Art. X, § 4. Of course, a debtor's estate might be subject to an involuntary bankruptcy proceeding. Hence, expeditious use of the homestead exemption is preferred in all situations.

ii. In *Engelke v. Estate of Engelke*, 921 So.2d 693 (Fla 4th DCA 2006), a trustee of a revocable trust appealed an order issued by the probate court requiring the trustee to pay the expenses of the deceased grantor's estate based on the provisions of the trust agreement. The grantor's estate had insufficient resources to pay such expenses. The primary asset in the revocable trust, however, was a one-half (1/2) interest as a tenant in common in the decedent's homestead. The trustee argued that the residence could not be used to satisfy such debts because it was protected by the Florida constitution as the decedent's homestead. The appellate court reversed the probate court holding "Because the decedent retained all control over his homestead during his lifetime, conveying no vested property interest in the homestead to the trust, we hold that homestead protections attached to the residence."

In *Engelke*, Paul Engelke ("**D**") died testate survived by a spouse and three (3) adult children who were all born from a prior marriage. Before they got married D and his spouse entered in a prenuptial agreement under which each of them waived their homestead rights in the other person's homestead. Following their marriage D and his spouse purchased a home. Following the purchase of this residence each of them eventually transferred their one-half (1/2) interests to their respective revocable trusts. D was the sole current trustee of his revocable trust when he transferred the interest in the residence to the trust. According to the terms of the trust agreement, following D's death, his spouse would have the right to live in the residence during her life, however, she would also be obligated to pay all of the expenses to maintain the home. Upon the death of D's spouse, D's children would receive the residence as the residuary beneficiaries under the trust agreement.

Paragraph A of Article IV of D's revocable trust agreement provides:

> Except as otherwise specifically provided in this Article, upon the death of the Grantor, to the extent that Grantor's residuary probate estate shall have insufficient liquidity as so certified by the Personal Representative of Grantor's estate, Trustee shall pay from the trust estate: (1) …; and (2) all of Grantor's

> funeral expenses, claims allowable against Grantor's estate, costs of last illness and costs of the administration of Grantor's estate including ancillary.

When D died his probate estate was valued at approximately $61,000. The trust had approximately $10,000 in cash and the one-half (1/2) interest in D's primary residence. The home was worth approximately $850,000 at D's death and it was encumbered with a $133,000 mortgage.

D's spouse was appointed as the personal representative of his estate while one of D's children was appointed as the successor trustee of his revocable trust. As personal representative, D's spouse certified to D's child as the trustee of the trust that the estate had insufficient funds to pay claims against the estate. D's spouse ask the probate court to compel the trustee to transfer property from the trust to the estate to pay such expenses. The trustee opposed the spouse-personal representative's motion on the grounds that the trust contained insufficient liquid assets to pay such expenses and the remaining asset, that is, the one-half (1/2) interest in the residence was protected from such claims as homestead property. Following a hearing on the matter the probate court found in favor of the personal representative and the trustee appealed arguing the court erred in regards to its ruling on the homestead property. The personal representative argued that the probate court's ruling was correct because the trust agreement specifically provided for the payment of such expenses if D's estate was insufficient, therefore, the trustee was obligated to deplete the homestead to pay such expenses.

Holding for the trustee, the appellate court noted:

> We note that in this case while [D]'s residence was held in a revocable trust, it was owned by a "natural person" for purposes of the constitutional homestead exemption. Because [D] retained a right of revocation, he was free to revoke the trust at any point in time. Accordingly, he maintained an ownership interest in his residence, even though a revocable trust held *title* to the property. We therefore conclude that [D]'s interest in his residence as beneficiary of his own revocable trust would entitle him to constitutional homestead protections. See *Bessemer Props. v. Gamble*, 158 Fla. 38, 27 So.2d 832, 833 (1946) (stating that 'a one-half interest, the right of possession, or any beneficial interest in land gave the claimant a right to exempt it as his homestead').

The court noted that a homestead that is gifted to an heir is protected from forced sale to pay the expenses of administering the estate. See *Thompson v. Laney*, 766 So.2d 1087 (Fla. 3d DCA 2000). According to the court:

It is only when the testator directs that a freely devisable homestead be sold and [the proceeds of such sale] distributed to a devisee that the constitutional protection from creditors is disregarded. See *Knadle v. Estate of Knadle*, 686 So.2d 631 (Fla. 1st DCA 2002). In such a case, the decedent has devised money and not the homestead itself. Otherwise, the homestead protections against forced sale attach upon the moment of the owner's death. See *In re Estate of Hamel*, 821 So.2d 1276, 1280 (Fla. 2d DCA 2002).

The court did not believe that use of a revocable trust by D changed the protection granted to homestead property because "Revocable living trusts are widely used will-substitute devices that provide flexibility in managing the settlor's assets during his or her lifetime."

Finally, the court noted:

> In other contexts, revocable trusts are treated similarly to wills. *See e.g.*, § 732.4015, Fla. Stat. (2005) (treating disposition by trust of grantor's homestead as a "devise" where grantor is survived by spouse or minor child); *see also Johns v. Bowden*, 68 Fla. 32, 66 So. 155 (1914) (retention of entire estate in grantor during his lifetime makes revocable trust in the nature of a testamentary disposition of homestead property); *In re Johnson's Estate*, 397 So.2d 970 (Fla. 4th DCA 1981). Frequently, as here, the trust contains provisions regarding payment of expenses of the estate after the settlor's death. We have found no case in which a general direction to pay the estate expenses has trumped the constitutional homestead protections which are the rights of the heirs as much as the decedent. Because revocable trusts are merely will substitute devices, we see no reason why the reasoning of *Thompson v. Laney*, precluding use of the homestead to satisfy estate debts, should not apply with equal force when homestead property is transferred through a revocable trust. Therefore, unless the trust specifically directs that the freely devisable homestead be sold, the rights of the heirs attach at the death of decedent, and the property is protected from the claims of all creditors.

See also, *HCA Gulf Coast Hosp. v. Estate of Downing*, 594 So.2d 774 (Fla. 1st DCA 1992); and *In Re: Estate of Cutler*, 32 FLW D583 (Fla. 3rd DCA 2007).

i. In *Pelecanos v. City of Hallandale Beach*, 914 So.2d 1044 (Fla 4th DCA 2005), the trial court imposed an equitable lien on the defendants' homestead for certain code violations. The appellate court noted that the homestead exemption is to be liberally construed in favor of protecting the family home. On the other hand, the court noted that the exceptions to the homestead exemption should be narrowly construed. In holding for the homeowners the court stated:

> Simply put, a municipal lien for code violations is not one of the specified exceptions. Therefore, a municipality's liens for code violations do affect a subsequent purchaser and do not affect the proceeds of any sale of homestead property as long as those proceeds are reinvested in a new homestead within a reasonable time. [Citations omitted.]

The city of Hallandale Beach, Florida argued that the equitable lien was valid because of the homeowner's egregious conduct in failing to comply with orders of the trial court. The court disagreed with this argument. The noted that it empathized with the frustration of the trial court in the homeowner's failure to comply with the judge's orders, however, it also noted that it was not its "province to judicially create another exception to the plain and unambiguous language of article X, section 4" of the Florida Constitution. In discussing the exceptions to

the homestead exemption, the court cited text from the case of *Butterworth v. Caggiano*, 605 So.2d 56, 60 (Fla. 1992) providing:

> These exceptions are unqualified. They create no personal qualifications touching the moral character of the resident nor do they undertake to exclude the vicious, the criminal, or the immoral from the benefits so provided. The law provides for punishment of persons convicted of illegal acts, but this forfeiture of homestead rights guaranteed by our Constitution is not part of the punishment.

j. In *Willis v. Red Reef, Inc.*, 921 So. 2d 681 (Fla. 4th D.C.A., 2006), Ernest and Sunday Willis (collectively "**D**") appealed a judgment imposing an equitable lien on their homestead.

In 1989, D and another individual established a corporation ("**C**") to own and manage a commercial building. On February 16, 1996, Red Reef, Inc. ("**P**") entered into a lease with C. Under the terms of the lease, P was to lease a portion of the building owned by C for the purposes of operating a restaurant. C breached the agreement because it did not permit P to take possession of the premises. P filed suit against C seeking specific performance and damages not exceeding $15,000 (except attorney's fees and costs).

Prior to P's initial suit being administratively dismissed, C entered into an agreement to sell its building to a third party for $3,100,000. The sale closed on or around the end of April, 1998. C retained almost none of the sale proceeds. After paying expenses related to the sale, the remaining proceeds (that is, $3,100,000) were distributed to the shareholders of C. D received $1,200,000 of the proceeds and the other shareholder received the remainder of the proceeds. D deposited their portion of the distribution in their joint checking account. Immediately after making this deposit, D used $490,345.19 of the distribution to satisfy the mortgage on their homestead located in Boca Raton, Florida.

In June of 1998, P got the trial court to set aside the order administratively dismissing its suit and in February of 2000, P filed an amended complaint getting the case transferred from county court to circuit court. In December of 2001, the trial court entered an amended final judgment against C. Under the terms of the judgment the court awarded P damages in excess of $1,500,000.

In March of 2002, P filed a complaint against the shareholders of C, D and the other shareholder, that alleged the fraudulent transfer of corporate assets, alter ego liability, and tortious civil conspiracy. A final judgment in this case was entered in April of 2004. This judgment stated that P was entitled to recover from D and the other shareholder under the fraudulent transfer action. The court imposed an equitable lien on D's homestead in the amount of $490,395.19, plus interest.

The issue in the case was whether D lost the homestead protection afforded by Article X, Section 4(a)(1) of the Florida Constitution by satisfying their mortgage with a portion of the sale proceeds. The court noted:

> The plain language of the Florida Constitution indicates that homesteads in Florida may not be used to satisfy court judgments except in three specifically enumerated instances: (1) unpaid property taxes for the homestead itself; (2) mortgages for the purchase or improvement of the homestead itself; or (3) mechanics' liens for work performed on the homestead.

P argued that an equitable lien was appropriate because the money used to satisfy D's mortgage was clearly traceable to the funds received from the sale of the commercial building by C. The court noted, however, that the issue is not determined by a party's ability to trace funds. The court stated:

> The supreme court in *Havoco* ruled that article X, section 4 exempts a Florida homestead, even where the debtor acquired the homestead using non-exempt funds with the specific intent of hindering, delaying, or defrauding creditors. *Id.* at 1019. The imposition of equitable liens on homesteads is limited to cases in which the homesteads were purchased with the fruits of fraudulent activity. *See Palm Beach Sav. & Loan Ass'n, F.S.A. v. Fishbein,* 619 So. 2d 267 (Fla. 1993) (equitable lien granted on homestead where funds used to extinguish mortgages on the homestead were obtained by fraud and forgery); *Jones v. Carpenter,* 106 So. 127 (Fla. 1925) (trustee entitled to equitable lien against homestead for amount of embezzled funds used to improve homestead).

Regardless of the fact that D fraudulently transferred the sale proceeds to their own personal account, this is not the type of "fraud or egregious conduct" that allows a court to impose an equitable lien on a homestead. P did not provide D with the money that was used to satisfy the mortgage on their personal residence. P's cause of action originated because of an action on a breach of a lease against C. The underlying claim against C resulted in a damage award more than three (3) years following the fraudulent transfer. Importantly, D did not fraudulently obtain funds from P to satisfy their mortgage. Under existing homestead law non-exempt wealth can be converted into an exempt homestead even though it is done with the actual intent to hinder, delay, or defraud creditors. Thus, the imposition of an equitable lien on D's homestead was in error.

k. In *Zureikat v. Al Shaibani*, 944 So.2d 1019 (Fla. App. 5th Dist. 2006), the defendant ("**D**") represented to the plaintiff ("**P**") that he was a real estate agent and broker offering to assist P with the acquisition of real estate in Orange County, Florida. P loaned D $200,000 for the purpose of using such funds as a deposit for D's purchase. The loan was documented by a promissory note. Under their agreement, D was to receive a commission on P's acquisition of the realty. P never acquired any real estate, however, D refused to refund the $200,000. Instead, D misappropriated the money using the funds for his personal benefit. D also made false representations regarding how he used the money. In discovery, D represented that he used the funds he obtained from P to satisfy some debt obligations and that he lost rest "in the stock market."

P sued D on a promissory note and for fraud and civil theft and obtained a consent judgment against D on the promissory note. P recorded the judgment.

In post judgment proceedings P discovered that D had a bank account that D did not disclose and that D deposited P's money into that account. P also learned that D withdrew the funds from this account and used the funds to acquire and improve real estate that became D's homestead. P argued that he was entitled to an equitable lien for his $200,000 that he traced to the purchase and improvement of D's homestead.

In permitting an equitable lien on D's homestead for $130,000, the court stated:

> It is well settled that trial courts may impose equitable liens in proceedings supplementary where there has been a showing of fraud, misrepresentation, or affirmative deception. In this case, the equitable lien afforded [P] the most complete relief possible in satisfying his judgment against [D]. (Citations omitted.)

In reaching its decision permitting an equitable lien against D's homestead the court also noted:

> Moreover, the equitable lien was properly awarded against homestead property because [P] established that proceeds from [D]'s fraudulent or reprehensible conduct were used to invest in, purchase, or improve the homestead. *See Smith v. Smith,* 761 So.2d 370, 372 (Fla. 5th DCA 2000); *Dyer v. Beverly & Tittle, P.A.,* 777 So.2d 1055, 1059 (Fla. 4th DCA 2001); *Greenberg v. Fontaine,* 618 So.2d 299, 301 (Fla. 2d DCA 1993); *Whigham,* 511 So.2d at 718; *see also Havoco of Am., Ltd. v. Hill,* 790 So.2d 1018 (Fla.2001) (discussing extensively the treatment of equitable liens on homestead property). More important, the Florida Supreme Court has held that, where funds obtained through one spouse's fraud are used to invest in, purchase, or improve the homestead, an equitable lien may be established despite the other spouse's innocence or ignorance of wrongdoing. *Palm Beach Sav. & Loan Ass'n, F.S.A. v. Fishbein,* 619 So.2d 267, 270-71 (Fla.1993); *In re Crum,* 294 B.R. 402, 405 (Bankr.M.D.Fla.2003).

i. In *Randazzo v. Randazzo*, 980 So.2d 1210 (Fla. App. 3rd Dist. 2008), Marc Randazzo ("**FH**") and Elena Randazzo ("**FW**") entered into a marital settlement agreement (the "**Agreement**") which was subsequently incorporated into a final judgment for dissolution of their marriage (the "**Judgment**"). Pursuant the Agreement, FW retained the couple's marital home (the "**Marital Home**") and FH retained a 49% interest in a restaurant business and all the debts and liabilities associated with such business. The Agreement also provided that FW was obligated to pay FH $190,000 (the "**Obligation**") within ninety days of the date of the Agreement. The time to make this payment could be extended to 120 days for good cause. Fulfilling his obligations under the Agreement, FH executed a deed transferring his entire interest in the Marital Home to FW. FH transferred his interest in the Marital Home to FW in anticipation of FW selling it and paying him the Obligation. Upon the expiration of the ninety-day period, FW did not pay the Obligation and she did not request an extension for good cause to make the payment.

After the Judgment was issued FH filed a Motion to Compel, for Enforcement, Attorney's Fees, Costs and for Other Relief for FW's failure to pay the Obligation. During a post dissolution proceeding, FW represented to the presiding magistrate that she had entered into a contract to sell the Martial Home and was scheduled to close on it the following month. The magistrate orally recommended that FH's motion be granted and an equitable lien be placed upon the Marital Home in FH's favor. Before the magistrate could file her written report and recommendation in the matter, however, FW filed for bankruptcy. The magistrate's written report found FW's conduct was "egregious." The magistrate's report provided that the equitable lien should not be recorded until the scheduled closing date for the sale of the Marital Home because FW represented that FH would be paid at closing. The report also provided that should closing on the sale of the Marital Home be delayed, the equitable lien would not be recorded until the subsequent closing date. If closing did not occur, the equitable lien could be recorded the day the transaction was no longer valid.

FW filed certain exceptions to the magistrate's report and a motion to vacate. Additionally, FW's bankruptcy filing stayed the proceedings in the dissolution case. During this time, FW sold the Marital Home and immediately purchased another residence (the "**New Home**"). FW claimed the New Home as her homestead and further claimed that it could not be subject to the equitable lien in favor of FH because of the Florida homestead exemption. The bankruptcy court ultimately relinquished jurisdiction of the homestead claim to the trial court in the divorce proceeding. After a hearing the trial court denied FW's exceptions to the magistrate's report, sustained the magistrate's findings and denied a motion for rehearing filed by FW. The trial court imposed a $190,000 equitable lien in favor of FH on FW's homestead.

The issue before Florida's Third District Court of Appeals was whether the equitable lien imposed by the trial court against FW's homestead was precluded by *Havoco*. The court referenced the general rule that "no judgment, decree or execution shall be a lien" upon homestead property. Art. X § IV(a)(1), Fla. Const. However, quoting the *Havoco* decision, the appeals court emphasized a court's authority to impose an equitable lien upon homestead beyond the literal language of the constitution where funds obtained through fraud or egregious conduct were used to invest in, purchase or improve homestead.

In this case, FW engaged in fraud *and* egregious conduct to obtain the funds she used to acquire her homestead. First, she received FH's interest in the Marital Home pursuant to the Agreement. Failing to abide by the Agreement, she used the proceeds from the sale of the Marital Home to purchase the New Home as her homestead. Furthermore, her actions showed that she lacked any intent to abide by the terms of the Agreement or the orders of the court in the post dissolution proceedings. Based on the standard that the trial court abused its discretion only where no reasonable man would agree with the decision, the appeals court affirmed the trial court's holding.

ii. *Hirchert Family Trust v. Hirchert*, 36 Fla. L. Weekly D1290b (5th Dist. Case No. 5D09-3054, 2011), the court imposed the equitable lien exception. Richard and Edith Hirchert, husband and wife, created the Hirchert Family Trust (the "**Trust**") in 1992. The Trust was a joint revocable trust commonly used by residents of California, a community property state. The Trust provided that upon the death of the first spouse to die, the

assets, including their home (the "**Original Marital Home**"), would be divided into two separate trusts, that is, the "**Survivor's Trust**" and the "**Residuary Trust**."

Edith died in 1996 and the Original Marital Home was divided between the two trusts. Seventy-five percent (75%) of the home was allocated to the Residuary Trust and the remaining twenty-five percent (25%) was allocated to the Survivor's Trust. In addition to being a beneficiary of both trusts, Richard was also the sole trustee.

The Survivor's Trust provided Richard with the right to both principal and earnings, however, his rights under the Residuary Trust were limited to earnings. Richard was not permitted to withdraw principal from the Residuary Trust until his own assets were fully dissipated.

In 1998, Richard married Johnee Ann Alle and conveyed title to the Original Marital Home held in the Residuary Trust to himself. Richard made this transfer without fully dissipating his own assets, therefore knowingly violating the terms of the trust.. Following this improper distribution Richard sold the Original Marital Home and purchased a another home with Johnee. Thereafter, the couple sold that home and purchased "Whispering Meadows" in California as joint tenants.

Richard died in 2003 and shortly thereafter Johnee sold Whispering Meadows for $775,000 and used the proceeds to purchase a home in Florida (the "**Florida Home**"). The successor trustee of the Trust discovered Richard's wrongful conduct and filed suit in California seeking the return of seventy-five percent (75%) of the proceeds of the sale of the Original Marital Home. The trial court in California ruled in favor of the successor trustee and imposed a constructive trust over the Florida Home in an amount equal to $431,422. The terms of the constructive trust prohibited Johnee from selling, mortgaging, hypothecating or otherwise transferring title to the Florida Home.

The trial court in California entered a post-judgment order requiring Johnee to convey the Florida Home to a court appointed receiver who could then sell the property. Johnee refused to comply and the California court directed a quitclaim deed be executed in favor of a receiver. The Florida trial court held that the original California judgment was entitled to Full Faith and Credit, however, the post-judgment order could not be enforced because the Kissimmee Home was protected homestead.

In *Hirchert*, the court held that the quit claim deed was not entitled to Full Faith and Credit because the California court did not have *in rem* jurisdiction over the Kissimmee Property. However, the court noted that the California court did have *in personam* jurisdiction over Johnee, therefore, the post-judgment order requiring Johnee to sell the Kissimmee Home was enforceable. Although the court determined that post-judgment order was enforceable, the issue remained whether the Kissimmee Home would be protected by the Florida homestead exemption.

In *Hirchert*, the court determined that Richard's misappropriation of trust funds (*i.e.*, a breach of his fiduciary duty) justified the imposition of a constructive trust to prevent unjust enrichment. As such, the court remanded the case to back to the trial court with instructions to

enforce the post-judgment order and convey title to the Kissimmee Home to the receiver. Moreover, the equitable lien exception was held to apply even though Edith was not the party who committed the wrongful act that procured the funds to purchase the homestead.

The economy will continue to present situations where debtors will seek refuge in Florida to take advantage of its generous homestead exemption. Since Florida provides an unlimited homestead exemption that emanates from its constitution, more conflicts are certain to occur involving foreign judgments and "debtbirds" seeking refuge in Florida.

Hirchert does not involve a traditional debtbird fleeing his or her creditors. Instead, *Hirchert* involves a widow who used the proceeds from the sale of her California home to acquire a home to live in Florida. The widow's deceased husband, however, breached his fiduciary duty in 1998 while serving as trustee of an irrevocable trust. Over 10 years later, the widow is about to lose Florida homestead even though she did not commit the original wrongful act on which the underlying judgment being enforced was predicated.

Contrast *Hirchert* with *Republic Credit Corporation I v. Upshaw (34 Fla. L. Weekly D635, March 2009)*, where a California debtbird fraudulently transferred proceeds from his California home into a Florida homestead. Mr. Upshaw landed home-free in Florida since Florida's UFTA is not one of the limited exceptions to Florida's constitutional homestead exemption. The result in each case cannot be reconciled unless the limitations to the Florida homestead are understood.

It is also important to note that while in most situations Florida law will provide unlimited protection of wealth shielded by homestead, the bankruptcy law does not. (A discussion of the rules related to homestead in bankruptcy is beyond the scope of this commentary. For a discussion of these rules see, Gopman, Lancaster and Vogelbacher, Steve Leimberg's Asset Protection Planning Newsletter # 64 (April 21, 2005); Gassman and Alper ("New Bankruptcy Bill – Who Pays It?" Asset Protection Planning Newsletter # 62 (Mar. 14, 2005); and Adkisson and Riser, Steve Leimberg's Asset Protection Planning Newsletter # 66 (May 3, 2005).)

Additionally, federal law (outside the bankruptcy context) has pierced the Florida homestead protection in certain situations. For a review of all the "**Homestead Hurdles**" encountered by those seeking Florida homestead protection, see Slenn, "New Migration Pattern: Snow Bird Levels Fall, Debt Bird Levels Rise," Bloomberg Law Reports, January 20, 2010.

For additional equitable lien cases see: *Labelle v. Labelle*, 624 So.2d 741 (Fla. 5th DCA 1993) (stating, "[T]he protection[s] afforded by Article X, Section 4 of the Florida Constitution . . . do not apply to properties which are purchased with fraudulently obtained, traceable proceeds and which are, therefore, subject to the imposition of a constructive trust."); *In re Fin. Federated Title & Trust, Inc.*, 347 F.3d 880, 881 (11th Cir. 2003) (holding that the Florida Constitution does not shield homestead property acquired with fraudulently obtained funds from an equitable lien or constructive trust); and *Palm Beach Savings & Loan Ass'n v. Fishbein*, 619 So. 2d 267 (Fla. 1993); *La Mar v. Lechlider*, 185 So. 833 (Fla. 1939) (equitable lien was affirmed because defendants declined to grant the plaintiffs an interest in their

homestead that was agreed in exchange for improvements plaintiffs made to the homestead); *Craven v. Hartley*, 135 So. 899, 901 (Fla. 1931) (an equitable lien was determined to be appropriate in a case where homeowner borrowed funds from lender to acquire property however neglected to execute a mortgage in favor of lender as agreed); see also *In re Bifani*, 24 Fla. L. Weekly Fed. B141a (M.D. Fla July 12, 2013) (equitable lien was affirmed because the debtor was engaged in litigation with his former business partner for nearly a decade and when that lawsuit appeared to be heading toward a judgment against him, the debtor transferred nearly all of his property to a close friend with whom he had been living, who then sold some of such property and invested it in homestead property).

i. See also, *Spikes v. OneWest Bank FSB*, 38 Fla. L. weekly D2a (D.C.A. 4, 2012) (equitable lien granted despite lack of eggregious conduct), providing:

> Generally, when an equitable lien is imposed on a homestead purchased with fraudulently obtained funds, the homestead exemption from forced sale does not apply to either spouse, even if one spouse is innocent or ignorant of wrongdoing. *See Hirchert Family Trust v. Hirchert*, 65 So. 3d 548, 551 (Fla. 5th DCA 2011). Equitable liens have been imposed on homestead property to prevent unjust enrichment. *See Palm Beach Sav.& Loan Ass'n v. Fishbein*, 619 So. 2d 267, 270 (Fla. 1993); *Hirchert*, 65 So. 3d at 552. If equity allows the innocent spouse to lose the protection of homestead when her spouse fraudulently obtains the funds to purchase the homestead, and equity will not protect the innocent spouse who will be unjustly enriched by the loan proceeds, then equity will not protect the innocent spouse from forced sale who attends the closing for a legitimate purchase money loan obtained by her husband, especially when she is willing to sign on the mortgage if asked. Moreover, to allow [defendant] to avail herself of the homestead protection in this case would grant a non-owner spouse greater homestead protection than the spouse who owned the property. As we see it, the three exceptions to homestead protection carved out in the constitution apply to the non-owner spouse to the same extent they apply to the owner spouse.

ii. See also, *In re Bifani*, Fed.Appx., 2014 WL 4457144, C.A.11 (Fla.), September 11, 2014 (NO. 14-10826, 14-11149).

l. A residence owned by a business entity such as a partnership will not qualify as homestead property. See *In Re Terri L. Steffen*, 405 B.R. 486 (U.S. District Court, M.D. Fla. April 27, 2009); *Buchman v. Canard*, 926 So.2d 390 (Fla. App. 3 Dist. 2005) ("partnership property cannot constitute the homestead property of one partner prior to the dissolution of the partnership").

7. **Homestead Exemption and Joint Ownership of Real Property.**

a. In *Daniels v. Daniels*, 237 So.2d 58 (Fla. 3rd Dist App. 1970), Mason Daniels ("**Mason**") and Victoria Daniels ("**Victoria**") were divorced by a final decree rendered on August 12, 1960. Pursuant to the divorce decree, Victoria and the children of the marriage were permitted to reside in a certain residence located in Dade County, Florida (the

"**Homestead**") previously owned by the parties as tenants by the entirety. The ownership of the Homestead was converted to tenancy in common upon the divorce. After the divorce Mason Daniels gave a note secured by a mortgage on his undivided one-half (1/2) interest in the Homestead to a straw man for his attorney, James Pilafian ("**James**"). Mason executed another note and mortgage covering the same undivided one-half (1/2) interest in favor of his attorney, James. These notes and mortgages, while in default, were assigned without recourse to Seymour Katz ("**Katz**"). Katz then instituted a foreclosure action against Mason's undivided one-half (1/2) interest in the Homestead. While the foreclosure action was pending Mason conveyed his interest in the Homestead to Victoria.

The trial court entered a judgment of foreclosure for the amount sought; however, it also ordered the Homestead could not be sold at a foreclosure sale because Victoria resided on the property and maintained the property as her homestead. Therefore, the Homestead could not be partitioned. Additionally, the trial court found that Mason's conveyance of his one-half (1/2) undivided interest in the Homestead to Victoria was subject to the outstanding mortgages involved in the foreclosure procedure.

The appellate court held based on public policy that a former husband cannot create an enforceable lien on his undivided one-half (1/2) interest in the homestead by giving his attorney notes secured by mortgages. However, the appellate court noted that when the Homestead loses its status as homestead property the liens would be subject to enforcement.

b. In *Tullis v. Tullis*, 360 So.2d 375 (Fla. 1978), Mr. Tullis ("**H**") and Mrs. Tullis ("**W**") during their marriage lived in a home owned by them as tenants by the entirety (the "**Residence**"). Prior to the dissolution of their marriage W moved out of the Residence; however, H with his minor daughter from a previous marriage continued to reside in the Residence. The final judgment of divorce made no disposition of the parties' respective interests in the Residence and did not award exclusive possession to either H or W. H continued to live in the Residence with his daughter. W brought suit for partition of the Residence then owned by H and W as tenants in common. H and W agreed that the Residence was not divisible.

On appeal the Florida Supreme Court reasoned that the homestead exemption was intended to protect the family home from forced sale for the debts of the owner and head of the family; however, the court never ruled that the homestead exemption precludes a common owner of property from suing for partition and obtaining a forced sale to obtain the beneficial enjoyment of his or her interest in the property. The Florida Supreme Court further reasoned that ***homestead interests should be protected from forced sale wherever possible, however, not at the expense of others owning interests in the property***. H and W agreed that the Residence was indivisible and that forced sale was the only method by which W could obtain the beneficial enjoyment of her one-half (1/2) undivided interest in the Residence. Furthermore, the trial court did not grant H exclusive possession of the Residence. As a result the Florida Supreme Court held that the Residence was subject to forced sale in the partition action between H and W because H and W were the co-owners of the Residence. See also *Wescott v. Wescott*, 487 So.2d 1099 (Fla. App 5th Dist. 1986).

c. **Commentary**: Based on *Daniels* and *Tullis* real estate owned in either tenancy in common or joint tenancy where one tenant occupies a residence as his or her homestead should qualify for the homestead exemption. Hence, creditors of a tenant who does not occupy the property should not be able to force the sale of the homestead property. Nonetheless, if there is a dispute between the co-owners of such a property, the court may possess the power to direct a sale of the homestead property to protect an interest in the property of one of the co-owners.

d. **Planning Opportunity**: Based on *Daniels* a co-owner who is not a debtor could move into a residence and claim it as homestead apparently precluding the forced sale of the debtor co-owner's interest in such a residence while it is the homestead of the non-debtor co-owner.

8. **Married Couples Residing in Separate Homesteads.**

a. In *Law v. Law*, 738 So.2d 522 (Fla. 4th Dist. 1999), Robert Law (the "**Debtor**") and his wife, Barbara ("**Wife**") separated in May of 1995. The Debtor was previously married to Phyllis Law ("**Former Wife**"). The Debtor moved from the residence he owned with his Wife as tenants by the entirety in Hollywood, Florida (the "**Hollywood Residence**") and moved into a home owned by his mother in Davie, Florida (the "**Davie Residence**"). The Debtor moved into the Davie Residence with his minor great-grandson. The Debtor was the legal guardian of his great-grandson. In February of 1997, the Debtor's mother became ill. The Debtor requested that his Wife assist him in taking care of his mother and his Wife moved into the Davie Residence. The Debtor's Wife continued to live in the Davie Residence until the Davie Residence was sold. After the Debtor's mother became ill, it was decided that the Davie Residence would be sold to pay for medical care for the Debtor's mother. The Debtor was given a power of attorney, which he used to sign a sales contract to sell the Davie Residence. The Debtor's mother died in March of 1997 and a few weeks later the Debtor filed a designation of homestead claiming the Davie Residence as exempt property. The Debtor then filed a declaratory action seeking to declare the Davie Residence to be his homestead. The Debtor's Former Wife had obtained a judgment against the Debtor for support payments and the Debtor claimed the Davie Residence was his homestead and should be exempt from his Former Wife's judgment.

The Debtor's Former Wife argued that because the Debtor had contracted to sell the Davie Residence prior to the Debtor's mothers death, the Debtor was precluded from having the intent to make the Davie Residence his homestead following his mother's death. The court dismissed this argument and noted that the agreement to sell does not preclude the Debtor from having the homestead exemption.

The Debtor's Former Wife also argued that the Davie Residence could not qualify as a homestead because the Hollywood Residence was the Debtor's homestead and a person cannot have two homesteads. The court referred to the bankruptcy case *Colwell v. Royal International Trading Corp.*, 226 B.R. 714 (S.D.Fla.1998). In *Colwell*, a husband and wife who had been living separately for more than three (3) years were permitted to each claim a separate homestead exemption. *Colwell* is important because it correctly concluded that a married couple living apart can each maintain a separate homestead exemption. The court in *Colwell*

noted that there is nothing inconsistent with Florida public policy if a homestead exemption is extended to each of two people who are married, ***but legitimately live apart in separate residences***. The court stated that "legitimately" means that there is no fraudulent or otherwise egregious act by the beneficiary of the homestead exemption. In applying this standard to the facts, the court reasoned that there was no evidence that the Debtor's and the Wife's separation in May, 1995 was for anything other than legitimate reasons and that there was sufficient evidence that the Debtor was residing in the Davie Residence when he inherited it coupled with the intention to remain in the Davie Residence until it was sold. The court held that the Debtor could claim the homestead exemption for the Davie Residence even though the Wife claimed the homestead exemption for the Hollywood Residence.

b. In *Colwell v. Royal International Trading Corporation, 226 B.R. 714 (S.D.Fla. 1998)*, on December 12, 1996, William Colwell ("**H**") and Ruby Colwell ("**W**") (collectively referred to as "**Debtors**") filed a joint petition for bankruptcy. The Debtors were legally married when they filed their bankruptcy petition. Nevertheless, the Debtors maintained separate residences for the 3½ year period immediately preceding the bankruptcy filing. H maintained a separate residence in Jupiter, Florida (the "**Jupiter Residence**") and W maintained a separate residence in Palm Beach Gardens, Florida (the "**Gardens Residence**"). H owned the Jupiter Residence in his individual name and W owned the Gardens Residence in her individual name. Each residence was afforded a separate homestead exemption for property tax purposes.

In the bankruptcy petition Debtors claimed both the Jupiter Residence and the Gardens Residence as exempt arguing that Article X § 4 of the Florida Constitution allows individual homestead exemptions for a husband and a wife who are separated and residing in individually owned homesteads. The bankruptcy trustee, however, argued that because the Debtors were still married, only one residence could be exempted from bankruptcy creditors.

The bankruptcy trustee argued that there are several Florida Statutes that conflict with granting dual homestead exemptions to the Debtors. First, § 61.075 of the Florida Statutes provides for the equitable distribution of marital assets and liabilities in dissolution of marriage proceedings. Absent an effective agreement to the contrary, the Debtors respective marital assets would be included among assets that are equitably distributed in a dissolution proceeding. As a result, the trustee argued that the Florida equitable distribution statute continues to apply to spouses irrespective of whether they are separated. Secondly, the trustee argued that Florida law provides surviving spouses the statutory right to elect a share of the deceased spouse's estate regardless of whether they are separated or not at the time of a spouse's death. As long as spouses remain married (whether living separately), the surviving spouse would be entitled to the elective share right over the deceased spouse's estate which would include the deceased spouse's homestead. The bankruptcy trustee argued that based on these statutes that the Debtors were not entitled to choose when to avail themselves to Florida's protective shield from creditors' claims and that to effectively claim separate homesteads the Debtors need to be divorced as Florida does not recognize marital separations.

The Debtors argued, however, that the source of law is the critical distinction between the statutes cited by the bankruptcy trustee and the constitutional homestead exemption. The probate and family law cited by the trustees was derived from statutes. On the other hand, the

homestead exemption is constitutional and may only be subject to those exceptions expressly enumerated in the Florida Constitution. The Debtors also argued that the Florida Supreme Court has long held that a wife may acquire a domicile separate from her husband and since there is no contrary authority existing in Florida, spouses living separately should be entitled to each claim a separate homestead exemption.

The court held that the Debtors intended to establish homesteads and did so by using and occupying their respective residences for 3½ preceding filing for bankruptcy.

Finally, the bankruptcy trustee argued that because the Debtors filed joint federal income tax returns, the Debtors were using their separate living arrangements as an instrument for defrauding creditors. However, the court dismissed this argument and held that filing joint income tax returns by the Debtors does not indicate living arrangements were an instrument for defrauding creditors.

The court held that in the absence of clear guidance from Florida courts construing Florida homestead laws and rights the Debtors were entitled to claim dual homestead exemptions.

c. In *In re Middleton*, 23 Fla. L. Weekly Fed. B157a (Bankr. N.D. Fla. 2011), court did not permit a debtor to claim the homestead exemption on a residence located in Panama City, Florida. The debtor acquired the residence in Panama City in February of 1998 in his individual name. Prior to that time the debtor lived with his wife at their "marital home" in Blakely, Georgia. This was a long term marriage at the time of the case. Less than thirty days before defaulting on his obligation to a creditor, Ron Phillips, the debtor conveyed his entire interest in the marital home in Georgia to his wife for no consideration. The debtor claimed that he became a Florida resident in January of 1999, however, he did not claim the homestead property tax exemption under Florida law until February 26, 2007. (This was shortly after Ron Phillips initiated a law suit against the debtor.) The debtor also held a Florida driver licence and was registered to vote in Florida.

The creditor, Ron Phillips argued that the Panama City residence was not the debtor's permanent residence and the claim of the homestead exemption on the property was an attempt to keep the property from the reach of creditors.

The court noted that the debtor and his wife "both claim that their marriage is intact." Aside from having an "intact marriage" the court noted a number of facts that led it to conclude the that the debtor could not claim the residence in Panama City as his homestead. For instance, the court noted that the debtor's financial, personal and social affairs revolve around his home and Blakely, Georgia and in 2007, the debtor's son was married and "the wedding announcements indicated that the Debtor was resident of Blakely, Georgia." The debtor's business was also located in Blakely, Georgia and he admitted to spending approximately eight days a month in Blakely, Georgia at his wife's home.

The court also noted:

> Here, the totality of the circumstances establishes that the Debtor and his family do not intend to permanently reside on the Panama City property. The Debtor's

financial and social affairs center on the Blakely home. The Debtor's paychecks are deposited into the joint account located in Blakely, Georgia and the Debtor stated that his checkbook from this account remains in Georgia. Most of the bills for the Debtor and his wife, including the utility bill for the Panama City property, are paid using checks from the joint account. The Debtor drives a company car registered in Georgia, attends church in Georgia, receives primary healthcare in Georgia and represents himself to be a resident of Georgia for numerous purposes. One court used the address listed on the Debtor's voter registration and driver's license as factors in its determination of a debtor's homestead. See In re Alexander, 346 B.R. 546, 551 (Bankr. M.D. Fla. 2006) (noting that the address listed on the debtor's driver's license, voter's registration card and checking accounts are all factors to be considered). However, I find that these items are not dispositive.

The court also noted:

Further, the Debtor and his wife both claim to have an "intact marriage," but only the debtor states that he intends to permanently reside on the Panama City property. In Law v. Law, 738 So.2d 522 (Fla. 4th DCA 1999), the court addressed couples living separately in "intact marriages" for Florida's homestead purposes. The court determined that when a couple is legimately separated and lives apart in different residences, each person can claim a homestead exemption when the separation was bona fide, but that "a husband and wife in an intact marriage cannot have two homesteads." Id. at 525. Although Mrs. Middleton has not claimed a Georgia homestead exemption, the Blakely home is where she intends to permanently reside.

Finally, the court held:

The Debtor's financial and social affairs link the Debtor to the marital home in Blakely, Georgia. Because there can be only one homestead claimed by spouses in an "intact marriage," and the evidence establishes that the Debtor has used the Panama City property only as a part-time residence, I find that the Debtor has used the Panama City property only as a part-time residence. I find that the Debtor cannot claim a Florida homestead exemption.

d. See also, *Brklacic v. Parrish*, 39 Fla. L. Weekly D1885a (4th Dist. Case No. 4D12-2597 Sept. 2014) (Individual maintaining a separate residence from his spouse who was already claiming a homestead exemption for property tax purposes on her primary residence was not permitted to claim a homestead exemption for property tax purposes on his primary residence under Article VII, § 6(b) of the Florida Constitution.)

Practice note: There is no prohibtion in the Florida Constitution against a married couple claiming two separate residences as their respective homesteads for purposes of the exemption from forced sale. Furthermore, there is no requirement in the Florida Constitution that a married couple have marital issues or that their marriage not be "intact" to claim the homestead exemption over separate residences. The Florida Constitution merely requires that

each person use the residnence that he or she is claiming as their homestead as his or her primary residence. This part of the court's holding in *Middleton* seems to rest on highly dubious grounds. Nevertheless, the court's decision appears to rest more on the fact that the Panama City residence was not the debtor's primary residence. Instead, the facts simply indicated that he lived permanently in Blakely, Georgia with his wife. Imposing a requirement of marital disharmony, despite that part of the holding of *Law* and *Colwell*, and especially based on subsequent caselaw, would seem a stretch, particulary in the world today where relationships are complicated and what was considered abnormal or immoral in years past is no longer the case.

9. **Claiming the Benefit of the Homestead Exemption.**

a. An individual who is a resident of Florida can claim the benefit of the homestead exemption by preparing a written statement containing a description of the individual's real property (or mobile or modular home) that is claimed as exempt. F.S. § 222.01(a). The statement must declare the real property (or mobile or modular home) is the individual's homestead. *Id*. The statement must be signed by the individual making it, and it must be recorded in the circuit court. *Id*.

b. If a levy is made on the land of an individual who has not declared his or her homestead, that individual (or his or her agent or attorney) may provide written notification to the officer making such levy of what the individual regards as his or her homestead. F.S. § 222.02. The notice must provide a description of the property claimed as homestead. *Id*. The notice must be made under oath before an officer who is authorized to administer oaths. *Id*. The notice may be made any time prior to the day designated for the sale of the property. *Id*.

c. Florida Statutes § 222.03 provides a procedure for a creditor to question the ***quantity of land*** that a debtor claims as the debtor's homestead.

i. To question quantity of the land a debtor claims as homestead, a creditor or the creditor's attorney must notify the officer levying on such property of the creditor's request that homestead be surveyed.

ii. If the homestead is not located within municipality, the individual claiming the exemption has the right to set apart the portion of land belonging to debtor that includes the residence or does not include the residence at the debtor's option.

iii. If the parcel claimed as homestead in an unincorporated area does not contain one hundred sixty (160) acres, the levying officer is directed to set apart the remainder from any other parcels claimed by the debtor. Nonetheless, in all cases the levying officer must set apart only contiguous land until the entire one hundred sixty (160) acres is set aside.

(1) The individual who asserts the exemption cannot be forced to claim any property or part of such property if a defect exists in the title (other than at the option of such individual).

(2) The expense related to conducting the survey will be charged to the excess property claimed as homestead when such property is sold in a forced sale; however, where it is determined that a debtor has claimed one hundred sixty (160) acres or less as the debtor's homestead, the expenses related to the survey must be paid by the creditor who demanded the survey be conducted.

d. Florida Statutes §222.04 provides that following a survey conducted pursuant to F.S. §222.03, the levying officer can sell the property levied upon that is not protected by the homestead exemption.

e. The exemption can apply to an individual who owns and occupies a mobile or a modular home as such individual's primary residence even though such home is located on land that does not belong to the debtor. F.S. § 222.05. Apparently, the individual must legally possess the property when he or she claims the homestead exemption. *Id*.

f. The Circuit Courts in Florida have jurisdiction to enjoin the sale of homestead property. F.S. § 222.10.

g. Caution is warranted when counseling a debtor who is a client claiming the homestead exemption in a bankruptcy proceeding. If amending a schedule to claim a homestead exemption will prejudice the creditors and the estate, a debtor will not be permitted to claim the homestead exemption. See *e.g.*, *In re Ballou*, 23 Fla. L. Weekly Fed B158 (M.D. Fla. 2011); and *In re Talmo*, 185 B.R. 637 (Bankr. S.D. Fla. 1995).

h. It is well settled in bankruptcy that "any challenge to the homestead exemption claim places a burden on the objecting party to make as strong showing that the Debtor is not entitled to the claimed exemption." *In re Harrison*, 236 B.R. 788, (Bankr. M.D. Fla. 1999). If a conversion occurs from one chapter of bankruptcy to another it also established law "that the claim of exemption is to be determined as of the petition date, and not as of the date of conversion." See 11 U.S.C. Sec. 348; *In re Sandoval*, 103 F.3d 20 (5th Cir. 1997); *In re Marcus*, 1 F.3d 1050 (10th Cir. 1993); *In re Buick*, 237 B.R. 607, 609 (Bankr. W.D. Pa. 1999); *In re Rivera*, 5 B.R. 313, 315 (Bankr. M.D. Fla. 1980 ("the right to claim exemptions by a Debtor is governed by the facts and governing circumstances which existed on the date the petition was filed and not by any changes which may have occurred thereafter."); and *In re Ballato*, 318 B.R. 205 (Banrkr. M.D. Fla. 2004).

10. **Proceeds from Sale of Homestead**. The homestead exemption can protect the proceeds of the sale of a residence in the same manner it protects the homestead provided the seller demonstrates by a preponderance of the evidence a good faith intention just prior to or at the sale to invest the sale proceeds in a successor residence within a reasonable time. *Rossano v. Britesmile, Inc.*, 919 So.2d 551 (Fla. App. 3rd Dist. 2005); *Orange Brevard Plumbing & Heating Co. v. La Croix*, 137 So.2d 201 (Fla. 1962); *In re Englander*, 95 F.3d 1028 (11th Cir. 1996), *cert. denied*, 117 S. Ct. 1469, 137 L.Ed.2d 682 (U.S. 1997); *In re Bandkau*, 187 B.R. 373 (Bankr. M.D. Fla. 1995) and *In re Quraeshi*, 289 B.R. 240 (Bankr. S.D. Fla. 2002).

a. **Query**: What constitutes a reasonable time? This limitation is determined by examining the facts and circumstances of the case. *Orange Brevard Plumbing & Heating Co. v. La Croix*, 137 So.2d 201 (Fla. 1962).

b. Only the portion of the sale proceeds that are intended for reinvestment in a successor homestead are exempt. *Rossano v. Britesmile, Inc.*, 919 So.2d 551 (Fla. App. 3rd Dist. 2005); *Orange Brevard Plumbing & Heating Co. v. La Croix*, 137 So.2d 201 (Fla. 1962); *In re Englander*, 95 F.3d 1028 (11th Cir. 1996), *cert. denied*, 117 S. Ct. 1469, 137 L.Ed.2d 682 (U.S. 1997); and *In re Binko,* 258 B.R. at 517.

c. Excess proceeds from the sale of homestead property, that is, funds not reinvested in a successor residence, will not retain the exemption. *Orange Brevard Plumbing & Heating Co. v. La Croix*, 137 So.2d 201 (Fla. 1962).

d. Sale proceeds should not be commingled with other funds belonging to the debtor. Instead, sale proceeds should be held in a segregated account. *Orange Brevard Plumbing & Heating Co. v. La Croix*, 137 So.2d 201 (Fla. 1962).

e. See *JBK Associates, Inc. v. Sill*, 40 Fla. L. Weekly D616a (4th D.C.A. 2015), affirmed 41 Fla. L. Weekly S189a (Fla. 2016), holding that where "a judgment debtor segregated his portion of the proceeds of the sale of his homestead in a brokerage account, where he purchased mutual funds and unit investment trusts"…"the debtor's investments were not so incompatible with the purpose of homestead that the protected status of the sale proceeds was destroyed." Rather sale proceeds from the sale of a homestead held in a brokerage account can qualify for the homestead exemption if there is intent to reinvest those proceeds into another homestead within a reasonable time. Caution is warranted, however, as the type of investments, for example, speculative investments, might lead a court to conclude that there is no intent to reinvest the proceeds in a homestead. Furthermore, the case did not address the issue of whether the gains from the sale of such securities would also be protected under the homestead exemption. The court stated:

> A judgment debtor segregated his portion of the proceeds of the sale of his homestead in a brokerage account, where he purchased mutual funds and unit investment trusts. A judgment creditor seeks to reach that portion of the debtor's proceeds arguing that these types of investments forfeited the debtor's homestead protection. We hold that the debtor's investments were not so incompatible with the purpose of homestead that the protected status of the sale proceeds was destroyed. funds were kept "separate and apart" from Sill's other funds. *Id.* at 206; *see also In re Bertola*, No. 11-29140 MER, 2012 WL 1945426 (Bankr. D. Colo. May 30, 2012). This case does not involve the speculative put and call option trading of up to 302 transactions per month that led a bankruptcy panel to conclude that such use of the proceeds was inconsistent with the purposes of Arizona's homestead exemption. *In re White*, 389 B.R. 693, 697, 704 (B.A.P. 9th Cir 2008).

Affirming the decision of the appellate court, the Florida Supreme Court held:

> Here, Sill placed the proceeds from the sale of the prior homestead in a separate account that was designated as his "homestead account." He thus manifested his intent pursuant to *Orange Brevard* to reinvest the sale proceeds into a new homestead. Moreover, he, in fact, used the money to purchase a new homestead within a reasonable period of time. Any decision contrary to the one we make here would require judgment debtors to place homestead sale proceeds in non-interest-earning mediums only -- perhaps an escrow account or even a jar under one's bed--and we decline to read Florida's homestead exemption provision so narrowly, especially given the liberal construction this area of Florida law typically enjoys. For those reasons, we approve the Fourth District's decision that Sill's actions in this case have not eliminated his homestead protection. We also reaffirm our decision in *Orange Brevard Plumbing & Heating Co. v. La Croix,* 137 So. 2d 201 (Fla. 1962).

11. **Too Much Homestead - Too Little Exemption**. If a homestead is situated on a tract of land that is greater than the acreage protected by the exemption, a debtor residing in a municipality may claim any contiguous one-half (1/2) acre part of the land as exempt provided the remainder of the land has "legal and practical use." *In re Englander*, 156 B.R. 862 (1992); and *In re Quraeshi*, 289 B.R. 240 (Bankr. S.D. Fla. 2002). If the property cannot be divided in the foregoing manner because of legal restrictions (for example, a division is prohibited under applicable zoning laws) or the remainder has no practical use, courts have ordered the property sold and the proceeds apportioned between the creditor and the debtor. In *In re Englander*, the court provided:

> The property cannot be practically or legally divided and a sale of the entire parcel with an accompanying apportionment of the entire proceeds is an "eminently fair resolution." [Citation omitted.] Through such a sale the debtors will receive the value of their homestead land, which will retain its exempt status under the doctrine of *Orange Brevard Plumbing & Heating Co. v. La Croix*, 137 So.2d 201 (Fla. 1962). The debtors can then repurchase a homestead or bid their exemption at the sale thereby fulfilling the purpose of the Florida homestead exemption law by providing shelter for the debtors and their family. [Citation omitted.] The creditors will benefit as the Trustee will recover the proceeds of the nonexempt tract for distribution.

See also, *In re Quraeshi*, 289 B.R. 240 (Bankr. S.D. Fla. 2002); *In re Wierschem*, 152 B.R. 345 (Bankr. M.D. Fla. 1993). According to *Quraeshi*, following a court ordered sale under these circumstances, a debtor is only entitled to receive a *pro rata* portion of the net proceeds of the sale, that is, the proceeds remaining after payment of any mortgage, liens and expenses related to the sale. See also *In re Wierschem*, 152 B.R. 345 (Bankr. M.D. Fla. 1993).

There is no case law in Florida holding that there is a *de minimus* exception to any overage involving homestead. Two cases which involve the issue of homestead overage do not directly address the consequences. In *Heil Co. v. Lavieri*, 205 So. 2d 21 (2nd D.C.A. Fla. Dec. 6, 1967), the court held that the appellee's property (which was slightly more than one-half acre) was homestead and exempt from sale to the extent of one-half acre. The court is silent, however, regarding the issues, or potential consequences, raised by the modest overage. In

Braswell v. Braswell, 890 So.2d 379 (3rd D.C.A. Fla. Dec. 22, 2004), the court focused on condominium homestead overages and the correct calculation of the inclusion of the common elements within the one-half acre limitation rather than choosing to opine on the overage itself.

Other jurisdictions have addressed the issue in rulings by refusing to adopt a *de minimis* rule where the property exceeded the homestead protection by an inconsequential sum. See *In re McCabe*, 299 B.R. 564 (Bankr. N.D. Iowa 2003); *Title Insurance Company of Minnesota v. Agora Leases, Inc*. 320 N.W.2d 884 (Sup. Ct. Minn. 1982). Although Florida is silent on the issue, Florida courts choose to narrowly construe the constitutional homestead exemption. *Butterworth v. Caggiano*, 605 So.2d 56 (Sup. Ct. Fla. 1992); *In re Baxt*, 188 B.R. 322 (Bankr. S.D. Fla. 1995).

12. **Portion of Property Located in Municipality used as Residence and Portion of Property used as Rental**. If a portion of the property claimed as homestead located in a municipality is used as the debtor's residence and a portion is used as rental property, only the portion use as the debtor's residence will qualify as the debtor's homestead. See *Menard v. University Radiation Oncology Associates, LLP*, 976 So.2d 69 (Fla. App. 4th Dist. 2008) ("Only the part of debtor's property used as his residence is exempt from levy and execution. That part leased to other occupants is not exempt."); *First Leasing and Funding of Florida, Inc. v. Fielder*, 591 So.2d 1152 (Fla. 2d DCA 1992); *Smith v. Guckenheimer*, 27 So. 900 (Fla. 1900); *In re Radtke*, 344 B.R. 690 (Bankry. S.D. Fla. 2006); *In re Nofsinger*, 221 B.R. 1018 (Bankry. S.D. Fla. 1998); and *In re Aliotta*, 68 B.R. 281 (Bankry. M.D. Fla. 1986). If the portion of the property that is leased to other occupants cannot be partitioned, the entire property "may be sold at public sale and only the debtor's *pro rata* share will be exempt." *Menard v. University Radiation Oncology Associates, LLP*, 976 So.2d 69 (Fla. App. 4th Dist. 2008). For an interesting, however, brief discussion of the law in this area see Lee, "Partial Property Rental May Limit Homestead Protection," XXXII ActionLine 20 (Winter 2010).

13. **Portion of Property Located Outside Municipality used as Residence and Portion of Property used as Rental**. If a portion of the property claimed as homestead located outside a municipality is used as the debtor's residence and a portion is used as rental property, the entire property will qualify for the homestead exemption (assuming the homestead property is within the 160 acres limitation). In *In re Oullette*, 21 Fla. L. Weekly Fed. B 773 (Bkrtcy. M.D. Fla.), Robert and Yasuko Oullette (collectively the "**Debtors**") filed a bankruptcy petition on June 4, 2008. The Debtors claimed certain real property located at 4162 Saunders Drive, Middleburg, Florida (the "**Property**") as exempt homestead property. The Property was located outside a municipality. There were two mobile homes located on the Property. The Debtors lived in one of the mobile homes and rented the other mobile home (the "**Rental**") to a third party for $450 a month.

The bankruptcy trustee filed an objection to the Debtors' claimed exemption. The bankruptcy trustee argued that the Rental was personal property and that it and the rent received from it were therefore property of the bankruptcy estate. Alternatively, the bankruptcy trustee argued that even if the Rental was real property, it and the rents from it were not exempt.

The Debtors argued that the Rental was real property. Florida law provides that a mobile home may be considered real property only when the owner of the mobile home is also the owner of the land the mobile home is situated and the mobile home is permanently affixed to such land. A mobile home is considered permanently affixed if it is tied down and connected to the normal and usual utilities. The Debtors presented pictures of the Rental showing skirting around the Rental and a sewer or septic pipe funneling from a hole in the skirting into the ground. The court held that the mobile home is real property.

According to the court, Article X, § 4(a)(1) of the Florida Constitution provides:

> (a) There shall be exempt from forced sale under process of any court, and no judgment, decree or execution shall be a lien thereon, except for the payment of taxes and assessments thereon, obligations contracted for the purchase, improvement or repair thereof, or obligations contracted for house, field or other labor performed on the realty, the following property owned by a natural person: (1) ***a homestead, if located outside a municipality, to the extent of one hundred sixty acres of contiguous land and improvements thereon, which shall not be reduced without the owner's consent by reason of subsequent inclusion in a municipality***; or if located within a municipality, to the extent of one-half acre of contiguous land, upon which the exemption shall be limited to the residence of the owner or the owner's family; *(emphasis added)*

The bankruptcy trustee argued that the homestead exemption should be denied because a portion of the Property (*i.e.*, the Rental) was not used as a residence of the owner or the owner's family. However, the Debtors argued the court should follow the reasoning in *Davis v. Davis*, 864 So.2d 458 (Fla. 1st Dist. Ct. Appl 2003). In *Davis*, property was claimed as exempt homestead that was less than 160 acres and located outside a municipality in which the owner used a portion of the property to operate a mobile home park. The court in *Davis* held that when the Florida Supreme Court interpreted the 1868 and 1885 homestead provisions it consistently held that the language which limited homestead to the "residence and business house of the owner" did not apply to homesteads located outside municipalities. Furthermore, the court noted that in the current constitutional language a semicolon serves to grammatically separate the language expressing the extent of a homestead outside a municipality from the language limiting a homestead within a municipality to the "residence of the owner or the owner's family."

The Debtors argued that based on the plain language of Article X, § 4(a)(1) and the applicable existing case law under the prior constitutions, the language limiting homesteads within municipalities to the residence of the owner or the owner's family should not apply to homesteads located outside municipalities.

The court held that the Rental located on the Debtors' Property, which the Debtors rent to a third party is exempt pursuant to Article X, § 4(a)(1) of the Florida Constitution and any rent due or paid after the petition was filed was also exempt.

This same concept has been recognized in several past cases. See *e.g.*, *Armour & Co. v. Hulvey*, 73 Fla. 294, 74 So. 212 (Fla. 1917); *Coleman v. Williams*, 146 Fla. 45, 200 So. 207

(Fla. 1941); *Wilson v. Florida Nat. Bank & Trust Co. at Miami*, 64 So.2d 309 (Fla. 1953); *Buckels v. Tomer*, 78 So.2d 861 (Fla. 1955); *Quigly v. Kennedy & Ely Insurance, Inc.*, 202 So.2d 610 (Fla. 3rd Dist. 1967), *rev'd*. 207 So.2d 431 (Fla. 1968).

14. **Portion of Commercially Zoned Property Used Execlusively as Debtor's Residence is Exempt Homestead**. In *In re Kain*, 25 Fla. L. Weekly Fed. B243a (Feb. 14, 2014), the court found that a bathroom and a portion of a kitchen in a commercially zoned property owned by the debtor were exempt homestead as those were the only portions of the property that the debtor used execlusively for her residence on the date of her bankruptcy petition. The court made its finding despite the fact that the debtor previously applied for and was denied a zoning variance in order to live on the property. In so ruling, the court, citing *In re Englander*, 95 F.3d 1028, 1032 (11th Cir. 1996), noted "that when property cannot be divided, the appropriate solution is to sell the property and apportion the proceeds between the homestead and non-homestead portion of the property." The court followed the holding of *In re Wilson*, 393 B.R. 778 (Bankr. S.D. Fla 2008). In *Wilson*, the court found the *Englander* approach to have been consistently followed when a debtor resides in a building used for residential and commercial purposes. *Id.* at 783. The debtor in *Wilson* was allowed to exempt the upstairs apartment where the debtor resided, despite the apartment being a portion of a commercially zoned nightclub.

15. **Intent to Permanently Abandon**. After property acquires its homestead status, it retains that characteristic unless it is permanently abandoned. *In re Gaines*, 2007 WL 1228157 (Bankr. M.D. Fla. April 18, 2007). There is no constitutional requirement that occupancy of the homestead be continuous. If a resident-debtor is absent from the claimed homestead for a prolonged period, however, the primary issue of *fact* that must be resolved is whether the debtor intended to return or permanently abandon the residence. See *e.g.*, *In re Ehnle*, 124 B.R. 361 (M.D. Fla. 1991).

a. **How Long is too Long?** There is no definite period of absence that conclusively proves a resident has abandoned the homestead. If there is no evidence of the intent to permanently abandoned the homestead, a resident can be absent for a fairly extended period. *Ehnle* at 364 (debtor and his wife were absent for more than one (1) year and property was held to be homestead). In *Marsh v. Hartley*, 109 So. 2d 34 (Fla. 2d DCA 1959), after being demoted, Hartley left his Orlando homestead for four (4) years to procure work in various cities in Florida, however, he successfully retained his homestead status in his residence in Orlando. The *Marsh* court held that so long as Hartley intended to return, his extended absence did not necessarily create an abandonment. *Id.* at 38. In another case where the court ruled against abandonment, a couple was experiencing marital problems. The wife relocated to Kentucky taking the couple's children with her. She moved in with her parents. In an attempt to save the marriage, the husband followed his wife and children to Kentucky. The couple returned to Florida approximately nine (9) months later after the wife completed her degree at a local university. *Monson v. First Nat'l Bank of Bradenton*, 497 F.2d 135 (5th Cir. 1974).

b. **Intent is a Factual Determination.** Intention is the crucial factor that must be established. *Ehnle* at 363. The courts have considered various facts. In *Monson*, the court focused on the fact that the husband was seeking to reconcile his marriage.

Id. at 139. The intent was further evidenced by the couple having retained their Florida licenses and voter registrations and not attempting to sell the Florida home. *Id.* The couple in *Ehnle* also retained ownership in the homestead while leasing a condo with an option to purchase that terminated when the condo was sold at foreclosure. *Ehnle* at 364. The court speculated that the couple may have intended to permanently change their residence when they moved to the condo but could not have established the condo as their permanent residence until they exercised their option. *Id.* In *Marsh*, although Hartley rented the homestead during his absence, he frequently returned to work in his woodshop and maintain the property. *Marsh* at 37. But for the economic necessity to move, Hartley lived in Orlando continuously for twenty-five (25) out of twenty-nine (29) years. *Id.* It is important to note, however, the debtor can lose on the facts. See *In re: Gaines*, 2007 WL 1228157 (Bankr. M.D. Fla. April 18, 2007). See also *In re Gentry*, 23 Fla. L. Weekly Fed. B179 (Bankr. M.D. Fla. November 15, 2011) (intent to permanently reside in residence connotes a desire to remain for an indefinite period). For a brief discussion of *Gentry* see **LISI** Asset Protection Planning Newsletter #192 (January 30, 2011) at http://www.leimbergservices.com Copyright 2012 Leimberg Information Services, Inc. (LISI). According to *In re Ballato*, 318 B.R. 205 (Brankr. M.D. Fla. 2004), "to conclude that the homestead exemption has been abandoned, the court must find that abandonment was voluntary. Absence from the homestead that is involuntary or compulsory, or which arises out of health, finaancial or family reasons does not constitute a relinquishment of the homestead rights." See also, *Barnett Bank of Cocoa, N.A. v. Osborne*, 349 So.2d 223 (Fla. 4th DCA 1977) holding "that the marital residence was subject to the homestead exemption of the former husband, notwithstanding that the former husband and wife having been divorced and the former wife having been awarded exclusive possession of the property." *Id*. *In re Buick*, 237 B.R. 607 (Bankr. W.D. Pa. 1999); *In re Beebe*, 224 B.R. 817 (Bankr. N.D. Fla. 1998); *In re: Estate of Pendrys*, 443 So.2d 402 (Fla. 4th DCA 1984); *In re Herr*, 197 B.R. 939 (Bankr. S.D. Fla. 1996).

16. **Claims by Federal Government**. Article VI of the Constitution of the United States of America provides in relevant part:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, *shall be the supreme Law of the Land*; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any state to the Contrary notwithstanding. [Emphasis added.]

Under the Supremacy Clause Congress can pass legislation that preempts state law (including the protection given to a homestead under Florida law). For example, §6321 of the Internal Revenue Code of 1986 (the "**Code**") provides:

> If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) ***shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person***. (Emphasis added.)

See also *U.S. v. Rodgers, et al.*, 461 U.S. 677, 76 L.Ed.2d 236 (1983); *David E. Grochocinski v. Martin Laredo et al*., No. 05 A 1785 (Bankr. N.D. Ill., Dec. 2005); *In re Garcia,* No. 09-33208-LMI, slip op. (Bankr. S.D. Fla. July 6, 2010), 2010 WL 2697020 ("the virtually limitless Florida homestead law prompted the enactment of section 522(o). . . the provisions of the Florida Constitution conflict with section 522(o). . . [and] by virtue of the Supremacy Clause, 11 U.S.C. § 522(o) preempts Florida's constitutional homestead exemption.")

In *United States. v. Estes*, 450 F.2d 62, 65 (5th Cir. 1971), the court noted that "Even though the homestead might be exempt under state law from the claims of private creditors, '[n]o provision of a state law may exempt property or rights to property from levy for the collection of, federal taxes owed."

The Supremacy Clause permits the United States government to effectively "sweep aside state-created exemptions." *In re Bolden*, 327 B.R. 657, 663 (Bankr. C.D. Cal. 2005) (quoting *United States v. Rodgers*, 461 U.S. 677, 701 (1983)).

A "state-created homestead exemption is ineffective against a federal tax lien." *Davenport v. United States*, 136 B.R. 125, 127 (W.D. Ky. 1991) (citing, *inter alia*, *United States v. Mitchell*, 403 U.S. 190 (1971); *United States v. Bess*, 357 U.S. 51 (1958)). A state law homestead exemption will "not erect a barrier around a taxpayer's home sturdy enough to keep out the Commissioner of Internal Revenue." *United States. v. Estes*, 450 F.2d 62, 65 (5th Cir. 1971).

See also, *Rubenstein v. Com'r.*, 134 T.C. No. 13 (2010).

When the federal government (or an agency thereof) obtains a money judgment against a defendant for *equitable restitution*, such judgment constitutes a "debt" subject to the rules proscribed in the Federal Debt Collection Procedures Act (the "**Debt Act**") (28 U.S.C. §3001 *et seq*.) Upon filing a certified copy of the abstract of the judgment, the judgment creates a lien on all of the real property of a judgment debtor. See 28 U.S.C. §3201(a). On application to a court, the court may order the United States to sell any real property subject to such judgment lien. See 28 U.S.C. §3201(f). The Debt Act provides that individual debtors may elect to exempt from recovery by creditors any property that is exempt from debt collection under the state or local law of the debtor's domicile. See 28 U.S.C. §3014(a)(2)(A).

In *United States v. Acculab Laboratories, Inc.,* Case No. 8:03-CV-1813-T-27TGW (M.D. Fla., 2011), the defendant claimed that his Florida homestead was exempt from seizure in an action under the False Claims Act. The United States District Court for the Middle District of Florida held:

> [F]ederal law governs the resolution of the defendant's claim of a homestead exemption. The Federal Debt Collection Procedures Act permits an individual in a proceeding like this to claim state law exemptions. In such a proceeding, the debtor bears the burden of persuasion. While federal law sets the procedures, state law governs the exemption.

However, the Debt Act does not apply to the collection of monies owed which are not defined as "debts" under the Act. (28 U.S.C. §3001(c)). Though the term "restitution" is specifically defined to be a "debt" under the Debt Act, the term "disgorgement" is not so defined. Restitution aims to compensate the victim of a wrongful act, whereas disgorgement is an equitable remedy meant to prevent unjust enrichment. The U.S. Court of Appeals for the Fifth Circuit has ruled consistently that an order of disgorgement is not deemed to be a "debt" under the Debt Act, and therefore, the district courts have the discretion to ignore state homestead and other exemptions in deciding whether to hold defendants in contempt for failure to pay disgorgement orders. See *SEC v. Huffman*, 996 F.2d 800, 802 (5th Cir. 1993); See also *SEC v. AMX, International, Inc*., 7 F.3d 71, 74-76 (5th Cir. 1993).

In *SEC v. Solow*, 682 F.Supp.2d 1312, 1326 (S.D. Fla., 2010), the United States District Court for the Southern District of Florida held that district courts "have broad equitable powers to reach assets otherwise protected by state law to satisfy a disgorgement…[f]or example, a district court can ignore state law exemptions as well as other state law limitations on the ability to collect a judgment in fashioning a disgorgement order."

Therefore, in a civil action for *equitable restitution* brought by an agency of the federal government against an individual defendant who is domiciled in Florida, the individual defendant may successfully claim a Florida state law homestead exemption from recovery of a judgment ultimately entered against the defendant. However, if an order of *disgorgement* is entered against the individual defendant, the presiding court may ignore Florida state law exemptions (as well as other state law limitations) on the ability of the federal agency to collect the judgment.

17. **Waiving Homestead Rights**. In *DeMayo v. Chames*, 2006 WL 626059 (Fla. App. 3 Dist. 2006; 31 Fla. L. Weekly D 1628 (Fla. 3rd DCA June 14 2006)), the defendant ("**D**") appealed a final judgment granting his former divorce attorney ("**A**") and the attorney's law firm attorneys' fees under a charging lien. The issue in the case was whether D had effectively waived D's constitutional right to claim the benefits of the Florida homestead exemption.

D retained A and A's law firm to represent him in post-divorce proceedings regarding modification of child support and alimony obligations. The retainer agreement signed by D provided:

> It is specifically agreed that [A's law firm] shall have and is hereby granted all general, possessory and retaining liens and all equitable, special and attorney's charging liens upon the client's interests in any and all real and personal property within the jurisdiction of the court for any balance due, owing and unpaid as well as a lien in any recovery whether by settlement or trial; and such lien or liens shall be superior to any other lien subsequent to the date hereof ***and that the client hereby knowingly, voluntarily and intelligently waives his rights to assert his homestead exemption in the event a charging lien is obtained to secure the balance of attorney's fees and costs***. (Emphasis added.)

The trial court eventually granted the request of A's law firm to withdraw as D's attorneys. Furthermore, the trial court held that it would enforce D's waiver in the retainer agreement of his right to claim the homestead exemption and it entered a judgment for attorney's fees in favor of A's law firm.

Citing numerous cases, the appellate court held that the homestead exemption could not be waived in this manner under current Florida law. *Carter's Adm'r v. Carter*, 20 Fla. 558 (1884); *Atlantic Coast Line R. Co. v. Beazley*, 54 Fla. 311, 45 So. 761, 786; *Sherbill v. Miller Mfg. Co.*, 89 So.2d 28, 31 (Fla.1956); *Havoco of America, Ltd. v. Hill*, 790 So.2d 1018, 1021 (Fla. 2001); *Olesky v. Nicholas*, 82 So.2d 510, 513 (Fla. 1955); *Butterworth v. Caggiano*, 605 So.2d 56, 60 (Fla. 1992); *In re Estate of Nicole Santos*, 648 So.2d 277, 282 (Fla. 4th DCA 1995); *In re Clements*, 194 B.R. 923, 925 (M.D.Fla.1996).

The concurring opinion in the appellate court case certified a question of great public importance to the Florida Supreme Court, that is, whether, given the subsequent precedent in Florida and other jurisdictions and certain textual changes to the constitutional provision providing the homestead exemption, the court would overrule its 123 year old holding in the *Carter* and *Sherbill* cases, that a waiver of the constitutional exemption from forced sale of a homestead is unenforceable against the claim of a general creditor.

In *Chames v. DeMayo*, 972 So.2d 850 (Fla. 2007), the Florida Supreme Court affirmed the decision of the appellate court holding that the homestead right could not be waived by a general waiver in this manner. A argued that the Court should recede from its precedent on three grounds:

(1) a 1984 amendment to the constitution morphed the purpose of protecting the family home into a personal right;

(2) most states permit waivers; and

(3) permitting a waiver of homestead protection is consistent with waivers of other constitutional rights.

Argument #1 shot down: Before 1984, the court noted that the homestead exemption was limited to one who qualified as "the head of a family," which required a showing of a duty to a dependant. In 1984, Florida voters approved an amendment to the homestead provision to change this phrase to a "natural person." The court disagreed that the voters intended to alter the purpose of the exemption and permit a waiver. It noted two of its post-1984 amendment rulings that continued to recognize the protection of the family and the home although the exemption had been expanded to benefit any natural person.

Argument #2 shot down: The court also acknowledged that it has been willing to recede from precedent when it conflicted with the law of the majority of states. However, the court was not persuaded by the argument advanced by Chames that there has been a majority trend toward states permitting waivers of constitutional and statutory homestead rights. After examining such rights in other jurisdictions, to the extent that a trend could be discerned, the court observed that "*the trend appears to go in the opposite direction*." In that regard, it found that relatively few jurisdictions permit a general waiver of homestead in an executory contract

and that Florida law was consistent with many of the cases which address waiver by a mortgage or a spouse's waiver of homestead rights in a marital agreement. Of the eight jurisdictions the *Carter* court surveyed regarding waiver of exemptions, the court determined that five continue to prohibit general waivers and two have switched (Pennsylvania, which at the time permitted a waiver, now prohibits it, and Louisiana, which at the time prohibited a waiver, now permits it); effectively, a wash.

Argument #3 shot down: The court noted that the third reason offered by Chames would be the most compelling reason to recede from its precedent. "*If . . . other constitutional rights can be waived, it would seem anomalous to prohibit waiver of homestead exemption.*" The court acknowledged a trend toward permitting the waiver of most personal constitutional rights. However, because the homestead exemption is a right that protects both the individual and the public, which includes the debtor's family and the State, it held that an individual cannot waive such right. Further, it noted that *Carter* and *Sherbill* do not conflict with the trend toward allowing waivers of constitutional rights since such waivers must be made knowingly, voluntarily, and intelligently. The constitutionally prescribed means to waive one's homestead exemption, by "*mortgage, sale, or gift*," guarantees such waiver is knowing, voluntary, and intelligent. Obtaining a mortgage ensures the individual has given thoughtful consideration to his or her act.

The holding *Chames* is not surprising considering the longstanding precedent to liberally construe the Florida homestead exemption and narrowly graft non-constitutional exceptions. The court's decision protects the average citizen from inadvertently waiving homestead rights hidden in boilerplate language. The court's recognition of the homestead exemption as a right that also protects the public prevents a single person with no descendants from waiving his or her homestead exemption from forced sale in a general manner. The court specifically limited its ruling to unsecured waivers of the homestead exemption. The court noted that the Florida Constitution permits a homestead to be mortgaged. Thus, an attorney or other advisor who desires to assist a client can ensure payment of a fee by requiring the client to mortgage the homestead to secure the debt or simply withdraw cash on a home equity line of credit to pay a retainer or other bill for legal services. The court stated: "*When a man executes a mortgage . . . upon certain specified property, the very nature of the transaction implies the exercise of discretion and the contemplation of inevitable consequences.*" Signing a six-page, single-spaced retainer agreement does not qualify as a "knowing, voluntary, intelligent waiver." If it did, every credit card company, lender and leasing company would include boilerplate provisions in their documents where customers would routinely waive their rights to claim the benefit of the homestead exemption.

In *Carter's Administrators v. Carter,* 20 Fla. 558, 570 (1884), the court stated:

> When a man executes a mortgage or bill of sale upon certain specified property, the very nature of the transaction implies the exercise of discretion and the contemplation of inevitable consequences. Such contracts are, therefore, upheld as well in respect to real as to personal property. We have in several cases held that a sale under a mortgage is not a *forced* sale because it was a sale under consent given under seal and irrevocably conveying an interest in the thing described. Such contracts are regulated by law and are specifically enforced in

> courts of equity. And by such transactions men may, through misfortune, become impoverished and their families brought to want. This is an incident of all human transactions, even where the utmost caution and circumspection are exercised, but this is not an argument in favor of encouraging indiscreet contracts made with a view to an evasion of the settled policy of the State. Few men would mortgage their household goods and their children's clothes to a hard creditor with the inevitable result brought vividly to their understanding, but many thoughtless and improvident people might be induced to obtain credit by merely "waiving the benefit of exemption," and thus placing the last blanket and bed and their own and the children's clothing at the mercy of a hard creditor, if an agreement like this should be sustained.
>
> In view of the recognized policy of the States in enacting exemption laws and of the practically universal concurrence of the authorities on the identical question, our conclusion is that the "waiver" of the benefit and protection of the exemption laws contained in this note is not valid to defeat a claim of exemption.

The court addressed the issue again in *Sherbill v. Miller Manufacturing Company, Inc.*, 89 So. 2d 28 (Fla. 1956). In *Sherbill*, the debtors executed a note waiving "the benefit of their homestead exemption as to this debt." The debtors failed to abide by the terms of the note, so the creditor reduced the note to judgment. The court of chancery decreed that the property may be sold by the Sheriff and that the debtors "are not entitled to designate this particular property homestead." Interestingly, the debtors took no legal action until a few hours prior to the sale of the homestead. Holding that such decree was not *res adjudicata* on the right to claim the homestead exemption, the court held "that such a waiver was not an alienation of the homestead and not enforceable, and . . . such a waiver was contrary to public policy of the exemption laws of [Florida]."

If a strong public policy against permitting these kinds of waivers did not exist, every credit card company, lender and leasing company would include boilerplate provisions in their documents where customers would routinely waive their rights to claim the benefit of the homestead exemption. The issue is whether this public policy argument is too broad in its reach. While it is arguable that an intelligent and knowing waiver might be strained in the context of a credit card arrangement, it is probably not a strained concept in the context of an attorney's engagement letter nor in the context of a large loan to a sophisticated investor. Furthermore, the current homestead provision does permit an individual to waiver his or her homestead rights in one specific situation, that is, in the case of a homestead that was originally acquired in an unincorporated area of a county that subsequently becomes part of a municipality. In such a case, if the homestead is "located outside a municipality" a debtor can claim up to "one hundred sixty acres of contiguous land and improvements thereon" as homestead and this "shall not be reduced *without the owner's consent* by reason of subsequent inclusion in a municipality."

In Quiroga v. Citizens Property Insurance Corporation, 2010 WL 1329996 (Fla. App. 3rd Dist.) (April 7, 2010), Jesse Quiroga (the "**Debtor**") engaged the law firm of Katzman Garfinkel and Rosenbaum (the "**Law Firm**") to recover insurance proceeds for damage caused

to the Debtor's home by two hurricanes. The Law Firm was retained pursuant to a contingency-fee agreement. Ultimately, the Law Firm was successful in securing insurance proceeds for the Debtor. Thereafter, the Debtor terminated the Law Firm's contingent fee representation of him and the Law Firm filed a charging lien against the insurance proceeds for its unpaid fee. The Debtor claimed that the insurance proceeds are exempt homestead property and therefore not subject to attachment by means of a charging lien.

Neither party disputed that the hurricane damaged property is constitutionally exempt homestead property because in the event a homestead is damaged through fire, wind or flood, the proceeds of any insurance recovery are imbued with the same privilege. See *Orange Brevard Plumbing & Heating Co. v. La Croix*, 137 So.2d 201 (Fla. 1962). The court held that because the Debtor did not and as a matter of public policy could not through an unsecured agreement such as the contingent fee agreement enter into an enforceable contract to divest himself from the exemptions afforded the Debtor under the Florida constitution. See *Chames v. DeMayo*, 972 So.2d 850 (Fla. 2007).

The court was clearly upset by the equities of the case and was troubled with its holding.

Query: Could the court have reached a different result by applying one of the three express exceptions to the homestead exemption? It is possible that the Law Firm could have agreed that the Debtor contracted with it creating an obligation for the repair of the Debtor's homestead.

18. In addition to Florida's homestead exemption, the law of Texas (*see* Tex. Const., art. 16, § 50; Tex. Prop. Code § 41.001), Iowa (*see* Iowa Code § 561.16), Kansas (*see* Kansas Stat. § 60-2301) and Oklahoma (*see* Okla. Stat. tit. 31, §§ 1(A)(1), (2)) also contain homestead exemptions that grant residents unlimited protection for the equity in their primary residences.

19. The debtor's homestead must be located in Florida to claim the benefit of the exemption. See *In Re Schlakman*, 20 Fla. L. Weekly Fed. B385 (May 4, 2007).

20. Where a creditor obtains avalid lien on a property that is not homestead and that property is subsequently transferred to a third who makes it his or her homestead, such status will not prevent the creditor or party possessing that valid lien from foreclosing on such homestead property. See *Supulveda v. Westport Recovery Corporation*, FLWSUPP 2105 SEPU, Circuit Court, 11th Judicial Circuit (Appellate) in and for Miami-Dade County. Case No. 13-152 AP. (Dec. 31, 2013). See also, *Porter-Mallard Co. v. Dugger,* 157 So. 429 (Fla. 1934).

21. An individual must occupy the property **and** have the actual intent to permanently live in that property to claim homestead. *See In re Charania*, 25 Fla. L. Weekly Fed. B268a (Bankr. S.D. Fla. Mar. 12, 2015). In *In re Charania*, the debtor ("Debtor") filed his chapter 7 bankruptcy petition (the "Petition") believing that he previously conveyed his interest in a home (the "home") by a quit-claim deed (the "deed") to his son and daughter-in-law. The deed was never recorded. Prior to the Petition, a creditor obtained a judgment against Debtor

and recorded its judgment against the home. Years later, Debtor sought to strip the creditor's lien by claiming that the home he thought he had conveyed was his homestead. The U.S. Bankruptcy Court, Southern District of Florida, reiterated that to qualify for homestead protection under Florida law, an individual must occupy the property and have the actual intent to permanently live in that property. While Debtor presently lived and continued to live in the home, he did not intend to permanently reside there at the time he filed for bankruptcy based on his Petition where he unequivocally stated that he did not believe that he had an ownership interest in the home at that time after either conveying or attempting to convey his interest in the home to his son and daughter-in-law. The court also found further evidence of Debtor's lack of intent to permanently reside based on the fact that his interest in the home was only discovered after Debtor's son and daughter-in-law attempted to sell the home. The objection to claim of homestead was sustained.

22. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "**Bankruptcy Act**")

a. The Bankruptcy Act contains some provisions that affect a debtor's ability to claim the Florida Homestead Exemption in a bankruptcy proceeding. In fact, the most significant changes under the Bankruptcy Act relate to the homestead exemption.

b. i. With respect to which state law applies to a debtor claiming exemptions to protect wealth, in place of the old six (6)-month look-back period, a new two (2) year (that is, seven hundred thirty (730) day) test is used. Pursuant to new § 522(b)(3)(A) of the Bankruptcy Code, if the debtor has moved from one state to another state within the two (2)-year period prior to filing the petition, the debtor's domicile for purposes of available state exemptions will be based on the six (6)-month period (or longer portion thereof) immediately preceding the two (2)-year period.

ii. In *In re Jevne*, 387 B.R. 301 (Bankr. S.D. Fla. 2008), the debtors (the "**Debtors**") were domiciled in Rhode Island from September 1994 through July 6, 2006. The Debtors moved to Florida in June 2006 and purchased real property located in Vero Beach, Florida (the "**Property**") for $325,000. On October 31, 2007, the Debtors filed a voluntary Chapter 7 petition. The Debtors listed the Property on Schedule A to the Chapter 7 petition and indicated its value as $292,500. The Debtors claimed the Property as exempt pursuant to Rhode Island Statutes 9-26-4.1, which provides for a $300,000 homestead exemption.

According to § 522(b)(3)(A) of the Bankruptcy Act, the time a debtor must be domiciled in a state to avail himself or herself of the property exemptions of such state is 730 days. If a domicile of a debtor was not located at a single location for 730 days, the state law where the debtor was domiciled for 180 days immediately preceding the 730-day period, provides the applicable exemption. The 730-day rule contained in § 522(b)(3)(A) of the Bankruptcy Act requires a court to determine if a particular state's homestead law applies extraterritorially if the client does not satisfy the 730-day period. The court identified four types of jurisdictions in regards to the extraterritorially effect of the homestead law of a state. First, states where the plain language of the homestead law explicitly limits its application to property within the state (*e.g.*, Alaska and Colorado). Second, states where the homestead

statutes are silent on the extraterritorial application however courts have construed the homestead statutes to have no extraterritorial force (*e.g.*, Florida and Kansas). Third, states where the homestead statutes are silent on the extraterritorial application however courts have construed the homestead statutes to have extraterritorial force (*e.g.*, New Hampshire and Minnesota). Fourth, states where both the homestead law and case law is silent on whether the homestead law has extraterritorial effect.

The court held that based on the strong public policy of liberally construing exemptions in favor of the debtor if the homestead statute and case law are silent as to whether the homestead exemption of a state should have extraterritorially effect, the court will treat the homestead exemption as having an extraterritorial effect.

The Rhode Island statute and case law did not address whether the state homestead exemption has extraterritorial effect and as a result held that such statute will be deemed to have such an effect and the Rhode Island homestead exemption applies to the Property.

Practice Note: Outside of bankruptcy it is important to note that the Florida homestead exemption would be available in full immediately for the debtor in *Jevne*. See *e.g.*, *Havoco of America, Ltd. v. Hill*, 790 So.2d 1018 (Fla. 2001) and *Conseco Servs, LLC v. Cuneo*, 904 So.2d 438 (Fla. 3d Dist. Ct. App. 2005).

c. i. Much has been made in the press about wealthy individuals acquiring multi-million dollar homes in Florida to shelter wealth from creditors. The Bankruptcy Act attempts to preclude a potential debtor's ability to shelter the debtor's wealth in a newly acquired homestead. Under § 522(p) of the Bankruptcy Code, the value of the homestead of a debtor (other than farmers) in excess of $125,000 (as adjusted for inflation pursuant to § 104(b)(1) and (2) of the Bankruptcy Code) is no longer exempt until 1,215 days (that is, three (3) years and four (4) months) after the debtor *acquired an interest* in the home. This limitation does not apply to any amount transferred from the debtor's prior principal residence if the prior principal residence was acquired before the 1,215-day period and if the prior residence is located in the same state as the new residence. Bankr. Code § 522(p)(2)(B). This rule applies even if the debtor moves from one state with an unlimited homestead exemption (*e.g.*, Texas) to another state with an unlimited homestead exemption (*e.g.*, Florida). **Query**: Is there a policy reason to limit the rule in this circumstance?

ii. In *McNabb*, 326 B.R. 785 (Bkrtcy.D.Ariz. 2005), the creditor and trustee invoked §§ 522(o) and (p) of the Bankruptcy Code to prevent the debtor from exempting the full value of the homestead he had acquired in Arizona just over one year before he filed his bankruptcy petition. The court analyzed the language of subsections (p) and (q) of § 522 of the Bankruptcy Code that makes it applicable "as a result of *electing* under subsection (b)(3)(A)…" (emphasis added). Under § 522(b) of the Bankruptcy Code, a debtor may elect to claim the federal exemptions under § 522(d) of the Bankruptcy Code "unless the State law that is applicable to the debtor . . . specifically does not so authorize." Most states, including Arizona, have "opted out" of permitting residents to choose the federal exemptions. Consequently, in such states, a debtor does not have the option to "elect" state exemptions; rather, the debtor *must* claim the available state exemptions. Therefore, according to the court in *McNabb*, the $125,000 (the amount in effect at this time) limitation provided under §§

522(p) and (q) of the Bankruptcy Code does not apply to debtors domiciled in opt-out states. (Florida is also an opt out state. See F.S. § 222.20 & 11 U.S.C. § 522(b).) The court contrasted the language of §§ 522(p) and (q) with the language of § 522(o), which applies "[f]or purposes of subsection (b)(3)(A)." But see *In re Rasmussen*, 349 B.R. 747 (Bkrtcy.M.D.Fla. 2006); *In re A. Steven Buonopane*, 344 B.R. 675, 2006 WL 1581903 (Bankr.M.D.Fla.); *In re Kaplan*, 331 B.R. 483 (Bankr. S.D. Fla. 2005); *In re Wayrynen*, 332 B.R. 479 (Bankr. S.D. Fla. 2005); *In re Virissimo*, 332 B.R. 208 (Bankr. D. Nev. 2005); *In re Heisel*, 332 B.R. 201 (Bankr. D. Nev. 2005) (all reaching the opposite result than *McNabb*). See also Steve Leimberg's Asset Protection Planning Newsletter #71 (October 6, 2005) at http://www.leimbergservices.com; Steve Leimberg's Asset Protection Planning Newsletter #72 (October 7, 2005) at http://www.leimbergservices.com; & Steve Leimberg's Asset Protection Planning Newsletter # 74 (November 17, 2005) at http://www.leimbergservices.com.

iii. In *In re Blair*, 334 B.R. 374 (Bankr. N.D. Tex. 2005), a bankruptcy court in Texas held that equity accrued when the debtor made mortgage payments during the 1,215-day period immediately prior to filing bankruptcy did not constitute the acquisition of an interest in a homestead under new § 522(p) of the Bankruptcy Code. In this case the court held, "one does not actually 'acquire' equity in a home. One acquires title to a home." See also Steve Leimberg's Employee Benefits and Retirement Planning Newsletter # 75 (December 9, 2005) at http://www.leimbergservices.com. But see *In re Rasmussen*, 349 B.R. 747 (Bankr. M.D. Fla. 2006) and *Parks v. Anderson*, 406 B.R. 79 (Bankr. D. Kan. 2009), both reaching a different result.

iv. In *In re Sainlar*, 344 B.R. 669 (Bankr. M.D. Fla. 2006), the court held that § 522(p) of the Bankruptcy Code is only applicable to a debtor's homestead that is acquired by the debtor within 1,215 days of the date a bankruptcy petition is filed the debtor. According to the court, the provisions of § 522(p) of the Bankruptcy Code do not apply to any increase in the value of the homestead that occurs during the 1,215-day period prior to filing the petition. See also Steve Leimberg's Asset Protection Planning Newsletter # 79 (April 6, 2006) at http://www.leimbergservices.com.

v. In *In re Rasmussen*, 349 B.R. 747 (Bankr. M.D. Fla. 2006), the court held that spouses in a joint bankruptcy case may effectively "stack" each of their separate $125,000 homestead exemptions to protect up to $250,000 of an interest in a homestead acquired within the 1,215-day prepetition period. (See also, *In re Cook*, 460 B.R. 911, 915 (Bankr. N.D. Fla. 2011).) The court cited the consistency in Florida law that permits spouses to stack other separate state law exemptions. Other states may not be as gratuitous as Florida, so one must check the applicable state law to determine if both spouses qualify for the homestead exemption. The court agreed with *In re Blair* and *In re Sainlar* in the result that the appreciation of the value of homestead during the 1,215-day period is not an "acquired interest" within the meaning of § 522(p). It also held that the phrase "interest that was acquired by the debtor" more accurately describes *actively* acquiring *equity* in a homestead. Thus, in addition to the exception for rollovers of equity from sales of a prior homestead in the same state, a debtor should limit the total equity payments in the 1,215-day prepetition period to $136,875 (or $273,750 for spouses). See also Steve Leimberg's Asset Protection Planning Newsletters # 93-94 (November 10, 2006) at http://www.leimbergservices.com.

vi. In *In re Reinhard*, 377 B.R. 315 (Bankr.N.D.Fla.2007), the debtor ("**D**") and D's wife acquired title to real estate located at 1976 Scenic Highway 30A, Seaside, Florida (the "**Seaside Property**") on February 24, 1995. D and D's wife resided in Tallahassee, Florida, until around June 30, 2005, when they moved to the Seaside Property and made it their primary residence. Shortly after D and D's wife moved to the Seaside Property, D and his wife designated the Seaside Property as their homestead. D filed for bankruptcy on November 3, 2006. At the time D's bankruptcy petition was filed, the Seaside Property was worth approximately $4,500,000 and was encumbered by approximately $2,050,000 of debt.

The chapter 7 trustee challenged D's claimed homestead exemption for the Seaside Property because the Seaside Property was designated as homestead within the 1,215-day look back period provided for under § 522(p) of the Bankruptcy Code. The bankruptcy trustee argued that D acquired an interest in the Seaside Property within the 1,215 day look back period by designating the Seaside Property as his homestead property. D argued that merely designating real property as homestead was not tantamount to acquiring an interest in real property under § 522(p) of the Bankruptcy Code.

Section 522(p) of the Bankruptcy Code limited the homestead exemption a debtor may claim in bankruptcy court to $125,000 (at the time of this case) if the debtor acquired his or her interest in the homestead within 1,215 days of the filing of the bankruptcy petition. According to the court, for § 522(p) of the Bankruptcy Code to apply, the following five elements must be satisfied:

(1) the debtor must acquire;

(2) an amount of interest;

(3) during the 1,215 day period;

(4) exceeding in the aggregate $125,000 in value; and

(5) in real or personal property that is claimed as a homestead.

The court reviewed Florida law to determine what D acquired when D designated the Seaside Property as his homestead. The court determined that the acquisition of homestead status does not confer any additional property interest or rights in the property. Therefore, it concluded that based on Florida law homestead is simply a constitutionally defined status, which exempts certain property from execution and limits its alienability.

The court also reviewed whether designating a property as a homestead comes within the scope of § 522(p) of the Bankruptcy Code. The court held that Congress intended the term "interest" to refer to a quantitative or monetary value in property because the statute refers to "any amount of interest." Additionally, the debtor is limited to an aggregate $125,000 in value in certain types of property. The court concluded that Congress intended to convey a monetary meaning in connection with the term "interest" through the use of the terms "amount" and "value" and use of the dollar figure of $125,000. The court held that because D under Florida law is not treated as having acquired any interest in property by designating the Seaside Property as D's homestead, D has not acquired an interest in property as contemplated under §

522(p) of the Bankruptcy Code and the full value of the Seaside Property qualified for the exemption provided for homestead property. *See also Parks v. Anderson*, 406 B.R. 79 (D. Kan. 2009); *In re Greene*, 346 B.R. 835 (Bankr. N.D. Nev. 2006), *rev'd*. *Greene v. Savage* (*In re Greene*), 9th Cir. No. 07-16067, 10/2/09; *In re Rogers*, 354 B.R. 792 (Bankr. ND. Tex. 2006); *In re Lyons*, 355 B.R. 387 (Bankr. D. Mass. 2006).

d. In *In re Leung*, 356 B.R. 317 (Bankr. D. Mass 2006) Robert G. Leung (the "**Debtor**") and his wife purchased real property in Quincy, Massachusetts as tenants by the entirety for $210,000 (the "**Residence**") in May of 1988, In April 2001, the Debtor and his wife transferred the Residence to the Debtor's wife for $1. In February 2005, the Debtor's wife transferred the Residence back to the Debtor and his wife as tenants by the entirety for $1 and the Debtor filed a Declaration of Homestead.

On September 6, 2005, the Debtor filed for bankruptcy. The Debtor listed his interest in the Residence on schedule A of his bankruptcy petition. His interest was described as "TXE." The Debtor listed the fair market value of the Residence at $500,000 and his interest in the Residence as $250,000. The Debtor also listed a mortgage on the property in the amount of $85,000 and the Debtor's share of that mortgage as $42,500. The Debtor claimed an exemption under Mass. Gen. Laws ch. 188, § 1 on schedule C of his bankruptcy petition. The value of the exemption was listed at $187,500.

The bankruptcy trustee objected to the claimed exemption arguing that the exemption should be limited to $125,000 pursuant to 11 U.S.C. § 522(p). Section 522(p)(1) of the Bankruptcy Code provides:

> Except as provided in paragraph (2) of this subsection and sections 544 and 548, as a result of electing under subsection (b)(3)(A) to exempt property under State, or local law, a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate $125,000 in value in . . . (D) real or personal property that the debtor or dependent of the debtor claims as a homestead.

The bankruptcy trustee argued that because the Debtor acquired his interest in the Residence within 1,215 days preceding the filing of the Debtor's bankruptcy petition, the Debtor's homestead exemption must be capped at $125,000 pursuant to Section 522(p)(1) of the Bankruptcy Code.

The Debtor made three arguments in response to the trustee's claim. First, he argued that he acquired his interest in the Residence prior to February, 2005. He claimed that he maintained an equitable interest in the Residence because he controlled the Residence and contributed his personal funds to maintain the Residence. The court dismissed this argument because there was no basis in Massachusetts law for holding that the Debtor had an equitable interest in the Residence while his wife held legal title to the Residence solely in her individual name.

Secondly, the Debtor argued that he did not "actively acquire" an interest in the Residence during the 1,215 day period because he received his interest in the Residence as a gift. The court dismissed this argument because under Massachusetts law a donee is permitted to disclaim or renounce a gift. Furthermore, the Debtor affirmatively filed a Declaration of Homestead. As a result, the court held that the Debtor "actively acquired" an interest in the Residence because he accepted delivery of the deed and made an affirmative homestead declaration.

Finally, the Debtor argued that the Residence was under the exception provided in Section 522(p)(2)(B) of the Bankruptcy Code. This provision provides that any interest acquired during the 1,215 days before the petition cannot include any interest transferred from a previous residence, outside of the 1,215 days, into the current residence so long as the residences are in the same state. The court noted that the purpose of this provision appears to protect persons who rather than seeking to take advantage of another state's exemption have benefitted as a result of his or her own state's exemption and the general appreciation of property values attributable to previous intra-state transactions. However, the court could not interpret Section 522(p)(2)(B) of the Bankruptcy Code to apply to the Debtor because the literal language of the statute requires a move from a previous principal residence to a current residence. The Debtor acquired an interest in the same property he previously owned and the court held that this situation is not covered by the statute.

Thus, the court held that the Debtor was only entitled to a $125,000 homestead exemption pursuant to Section 522(p) of the Bankruptcy Code.

e. Under § 522(q), the value of homestead in excess of $125,000 (as adjusted for inflation) is not exempt if the debtor is convicted of a felony in conjunction with an abusive filing (as determined by the bankruptcy court) or the debtor owes a debt related to:

(A) a violation of federal or state securities laws;

(B) fraud, deceit, or manipulation (i) in a fiduciary capacity or (ii) in connection with the purchase or sale of registered securities. *See In re Presto*, 376 B.R. 554, 592 (S.D.Tex. 2007);

(C) a violation of the civil RICO laws; or

(D) any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death in the preceding five (5) years. *See In re Larson*, 513 F.3d 325 (1st Cir. 2008) (cap on debtor's homestead exemption based on the determination that "**criminal act**" includes crimes of negligence-here, negligent vehicular homicide).

Congress made an exception to this specific one hundred twenty-five thousand dollar ($125,000) cap on the exemption of homestead (that is, preserving more than one hundred twnety-five thousand dollars ($125,000) of value) if a court determines it is "**reasonably necessary for the support of the debtor and any dependent**." Bankruptcy Code § 522(q)(2).

Query: Does the 1215 day limitation period set forth in § 522(p) of the Bankruptcy Code apply to § 522(q) of the Bankruptcy Code? Nothing in either section would seem to suggest that the 1215 period found in § 522(p) of the Bankruptcy Code is applicable to § 522(q) of the Bankruptcy Code. Nonetheless, in what appears to be *dicta*, the court in *In re Burns*, 395 B.R. 756, 21 Fla. L. Weekly Fed. B 487 (M.D. Fla. 2008) suggested that the 1215 day time limitation found in § 522(p) of the Bankruptcy Code is applicable to § 522(q) of the Bankruptcy Code. This does not seem possible under a literal reading of the statute. In *Burns*, it was not necessary for the court to rule on this issue to reach its decision because the court ultimately held that § 522(q) of the Bankruptcy Code was inapplicable because the debtors' alleged conduct did not rise to the level of willful, wanton and reckless conduct. The court also held that even if it did rise to that level, the debtors' equity in their homestead did not exceed the dollar limitation protected under such statute.

i. As previously mentioned, according to the court in *McNabb*, the $136,875 limitation provided under § 522(q) of the Bankruptcy Code does not apply to debtors domiciled in opt-out states. But see *In re A. Steven Buonopane*, 344 B.R. 675 (Bankr. M.D. Fla. 2006); *In re Kaplan*, 331 B.R. 483 (Bankr. S.D. Fla. 2005); *In re Wayrynen*, 332 B.R. 479 (Bankr. S.D. Fla. 2005); *In re Virissimo*, 332 B.R. 208 (Bankr. D. Nev. 2005); *In re Heisel*, 332 B.R. 201 (Bankr. D. Nev. 2005) (all reaching the opposite result than *McNabb*).

f. i. Under § 522(o), if within the ten (10) years prior to filing a petition a debtor converts non-exempt property to homestead with the actual intent to hinder, delay, or defraud a creditor, the value of the homestead is reduced by the value of such converted property. Thus, if a client plans to acquire a residence as his or her homestead, satisfy a mortgage on a residence that is the client's homestead or make significant improvements thereto, it will be imperative to document the legitimate intentions of the client to avoid the appearance of a fraudulent conversion.

ii. In *Addison v. Seaver (In re Addison),* 540 F.3d 805, 811 (8th Cir. 2008), [RESERVED].

iii. In *In re Osejo*, U.S. Bankruptcy Court, S.Dist. Florida, Case No. 10-31218-BKC-JKO, Chapter 7, 22 Fla. L. Weekly Fed. B727a (2011), the trustee successfully petitioned the court to avoid the conversion of non-exempt property into homestead pursuant to § 522(o) of the Bankruptcy Code. In reaching its conclusion the court noted:

> The Debtor did not break down on the stand *a la* Perry Mason at the...evidentiary hearing and confess her intent to hinder, delay, or defraud creditors. The Trustee did not introduce a serendipitous Facebook posting where the Debtor announced nefarious aims. The Debtor did, however, fail to disclose in her…sworn filings that she had in April sold non-exempt securities which yielded $42,309.13. She testified…that the proceeds of that previously undisclosed April 29th sale were used to improve the homestead she acquired shortly before the bankruptcy filing. She did not amend her Statement of Financial Affairs to disclose the April 29th sale until the day of her second 341 Meeting of Creditors, after the Trustee had hired counsel to look into the matter.

> How the Debtor managed to forget about a $42,309.13 securities sale three months before her bankruptcy filing is interesting. It is especially interesting in light of the fact that she used that money to improve a homestead which she claimed as exempt on Schedule C. There were other nondisclosures as well. The Debtor checked "None" on Schedule B, Item 17 when she was in fact owed $105,000 by her ex-husband. The Debtor checked "None" on Schedule B, Item 12 when she in fact held a 401k account worth $65,036.84 and a vested retirement account worth $133,230.23. Like the $42,309.13 April 29th securities sale, the Debtor only amended her schedules to disclose these assets on the day of the second 341 Meeting of Creditors -- after the Trustee hired counsel to investigate. The Debtor argues that liberal amendment policy in bankruptcy negates the suspicious timeline here, but I am familiar with Fed. R. Bankr. P. 1009(a), and the Debtor's general right to amend her schedules during the pendency of her case does not vitiate clear constructive intent to hinder her creditors. Honesty after one is caught is honestly not honesty. The vast majority of Chapter 7 individual cases in this division slide through their first 341 Meeting of Creditors with a Report of No Distribution entered soon thereafter. As skilled as panel trustees may be, they cannot catch everything -- especially when Debtors are less than forthcoming. This Debtor's nondisclosures were, as a whole, material and intentional. She gambled, and she lost. That the Debtor amended her schedules after the Trustee smelled fraud, continued the 341, and hired counsel does not exonerate her.

iv. *In re Cook*, 460 B.R. 911, 915 (Bankr. N.D. Fla. 2011),

The court noted:

> "Absent extrinsic evidence of fraud . . . the debtor's mere conversion of non-exempt property to exempt property, even while insolvent, is not evidence of fraudulent intent as to creditors." *Hanson v. First Nat'l Bank in Brookings,* 848 F.2d 866, 868 (8th Cir. 1988). I find that Centennial Bank and the Trustee have failed to present any extrinsic evidence that establishes that the Debtors acted with the requisite intent to defraud their creditors when they used the tax refund to acquire their homestead. The circumstances and facts establish the Debtors' primary motivating factor in purchasing the home was to ensure that they had a place to reside.

At the time of this holding, the reasoning of the court was somewhat suspect. However, in *In re Cook*, 535 B.R. 877, 2013 WL 10936746 at *11 (Bankr. N.D. Fla. 2013), the court noted "[t]his Court originally held that Centennial and the Trustee failed to present extrinsic evidence that the Cooks acted with intent to hinder, delay, or defraud a creditor when they used their tax refund to buy and improve their homestead. Nothing has changed." In the interim between the 2011 and 2013 orders, Bankruptcy Judge Lewis M. Killian, Jr. retired; Judge Karen Specie decided the latter case. Unlike the 2011 order, Judge Specie, in her 2013 order entitling the debtors to their homestead exemption, compared the facts in *Cook* to the case of *In re Booth*, 417 B.R. 820 (Bankr.M.D.Fla.2009):

> As in *Booth*, after two evidentiary hearings this Court believes that the Cooks did not intend to file bankruptcy and thought they could still work things out with Centennial when they bought their home. This Court also believes the Debtors' testimony that their intent was to find a permanent home to replace the one they had sold under pressure from the bank, and was not to hinder, delay, or defraud anyone. . . . Centennial and the Trustee urge, as Centennial did on appeal, that the Cooks' failure to list the receipt of their income tax refund in their SOFA constitutes extrinsic evidence of their alleged fraudulent intent when they spent the refund on their homestead. This Court disagrees. The court in *In re Booth* disagreed with a similar argument. Omissions from bankruptcy schedules may be relevant to denial of a debtor's discharge but are not necessarily relevant to an objection to homestead exemption. . . . They, like the debtor in *In re Booth*, used the tax refund to buy a home for which they had been searching for a long time. *Id.* at *11-12.

v. In *In re Willcut*, 2012 WL 1929913 (10th Cir.BAP (Okla.)), the court concluded that "the phrase 'the value of an interest in...real [ ] property...shall be reduced' in 11 U.S.C. § 522(o) means that the equity in a debtor's home that was obtained through fraudulent transfer of non-exempt assets into exempt assets is to be reduced." Thus, if no equity exists, there would not be any value subject to reduction

vi. In *In re Cowin*, 2014 WL 1168714 (Bkrtcy. S.D. Tex.), Charles Philip Cowin (the "**Debtor**") developed real estate in New Mexico and owned several properties in Texas. By early 2008, the Debtor acquired the contractual right to purchase twenty-two (22) condo units at 300 St. Joseph Parkway in Houston, Texas ("**St. Joseph**"), a complex being developed by Midtown Edge, L.P. ("**MELP**"). On March 28, 2008, the Debtor exchanged his contractual right to purchase all but six of the condo units at St. Joseph for a $230,000 promissory note from MELP (the "**2008 Note**"). Under the terms of the 2008 Note, MELP was required to pay the balance by December 31, 2008. MELP defaulted on the 2008 Note and the Debtor filed suit against MELP in the District Court of Harris County, Texas in August of 2009 (the "**State Court Lawsuit**").

On May 18, 2010, the Debtor and MELP settled the State Court Lawsuit by entering into a confidential settlement agreement (the "**CSA**"). Under the terms of the CSA, the Debtor agreed to exchange the 2008 Note for a replacement promissory note in the amount of $276,500.48 (representing the balance of the 2008 Note at that time) and the contractual right to purchase Unit 320 at St. Joseph ("**Unit 320**") for $289,000. In accordance with the CSA, the Debtor wrote "Cancelled" on the first page of the 2008 Note and surrendered it to MELP and MELP gave the Debtor a $276,500.48 promissory note (the "**2010 Note**"). Additionally, MELP and the Debtor executed a contract for deed (the "**Contract for Deed**") granting the Debtor the contractual right to purchase Unit 320 for $289,000.

On March 11, 2011, the Debtor exercised his right under the Contract for Deed to purchase Unit 320. The Debtor paid the $289,000 price by (a) surrendering the 2010 Note, which had a balance of $236,120 at that time, by writing "Pd in full" on such note and delivering it to MELP; (b) giving MELP a signed promissory note for $52,880, representing the amount by

which the $289,000 purchase price exceed the balance owed by MELP under the 2010 Note; and (c) delivering a signed deed of trust to MELP securing the $52,880 promissory note.

During the course of the Debtor's dealings with MELP, the Debtor filed two separate Chapter 11 Bankruptcy petitions with the Court. The Debtor filed the first such petition on February 24, 2010 (initiating the "**First Chapter 11 Case**") and the second on May 19, 2010 (initiating the "**Second Chapter 11 Case**"). On January 6, 2012, the Court dismissed the Second Chapter 11 Case with prejudice because the Debtor had filed two Chapter 11 petitions within the prior two years without filing a plan and disclosure statement.

On February 21, 2013, the Debtor filed a Chapter 7 Bankruptcy petition with the Court (initializing the "**Chapter 7 Case**"). The Debtor claimed a homestead exemption with respect to Unit 320 in his Chapter 7 filings. The Chapter 7 trustee (the "**Trustee**") filed an objection to the Debtor's claimed homestead exemption under § 522(o) of the Bankruptcy Code ("**§ 522(o)**").

§ 522(o) provides, in the relevant part, that the value of a debtor's interest in real or personal property that such debtor claims as a homestead exemption:

> shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10-year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor and that the creditor could not exempt, or that portion that the debtor could not exempt, under subsection (b), if on such date the debtor held the property so disposed of.

The Court stated that a party objecting to the amount of a debtor's claimed homestead exemption must prove the following four elements to prevail under § 522(o):

> 1. the debtor disposed of property within ten years preceding the bankruptcy filing;
>
> 2. the disposed property was non-exempt;
>
> 3. some or all of the proceeds from the disposition of this non-exempt property were used to buy a new homestead, to improve an existing homestead or reduce the debt associated with an existing homestead; and
>
> 4. the debtor disposed of the non-exempt property with the intent to hinder, delay or defraud a creditor.

The Court found that the Trustee had satisfied the first element by establishing that the Debtor filed his Chapter 7 petition on February 21, 2013 and disposed of the 2010 Note on March 11, 2011 by cancelling it. Additionally, the Court found that the Trustee had satisfied the second element by establishing that promissory notes are non-exempt property under Section 42.002 of the Texas Property Code. Furthermore, the Court found that the Trustee had satisfied the third element by establishing that the Debtor used the non-exempt property (that is, the 2010

Note) to pay for a substantial portion of Unit 320 for which the Debtor had claimed a homestead exemption.

With regard to the fourth element of § 522(o), the Court engaged in a thorough analysis of how a trustee may establish that a debtor disposed of property with the intent to hinder, delay or defraud his or her creditors (or with "**Fraudulent Intent**"). Conceding that a trustee is rarely able to prove a debtor's Fraudulent Intent by direct evidence (*e.g.*, the debtor's own writing or admission), the Court noted that a trustee may alternatively prove a debtor's Fraudulent Intent by indirect evidence by establishing the existence of the following thirteen "badges of fraud" (including ten such badges set forth in the Texas Uniform Fraudulent Transfer Act and three additional badges previously adopted by the Court):

1. The transfer was to an insider;

2. The debtor retained possession or control of the property after the transfer;

3. The transfer was concealed;

4. The debtor had been sued before the transfer was made;

5. The transfer was one of substantially all of the debtor's assets;

6. The debtor has absconded;

7. The debtor concealed the asset;

8. The value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred;

9. The debtor was insolvent or became insolvent shortly after the transfer;

10. The transfer occurred shortly before or after a substantial debt was incurred;

11. The transfer was completed immediately before the debtor filed his bankruptcy petition;

12. The debtor is unable to explain the disappearance of assets; and

13. The debtor has engaged in a pattern of "sharp dealing" prior to the bankruptcy.

Additionally, the Court noted that "not all, or even a majority, of the 'badges of fraud' must exist to find actual fraud" and that a court can properly infer a debtor's fraudulent intent when several of such badges are present.

The Court found the presence of the following badges of fraud:

1. **The transfer was concealed** (the third badge of fraud). The Court determined that the Debtor made numerous misrepresentations in the schedules submitted along with each of his bankruptcy petitions to conceal the transfer of the 2010 Note to MELP that enabled him to acquire the warranty deed to Unit 320. This included failing to disclose his exchange of the 2008 Note for the 2010 Note, falsely representing that he had a fee simple interest in Unit 320 at times when he did not, failing to disclose the existence of promissory notes evidencing his debts, failing to disclose the existence of the Contract for Deed and substantially underreporting amounts owed to him by MELP.

2. **The Debtor had been sued before the transfer was made** (the fourth badge of fraud). The Court determined that by the Debtor's own admission he was the defendant in a least five lawsuits pending at the time of the March 11, 2011 Contract for Deed.

3. **The transfer was one of substantially all of the Debtor's assets** (the fifth badge of fraud). The Court determined that when the Debtor surrendered the 2010 Note on March 11, 2011, he surrendered the only material, unencumbered asset he owned.

4. **The Debtor concealed the asset** (the seventh badge of fraud). The Court noted that with regard to intangible property such as the 2010 Note, the appropriate inquiry is whether the Debtor concealed the existence of such property in the filings he submitted during the course of his multiple bankruptcy filings. The Court determined that the Debtor received the 2010 Note from MELP prior to his Second Chapter 11 Case, however, failed to disclose the existence of such asset on his Schedule B or in an amendment thereto in his Second Chapter 11 Case. Additionally, the Court determined that the Debtor similarly failed to disclose the transfer of the 2010 Note to MELP to acquire Unit 320.

5. **The value of the consideration received by the Debtor was not reasonably equivalent to the value of the assets transferred** (the eighth badge of fraud). The Court noted that the appropriate focus is whether the consideration received was reasonably equivalent to the value of the asset transferred from the standpoint of creditors, *not* from the standpoint of a debtor. The Court determined that the value of the consideration received, from the standpoint of the creditors, was not reasonably equivalent to the asset transferred. In other words, the transfer of the 2010 Note, which satisfied $236,120 of the purchase price of an exempt asset, deprived the Debtor's creditors of a non-exempt asset worth $236,120.

6. **The Debtor was insolvent or became insolvent shortly after the transfer** (the ninth badge of fraud). The Debtor's transfer of the 2010 Note to MELP occurred on March 11, 2011. The Court noted that a debtor's insolvency on a particular date can be established either by a balance sheet for such date or by demonstrating that a debtor was insolvent a reasonable time before or after such date. The Court determined that the Debtor was unable to rebut the presumption of his insolvency on the date he filed his petition for the Second Chapter 11 Case, that is, May 19, 2010. Additionally, the Court determined that the Debtor was also insolvent on the date he filed his petition for the Chapter 7 Case, that is, February 21, 2013. Having determined that the Debtor was

insolvent on May 19, 2010 and also on February 21, 2013, the Court found that the Debtor was insolvent on March 11, 2011.

7. **The transfer occurred shortly before the Debtor incurred a substantial debt** (the tenth badge of fraud). The Court determined that the Debtor incurred a debt shortly after the date he transferred the 2010 Note to MELP, evidenced by the $52,880 note he delivered to MELP. The Court determined that such debt was substantial for two reasons. First, the Court had previously found that a debt of $50,000 is substantial. Furthermore, the Court noted that the debt is substantial because the Debtor failed to obtain the court approval required under § 364 of the Bankruptcy Code for a debtor-in-possession (in the Second Chapter 11 Case) to incur such a debt.

8. **The Debtor is unable to explain the disappearance of assets** (the twelfth badge of fraud). The Court determined that the Debtor engaged in a prolonged concealment of the 2010 Note as well as its transfer as part of the consideration for Unit 320. The Court dismissed the Debtor's arguments that he did not understand the required disclosure and was not responsible for any omission. The Court noted that the more sophisticated the debtor, the lower the bar for establishing such debtor's reckless indifference to the truth. The Court found that the Debtor had a very high degree of sophistication considering his education and experience. Additionally, the Court found that the Debtor demonstrated a reckless indifference to the truth by failing to disclose the existence of the 2010 Note in the Second Chapter 11 Case and blaming the omission on his attorneys.

9. **The Debtor engaged in a pattern of "sharp dealing" prior to the bankruptcy** (the thirteenth badge of fraud). The Court noted that it has construed the term "sharp dealing" to mean "unethical action and trickery." The Court determined that the Debtor engaged in a protracted pattern of sharp dealing before and during his Chapter 11 filings, including: falsely representing that he had a fee simple interest in Unit 320; substantially underreporting amounts owed to him by MELP; failing to disclose the existence of the Contract for Deed; failing to disclose his exchange of the 2008 Note for the 2010 Note; falsely reporting non-existent liabilities; failing to obtain required court approval for his surrender of the 2010 Note on March 11, 2011; and conspiring with several others to deprive properly perfected lienholders of thousands of dollars in 2006.

The Court found that the Trustee established nine out of the thirteen badges of fraud, more than adequately meeting his burden of proof in showing that the Debtor disposed of a nonexempt asset (that is, the 2010 Note) with Fraudulent Intent. Furthermore, the Court noted that even if the Trustee had established only a few badges of fraud – particularly the third, seventh and tenth – it would have still concluded that the Debtor disposed of the 2010 Note with Fraudulent Intent. The Court found that the Debtor's defenses to the nine badges of fraud were without merit, sustained the Trustee's objection and ordered a $236,120 reduction in the Debtor's homestead exemption with respect to Unit 320.

In re Cowin provides an excellent analysis and discussion of the factors a court may use to determine whether a debtor has acquired a homestead using non-exempt property such debtor

disposed of with the intent to hinder, delay or defraud his or her creditors under § 522(o) of the Bankruptcy Code. For other cases discussing the factors necessary to prove actual intent under § 522(o) see *In re Enloe*, 2015 WL 7888919 (Bankr.S.D.Tex.2007); *In re Presto,* 376 B.R. 554 (Bankr.S.D.Tex.2007), and *In re Sissom,* 366 B.R. 677 (Bankr.S.D.Tex.2007).

vii. In *In re Roberts*, 25 Fla. L. Weekly Fed B209a (Bankr. N. Dist. Fla. Mar. 11, 2015), the debtors (a) liquidated non-exempt assets, including selling a vacant lot and a boat, (b) used the proceeds of a commercial loan, and (c) used the proceeds from the short sale of a seperate home, to construct their "**dream home**." During construction and unknown to several commercial lenders, the debtors were on the verge of defaulting on significant commercial debt. The debtors filed Chapter 7 Bankruptcy, listing their dream home as their exempt homestead under Article X, Section 4 of Florida's Constitution. The Chapter 7 Trustee (the "**trustee**") filed an objection under 11 U.S.C. § 522(o)(4), claiming that the debtors' exemption should be reduced in an amount equal to the value of non-exempt assets the debtors liquidated within ten years pre-petition. The trustee argued, based on facts taken at trial, that the debtors' liquidation of the non-exempt assets and construction of their dream home while on the verge of defaulting on significant commercial debt was done with intent to hinder, delay or defraud their creditors. The trustee's objection to homestead exemption was sustained and the claimed homestead exemption was reduced in amount equal to value of non-exempt assets the debtors liquidated within ten years pre-petition pursuant to 11 U.S.C. § 522(o)(4). The court decided that the debtors' non-fraudulent explantion for the transfers was "not credible and concluded that the debtor intended 'to keep the money out of the hands of his creditors' rather than to jump start or save money on the other project.." (quoting *In re Jennings*, 533 F.3d 1333 (11th Cir. 2008)).

viii. See also *In re Enloe*, 2015 WL 7888919 (Bankr. S.D. Tex. 2015), where the court held the debtor made the conversion of nonexempt wealth into homestead with the actual intent to hinder, delay or defraud his creditors within the meaning of § 522(o). The court stated:

> The question, then becomes whether Enloe transferred non-exempt assets into his homestead with "the intent to hinder, delay, or defraud a creditor." This phrase is not defined in § 522(o), but is used elsewhere in the Bankruptcy Code. For example, § 548(a) provides that the trustee may avoid transfers within two years of the petition date if the debtor made the transfer "with the actual intent to hinder, delay, or defraud" creditors. The phrase is also used in § 727(a)(2) with regards to denying a debtor's discharge. "Given these similarities in language courts have looked to decisions interpreting §§ 548(a)(1) and 727(a)(2) when interpreting § 522(o)." In re Cipolla, 476 Fed.Appx. 301, 306 (5th Cir. 2012).
>
> The court in *Enloe* also noted:
>
> Evidence of actual intent is required to support a finding sufficient to deny a discharge, or in this case, to deny a homestead exemption. *Id*. (Citing *In re Dennis*, 330 F.3d 696, 701 (5th Cir. 2003)). Constructive intent is insufficient. Nevertheless, because direct evidence of actual intent is rarely available, actual intent may be inferred from circumstantial evidence. *Dennis*, 330 F.3d at 701. To

that end, courts may look to "badges of fraud" to assist them in discerning fraudulent intent.

g. **Planning Tip**: A technical reading of new § 522(p) suggests that a potential debtor should *acquire* a home in a full homestead exemption state, such as Florida, to begin the 1,215-day period. *See e.g.*, *In re Greene*, 583 F.3d 614 (9th Cir. 2009). As noted above, the intent behind the purchase should be carefully documented due to the ten (10)-year fraudulent conversion rule. Still, a potential debtor will have to live in that state for at least two (2) years to qualify for that state's exemptions. *But see In re McNabb*, 326 B.R. 785 (Bkrtcy. D. Ariz. 2005) discussed above.

h. **Planning Around the Bankruptcy Rules:**

i. **Section 522(o) of the Bankruptcy Code**: What fraudulent conversion-transfer rule applies to the following situations:

(1) A transfers funds to B. Over two (2) years after B receives this gift B uses the funds to acquire a homestead in B's individual name.

(2) A transfers funds in trust to B. Over two (2) years after this transfer, the trustee of the trust purchases a residence for B in B's individual name. B's residence qualifies as homestead under Florida law.

(3) A lives with B. B, a Florida resident owns his own home that qualifies for homestead protection. A provides funds to B to satisfy B's mortgage.

Under § 548 of the Bankruptcy Code, the bankruptcy trustee is given the power to avoid particular transfers effectuated by a debtor that are made within ***two (2) years*** prior to the date that a bankruptcy case is filed. This general fraudulent transfer rule is modified by other fraudulent transfer and conversion rules such as the rules set forth in §§ 522(o) and 522(p) of the Bankruptcy Code.

ii. **Section 522(p) of the Bankruptcy Code**: A, a surgeon living in Springfield, Missouri, is in a high liability specialty. A is also highly compensated in his specialty. A acquires a waterfront home located on Siesta Key in Sarasota, Florida in March of 2005. The home has a fair market value of five million dollars ($5,000,000). When does the one thousand two hundred fifteen (1,215) day period begin to run?

iii. **Re-Thinking the Structure of Gifts to Buy Homes.** A and B are husband and wife and each works as an emergency room physician. A and B each come from families of substantial means. A and B are each currently named in a law suit involving the same patient even though each of them was working a different shift at the hospital during the patient-plaintiff's visit to the emergency room. The parents of A and B offer to purchase home for them and their new born child when they announce they are moving to Florida. A and B receive funds from their parents and purchase a new residence located in Florida where each of them now work as emergency room physicians at the same local hospital. A and B's parents could have settled a trust for their benefit and gifted the funds

directly to the trust rather than to A and B. The trustee of the trust could have acquired the residence for the use and benefit of A and B or to lease it to them?

iv. **Tenancy by the Entirety:** Although the Bankruptcy Act has several time requirements, tenancy by the entirety ownership may avoid the application of these rules to a debtor's primary residence in Florida. See *e.g.*, *In re Schwarz*, 362 B.R. 532 (Bankr. S.D. Fla. 2007) and *In re Zolnierowicz*, 380 B.R. 84 (Bankr. M.D. Fla. 2007).

j. **Transferring Homestead Property**. See *Stornawaye Financial Corp. v. Hill (In re Hill)*, 1st Cir. No. 08-9006, 4/1/09).

21. The party challenging the claim of the homestead exemption has the burden "to make [a] strong showing that the debtor is not entitled the claimed exemption." *In re Laing*, 329 B.R. 761, 770 (Bankr. M.D. Fla. 2005) (citing *In re Harrison*, 236 B.R. 788, 790 (Bankr. M.D. Fla. 1999)).

22. **Long Term Leasehold**. When a lessee's interest in a leasehold estate includes the right to use and occupy the premises for a long term and the lessee has made the residence his principal and exclusive residence, such an interest is entitled to Florida's homestead exemption from forced sale. In *Geraci v. Sunstar EMS*, Case Number 2D11-1234, (Fla. 2nd DCA June 27, 2012); *In re Dean*, 177 B.R. 727, 729-30 (Bankr. S.D. Fla. 1995).

23. **Cooperative Apartments**. Two cases have held that stock in a cooperative apartment community does not constitute a homestead for purposes of devise and descent. See *In re Estate of Wartels*, 357 So. 2d 708 (Fla. 1978) ("a cooperative apartment may not be considered homestead property for the purpose of subjecting it to Florida Statutes regulating the descent of homestead property"). The holding of *Wartels* was followed in *Phillips v. Hirshon*, 958 So. 2d 425 (Fla. 3d DCA 2007). Nevertheless, the *Wartels* case was decided before the adoption of the Cooperative Act. Thus, the appellate court certified the following question of great public importance to the Florida Supreme Court:

> DOES THE FLORIDA SUPREME COURT'S DECISION IN IN RE ESTATE OF WARTELS V. WARTELS, 357 SO.2d 708 (FLA. 1978), HAVE CONTINUING LEGAL VITALITY IN LIGHT OF THE ADOPTION BY THE FLORIDA LEGISLATURE OF THE COOPERATIVE ACT, CHAPTER 76-822, LAWS OF FLORIDA? IF THE ANSWER IS YES, IS IT LEGALLY PERMISSIBLE TO INTERPRET ARTICLE X, SECTION 4(A)(1) OF THE FLORIDA CONSTITUTION DIFFERENTLY FOR FORCED SALE PURPOSES THAN DEVISE AND DESCENT PURPOSES UNDER ARTICLE X, SECTION 4 OF THE CONSTITUTION?

Although the Florida Supreme Court initially accepted jurisdiction to review the appellate decision, it later discharged jurisdiction in a *per curiam* decision. *Levine v. Hirshon*, 980 So. 2d 1053 (Fla. 2008). Since the definition of homestead for purposes of its restriction on **devise and descent** derives from the same subsection 4(a)(1) under Article X of the Florida Constitution as is used for its exemption from **forced sale**, the *Wartels* decision seemingly denies an exemption from forced sale for a cooperative apartment used as a primary residence.

Consequently, there may be a direct conflict between the Florida Supreme Court and the Third District Court of Appeal and a decision of the Fifth District Court of Appeal, which held that a debtor was permitted to claim the benefit of the homestead exemption from forced sale for the debtor's interest in a cooperative apartment community. See *S. Walls, Inc. v. Stilwell Corp*., 810 So. 2d 566 (Fla. 5th DCA 2002). Regardless, a cooperative apartment is not homestead for purposes of restrictions on devise and descent.

24. In *Law v. Siegel*, 24 Fla. L. Weekly Fed. S577a (S. Ct. March 4, 2014), the United States Supreme Court held that the Bankruptcy Court may not contravene the provisions of the Bankruptcy Code by ordering that a debtor's exempt property be used to pay debts and expenses for which that property is not liable under such code. In *Law*, the debtor ("**D**") claimed that $75,000 of the value of his house was exempt under California's homestead exemption, and that the house was subject to two voluntary liens. The bankruptcy trustee ("**T**") alleged, and the Bankruptcy Court concluded, that one of the liens was fraudulent and that D had submitted fabricated evidence in an effort to persuade the court that the lien was legitimate. T incurred more than $500,000 in attorney's fees proving D's position was fraudulent. The Bankruptcy Court granted T's motion to "surcharge" D's $75,000 homestead exemption, making those funds available to defray T's attorney's fees. The Ninth Circuit Court of Appeals affirmed, holding that the surcharge was proper compensation to the estate for the actual monetary costs imposed by D's misconduct and to protect the integrity of the bankruptcy process. The Supreme Court, however, held that the bankruptcy court's "surcharge" was unauthorized because it contravened a provision of the Bankruptcy Code, that is, §522(b)(3)(A), which, by reference to California law, entitled D to exempt $75,000 of equity in his home from the bankruptcy estate. The Supreme Court noted that §522 sets forth a number of exceptions and limitations to the exemptions, and in crafting the provisions of §522, Congress balanced the difficult choices that exemption limits impose on both debtors and creditors. Section 522 does not give a court the discretion to grant or withhold exemptions based on whatever considerations a court deems appropriate. Therefore, D was entitled to claim the $75,000 homestead exemption and the surcharge imposed by the Bankruptcy Court was not permitted.

B. Life Insurance & Annuities.

1. a. If a Florida resident dies "leaving" insurance on his or her life, the proceeds of any such policy will inure to the benefit of the person who is designated as the beneficiary of such policy and such proceeds will be exempt from the claims of the **insured's** creditors unless the policy or a valid assignment of the policy provides it is for the benefit of a creditor. F.S. § 222.13. Care must be taken, however, when designating a revocable trust of the insured as a beneficiary to avoid unintentionally exposing insurance proceeds to creditors. See *e.g. Morey v. Everbank*, 93 So.3d 482 (Fla. 1st Dist. Ct. App. 2012); Adkinson, **LISI** Asset Protection Planning Newsletter #206 (August 28, 2012) at http://www.leimbergservices.com. Copyright 2012 Leimberg Information Services, Inc. (LISI). For an excellent discussion of *Morey*, see Karibjanian, "Protect Life Insurance Proceeds from Claims of Creditors," 40 EP * (Mar. 2013).

b. Nevertheless, if the insurance proceeds become payable to the insured or his or her estate (or executors, administrators, or assigns), such proceeds will

constitute a part of the insured's estate for all purposes and will be administered by the personal representative of the insured's estate according to the Florida Probate Code. *Id*. It does not matter whether the insured's estate is specifically designated as the beneficiary of such insurance or such proceeds become payable to the insured's estate through another source. *Id*.

c. **Practice Note**: This exemption does not protect insurance proceeds from a beneficiary's creditors. Nonetheless, if the insurance proceeds are payable to an irrevocable trust, the trust can be designed to maximize the protection of those proceeds from the claims of a beneficiary's creditors.

2. a. The cash surrender value of an insurance policy issued on the life of a citizen or resident of Florida and the proceeds of an annuity contract issued to a citizen or resident of Florida (in whatever form) cannot be attached, garnished or become subject to legal process in favor of any creditor of the insured or of any creditor of the person who is the beneficiary of such annuity contract, unless the policy or annuity was effected for the benefit of such creditor. F.S. § 222.14.

b. **Practice Note**: This provision protects the cash surrender value of an insurance policy from a creditor of the insured and not any other party. See *In re Allen*, 203 B.R. 786 (Bkrtcy. M.D. Fla. 1996); *In re Lowery*, 272 B.R. 317 (Bkrtcy. M.D. Fla. 2001). The protection afforded an annuity appears to be more expansive protecting the proceeds of any annuity contract from "any creditor of the person who is the beneficiary of such annuity."

c. **Practice Note**: The exemption under F.S. § 222.14 protects the cash surrender value of a life insurance policy. See *Bank of Greenwood v. Rawls*, 158 So. 173 (Fla. 1934) (holding "the cash surrender value of a life insurance policy includes any cash value that may be obtained either by means of negotiation or pursuant to an agreement for surrendering the policy in consideration of a sum of money to be paid in whole or in part conditioned upon a surrender of the life insurance feature of the policy, and is not limited to such a cash surrender value as can be demanded and legally enforced against an unwilling insurance company according to the usual significance of the term cash surrender value.") The statute is ambiguous whether the exemption protects withdrawals from the policy or amounts received pursuant to a policy loan. Unlike the exemption for the proceeds of an annuity contract, read literally the exemption for the cash value of an insurance policy seems to preclude a debtor from accessing the surrender value of the policy without risking forfeiting the benefit of the exemption. Nevertheless, there is authority to the contrary.

In two related cases, the Fourth District Court of Appeal evaluated the actions of a debtor, John Faro (the "**Debtor**"). See *Technical Chemicals and Products, Inc. v. Porchester Holdings, Inc.*, 785 So.2d 636 (Fla. App. 4th Dist. 2001); *Faro v. Porchester Holdings, Inc*., 792 So. 2d 1262 (Fla. App. 4th Dist. 2001). In 1994, Porchester Holdings, Inc. obtained a judgment against the Debtor in the amount of $192,000. See *Technical Chemicals and Products, Inc. v. Porchester Holdings, Inc.*, 785 So.2d 636 (Fla. App. 4th Dist. 2001). Porchester Holdings, Inc. assigned this judgment to Technical Chemicals and Products, Inc. (the "**Creditor**"). The Debtor owned several insurance policies issued by Mass Mutual. On November 3, 1998, Mass Mutual issued a check in the amount of $100,000 to the Debtor as a

loan on the Debtor's limited whole life policy. On April 15, 1999 in the first case, the Creditor filed a motion for a writ of garnishment on Mass Mutual. At the time the writ of garnishment was filed, the Debtor had not cashed the $100,000 check. On May 6, 1999, Mass Mutual requested a stop payment on the check and decided that it would not issue another check until the court determined whether the cash surrender value of the limited whole life policy was subject to garnishment. The Fourth District Court of Appeal affirmed an order dissolving the writ of garnishment under § 222.14 because the Debtor never received the cash surrender value of the limited whole life policy. Mass Mutual had stopped payment on the check. In the subsequent case, the Creditor attempted to garnish the additional cash surrender value of two of the four Mass Mutual policies when the Debtor successfully requested a withdrawal. *Technical Chemicals*, *Faro v. Porchester Holdings, Inc.*, 792 So. 2d 1262 (Fla. App. 4th Dist. 2001). In 1997, the Debtor withdrew $30,000 from the cash surrender value of two of the Mass Mutual policies. The Debtor used the $30,000 to purchase a certificate of deposit from a bank. Simultaneously, the Debtor secured a loan from the bank by executing a promissory note and assigning the bank a security interest in the certificate of deposit as collateral for the loan. In 1998, the Creditor served a writ of garnishment on the bank, seeking to attach the certificate of deposit to satisfy its judgment against the Debtor. The Debtor moved to dissolve the writ of garnishment on the basis that the certificate of deposit was funded with the cash surrender value of his life insurance policies, and assets that were statutorily exempt from garnishment under § 222.14. Reversing the trial court, the appellate court held that the certificate of deposit was protected under § 222.14 because it was purchased with the cash surrender value of the Debtor's life insurance policies. Citing *Goldenberg v. Sawczak*, 791 So. 2d 1078 (Fla. 2001), the appellate court noted that the words in § 222.14 "upon whatever form" means that the form of payment "is not relevant for purposes of having the exemption apply."

Notwithstanding the foregoing case law, the ambiguity in the statute may prove problematic and frustrating for a debtor who needs to access such funds because of the significant problems that can exist with protecting withdrawals made by the insured and policy loans taken by the insured. As the foregoing cases demonstrate, it was not easy for the Debtor to retain the benefit of the exemption.

As a result it may be prudent for the insured to transfer his or her insurance policies to a non-debtor spouse or child or possibly a self-settled asset protection trust established in an appropriate jurisdiction. Common jurisdictions permitting self-settled asset protection trusts now include Alaska (Alaska Laws, SLA 1997, Ch. 6 (H.B. 101), A.S. §§ 13.12.205(2), 13.27.050(a), 13.36.035, 13.36.310, 13.36.390, 34.40.010, 34.40.110(a), 34.40.110), Delaware (12 Del. Code Ann. §§ 3570-3576 (1997)), Missouri (M.R.S. §§ 428.005-428.059, 456.020, and 456.080), Nevada (N.R.S. § 166.040), Rhode Island (Title 18, Chapter 9.2 of the General Laws of Rhode Island (The Qualified Dispositions in Trust Act)), South Dakota (SDCL § 55-16-1, *et. seq*), Tennessee (TCA § 35-15-505(1)), Utah (Utah Code § 25-6-14(1)(a)), Wyoming (W.S. 4-1-510), Belize (Trusts Act), the Commonwealth of the Bahamas, the Cook Islands (International Trusts Act 1984) and Nevis (Nevis International Exempt Trust Ordinance, 1994).

Of course, care must be taken to avoid gift tax on the transfer of an insurance policy. In this case the exemption should continue to apply because the statute does not require the insured to own the insurance policy directly. See F.S. § 222.14, providing in relevant part, "The cash surrender values of life insurance policies *issued upon the lives of citizens or*

residents of the state . . .upon whatever form, shall not in any case be liable to attachment, garnishment or legal process in favor of any creditor of the person whose life is so insured." (Emphasis supplied). It will be less of a risk that any part of the cash surrender value will be attached if a trustee of an asset protection trust withdraws funds from an insurance policy that are needed for a discretionary distribution or application for the benefit of the insured than for the insured to withdraw funds from an insurance policy personally. Thus, if it is anticipated that the insured-owner would need to access the cash surrender value in the policy if the insured-owner experienced creditor problems, it is prudent to recommend an asset protection trust be used to own the policy. An insured who is a Florida resident should be able to transfer the policy at any time without the risk that the transfer could constitute a fraudulent transfer under Florida law. See F.S. § 726.102(2); *Bank of Greenwood v. Rawls*, 158 So. 173 (Fla. 1934).

d. **Practice Note**: The exemption for the proceeds of an annuity contract has been held to apply to single premium deferred annuities. In *In re Goldenberg,* 791 So.2d 1078 (Fla. 2001), Dr. Goldenberg ("**D**") performed gall bladder surgery on Shirley Sawczak ("**S**"). S filed suit against D for malpractice claiming that D transected her common bile duct during the surgery causing her life-long injuries. D did not have any malpractice insurance. D filed a petition under Chapter 7 of the Bankruptcy Code the same day that jury deliberations were scheduled. S was granted an emergency motion for relief from the bankruptcy automatic stay so that the malpractice trial could be completed. S obtained a judgment against D in the amount of $4,000,629. On the schedules attached to the bankruptcy petition, D listed assets totaling $3,791,119, of which D claimed $3,751,678 as exempt. Included in these exempt assets were seven annuity contracts with a combined value of $355,894 (hereinafter referred to as the "**annuities**").

The annuities were single premium deferred annuities. The single premium accumulated interest until the maturity date. The annuities provided for a commencement or maturity date when certain sums would become payable to the annuitant or his survivors under various settlement options. The annuities also allowed for the surrender of the contract in exchange for a designated lump sum payment defined as either the surrender value or net surrender value until the maturity date of each respective annuity contract. The surrender value was affected by the timing of when the annuity contract was surrendered. The earlier the annuity contract was surrendered, the higher the surrender penalty. D was both the owner and annuitant of the annuities.

S objected to D's claimed exemption for the annuities on two grounds. First, S argued that D had options to purchase the annuity contracts when D filed for bankruptcy and options to purchase annuity contracts were not exempt under the annuity exemption. Second, S argued that § 222.14 of the Florida Statutes exempts only the proceeds of annuity contracts and did not include cash surrender value. The bankruptcy court rejected D's first argument and held that neither the title nor the text of the statute distinguishes the proceeds received from a surrender of the annuity contract from the proceeds received after the contract is annuitized. The district court did not agree with the bankruptcy court and held that D's annuity contracts were not exempt because D did not have annuity contracts until the funds in the annuity account attained maturity. D appealed the district court's opinion. The appellate court refrained from

expressing an opinion regarding the conflict between bankruptcy court and district court and certified the following question to the Florida Supreme Court:

> ARE THE CASH SURRENDER VALUES OF DR. GOLDENBERG'S ANNUITY CONTRACTS EXEMPT FROM LEGAL PROCESS UNDER FLA. STAT. ANN. § 222.14 (WEST 1998)?

D emphasized that the phrase "upon whatever form" used in § 222.14 of the Florida statutes indicates that the form of payment is immaterial in determining if the exemption applies. As a result, D asserted that money received from the surrender of an annuity should be treated as exempt and being only a separate form of payment under the annuity contract.

S argued that § 222.14 of the Florida Statutes distinguishes between exemptions for cash surrender values in the case of life insurance contracts and proceeds in the case of annuity contracts. S also argued that no reliance on legislative history is necessary because the statute is clear and the plain meaning of the statute is that only proceeds of annuity contracts are exempt. As a result, S asserted that annuity contracts should be subject to legal process to the extent of the cash surrender values.

The Florida Supreme Court held in accordance with its decision *In re McCollam*, 612 So.2d 572 (Fla. 1993) that if the legislature intended to limit the exemption to particular annuity contracts, it would have included such restrictive language when the statute was amended to include annuity contracts. The legislature had not inserted any such restrictive language into § 222.14 of the Florida Statutes. The Florida Supreme Court held that there was no basis in the statute for a narrow definition of the term "proceeds" that did not include the cash surrender value of the annuity contracts. As a result, the Florida Supreme Court answered the certified question in the affirmative and held that the proceeds of an annuity contract where there is a surrender penalty are exempt from legal process by virtue of § 222.14 of the Florida Statutes.

e. **Practice Note**: At least one court has held that the exemption for the proceeds of an annuity contract applies to a private annuity. See *In re Mart*, 88 B.R. 436 (Bkrtcy. S.D. Fla. 1988). Nevertheless, the meaning of the term "issued" in the statute is ambiguous and it is doubtful that the definition of annuity was ever intended to include a private annuity. See II.B.2.g. below. In *Mart*, the debtor ("**D**") claimed an exemption for the value of an annuity contract D entered into with a trust known as the Ainickel Irrevocable Trust (the "**Trust**"). Seven of D's creditors and the bankruptcy trustee (collectively, the "**Objectors**") challenged the claimed exemption. On November 6, 1986, D established and funded the Trust with two thousand dollars ($2,000). D's daughter was designated as trustee of the Trust. The Trust was irrevocable, contained a spendthrift provision and was for the sole benefit of D's seven children, nieces and nephews. The Trust was designed to terminate upon the death of the survivor of D and D's wife.

On November 7 (that is, one day after the creation and initial funding of the Trust), D and his wife entered into an annuity agreement with their daughter, as trustee of the Trust. D conveyed a parcel of real estate located in Ohio to the Trust and a five hundred thousand dollar ($500,000) promissory note payable to D and his wife by Riverside Shoppes, Ltd. (collectively

referred to as the "**Properties**"). In exchange for the Properties, the trustee of the Trust agreed to pay stipulated sums at stated intervals to D and D's wife or the survivor of them. The value of the Properties was initially estimated at eight hundred fifty thousand dollars ($850,000). The annuity agreement was modified eleven months later to reduce the estimated value of the Properties to three hundred fifty thousand dollars ($350,000) and to reduce the stipulated payments to three thousand dollars ($3,000) a month. Both the Trust and annuity agreement were suggested and drafted by the D's estate planning attorney.

Section 222.14 of the Florida Statutes provides that "[t]he proceeds of annuity contracts issued to citizens or residents of this state, upon whatever form, shall not in any case be liable to attachment, garnishment or legal process in favor of any creditor . . . ." In its opinion the court noted that there is no basis in the statute to limit the exemption to annuities provided by "completely unrelated, public entities" and that such statute must be construed liberally in the debtor's favor. (Note, however, that as discussed below the statute may on its face provide a basis to limit the exemption to a commercial annuity.)

The Objectors argued that the exemption should not apply because the income stream lacks the level of certainty that is traditionally associated with annuity payments and that D has exercised absolute control over the income stream. Furthermore, the Objectors made the policy argument that if D's income stream is an annuity, any debtor can protect his or her assets by transferring his or her property to a related party in exchange for an income stream and label the transaction as an annuity. The court acknowledged that interpreting the annuity exemption in this manner, similar to many statutory exemptions, invites potential abuse. However, it rejected the Objectors' contentions and held that the statutory exemption for annuity payments provided by Florida law is not confined to annuities provided by "completely unrelated, public entities." The court also held that there was no intent to defraud D's creditors because the Trust and the annuity agreement were established for estate planning purposes and to minimize potential estate taxes, not to defraud creditors. (One is left to wonder whether the annuity transaction would pass scrutiny under Treas. Regs. § 25.7520-3(b)(2).)

It should be noted that when this case was decided, pursuant to § 548 of the Bankruptcy Code, a fraudulent transfer could be avoided if it was made within the year preceding bankruptcy. This statute, however, did not apply in this case because the annuity was established thirteen (13) months prior to bankruptcy. Additionally, pursuant to § 544(b) of the Bankruptcy Code a fraudulent transfer could be avoided by creditors to the extent such transfer could be avoided under state law. At the time of the bankruptcy, § 726.01 of the Florida Statutes applied to fraudulent transfers. Although § 726.01 of the Florida Statutes contained no specific time limitation, it did require proof of actual fraudulent intent to avoid a transfer. The court refused to set aside the transfer under § 726.01 of the Florida Statutes because the facts did not support a finding of fraudulent intent. The facts did not support a finding of fraudulent intent because D's independent certified public accountant verified that when the annuity transaction was effectuated D was solvent and had no lawsuits pending, D owned other property having a value totaling $4 million more than his liabilities, the annuity involved was less than ten percent (10%) of D's net assets and there was no motive to convert or conceal any other assets.

It seems unlikely that the exemption provided in § 222.14 for annuities was ever intended to apply to a private annuity transaction. Rather, the exemption appears to be intended to apply to commercial annuities. Although the court in *Mart* neglected to recognize it, the plain meaning of the statute is clear. According to legislative history, the Florida legislature amended § 222.14 in 1978 to expressly exempt the proceeds of annuity contracts because of a change to the Florida Insurance Code the previous year. The "staff analysis and economic statement" report for the two committees in the senate charged with reviewing the proposed legislation provides:

> *In 1977 the definition of "life insurance" in the Insurance Code, ch. 624-632, F.S., was expanded to include annuity contracts (ch. 77-295)*. Currently, § 222.14, which is not in Insurance Code, exempts the cash surrender value of life insurance from attachment, garnishment or legal process. *It is not clear whether the term "life insurance" as used in § 222.14 includes proceeds of annuities*.
>
> This bill specifically insulates the proceeds of annuities from the claims of creditors if the annuity is *issued* to a citizen or resident of Florida. A creditor of the annuity beneficiary cannot attach or garnish the proceeds unless the annuity contract was acquired for the benefit of the creditor. (Emphasis added.)
>
> *The beneficiaries of* ***such annuities*** would be protected because creditors could not have the proceeds attached or garnished.

In 1977, the definition of life insurance in the Florida Insurance Code was expanded to include annuity contracts. Thus, according to the legislative history under § 222.14, an amendment was necessary to clarify that the proceeds of annuity contracts were also exempt because an annuity was considered life insurance in the Florida Insurance Code. The Florida Insurance Code governs commercial annuities, not private annuity arrangements of any type. The Florida Insurance Code contained in Chapter 624 of the Florida Statutes defines "**life insurance**" as insurance of human lives, including the granting of annuity contracts, whether fixed or variable annuity contracts. F.S. § 624.602(1). A "**life insurer**" or "**life insurance company**" is an "**insurer**" engaged in the business of issuing life insurance contracts. F.S. § 624.602(2). The term "**insurer**" is defined to include every person engaged as indemnitor, surety or contractor in the business of entering into contracts of insurance or of annuity. F.S. § 624.03. The Florida Insurance Code requires that for any person to act as an insurer or any insurer to directly or indirectly transact insurance in Florida the insurer must have a certificate of authority issued to the insurer by the Florida Office of Insurance Regulation of the Financial Services Commission. F.S. § 624.401. As previously discussed, Section 222.14 was amended to make its terms consistent with Florida Insurance Code.

A typical trustee of a private trust such as the trustee in *Mart*, is not considered an insurer because neither the trustee nor the trust is engaged in the business of issuing annuity contracts. As a result, because the legislative history of § 222.14 specifically refers to the Florida Insurance Code and its definition of life insurance, it seems clear that the Florida legislature only intended the annuity exemption to apply to commercial annuities that are governed by the Florida Insurance Code. Plainly stated, the holding in *Mart* is wrong. The next court to review this issue should not reach the same conclusion because it is not supported

by the plain language in the statute. (*Mart* is not an anomaly. The Bankruptcy Courts in Florida have a history of incorrectly interpreting Florida asset protection law similar to the holding in *Mart*. See *e.g.*, *In re Planas*, 199 B.R. 211 (1996) (affirmed in part, reversed in part), *In re Lawrence*, 238 B.R. 498 (1999), *In re Bosonetto*, 271 B.R. 403 (2001) and *In re McAnany*, 294 B.R. 406 (Bankr. M.D. Fla. 2003).)

The Florida Supreme Court provided an extensive analysis of the application of the annuity exemption in the case of *In re McCollam*, 612 So.2d 572 (Fla. 1993). In *McCollam*, McCollam (the "**Debtor**") was the beneficiary under a commercial annuity contract purchased by Travelers Insurance Company to provide payments to the Debtor in connection with a general release and settlement agreement entered into on July 9, 1985. The annuity contract was purchased for the Debtor pursuant to a settlement for a wrongful death claim by the estate of the Debtor's father. Pursuant to the terms of the annuity contract, the Debtor was entitled to receive $1,320 per month, including a 3% annual increase, that was to cease upon the Debtor's death. The Debtor also was entitled to five periodic lump sum payments under the annuity contract. LeCroy (the "**Creditor**") had a claim against the Debtor arising from an automobile accident that occurred on July 16, 1987, approximately two years after the annuity contract was purchased for the Debtor's benefit. Subsequently, the Debtor filed a petition for bankruptcy on July 11, 1989, in which the Debtor claimed an exemption for the annuity contract under section 222.14.

Both the bankruptcy court and the federal district court concluded that the annuity contract was an annuity under section 222.14. On further appeal, the Eleventh Circuit Court of Appeals certified the following question to the Florida Supreme Court:

> WHETHER, AS A MATTER OF LAW, AN ANNUITY CONTRACT WHICH IS ESTABLISHED IN LIEU OF A CREDITOR PAYING A DEBTOR A LUMP SUM PRESENTLY OWED IS EXEMPT FROM CREDITOR CLAIMS IN BANKRUPTCY UNDER FLA. STAT. § 222.14

The Creditor argued that a literal reading of section 222.14 would invite substantial abuse of the exemption. Furthermore, the creditor also asserted that the court should focus on the existence of the underlying obligation rather than the payment structure of the annuity. The Creditor also argued that the Debtor was a party to a structured settlement, Travelers Insurance Company remained liable for all sums and obligations contained in the agreement and the annuity was merely purchased as security for Travelers Insurance Company's obligation.

Interestingly, the Florida Supreme Court rendered a 4 to 3 split decision in this case. The majority opinion focused on the meaning of the term "annuity contracts" contained in section 222.14. The Court reviewed other chapters of the Florida Statutes to flush out the meaning of "annuity contracts" because the legislature did not define the term "annuity contracts" in chapter 222 of the Florida Statutes. The majority opinion noted:

> The term is included, without definition in a number of statutes. See, e.g., §§ 61.076 (dissolution of marriage); 175.071, 175.201 (firefighters pension trust funds); 240.344 (community college retirement annuities); 627.464-.471, 627.601 (insurance). However, section 238.01(15), Florida Statutes (1989),

> defines annuity for the purposes of the retirement system for school teachers as: "annual payments for life derived as provided in this chapter from the accumulated contributions of a member. All annuities shall be paid in equal monthly installments.
>
> The majority opinion also noted:
>
> [O]ther courts have defined an annuity as " 'a yearly payment of a certain sum of money granted to another in fee for life or for years . . . . In its broader sense it designates a fixed sum . . . payable periodically, at aliquot parts of a year, at stated intervals, and not necessarily annually.'" *In re Gefen*, 35 B.R. 368, 371 (Bankr.S.D.Fla.1984) (quoting *In re Talbert*, 15 B.R. 536, 537 (Bankr.W.D.La.1981)).

The majority opinion answered the certified question affirmatively concluding by that the annuity contract in this case came within the plain and ordinary meaning of the term annuity contract under section 222.14.

The dissenting opinion argued that the term "annuity contract" in the statute was ambiguous. As a result, the dissenting opinion reviewed the legislative history to resolve the ambiguity. The dissenting opinion noted that "[t]he legislature intended to expand the scope of section 222.14 of the Florida Statutes to the same extent that it expanded the insurance code definition of life insurance." The dissenting opinion also argued that annuity contracts exempt under § 222.14 are only those that involve the insurance of human lives as defined in the Florida Insurance Code. The dissenting opinion concluded that the annuity contract was a glorified account receivable that violates the legislature's intent and unjustly deprives the Creditor of property he is entitled to under federal and state law.

McCollam presented a strange result. The majority opinion reached the proper conclusion with a faulty analysis. On the other hand, the dissenting opinion reached the wrong conclusion with the correct analysis of the statute. The majority opinion was correct because the Debtor could have received a lump sum payment and purchased an annuity with that money. The annuity would have been protected under section 222.14. The result should not change merely because the Debtor chose to settle her case by agreeing to have a commercial annuity contract directly purchased for her benefit. The analysis of Florida law in the majority opinion regarding the definition of the term "annuity contract" was wrong. As noted in the dissent, the court should have examined the meaning of the term annuity contract and the other relevant definitions provided under the Florida Insurance Code instead of merely referencing the Florida Insurance Code. The dissent's analysis of legislative history regarding the definition of an "annuity contract" under the Florida Insurance Code was correct. *McCollam* is an important case to review for anyone advising clients on the application of § 222.14 to a private annuity arrangement. It demonstrates the recognition by the court of the need to look beyond the statute to determine the application of the exemption. Importantly, *McCollam* involved a commercial annuity arrangement. *McCollam* sets up a showdown regarding whether § 222.14 applies to a private annuity, a result that obviously should not occur under the legislative history of the statute. It can also be argued that the statute is clear on its face and should not apply to private annuities.

The issue of private annuities as it relates to creditor claims prompted a thorough discussion of substance over form in the case of *In re Wyly,* 2006 WL 3639176 (Bankr. N.D. Tex. June 29, 2016) in which the court thoroughly scrutinized a debtor's assertion that payments resulting from offshore private annuities were exempt from the reach of the SEC under Texas law. The court held that the debtor's unique manipulation of the contracts could not withstand the SEC's argument that the arrangements were nothing more than "self-settled instruments." *Id.* at 18. The SEC cited a number of cases in support of this assertion which the court dismissed as distinguishable, however informative. See *In re Shurley,* 115 F.3d 333 (5th Cir.1997); *Daniels v. Pecan Valley Ranch, Inc.,* 831 S.W.2d 372 (Tex.App. San Antonio 1992); *In re Robbins,* 211 B.R. 2 (Bankr.D.Conn.1997). Ultimately, the debtor's unfettered access and enjoyment of the assets led the court to conclude that the payments were not true annuities, rather, they were a means to accumulate substantial offshore wealth.

f. **Mere Periodic Payments**: In *In re Pizzi*, 153 B.R. 357 (Bnkry S.D. Fla 1993), Pizzi (the "**Debtor**") won the Connecticut State Lottery in 1985. Connecticut agreed to make twenty (20) annual payments of approximately $160,000 to the Debtor. To fund its obligation to the Debtor, the State of Connecticut purchased a commercial annuity contract from Metropolitan Life; the State of Connecticut, not the Debtor, was listed as the owner and beneficiary of the annuity contract. Connecticut would simply remit the payments it received from Met Life to the Debtor. The Debtor went into bankruptcy and attempted to claim that her lottery winnings were exempt under § 222.14 as payments under an annuity contract, however, the court disagreed. The court noted that the annuity contract was issued to the State of Connecticut and not the Debtor. Furthermore, the named beneficiary on the annuity contract was the State of Connecticut and not the Debtor. According to the court, "Whether or not the [Debtor] is alive, the State of Connecticut receives the yearly payments." The court stated:

> Ms. Pizzi has no contract with Met Life and has no right to assert any claim against Met Life under its annuity contract with the State. She receives her money directly from the State of Connecticut and is entitled to that money whether or not the State receives payments under its annuity contract. Since her rights are solely against the State, the Debtor is not the beneficiary of the annuity contract.

The bankruptcy court also rejected any notion that the installment payments the Debtor received were protected under the expansive definition utilized by the *McCollam* court.

> *McCollam's* holding should not be extended further to enable debtors to exempt payment streams that are not payments under an actual annuity contract. Thus, *McCollam* does not compel a finding that the payment stream from Connecticut to the [Debtor] is itself an annuity and this Court will not broadly interpret *McCollam* to reach that result.
>
> Here, the income stream flowing directly to the [Debtor] is not an annuity at all. The monies are prize winnings stemming from the winning of the lottery. The Connecticut Lottery regulations never refers to the winnings as proceeds of an annuity, and the winner is never referred to as the beneficiary or payee of an

> annuity. The only annuity contract here is the annuity purchased by the State of Connecticut for its benefit and as discussed earlier, the [Debtor] is not a beneficiary of that contract. Even under the broad definition of annuity adopted in *McCollam*, the monies [Debtor] receives from Connecticut each year are not the "proceeds of an annuity contract under Fla.Stat. § 222.14.

Note: *Pizzi* should be compared with *In Re Dixson*, 153 B.R. 594 (Bankr. M.D. Fla 1993). Although not entirely clear, it seems that the debtor's lottery winnings from Arizona were satisfied by a commercial annuity, that is, the debtor received payments directly from an annuity contact, not a state government. According to the court in Dixson, "The State of Arizona, in satisfaction of its obligations, purchased an annuity contract from the Central Life Assurance Company[.] For the years 1986, 1987, and 1988, debtor and his former wife received the proceeds of the annuity." In Dixson, the court held that the payments from the annuity contract were protected by § 222.14.

In re Connor, 172 B.R. 119 (Bankr. M.D. Fla 1993) held that a series of installment payments owed to the debtor by her ex-husband under a divorce settlement agreement were not exempt under § 222.14. Although a series of installment payments is one characteristic of an annuity contract, the court noted that the payment stream is not the sole requirement for an annuity contract to be found to exist. Rather, an annuity contract must be identified as such in the contract. The court examined the intention of the parties as expressed in the written agreement calling for the payments to the debtor. The court found:

> The bargain was structured so that the former husband could pay installments. Paragraph 7 [of the settlement agreement] refers to the exchange as an "equitable distribution" and refers to the debtor and her former husband as parties to the contract, not as beneficiary or payee. It is clear, from the four corners of the agreement, that the parties did not intend for the settlement agreement to be an annuity.

In *In re Solomon*, 95 F.3d 1076 (11th Cir. 1996), the debtor settled a lawsuit against an insurance company in 1985. The settlement agreement called for the insurance company to make a series of payments to the debtor. As part of the settlement, the insurance company agreed to purchase an annuity contract from Transamerica Annuity Service Corporation. However, the insurance company designated itself as the beneficiary of the annuity contract; the debtor was not a party to the contract.

The debtor filed for bankruptcy in 1993 and claimed that the payments under the settlement agreement with the insurance company were exempt as an annuity contract. The court disagreed stating that § 222.14 "does not shield all debts or 'accounts receivable' structured to resemble annuities from a debtor's bankruptcy estate. We read *McCollam* to require the existence of an actual annuity *contract* before a series of payments may be exempt." A series of payments cannot be an annuity contract protected by § 222.14 unless the parties intended to create an annuity contract. The court reviewed the terms of the settlement agreement and found it to be "a garden variety release of liability." The court rejected the notion that the parties intended to create an annuity contract.

g. **"Beneficiary" defined under § 222.14 of the Florida Statutes**: In *Connor v. Seaside National Bank*, Case No. 5D13-3323 (Fla. 5th DCA 2014), the proceeds of annuities which had been purchased by the debtor's ("**D**") former spouse and distributed to D in a divorce proceeding were held to be exempt from garnishment under Fla. Stat. § 222.14. Though D was neither the annuitant nor the purchaser of the exempt annuities, she was the "beneficiary" of the annuity proceeds as defined in Fla. Stat. § 222.14 because D was entitled to payment of the annuity proceeds in accordance with the divorce decree.

h. **Query**: Does the exemption for the proceeds of an annuity contract ***issued*** to a citizen or resident of Florida apply to a settlor-donor's interest in a charitable remainder trust or a grantor retained annuity trust? The exemption for the proceeds of an annuity contract *issued* to a citizen or resident of Florida should not apply to a settlor-donor's interest in a charitable remainder annuity (or uni) trust or a grantor retained annuity (or uni) trust because such trusts are forms of a "**self-settled trust**." A self-settled trust is a trust in which the settlor, *i.e.,* the donor, remains eligible to receive distributions of income and/or principal from the trust. (As extensive discussion of self-settled trusts is included in this outline. See *infra*.) If the annuity exemption does not apply to a donor's interest in a charitable remainder trust or a grantor retained annuity trust, Florida's general rule regarding self-settled trusts will apply. This rule is now codified in § 736.0505 of the Florida Statutes. With respect to the assets of an irrevocable trust, a creditor or assignee of a settlor may reach the maximum amount that can be distributed to or for the benefit of the settlor. F.S. § 736.0505(1)(b). No case law exists on this issue. Nonetheless, it seems difficult for a debtor to prevail on the argument that the annuity exemption applies to such an interest for two reasons.

Reason #1 - One cannot "Issue" an Annuity to Oneself: The statute uses the term "**issued**." It does not seem possible for a debtor to cause an annuity contract to be "**issued**" to himself in a self-settled trust arrangement. Only a third party can "**issue**" an annuity to an annuitant. The terms "issue" and "issuer" are not defined in the text of the statute. Nevertheless, it seems reasonable to assume that the definition of "issuer" found in § 517.021(14) of the Florida Statutes would apply. F.S. § defines an issuer as "[a]ny person who proposes to issue, has issued, or shall hereafter issue any security. Any person who acts as a promoter for and on behalf of a corporation, trust, or unincorporated association or partnership of any kind to be formed shall be deemed an issuer." Additionally, Blacks Law Dictionary defines the term issuer as "a person or entity (such as a corporation or bank) that issues securities, negotiable instruments, or letters of credit." In the context of self-settled trusts there is no act whereby one party "issues" anything of value to another party.

Reason #2 - Legislative History Provides that Exemption is Intended to Apply Only to Commercial Annuity Arrangements: As explained, reference to the Florida Insurance Code set forth in Chapters 624 through 632 of the Florida Statutes leads to the conclusion that the exemption is only intended to apply to commercial annuity arrangements. For the exemption to apply *such annuity* must be included in the definition of life insurance and must be issued by an insurance company engaged in the insurance business and licensed to sell insurance. Therefore, a charitable remainder annuity (or uni) trust and a grantor retained annuity (or uni) trust does not come within the scope of this exemption. This interpretation makes sense because it drastically reduces many scenarios where a potential debtor could abuse the exemption.

Brown Case: Although raised on appeal in regards to a charitable remainder unitrust trust, the issue of whether the annuity exemption is applicable to a settlor's interest in such an arrangement was not decided by the court in *In re Brown*, 303 F.3d 1261 (11th Cir. 2002). In *Brown*, a debtor ("**D**"), who suffered from chronic alcoholism, inherited approximately $250,000. To protect her inheritance from her own improvidence, D transferred it to an irrevocable trust entitled "Irrevocable Charitable Remainder Unitrust Agreement" (the "**CRUT**"). Pursuant to the terms of the CRUT, D was entitled to receive an annual amount equal to 7% of the net worth of the trust, valued as of the first day of each taxable year. The payments were due to D in monthly installments. D was unemployed and was dependent on the monthly installments from the CRUT. D also served as trustee of the CRUT; however, D's powers were merely limited to directing investment decisions. D did not possess the power to invade the trust corpus or to alter the amount of payments due under the CRUT. The CRUT also contained a spendthrift clause prohibiting D from assigning or otherwise alienating her interest in the trust. Upon D's death, the 7% yearly unitrust payments were directed to be made to D's daughter for the remainder of her life. At the death of D's daughter, the remaining corpus of the CRUT was directed to pass to four charities designated in the trust.

On February 4, 1999, D filed a petition for bankruptcy under Chapter 7. D listed secured and unsecured claims in the amount of $110,023.53. D acknowledged her interest in the CRUT, however, she did not include her interest in the trust as part of her bankruptcy estate. D claimed that her interest in the CRUT was excluded from her bankruptcy estate because the trust agreement contained a spendthrift provision that prevented her from alienating her interest in the trust. After engaging in an excellent analysis of the current Florida law, the court held that D's retained interest in the CRUT was included in the bankruptcy estate because it was a self-settled trust.

D attempted to raise the argument that her income interest in the CRUT should be exempt from D's bankruptcy estate because it constituted an annuity under Florida law and the annuity exemption under § 222.14 should apply to protect it. However, D failed to timely assert the application of the annuity exemption; therefore, the appellate court refused to permit D to argue the exemption applied on appeal. Even if D was permitted to raise this issue on appeal, it seems unlikely that the court would have given her the protection of the annuity exemption. The foregoing authority seems too compelling.

If protection of a retained interest in a charitable remainder annuity (or uni) trust or a grantor retained annuity (or uni) trust is desirable, one might consider establishing such a trust in (or moving an existing trust to) a jurisdiction that provides creditor protection for self-settled trusts. For example, Alaska, Delaware, Rhode Island and South Dakota provide asset protection for such an interest under the trust law of such jurisdictions. Residency in such a state is not required to take advantage of its trust law. See *e.g.*, Subchapter VI of Chapter 35 of Part V of Title 12 of the Delaware Code. By way of example, 12 Del Code Ann. §3570(10)b provides for the protection of a donor-settlor's interest when a trust agreement contains a provision permitting the potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust (as such trusts are defined in §664 of the Internal Revenue Code).

i. Based on the legislative history that the exemption for annuities is intended to apply to commercial annuity arrangements that are within the definition of life insurance, the annuity exemption should not apply to a third party-non-settlor's interest in a charitable remainder trust or any other third party trust that grants a beneficiary an annuity interest in the trust. Nonetheless, inclusion of a spendthrift clause in such a trust should provide some level of protection before the payments are received by the beneficiary. See F.S.§ 736.0502.

3. Private placement life insurance ("**PPLI**") is an attractive asset protection and tax-efficient investment planning vehicle for Florida residents under the exemption set forth in § 222.14. PPLI is a variable life insurance product that provides a platform which permits more flexibility in the choice of investments and asset managers for the wealth accruing inside the policy. The higher quality PPLI policies are usually issued by life insurance companies conducting business in certain foreign jurisdictions. For instance, Bermuda and the Commonwealth of the Bahamas have each developed a substantial legal and commercial infrastructure for PPLI products. To acquire PPLI an insured will often settle one or more trusts in an appropriate foreign jurisdiction. For example, Nevis, the Commonwealth of the Bahamas or Bermuda. If designed properly, the trust structure can offer significant asset protection and estate planning benefits. The protection afforded by the trust structure and the life insurance exemption under § 222.14 provides a double layer of protection for a Florida resident. Although not a concern in a properly structured asset protection trust arrangement, use of the PPLI (or other life insurance) wrapper can effectively eliminate the concerns illustrated in certain asset protection trust cases. See *e.g.*, *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002) and *Federal Trade Commission v. Affordable Media*, 179 F.2nd 1228 (9th Cir. 1999).

C. Retirement Accounts.

1. Cash and other property payable to an owner, a participant, or a beneficiary from, and any interest of any such individual in a retirement or profit-sharing plan qualified under §§ 401(a), 403(a), 403(b), 408 (that is, an individual retirement account ("**IRA**")), 408A (that is, a Roth IRA), or 409 of the Code is exempt from the claims of creditors of the beneficiary or participant. F.S. § 222.21(2)(a). The exemption applies if the retirement account qualifies as a qualified plan or IRA under the Code. The exemption also applies to governmental and church plans that qualify for tax-exempt status under §§ 414, 457, and 501(a) of the Code. *Id*.

2. The foregoing exemption does not protect the value of the account from a qualified domestic relations order. See F.S. § 222.21(2)(d). A "**qualified domestic relations order**" is a domestic relations order which creates or recognizes the existence of an alternate payee's right to, or assigns to an alternate payee the right to, receive all or a portion of the benefits payable with respect to a participant under a plan. 29 U.S.C. § 1056(d)(3)(B).

3. Section 1056(d)(i) of the Employee Retirement Income Security Act of 1974 ("**ERISA**") requires a qualified plan to contain an anti-alienation provision. 29 U.S.C. § 1056(d)(i). Section 541(c) of the Bankruptcy Code under Title 11 of the U.S. Code provides in relevant part:

> (1) *Except as provided in paragraph (2) of this subsection*, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section *notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law that restricts or conditions transfer of such interest by the debtor*;
>
> (2) *A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title*. (Emphasis supplied.)

ERISA has been held to constitute "applicable nonbankruptcy law," within the meaning of § 541(c)(2), therefore, property held in an ERISA plan has been held property that is excluded from the bankruptcy estate. See *Patterson v. Shumate*, 504 U.S. 753 (1992).

4. A debtor cannot claim an exemption in an IRA because the IRA engaged in prohibited transactions that caused it to lose its exempt status. *In re Kellerman*, No. 4:15-cv-00347 (Bankr. E.D. Ark. Sept. 14, 2015) (Doc 2015-20777). For an excellent discussion on *Kellerman*, see, Rubin, "Kellerman v. Rice: IRA Loses Its Bankruptcy Exemption Due to Loan Transaction," **LISI** Employee Benefits and Retirement Planning Newsletter #650 (Nov. 12, 2015) at http://www.leimbergservices.com.

5. Some firms use standard language in their account agreements to create liens on IRAs. At least two courts have suggested that granting such a lien on an IRA may constitute a prohibited transaction that causes such accounts to lose their tax exempt status, potentially making such accounts subject to third-party creditor claims. *Yoshioka v. Charles Schwab Corp.*, 2011 WL 6748984 (N.D. Cal. 2011); but see *Daley v. Mostoller*, 6th Cir. 12-6130 (June 17, 2013) (reversing *In re Daley*, 459 B.R. 270 (Bankr. E.D. Tenn. 2011) and holding that a "naked lien," stripped of any connection to a credit transaction, doesn't disqualify a retirement plan from exempt status. The court also stated, "there is a statutory presumption that his account is exempt. If a retirement fund 'has received a favorable determination' from the IRS, 'those funds shall be presumed to be exempt from the estate.'"). For an excellent discussion of *Daley* see, Levine, "James L. Daley: Courts Differ on Whether Cross-Collateralization Language Disqualifies an IRA," **LISI** Employee Benefits and Retirement Planning Newsletter #623 (July 18, 2013) at http://www.leimbergservices.com.

6. The exemption provided under F.S. § 222.21 appears to resolve certain issues that may exist for debtors residing in states other than Florida regarding the ability of a creditor to reach assets in a plan qualified under ERISA. See *e.g.*, *Hoult v. Hoult*, (1st Cir. 2004); *Guidry v. Sheet Metal Workers Natl. Pension Fund*, 493 U.S. 365 (1990); *Wright v. Riveland*, 219 F.3d 905 (9th Cir. 2000); *Robbins v. DuBuono*, 218 F. 3d 197 (2d Cir. 2000); *Trucking Employees of North Jersey Welfare Fund, Inc. v. Colville*, 16 F.3d 52 (3d Cir. 1994). See also Golden, "Can Creditors Tap Retirement Assets?," 143 Trusts & Estates 54 (Sept. 2004). However, see Jay D. Adkisson, *Fraudulent Transfers into an ERISA Plan Can Be Unwound Despite the ERISA Protections*, FORBES: PERSONAL FINANCE (Aug. 14, 2016, 12:58 PM), http://goo.gl/1VbcT1 (describing the exceptions to the protections afforded debtors under ERISA involving late disqualifying transfers or fraudulent transfers); *In re Jones:* 26 Fla.

L. Weekly Fed. B75a (Feb. 2016) (holding that a debtor's liquidation of exempt funds constituted a fradulent transfer and denying discharge under F.S. § 222.21(c)).

7. a. **The Bankruptcy Act**: Whether the debtor elects (or is forced to elect) state law exemptions or federal bankruptcy exemptions, §§ 522(b)(3)(C) and 522(d)(12) of the Bankruptcy Code provide an express, identical exemption for:

> *retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code.*

Thus, *both* the state and federal exemptions are now based on the tax-qualified status of the retirement funds. Consequently, the exemptions cover qualified retirement plans, IRAs and Roth IRAs. However, with respect to "individual retirement accounts described in section 408 or 408A of the Internal Revenue Code" (that is, IRAs and Roth IRAs), "other than a simplified employee pension (SEP) under section 408(k) . . . or a simple retirement account (SIMPLE-IRA) under section 408(p)," § 522(n) of the Bankruptcy Code limits the exemption to $1 million, exclusive of amounts attributed to qualified rollovers. Thus, in a bankruptcy proceeding, the value of IRAs and Roth IRAs in excess of $1 million may be available to creditors despite the specific exemption under Florida law. SEPs and SIMPLE-IRAs are expressly excluded from the cap.

b. **Practice Note**: It may be prudent to maintain separate accounts for IRAs funded with rollover contributions and IRAs funded with annual contributions because of the unlimited exemption for rollover contributions.

c. **Planning Tip**: If an individual with a large IRA qualifies to participate in a retirement plan under §§ 403(b) and 457 of the Code, that individual should consider rolling his or her IRA into such a plan because those plans are not subject to the $1 million limitation.

d. Section 522(b)(4) of the Bankruptcy Code contains a presumption that funds held in an account under a retirement plan that has received a favorable ruling from the IRS regarding its qualified status may be exempt from the bankruptcy estate. Assets held in an account under a retirement plan that has not received a favorable determination from the IRS regarding its qualified status will be exempt if the debtor establishes that a court or the IRS has not issued a contrary ruling and either the assets have been administered in substantial compliance with the Code or the debtor was not responsible for any failure to comply with such rules.

e. Section 522(b)(4)(D) of the Bankruptcy Code permits an exemption for either "eligible rollover distributions" (as defined under IRC § 402(c)) or distributions from certain qualified plans that are rolled over into another qualified plan within sixty (60) days. Section 402(c) of the Code permits rollovers of certain distributions made from qualified plans directly to the plan beneficiary, nonetheless, under § 402(c) of the Code those distributions must be rolled over into another qualified plan within sixty (60) days to qualify for the favorable tax treatment.

8. a. **Inherited IRAs**: In *Robertson v. Deeb*, 16 So. 3d 936 (Fla. 2d Dist. Ct. App. 2009), Kevin J. Deeb (the "**Creditor**") sued Richard A. Robertson (the "**Debtor**") on a promissory note and obtained a judgment against the Debtor in excess of $188,000. The Creditor obtained and served a writ of garnishment on RBC Wealth Management ("**RBC**"). RBC identified an account titled "Richard A Robertson Beneficiary, Harold Robertson Decedent RBC Capital Markets Custodial IRA" (the "**Account**") that contained $75,372 in cash and securities. The Debtor filed a claim of exemption and argued that the IRA, which he had inherited from his father, was exempt from garnishment pursuant to section 222.21(2)(a) of Florida Statutes.

The Creditor argued that section 222.21(2)(a) did not apply to the Account because it was an inherited IRA. The Creditor argued that at the death of the Debtor's father the Account became the Debtor's property and did not qualify for the same exemption from taxation. The Creditor argued that section 222.21(2)(a) no longer applied because the Debtor was a beneficiary of the fund or account that qualified as an IRA when his father was living.

The Creditor argued that the plain language of section 222.21(2)(a) reflects the legislature's intent to exempt a "fund or account" that is maintained as an IRA in accordance with a plan or governing instrument that is exempt from taxation under certain provisions of the Internal Revenue Code. The Creditor argued that the plain language of section 222.21(2)(a) does not exempt inherited IRAs, which are separate funds or accounts that are created when the original fund or account passes to a beneficiary upon the death of the participant. Additionally, the Creditor argued that the "fund or account" that is exempt from garnishment under section 222.21(2)(a) is identified by its tax exempt status but when IRAs are distributed upon the death of the owner they become inherited IRAs and the tax exempt status of such account changes drastically.

The court held that the plain language of F.S. § 222.21(2)(a) refers only to the original "**fund or account**" and the tax consequences of inherited IRAs similar to the Debtor's IRA, render such a separate "fund or account" and such funds or accounts are not exempted by section 222.21(2)(a) and are subject to garnishment.

b. **Planning Note**. The *Robertson* decision was based on dubious grounds. On May 31, 2011, this decision was overturned by the Florida legislature when F.S. § 222.21(2)(c) was signed into law by Governor Rick Scott. This section exempts from creditor claims an owner, beneficiary, or participant in a traditional and inherited IRA. Additionally, the law is written to apply retroactively to any inherited IRA without regard to the date the account was established. Notwithstanding the new statute, it is still important to ensure that IRAs do not pass directly to a beneficiary with creditor issues upon the participant's death because inherited IRAs may not be protected in all situations as the original IRA was for the participant. For instance, a beneficiary may live in a state other than Florida and that state might not provide as generous an exemption as Florida. Therefore, it is still recommended that such accounts should be directed to pass to wholly discretionary spendthrift trusts in conjunction with the participant's estate plan to ensure that creditor protection of the benefits extend to the beneficiaries of such IRAs. But see, *In re Trawick*, 497 B.R. 572 (Bkrtcy.C.D.Cal. 2013); *In re Mathusa*, No. 6:10-bk-13336-KSJ (March 28, 2011); *In re Theim*, 107 A.F.T.R.2d 529 (Bkrtcy. Ct. AZ 2011); and *Chilton v. Moser*, 107 A.F.T.R.2d 1391

(E.D. Tex. March 16, 2011) holding inherited IRAs were exempt under the Bankruptcy Code. See Bankruptcy Code §§ 522(d)(12) and 522(b)(3)(C). See, however, *Clark v. Rameker*, 79 DTR K-2, 4/24/13, which held that funds held in an inherited IRA are not exempt for bankruptcy purposes. The Supreme Court resolved this split among the Circuits in its unanimous affirmation of the decision in *Clark*. See *Clark v. Rameker*, 573 U.S. ____ (2014); **LISI** Estate Planning Newsletter #248 (June 16, 2014) at http://www.leimbergservices.com. For an excellent discussion of the rules relating to designating a trust as the beneficiary of an IRA or other qualified retirement plan see Mary E. Vandenack: Reconsidering the Design of Trusts Used As IRA and Qualified Account Beneficiaries Post-Clark, **LISI** Asset Protection Planning Newsletter #252 (July 7, 2014) at http://www.LeimbergServices.com. See also *In re Andolino*, Case No. 13-17238 (RG) (Feb. 25, 2015), where the U.S. Bankruptcy Court for the District of New Jersey held that an IRA inherited by a New Jersey debtor from his mother was excluded from his bankruptcy estate under Section 541 of the Bankruptcy Code.

c. At least seven states have statutes exempting inherited IRAs from the reach of a debtor's creditors. See *e.g.*, Alaska Stat. § 09.38.017(a) (amended 2013); Ariz. Rev. Stat. § 331126(B) (amended 2011); Fla. Stat. § 222.21(2)(c) (amended 2011); Mo. Stat. § 513.430.1(10)(f) (amended 2013); N.C. Gen. Stat. § 1C-1601(a)(9) (amended 2013); Ohio Rev. Code §2329.66(A)(10)(e) (amended 2012); Tex. Prop. Code § 42.0021(a) (amended 2011)

9. A debtor's interest in a Keogh plan does not need to comply with ERISA to qualify for the exemption under Florida Statutes § 222.21(2)(a). See *Baker v. Tardif* (*In re Baker*), 11th Cir., No. 09-13144 Dec. 22, 2009. A Keogh need only qualify under § 401(a) of the Code. Florida has opted out of the exemptions provided in the Bankruptcy Code. *Id*.

10. An IRA is generally exempt from income taxes. However, when an IRA engages in a prohibited transaction, that exemption is lost. See *e.g. In Re: Kellerman, et ux*, No. 4:09-bk-13935 Bk Ct., E. AK, (May 26, 2015); Mike Jones & Michelle Ward, *In Re Kellerman*: Bankruptcy Court Finds Prohibited IRA Transactions Spoil Exclusion, **LISI** Asset Protection Planning Newsletter #301, (July 7, 2015) at http://www.LeimbergServices.com.

D. Wages.

1. The "**disposable earnings**" of a "**head of family**" whose disposable earnings are less than or equal to $750 a week are exempt from attachment or garnishment. F.S. § 222.11(2)(a).

2. The disposable earnings of a head of a family that are greater than $750 a week cannot be attached or garnished **unless such individual agrees in writing to permit such earnings to be attached or garnished**. F.S. § 222.11(2)(b). An agreement to waive the exemption must be:

a. written in the same language as the contract or agreement to which it relates;

b. contained in a separate document that is attached to the contract or agreement; and

c. set forth in at least 14-point type in substantially the following form:

> IF YOU PROVIDE MORE THAN ONE-HALF OF THE SUPPORT FOR A CHILD OR OTHER DEPENDENT, ALL OR PART OF YOUR INCOME IS EXEMPT FROM GARNISHMENT UNDER FLORIDA LAW. YOU CAN WAIVE THIS PROTECTION ONLY BY SIGNING THIS DOCUMENT. BY SIGNING BELOW, YOU AGREE TO WAIVE THE PROTECTION FROM GARNISHMENT.
>
> _____
>
> (Consumer's Signature) (Date Signed)
>
> I have fully explained this document to the consumer.
>
> _____
>
> (Creditor's Signature) (Date Signed)

Id.

3. The disposable earnings of a person who is a head of family cannot be attached or garnished in excess of the amount permitted under the Consumer Credit Protection Act, 15 U.S.C. § 1673. F.S. § 222.11(2)(c).

4. Exempt earnings that are credited or deposited in a financial institution are exempt from attachment or garnishment for six (6) months following the deposit of such earnings at a financial institution if the earnings can be traced and identified as earnings. F.S. § 222.11(3). Commingling of such funds will not by itself vitiate this tracing rule. *Id*.

5. The term "**earnings**" includes compensation paid or payable in money of a sum certain for personal services or labor. F.S. § 222.11(a). This compensation can be denominated as wages, salary, commission, or bonus. *Id*.

6. The term "**disposable earnings**" means the portion of the earnings of a head of a family that remain following deduction of any amount required by law to be withheld. F.S. § 222.11(b).

7. The term "**head of family**" includes any individual (the statute uses the term "**natural person**") who provides more than half of the support *for a child or other dependent*. F.S. § 222.11(c).

8. **Practice Note**: The term earnings does not appear to include a profits or dividend distribution from a business entity.

Practice Note: The statute does not require the child to be a minor or the "**dependent**" to be a descendant. Presumably, a spouse or a parent, for instance, could qualify as a "**dependent**."

Additionally, the debtor need not make more than the debtor's spouse to qualify for the wage exemption as long as the debtor is responsible for more than half of another person's support. See *FIA Card Services, N.A. v. Phillips*, County Court, 9th Judicial Circuit in and for Orange County (Case No. 2009-SC-8138. Oct. 2011). See also, *Grow Financial Credit Union v. Wright*, FLW Supp. 2007GROW (County Court, 10th Judicial Cir. Polk County, Case No. 2010CC-3737. October 9, 2012). *Chase Bank USA, N.A. v. Alfie*, County Court, 17th Judicial Circuit in and for Broward County. Case No. CONO 07-006826 (72), FLWSUPP 2209ALFI (June 2015). In *Alfie*, the defendant ("**D**") testified that she lived with her elderly parents and provided more than one-half ($^{1/2}$) of their economic support. Thus D claimed she was eligible to claim the head of family exemption under Fla. Stat. §222.12. D claimed her parents were "other dependents" under the exemption. The Court relies on the interpretation of the "head of family" test found in *Mazzella v. Boinis*, 617 So. 2d 1156 (Fla. Dist. Ct. App. 4th Dist. 1993) citing *Killian v. Lawson*, 387 So. 2d 960, 962 (Fla. 1980) and *Holden v. Estate of Gardner*, 420 So. 2d 1082, 1083 (Fla. 1982), where the Debtor may show either of the: (1) existence of a legal duty to support arising out of the family relationship at law known as a "family in law"; or (2) continuing communal living by at least two individuals under such circumstances that one is recognized as in charge, known as "family in fact". The court held that D did not qualify under the "*family in law test*" since she had no legal obligation to support her mother and father. Nonetheless, the court found that D did satisfy the "*family in fact test*" as she is the person "in charge" and possessed "a moral obligation to provide support for her elderly, unemployed parents whose sole source of income is a combined $600 per month from social security." See *Nationwide Fin. Corp. v. Thompson*, 400 So.2d 559 (Fla. DCA 1, 1981). Finally, the court also recognized that under *Mazzella* (*citing Patten Package Co. v. Houser*, 102 Fla. 603, 136 So. 353 (1931); *Farland Loan & Savings Co. v. Pittman*, 108 Fla. 442, 146 So. 554 (1933); *Slatcoff v. Dezen*, Fla. 1954, 76 So.2d 792), exemption statutes should be construed liberally in favor of a debtor. Thus, the court held that the term "other dependent" in Fla. Stat. §222.11 should apply to D's elderly and unemployed parents.

9. **Practice Note**: Care must be taken to qualify payments from a closely-held business to an owner of the business as disposable earnings, especially where the owner is sole owner of the business. See *e.g.*, *In re Zamora*, 187 B.R. 783 (Bkrtcy. S.D. Fla. 1995); *In re Stroup*, 221 B.R. 537 (Bkrtcy. M.D. Fla. 1997); *In re Fraley*, 148 B.R. 635 (Bkrtcy. M.D. Fla. 1992); and *In re: Cook*, 23 Fla. L. Weekly Fed. B71a (U.S. Bankruptcy Court, N.D. Fla., Case No. 11-50287-LMK, Aug. 8, 2011). The same may be true where the wage earner is in a position to exert a great deal of influence over the sole owner of a business and a great deal of control over the operation of the business. See *e.g.*, *In re Manning*, 163 B.R. 380 (Bkrtcy. S.D. Fla. 1994) (funds distributed to spouse from business held not to qualify as wage income and thus were not exempt).

a. In *In re Manning*, 163 B.R. 380 (Bkrtcy. S.D. Fla. 1994), the debtor's wife owned one hundred percent (100%) of the stock of Galaxy Construction Management, Inc. The debtor served as the president of the corporation and was responsible for its daily operations. Furthermore, the debtor negotiated contracts for the company, prepared bids and specifications for projects and engaged subcontractors, suppliers and materialmen for the company. The debtor claimed that distributions he received from the corporation were exempt wages. The trustee objected to the debtor's claim arguing the debtor was an independent contractor and not an employee of the company.

In holding that distributions from this corporation to the debtor did not qualify as wage income, the court stated:

> After considering the relevant factors, the Court finds that the Debtor in this case was more like an independent contractor than an employee primarily because of the control he exerted over the corporation. Stated simply, [the debtor] ran Galaxy. He determined his own salary, and whether he would receive commissions or bonuses. He had no employment contract. The Debtor used his own tools and other than gasoline, he paid his own expenses.
>
> The Debtor argues that he was an employee because he was paid a weekly salary, and not on a "**by the job**" basis. However, he determined his own salary, and sometimes did not take the salary if Galaxy was running low on cash. He also argues that Galaxy provided him with office space and support personnel. While true, this did not diminish his control over the corporation. Finally, he argues that technically, he could have been fired since he did not own Galaxy. *As a practical matter, however, he was not subject to firing since his wife was the sole owner*. (Emphasis supplied.)

The court then concluded:

> a debtor that owns or controls a business cannot exempt the funds he distributes to himself from the business *simply by calling the money "wages." For the exemption to apply, the debtor must not only perform personal services to the business, he must also receive regular compensation dictated by the terms of an arms-length employment agreement*. (Emphasis supplied.)

b. *In re Zamora*, 187 B.R. 783 (Bkrtcy. S.D. Fla. 1995), involved distributions to an attorney from his solo practice. In holding that such distributions would not qualify as wage income the court stated:

> An employee has regular earnings pursuant to an employment agreement. He or she is paid directly for personal labor or services. By contrast, this Debtor and others similarly situated who run their own businesses, have control over the timing and amount of their compensation. Certainly, the legislature did not intend to exempt *all funds* a person chooses to "draw" from a business where the individual has full discretion over what expenses to pay or not pay in order to fund the draw.

c. As a result of the foregoing, it is prudent for an owner of a closely-held business to enter into an employment contract with the business designed to mirror similar arms-length agreements. If such an agreement is carefully prepared, a portion of the distributions that an owner of a closely-held business receives from the business should be able to qualify as wage income under this exemption. See *e.g.*, *In re: Cook*, 23 Fla. L. Weekly Fed. B71a (U.S. Bankruptcy Court, N.D. Fla., Case No. 11-50287-LMK, Aug. 8, 2011). Of course, this result is far from guaranteed. Additionally, tax consequences of such payments must also be carefully considered.

d. Also, dividends, even dividends characterized as bonus income from a closely held business will not qualify as wage income under the wage exemption. *Id*. ("Black's Law Dictionary defines a dividend as 'a portion of a company's earnings or profits distributed *pro rata* to its shareholders...in the form of cash or additional shares.' Black's Law Dictionary 547 (9th ed. 2009). On the other hand, a bonus is defined as a "premium paid in addition to what is due or expected" and is "paid for services." *Id.* at 206.")

10. a. Payments made to an independent contractor will probably not qualify as earnings under this exemption. See *In re Schlein*, 8 F.3d 745 (11th Cir. 1993); *Refco, Inc. v. Sarmientom*, 487 So.2d 75 (Fla. 3d D.C.A. 1986); *In re Montoya*, 77 B.R. 926 (Bankr. M.D. Fla. 1987); *In re Moriarty*, 27 B.R. 73 (Bankr. M.D. Fla. 1983); *In re Malloy*, 2 B.R. 674 (Bankr. M.D. Fla. 1980).

b. In *In re Barr*, U.S. Bankruptcy Court, Middle District of Florida, Case No. 6:15-bk-00535-KSJ, Chapter 7. March 19, 2015, the issue was whether the debtor ("**D**") was an independent contractor or an employee for purposes of claiming the wage exemption. D argued that she was the "functional equivalent of an employee" because she was paid a commission for the services she performed. D provided that was performing personal marketing and sales services to obtain outside investors at the direction of her employer. To perform her job functions she used her employer's materials and her employer paid all expenses related to her job function. Pursuant to her agreement with her employer D identified an possible investor, communicated often with the possible investor, induced the possible investor to vet her employer's product, attended meetings with the possible investor and her employer and assisted her employer in completing the investment by the investor. D asserted her work was completed using materials prepared by her employer and her employer paid the expenses associated with her work. This included paying for a dinner between D, the possible investor, and her employer and for a holiday gift for the possible investor. The court noted that the wage exemption does not apply to an independent contractor's earnings. The court provided further:

> there is "no hard and fast rule. . .to control the determination of the question as to whether one occupies the status of an employee or that of an independent contractor." Each case must stand on its own facts. The inquiry is not determined by whether the debtor was labeled an employee or an independent contractor solely and although there is no absolute rule for determining whether a debtor received compensation as an independent contractor or an employee, the typical indicia that a debtor was an independent contractor include:
>
> > the existence of a contract for the performance by a person of a certain piece or kind of work at a fixed price, the independent nature of his business or his distinct calling, his employment of assistants with the right to supervise their activities, his obligation to furnish necessary tools and supplies, his right to control the progress of the work except as to the final results,

> the time for which the workman is employed, the method of payment, whether by time or by job, and whether the work is part of the regular business of the employer.

In re Moriarty, 27 B.R. 73, 74 (Bankr. M.D. Fla. 1983) (*citing Magarian v. Southern Fruit Distributors, et al.,* 146 Fla. 773 (Fla. 1941)). *See also Cantor v. Cochran,* 184 So.2d 173 (Fla.1966) (adopting the Restatement (Second) of Agency § 220 (1958) for determining whether one is an employee or independent contractor).

After taking the foregoing into consideration, the court determined that D was an employee and the commissions she recevied pursuant to her employment agreement qualifed for the wage exemption. This was the result even though D is characterized as an independent contractor and her compensation was limited to the success of a specific charge.

11. a. Receivables of a professional practice or personal service corporation should not qualify as wage income. See *e.g.*, *In re Zamora*, 187 B.R. 783 (Bkrtcy. S.D. Fla. 1995).

b. According to several bankruptcy courts, severance pay will not qualify for the wage exemption. See *e.g.*, *In re Stroup*, 221 B.R. 537 (Bkrtcy. M.D. Fla. 1997) ("severance pay in its various forms is not considered 'earnings' under the protection of Florida Statute Section 222.11…This is because the debtor has not performed any personal services or labor after termination which is necessary to obtain the exemption protection."); *In re Dennison*, 84 B.R. 846 (Bankr. S.D. Fla. 1988); *In re Harrington*, 70 B.R. 301 (Bankr. S.D. Fla. 1987); and *In re Howe*, 381 F.Supp. 1025 (N.D. Fla. 1974).

13. The exemption has been held to apply to a non-resident debtor. See *Ulisiano v. Ulisiano*, 40 Fla. L. Weekly D153a, 4th District. Case No. 4D14-2786 (January 7, 2015).

E. Disability Benefits.

Florida Statutes § 222.18 provides that disability income benefits from a policy or contract of life, health, accident, or other insurance in any form cannot be attached, garnished, or subject to legal process in Florida in favor of any creditor of the recipient of such benefits. This exemption does not apply if the policy or contract was obtained for the benefit of the creditor seeking to garnish or attach such benefits. *Id*.

F. Tax Advantaged Savings Accounts.

1. a. Since 1999, Florida has exempted the Florida Prepaid College Program and the Florida College Savings Program. In 2005, the Florida legislature expanded the exemption to broadly include any qualified tuition program under § 529 of the Code. F.S. § 222.22(1). Additionally, Coverdell Education Savings Accounts (*i.e.*, Educational IRAs) established under § 530 of the Code are accorded the same treatment. F.S. § 222.22(3). Thus, transfers to and from, the assets of, and the income of § 529 plans and Educational IRAs may not be attached, garnished, or become subject to legal process in Florida in favor of any

creditor of the individual who purchased the account or a beneficiary of such advance payment contract.

b. Section 541 of the Bankruptcy Code excludes from the bankruptcy estate the value of certain education IRAs and tuition plans established under §§ 529 and 530 of the Code. Generally, these plans must benefit a child, stepchild, grandchild, or step-grandchild of the debtor. The exclusion for § 529 plans is limited to funds not exceeding the contribution limits of § 529 (that is, the amount necessary to provide for the beneficiary's education expenses) that were contributed not later than one (1) year preceding filing of the petition, and $5,000 for all such accounts having the same designated beneficiary contributed during the period between one (1) year and two (2) years preceding the petition date. The exclusion for education IRAs is limited to assets not exceeding the contribution limits of § 4973(e) of the Code (that is, $2,000 or less) that were contributed not later than one (1) year preceding filing of the petition, and $5,000 for all such accounts having the same designated beneficiary contributed during the period between one (1) year and two (2) years preceding the petition date. The effect of these provisions is to include in the bankruptcy estate the amounts not qualifying for the new exclusions. Nevertheless, the value of such an account may still be exempt from the bankruptcy estate if the debtor opts for state law exemptions under § 522 of the Bankruptcy Code and the debtor's state protects such contributions from creditors. Section 521 of the Bankruptcy Code requires a debtor (that is, the "**contributor**" under §§ 529 and 530 of the Code) to file a notification of an interest in an education IRA or qualified state tuition program.

2. Health Savings Accounts (HSAs) and Archer Medical Savings Accounts (MSAs), which provide tax benefits to account owners with high deductible health plans, are also protected from the claims of creditors. F.S. § 222.22(2). Money paid into or out of, the assets of, and the income of such accounts will not be subject to attachment, garnishment, or legal process in Florida in favor of any creditor of such individual or beneficiary of such account. *Id*.

G. Miscellaneous.

Florida Statutes § 222.25(1) provides that an individual's interest that does not exceed $1,000 in value in a single motor vehicle (as defined in F.S. § 320.01) will be exempt from attachment, garnishment, or other legal process by a creditor of the individual. Furthermore, under F.S. § 222.25(2) an individual's interest in any professionally prescribed health aids for the individual or for a dependent of the individual will be exempt from attachment, garnishment or other legal process. Additionally, under F.S. § 222.25(3) an individual's interest in a tax refund or credit or the traceable deposits at a financial institution of an individual's interest in a tax refund or tax credit under § 32 of the Code will not be subject to attachment, garnishment or legal process. These exemptions will not apply to a debt owed for child support or spousal support.

H. Tenancy by the Entireties.

1. Although technically not an exemption, Florida law recognizes tenancy by the entireties ("**T by E**"), a form of ownership that can only exist between two individuals

who are married to each other. *Estate of Berlin v. Pecora*, 968 So.2d 47 (Fla. 4th D.C.A. 2007); *In re McRae*, 282 B.R. 704 (2002); *In re Koesling*, 210 B.R. 487 (1997); and *Amsouth Bank of Florida v. Hepner*, 647 So.2d 907 (Fla. 1st D.C.A. 1994).

2. Property owned in T by E under Florida law cannot be reached to satisfy the claims of a creditor of only one spouse. See *Bridgeview Bank Group v. Callaghan*, 84 S.3d 1154 (Fla. 4th D.C.A. 2012); *In re Sinnreich*, 391 F.3d 1295 (Cir. 11, 2004); *Beal Bank, SSB v. Almand and Associates*, 780 So.2d 45 (Fla. 2001); *Neu v. Andrews*, 528 So. 2d 1278 (Fla. 4th D.C.A. 1988); *Losey v. Losey*, 221 So.2d 417 (Fla. 1969); and *Winters v. Parks*, 91 So.2d 649 (Fla. 1956). See also, *Sitomer v. Orlan*, 660 So.2d 1111 (Fla. 4th D.C.A. 1995) (T by E property is not divisible by or on behalf of one spouse acting alone and thus, may not be seized to satisfy the obligations of only one spouse.

3. a. In Florida, a married couple can own real property as T by E. *Beal Bank, SSB v. Almand and Associates*, 780 So.2d 45 (Fla. 2001); *In re Suggs' Estate*, 405 So.2d 1360 (Fla. 5th D.C.A. 1981); *Losey v. Losey*, 221 So.2d 417 (Fla. 1969); *Losey v. Losey*, 222 So.2d 791 (Fla. 3rd D.C.A. 1969); *Lauderdale v. Lauderdale*, 96 So.2d 663 (Fla. 3rd D.C.A. 1957); *Kerivan v. Fogal*, 156 Fla. 92, 22 So.2d 584 (1945); and *Giachetti v. Giachetti*, 157 Fla. 259, 25 So.2d 658 (1946).

b. Florida law also permits ownership of personal property in T by E. *Cohen v. Mathews*, 307 Fed. Appx. 266, (11th Cir. 2009); *Estate of Berlin v. Pecora*, 968 So.2d 47 (Fla. 4th D.C.A. 2007); *In re McAnany*, 294 B.R. 406 (Bankr. M.D. Fla. 2003); *Beal Bank, SSB v. Almand and Associates*, 780 So.2d 45 (Fla. 2001); *Cacciatore v. Fisherman's Wharf Realty Ltd. Partnership ex rel. Emalfarb Investment Corp.*, 821 So.2d 1251 (Fla. D.C.A. 2002); *In re Bundy*, 235 B.R. 110 (Bankr. M.D. Fla. 1999); *In re Campbell*, 214 B.R. 411 (Bankr. M.D. Fla. 1997); *Lapp v. U.S.*, 316 F. Supp. 386 (S.D. Fla. 1970); *Bailey v. Smith*, 89 Fla. 303, 103 So. 833 (1925); *Winters v. Parks*, 91 So.2d 649 (Fla. 1956); *Lauderdale v. Lauderdale*, 96 So.2d 663 (Fla. 3rd D.C.A. 1957); *Anderson v. Carter*, 100 So.2d 831 (Fla. 2nd D.C.A. 1958); *Lacker v. Zuern*, 109 So.2d 180 (Fla. 2nd D.C.A.1959); *Tingle v. Hornsby*, 111 So.2d 274 (Fla. 1st D.C.A. 1959); *Lacker v. Zuern*, 109 So.2d 180 (Fla. 2nd D.C.A. 1959); *Lerner v. Lerner*, 113 So.2d 212 (Fla. 2nd D.C.A. 1959); *Crawford v. U.S. Fidelity & Guaranty Co.*, 139 So.2d 500 (Fla. 1st D.C.A. 1962); *Colclazier v. Colclazier*, 89 So.2d 261 (Fla. 1956); and *Doing v. Riley*, 176 F.2d 449 (5th Cir. 1949).

c. A married couple who receives and holds title to real estate in their names (*e.g.*, John Doe & Mary Doe, husband and wife) is presumed to own it in T by E unless the deed expressly indicates otherwise. *Matthews v. McCain*, 170 So. 323, 125 Fla. 840 (Fla. 1936); *Knapp v. Fredricksen*, 4 So.2d 251, 148 Fla. 311 (Fla. 1941); *Strauss v. Strauss*, 3 So.2d 727, 148 Fla. 23 (Fla. 1941); *Kollar v. Kollar*, 21 So.2d 356, 155 Fla. 705 (Fla. 1945); *Losey v. Losey*, 207 So.2d 283, quashed 221 So.2d 417, opinion conformed to 222 So,2d 791 (Fla. 3rd D.C.A.1968); *In re Silvian's Estate*, 347 So.2d 632 (Fla. 4th D.C.A. 1977); *Roger Dean Chevrolet, Inc. v. Fischer*, 217 So.2d 355 (Fla. 4th D.C.A. 1969); *Amsouth Bank of Florida v. Hepner*, 647 So.2d 907 (Fla. 1st D.C.A. 1994); Schoenrock v. Schoenrock, 202 So.2d 571 (Fla 2nd D.C.A. 1967); and *In re Suggs' Estate*, 405 So.2d 1360 (Fla. 5th D.C.A. 1981).

d. i. There is also a presumption of ownership in T by E for married couples as to bank accounts. See *Beal Bank, SSB v. Almand and Associates*, 780 So.2d 45 (Fla. 2001) which reverses prior case law holding that no such presumption applies to any type of personal property and holds that a presumption does apply to bank accounts. See also *Xayavong v. Sunny Gifts, Inc.*, 891 So.2d 1075 (Fla. 5th D.C.A. 2004), providing, "In *Beal Bank* the Supreme Court extended the rebuttable presumption of tenancy by the entireties to financial accounts *and apparently to other personal property*." Nonetheless, questions remain as to the application of this presumption to other types of personal property. See *e.g.*, *In re McAnany*, 294 B.R. 406 (Bankr. M.D. Fla. 2003), providing, "the Florida Supreme Court's decision in *Beal Bank does not extend the presumption of tenancy by the entireties to all personal property*. *If the Florida Supreme Court wanted to extend the presumption of tenancy by the entireties to all personal property it clearly could have*. *However, the court chose not to do so and spoke in regards to bank accounts throughout the entire opinion*." See also, *Gibson v. Marr*, 395 So.2d 1278 (Fla. 4th D.C.A. 1981); *Dickey v. Kaiser Aluminum & Chemical Sales, Inc.*, 286 F.2d 137 (Cir. 5 1960); and *In re Allen*, 203 B.R. 786 (Bkrtcy. M.D. Fla. 1996). If the rule in *Beal* does not apply to other types of personal property, it may be necessary to prove a T by E exists unless documentation related to title of such property expressly indicates it is held in T by E. *Id*. According to case law, the burden of proof may be high. See *Terrace Bank of Florida v. Brady*, 598 So.2d 225 (Fla. 2nd D.C.A. 1992), which applies a clear and convincing standard. But see *Cohen v. Mathews*, 307 Fed. Appx. 266, (11th Cir. 2009), providing "there is no support for the contention that the *Beal Bank* presumption does not apply to personal property other than bank accounts. While the personal property at issue in *Beal Bank* was bank accounts, later cases have applied *Beal Bank* to other forms of personal property. See *Cacciatore v. Fisherman's Wharf Realty Ltd. P'ship*, 821 So.2d 1251, 1253 (Fla. Dist. Ct. App. 2002) (extending *Beal Bank* to stock certificates); *Kossow*, 325 B.R. at 485 (applying *Beal Bank* to household furnishings)." See also *In re Daniels*, 309 B.R. 54, 59 (Bankr. M.D. Fla. 2004) which provided, "while the court in *Beal Bank* explicitly addressed an issue involving only marital bank accounts, the court also discussed in detail ownership issues surrounding marital personal property in general and expressly concluded that strong policy reasons exist for extending the tenancy by the entireties presumption to jointly owned marital personal property, not just to financial accounts." *In re Caliri*, 347 B.R. 788 (2006) extended *Beal* to an interest in a catamaran. See also, *In re Newcomb*, 23 Fla. L. Weekly Fed. B496a (M.D. Fla. 2012), extending the holding of *Beal* to joint tax refunds. Florida Statutes § 655.79(1) provides that any account that is held in the name of two persons who are married to each other will be considered to be held in T by E. Theefore, unless the account documentation otherwise specifically disclaims a T by E form of ownership, it is presumed that such an account is held in T by E. Property held in T by E is considered held "*per tout*," that is, the whole, not a share or divisible part. Such property belongs to neither spouse individually and any assignment or transfer of property in such an account requires the consent of both spouses.

ii. To avoid questions regarding the character of ownership of personal property between spouses whenever possible documents of title should expressly indicate ownership in T by E. *In re Golub*, 80 B.R. 230 (Bkrtcy. M.D. Fla. 1987) and *Beal Bank, SSB v. Almand and Associates*, 780 So.2d 45 (Fla. 2001) ("an express designation on the signature card that the account is held in tenancy by the entireties ends the inquiry as to the form of ownership."). Although the presumption of T by E does apply for bank accounts, it is recommended that the signature card for the account expressly provide that the account is held

in T by E. It is also recommended that some documentation related to the bank account exist that authorizes either spouse to act for the other regarding writing a check on the account. *Id*.

iii. Although the case dealt only with the ownership of bank accounts, it is possible that the court in *Beal* intended to extend the presumption of T by E to all types of personal property. In *Beal*, the court stated:

> Although we understand the considerations that originally led to this Court's decision not to adopt a presumption of tenancy by the entireties in personal property similar to that in real property, *we conclude that stronger policy considerations favor allowing the presumption in favor of tenancy by the entireties when a married couple jointly owns personal property*. (Emphasis supplied.)

iv. At least as to bank accounts, *Beal* held, "as between the debtor and a third party-creditor…if the signature card of the account does not expressly disclaim the tenancy by the entireties form of ownership, a presumption arises that a bank account titled in the names of both spouses is held in tenancy by the entireties." Of course, the *Beal* court also held that this presumption can be overcome by proof to the contrary. The burden of proof, that is, a preponderance of the evidence, is on the creditor.

v. In *Hector Supply Co*., the court held that an "express designation on the signature card that the account is held in tenancy by the entireties ends the inquiry as to the form of ownership." In other words, such a designation provides conclusive evidence of ownership in T by E. See also, *Morse v. Kohl, Metzger, Spotts, P.A.*, 725 So.2d 436 (Fla. 4th D.C.A. 1999), holding that when the signature card specifically provides that a bank account in is held in T by E extrinsic evidence is not permitted to disprove the account is not held in T by E. See also *Sheeler v. United States Bank of Seminole*, 283 So.2d 566 (Fla. 4th D.C.A. 1973). In *Beal*, the court approved this holding.

vi. *Beal* also held that "a statement on the signature card that the bank account is titled in the name of husband and wife is held as a joint tenancy with right of survivorship does not alone constitute an express disclaimer that an account is *not* held as tenancy by the entireties." See *Beal Bank, SSB v. Almand and Associates*, 780 So.2d 45 (Fla. 2001). If the signature card does not expressly disclaim the existence of a T by E, the presumption arises in favor of T by E. *Id*. See also *Cohen v. Mathews*, 307 Fed. Appx. 266, (11th Cir. 2009) for a similar holding as to a stock certificate.) (If the signature card expressly disclaims ownership of an account in T by E no presumption will be recognized by a court. *Id*. Except in the case of fraud, such an express disclaimer will preclude a husband and wife from claiming the account is held in T by E. *Id*. Furthermore, entities account status will be disclaimed "if the financial institution affirmatively provides the depositors with the option on the signature card to select a tenancy by the entireties among other options, and the depositors expressly select another form of ownership option of either a joint tenancy with right of survivorship or a tenancy in common." See *Wexler v. Rich*, 37 Fla. L. Weekly D460a.

vii. If one spouse can withdraw funds from a bank account without the consent of the other spouse, this authority will not frustrate the T by E. See *Beal*

Bank, SSB v. Almand and Associates, 780 So.2d 45 (Fla. 2001). **Nonetheless, the account agreement must grant each spouse the authority to act for the other**. *Id*.

4. To establish a T by E in Florida there must exist a unity of:

a. Time;
b. Title;
c. Interest;
d. Possession;
e. Survivorship; and
f. Marriage.

Estate of Berlin v. Pecora, 968 So.2d 47 (Fla. 4th D.C.A. 2007); *Beal Bank, SSB v. Almand & Assocs.*, 780 So.2d 45 (Fla. 2001); *Junk v. Junk*, 65 So.2d 728 (Fla. 1953); *Andrews v. Andrews*, 155 Fla. 654, 21 So.2d 205 (1945); and *In re Caliri*, 347 B.R. 788 (2006).

[Reserved for detailed discussion of creation of T by E Estate.] For an excellent discussion of the law in this area, see Buzby-Walt, "Are Florida Laws on Tenancy by the Entireties in Personalty as Clear as We Think?," 65 Fla. Bar Jrnl. 52 (Sept/Oct. 2011). But for an equally excellent discussion of the law in this area, see Gassman & Pless, "Florida Supreme Court Cases Confirm Tenancy by Entireties in Personal Property," **LISI** Estate Planning Newsletter #1887 (November 8, 2011) at http://www.leimbergservices.com.

5. Upon the death of one spouse the T by E estate vests in the surviving spouse and becomes the individually owned property of such spouse. *Estate of Berlin v. Pecora*, 968 So.2d 47 (Fla. 4th D.C.A. 2007); *Cacciatore v. Fisherman's Wharf Realty Ltd. P'ship*, 821 So.2d 1251 (Fla. 4th D.C.A. 2002); *Colclazier v. Colclazier*, 89 So.2d 261 (Fla. 1956); *Baumgardner v. Kennedy*, 343 So.2d 1323 (Fla. 3rd D.C.A. 1977); *Menendez v. Rodriguez*, 106 Fla. 214, 143 So. 223 (1932); *Knapp v. Fredricksen*, 148 Fla. 311, 4 So. 2d 251 (1941); *Bamber v. Bamber*, 216 So.2d 806 (Fla. 3rd D.C.A. 1968); *Bendl v. Bendl*, 246 So.2d 574 (Fla. 3rd D.C.A. 1971); *Anderson v. Trueman*, 100 Fla. 727, 130 So. 12 (1930); *Logan Moore Lumber Co. v. Legato*, 100 Fla. 1451, 131 So. 381 (1930); and *Winters v. Parks*, 91 So.2d 649 (Fla. 1956).

6. In *Republic Credit Corporation I v. Upshaw*, 4th Dist. Case No. 4D08-1591 (March 25, 2009), Republic Credit Corporation I ("**Republic**") filed suit against Robert Upshaw (the "**Defendant**") seeking to recover damages for the Defendant's default on three promissory notes. The Defendant and his wife were residents of California when the litigation commenced. During the course of the litigation, the Defendant and his wife sold their California residence realizing a gain in excess of $400,000. The Defendant and his wife wired $350,000 of the proceeds of the sale of the California residence to an attorney's trust account in Florida and deposited $63,304.22 into a bank account established in only Elizabeth's name. The Defendant and his wife used $200,000 from the attorney's trust account as a down payment on the purchase of a home in Palm Beach Gardens, Florida.

Republic obtained a judgment in its favor against the Defendant. Republic domesticated its judgment against the Defendant in Florida and filed a complaint against the Defendant and the Defendant's wife to avoid the monetary transfers as fraudulent.

The Defendant and his wife argued that the California residence was tenancy by the entireties property and that the sale proceeds retained such character under Florida law and tenancy by entireties property is not subject to avoidance under Florida Uniform Fraudulent Transfer Act. The court noted that California law does not recognize tenancy by the entireties as a form of ownership. The court further noted that the proceeds from the sale of the California residence could not have retained entireties characteristics that such funds never possessed previously. As a result, the court concluded that the sale proceeds were assets subject to attachment by a judgment creditor. The court also noted that because the trial court deemed the California sales proceeds tenancy by entireties property, the trial court never made findings as to whether any fraudulent transfers occurred. The court remanded the case for a determination regarding whether the proceeds from the sale of the California residence were fraudulently transferred by the Defendant to his wife. However, citing *Havoco of Am. Ltd. v. Hill*, 790 So.2d 1018, 1028 (Fla. 2001), the court noted "[t]he transfer of nonexempt assets into an exempt homestead with the intent to hinder, delay, or defraud creditors is not one of the three exceptions to the homestead exemption provided in article X, section 4."

7. In *In re Holland*, 2009 WL 2971087 (Bankr. N.D. Ill. 2009), the court recognized that a debtor who resided in Illinois but owned real estate in Florida in T by E with her non-debtor spouse could exempt such property from the bankruptcy estate. The court provided, "The district court held that 'the reference to 'applicable nonbankruptcy law' as used in section 522(b)(3)(B) does not mean the exemption law of the debtor's domicile.' [Citation omitted.] Rather, general choice of law principles of Illinois or Florida, as the *situs* of real property, is the 'applicable nonbankruptcy law' for this issue in this case."

8. In *In re Gillette*, 248 B.R. 845 (M.D. Fla. 1999), Cher Lynn Gillette (the "**Debtor**") and her husband, Pujol, were married in 1993 while they were California residents. In December 1995, the Debtor and her husband moved to Sarasota, Florida. On February 8, 1996, the Debtor and her husband signed a Strong Funds Account Application. The completed account application stated the following:

> 1. The account established pursuant to the application would be a "joint account," defined as an account held by "joint tenants with right of survivorship, unless otherwise specified." The Debtor was identified as the owner of the account, and Pujol was identified as the joint owner.
>
> 2. The mailing address for the Debtor was listed as 1370 Trancas Street, # 145, Napa, California.
>
> 3. The address for Strong Funds was Post Office Box 2936, Milwaukee, Wisconsin.

> 4. As the initial investment, the sum of $35,000 was to be deposited into a Money Market Fund, and the sum of $35,000 was to be deposited into a Short Term Bond Fund.

On February 8, 1996, the Debtor signed a check made payable to Strong Funds in the amount of $70,000. The check was written on an account owned by the Debtor and her husband which was maintained at WestAmerica Bank in Fairfield, California. On June 30, 1996, the Debtor signed an additional check made payable to Strong Funds in the amount of $20,000. This check was written on the same WestAmerica Bank account. Approximately twenty checks were written on the Strong Money Market Fund from August, 2006 until October, 2007. Two of the twenty checks were signed by both the Debtor and her husband and the remaining checks were signed by only the Debtor. On January 7, 1997, the Debtor filed for bankruptcy. On the Debtor's Schedule C to the petition, she listed as exempt under Florida law her one-half (½) interest as JTE in Strong Money Market Account and her one-half (½) interest as JTE in Strong Short Term Bond Fund.

The Debtor argued that a one-half (½) interest in the Strong Money Market Fund and the Strong Short Term Bond Fund were exempt under Florida law because the accounts were owned as tenants by the entirety. However, the bankruptcy trustee argued that the law of either California or Wisconsin controlled whether the Debtor was entitled to claim exemptions for the Strong accounts. The bankruptcy trustee alleged that California law should apply because the Debtor resided in California when the Strong accounts were established and the money funding the Strong accounts originated from California. Alternatively, the bankruptcy trustee argued that the law of Wisconsin should apply because that is where the Strong accounts were maintained.

The court held that based on the Florida conflict of law rules "the disposition of a joint bank account . . . is governed by the law of the situs of the account, regardless of the domicile of any party to the account." As a result, the court held that the Debtor's ownership interest in the Strong accounts is determined under Wisconsin law. Wisconsin does not recognize tenancy by the entirety ownership; therefore, the Strong accounts were treated as though such accounts were held in joint tenancy with right of survivorship and such property was held not to be exempt from process under Wisconsin law. Accordingly, the court ruled in favor of the bankruptcy trustee that the claimed exemption for the Strong accounts was disallowed.

> 9. Section 319.22 of the Florida Statutes provides in relevant part:
>
> 1. When a motor vehicle or mobile home is registered in the names of two or more persons as co-owners in the alternative by use of the word "or," such vehicle shall be held in joint tenancy...This provision shall apply even if the co-owners are husband and wife.

If a vehicle is registered in the names of a husband "or" wife, this statute provides that the spouses hold title to the vehicle as joint tenants, not in an entireties estate. See also *In re Gillette*, 248 B.R. 845 (M.D. Fla. 1999); *Amsouth Bank of Florida v. Hepner*, 647 So.2d 907 (Fla. 1st DCA 1994).

10. a. *U.S. v. Craft*, 122 S. Ct. 1414 (2002), the Internal Revenue Service (the "**Service**") successfully argued that T by E does not protect the interest in entireties property of a debtor-spouse from a Federal tax lien under § 6321 of the Code. See also *Howard D. Popky et ux. v. United States*, 419 F.3d 242, 244 (3d Cir. 2005)); *In re Pletz*, 221 F.3d 1114 (9th Cir. 2000); *U.S. v. Davenport*, 106 F.3d 1333, 1336-37 (7th Cir. 1997); but see *U.S. v. Adent*, 821 F.3d 911 (2d Cir. 2016) (describing some of the factors in avoiding a forced sale for property owned as joint tenancy with right of survivorship). Chuck Rubin's, "*US v. Adent*: Jointly Owned Property and IRS Liens and Foreclosures," **LISI** Estate Planning Newsletter #97 (July 25, 2016) at http://www.leimbergservices.com provides a brief but thorough discussion of the considerations at stake in *Adent.* [RESERVED.]

b. In *U.S. v. Hatchett*, 330 F.3d 875 (6th Cir. 2003), the court permitted the Service to force the sale of T by E property in satisfaction of an lien held by the Service. See also, *U.S. v. Barczyk*, (6th Cir. No. 10-1498 (Aug. 18, 2011) (Sale of T by E property in Michigan permitted to enforce tax lien pursuant to § 7403(c) of the Code). [RESERVED.]

11. As an asset protection strategy T by E has its limitations and it is important for the planner to understand those limitations. In practice, however, this form of ownership can provide a useful planning device to act as a springboard to assist a client who is a Florida resident in developing a stronger asset protection plan. The creditor protection aspects of T by E ownership in Florida are somewhat more generous than the protection afforded to debtors in other states. See *e.g.*, *Levinson v. R & E Prop. Corp.*, 395 B.R. 554 (E.D.N.Y. 2008) (involving T by E in New York) and *In re Yotis*, 2014 WL 4369411 (N.D.IL. 2014).

12. Can T by E property be held in trust for the benefit of a husband and wife under Florida law. For an interesting discussion of this issue see, Harrison, "Trusts: TBE or Not TBE," 87 Fla. Bar Jrnl. 30 (May 2013). In Florida, as opposed to Delaware (see discussion *infra*), it remains unclear whether property can be held in a revocable trust and constitute T by E property or whether an interest in a revocable trust can qualify as T by E property. The issue is more uncertain in regards to an irrevocable. Thus, caution is warranted before attempting to use a trust in Florida as a vehicle to create T by E property interests.

a. **Limitations:**

i. Divorce severs the T by E estate.

ii. Death severs the T by E estate. No one can predict when a spouse might die. An unexpected death could lead to disastrous results for an asset protection plan that is based on T by E property.

iii. In *U.S. v. Craft*, 122 S. Ct. 1414 (2002), the Service successfully argued that T by E does not protect the interest in entireties property of a debtor-spouse from a Federal tax lien under § 6321 of the Code. But see *U.S. v. Adent*, 821 F.3d 911 (2d Cir. 2016) (describing some of the factors in avoiding a forced sale for property owned as joint tenancy with right of survivorship). Chuck Rubin's, "*US v. Adent*: Jointly Owned

Property and IRS Liens and Foreclosures," **LISI** Estate Planning Newsletter #97 (July 25, 2016) at http://www.leimbergservices.com provides a brief but thorough discussion of the considerations at stake in *Adent.* See also *Howard D. Popky et ux. v. United States*) (No. 04-2798) (United States Court of Appeals for the Third Circuit).

b. **Flexibility**: For a client who is subject to a lawsuit or a foreseeable claim, owning assets in T by E may provide a mechanism that enables the client to engage in prudent asset protection planning without subjecting the client's transfers to scrutiny as fraudulent transfers. See F.S. §726.102(2)(c) and (12), F.S. § 726.105 and F.S. § 726.106.

13. As certain cases suggest, never discard the opportunity to argue that a T by E estate exists. See *e.g.*, *Estate of Berlin v. Pecora*, 968 So.2d 47 (Fla. 4th DCA 2007).

14. Section 541(b)(2)(B) of the Bankruptcy Code applies to all bankruptcy cases regardless of which exemption system (that is, state law or the bankruptcy exemptions) governs a case. This provision provides an exemption for a debtor's interest in property held in T by E or as a joint tenant immediately prior to the commencement of the case to the extent that such interest is exempt from process under applicable nonbankruptcy law.

15. A transfer of non-exempt wealth into T by E does should not sheild a fraudulent transfer claim. See *e.g.*, *In re Titus*, 479 B.R. 362 (Bkrtcy. W.D. Pa.2012).

16. It may be possible to claim a joint tax refund qualifies as T by E property. See *e.g.*, *In re Newcomb*, 483 B.R. 554 (Bankr. M.D. Fla. 2012). In *Newcomb*, the court provided:

> Federal courts have since extended the holding of *Beal* Bank to federal tax refunds, holding that married couples can own joint income tax refunds as tenants by the entirety. *See In re Gorny,* 2008 WL 5606583 (Bankr. M.D. Fla. Aug. 28, 2008) (debtor and his non-filing spouse's joint tax refund constituted tenancy by the entirety property); *In re Freeman,* 387 B.R. 871, 875 (Bankr. M.D. Fla. 2008) [21 Fla. L. Weekly Fed. B317a] (debtor properly claimed joint tax refund of the debtor and her non-filing spouse as exempt tenancy by the entirety property); *In re Kossow,* 325 B.R. 478, 485 (Bankr. S.D. Fla. 2005) [18 Fla. L. Weekly Fed. B229a] (the presumption of tenancy by the entireties as set forth in *Beal Bank* applies to a joint federal tax refund). *See also In re Hinton,* 378 B.R. 371, 379 (Bankr. M.D. Fla. 2007) [21 Fla. L. Weekly Fed. B40a] (spouses may elect to own federal tax refunds as tenants by the entirety, but even if a joint tax refund was arguably not tenancy by the entirety property prior to being deposited in the couple's joint bank account, once deposited in such account the deposit is owned as tenants by the entirety).

But see *In re Ascuntar*, 24 Fla. L. Weekly Fed. B27a (Bankr. S.D. Fla., January 2, 2013) (an individual debtor may not claim that his interest in a joint tax refund received postpetition is held as tenant by the entirety with his non-debtor spouse). In *Ascuntar*, the Bankruptcy Court for the Southern District of Florida (the "**Court**") held that the interest of an individual debtor in a joint tax refund received postpetition was not held as a tenant by the entirety with his

spouse and was therefore not exempt. Unless a refund is received prepetition and deposited into a tenants by the entireties ("**T by E**") account, each spouse retains an individual ownership interest in an expected postpetition refund, and such refund lacks the unity of interest required to qualify as T by E property.

The debtor ("**D**") filed an individual Chapter 7 petition on February 17, 2012. On February 29, 2012, D and his non-filing spouse received their 2011 joint federal income tax refund (the "**Refund**") in the amount of $3,914.00. In his Amended Schedule C, filed on April 27, 2012, D listed the Refund as property owned with his wife as T by E, claiming 100% of the Refund was exempt under 11 U.S.C. § 522(b)(3)(B).

The Refund was attributable to taxes withheld from both D and his wife. The amounts withheld from D's earnings accounted for 57.6% of the total. The Bankruptcy Trustee ("**T**") argued that the portion of the Refund attributable to the amount withheld from D's earnings was D's individual property and therefore property of the estate.

A tax refund received postpetition is property of the estate if it is attributable to wages earned and withholding payments made during prepetition years. *Carlson v. Moratzka (In re Carlson)*, 394 B.R. 491 (B.A.P. 8th Cir. 2008) (citing *In re Benn*, 491 F.3d 811 (8th Cir. 2007)).

Section 522(b)(3) of the Bankruptcy Code allows individual debtors to exempt any interest in T by E property provided that such interest is exempt under state law. See *In re Stanley*, 122 B.R. 599 (Bankr. M.D. Fla. 1990). T by E property is exempt from process to satisfy debts owed to individual creditors of either spouse. *Neu v. Andrews*, 528 So.2d 1278 (Fla. 4th DCA 1988). A Florida debtor filing an individual case may exempt T by E property in his or her case except to the extent of joint debts. See *In re Monzon*, 214 B.R. 38 (Bankr. S.D. Fla. 1997).

In *Beal Bank, SSB v. Almand and Associates*, 780 So.2d 45 (Fla. 2001), the Florida Supreme Court held that T by E property possesses six characteristics: (1) unity of possession; (2) unity of interest; (3) unity of title; (4) unity of time; (5) survivorship; and (6) unity of marriage.

The Court reasoned that, as to the Refund, D could not satisfy the element of unity of interest. Therefore, the Refund was not T by E property.

Generally, state law applies when a court examines the nature of property interests. *Butner v. U.S.*, 440 U.S. 48 (1979). However, the Court reasoned that, because federal created the interests in the Refund, the Court should examine federal law as to the nature of the property interests in this case. See *In re Schwinn*, 400 B.R. 295 (Bankr. D. Kan. 2009); *In re Marvel*, 372 B.R. 425 (Bankr. N.D. Ind. 2007).

Under federal tax law, each spouse has a separate interest in a refund. *Gordon v. U.S.*, 757 F.2d 1157 (11th Cir. 1985). In *Gordon*, the Eleventh Circuit explained that "[w]here spouses claim a refund under a joint return, the refund is divided between the spouses, with each receiving a percentage of the refund equivalent to his or her proportion of the withheld tax payments."

The Court also applied Revenue Ruling 74-611, 1974-2 C.B. 399 (1974) to the case. Revenue Ruling 74-611 held that when a husband and wife file a joint return, Section 6013 of the Internal Revenue Code imposes joint and several liability upon them for the tax computed on their aggregate income, however, such obligation does not create a joint interest in any overpayment. The ruling held that "[a] joint income tax return does not create new property interests for the husband and wife in each other's income tax overpayment."

The Court reasoned that, because each spouse has a separate interest in an expected tax refund, spouses lack the unity of interest element necessary to establish T by E ownership in an expected joint refund. See *In re Morine,* 391 B.R. 480 (Bankr. M.D. Fla. 2008); *In re Kant*, 2006 WL 4919043 (Bankr. M.D. Fla. April 12, 2006).

D argued that the issuance of the Refund in a joint check created a presumption that the Refund was T by E property. However, the Court reasoned that the expected refund would need to satisfy the unity of interest element to be T by E property. The Court further reasoned that, for an expected refund to satisfy the unity of interest element, the filing of a joint return would have to create the joint interest in the expected refund. The Court held that the filing of a joint return does not create a joint interest in an expected refund. See *Gordon*, *supra*, and Rev. Rul. 74-611.

The Court reasoned that a refund must be received and deposited into a T by E account prepetition to satisfy the unity of interest element of T by E property. For instance, in *Dillworth v. Hinton (In re Hinton)*, 378 B.R. 371 (Bankr. M.D. Fla. 2007), a refund was received prepetition and was deposited into a T by E account prepetition. The court in that case held that a refund that had been deposited in a T by E account was held as T by E. In *Ascuntar*, however, D did not receive nor deposit the Refund into a T by E account prepetition. Therefore, the Court found no unity of interest in the Refund as of the petition date.

The Court held that an individual debtor may not claim that his interest in a joint tax refund received postpetition is held as T by E with his spouse. Therefore, a debtor's interest in a refund received postpetition is includable in the estate.

17. There are important differences regarding the enforcability of a Federal tax lien on T by E property if it is transferred during life as oppossed to being transferred by operation of law to the survivor of the entireties estate. See *e.g.*, *US v. Tyler*, 2013-1 USTC Para. 50,373. For a brief, however, execellent commentary on this case see, Rubin, "*US v. Tyler*: Tax Liens, Tenancy by Entireties, and the Federal Claims Statute Combine to Produce Fiduciary Liability," **LISI** Estate Planning Newsletter #2127 (August 6, 2013) at http://www.leimbergservices.com.

I. Workers' Compensation Benefits.

Florida Statutes § 440.22 provides:

> No assignment, release, or commutation of compensation or benefits due or payable under this chapter except as provided by this chapter shall be valid, and such compensation and benefits shall be exempt from all claims of creditors, and from levy, execution and attachments or other remedy for recovery or

> collection of a debt, which exemption may not be waived. However, the exemption of workers' compensation claims from creditors does not extend to claims based on an award of child support or alimony.

This statute has also been held to exempt workers' compensation benefits even after such payments are received by an individual. See *In re: Fraley*, 148 B.R. 635 (Bankr. M.D. Fla. 1992).

J. Fraudulent Asset Conversions.

1. Section 222.30 of the Florida Statutes contains Florida's fraudulent conversion rule. A "**conversion**" includes any method of selling or disposing an asset such that the products or proceeds of the asset become exempt from the claim of a creditor of the debtor yet the products or proceeds of the asset remain the property of the debtor. F.S. § 222.30(1).

2. If a debtor converts nonexempt property to exempt property with the intent to hinder, delay, or defraud a creditor, the conversion is a fraudulent asset conversion as to the creditor. It does not matter whether the creditor's claim accrued prior to or after the conversion of the asset. F.S. § 222.30(2).

3. If a creditor proves a debtor made a fraudulent asset conversion, the creditor may:

a. Avoid the conversion to the extent necessary to satisfy its claim. F.S. § 222.30(3)(a).

b. Attach the asset converted as provided by applicable law (or obtain such other provisional remedy against the asset). F.S. § 222.30(3)(b).

c. Obtain an injunction prohibiting a debtor from further converting an asset or of other property or any other relief the circumstances may require. F.S. § 222.30(3)(c).

4. If a creditor has obtained a judgment against the debtor, it can levy on the converted asset or its proceeds upon an order of the court. F.S. § 222.30(4).

5. Any claim that an asset was fraudulently converted must be brought **within four (4) years** after the conversion was made by the debtor, otherwise the action is extinguished. F.S. § 222.30(5).

6. If an asset is converted and subsequently transferred to a third party, the fraudulent transfer rules can apply to the transfer to the third party. F.S. § 222.30(6).

7. a. The fraudulent conversion statute has been held inapplicable under the Florida Constitution to the conversion of a non-exempt asset to homestead property. See *Havoco of America, Ltd. v. Hill*, 790 So. 2d 1018 (Fla. 2001) & *Conseco Servs, LLC v. Cuneo*, 904 So.2d 438 (Fla. App. 3rd Dist. 2005). Thus, the conversion of non-exempt property

to exempt homestead property appears permissible at any time before such non-exempt property is seized by a creditor. *Id*. But see §§ 522(b)(3)(A), 522(o), 522(p)(2)(B), 522(q) of the Bankruptcy Code.

b. ***Query***: The fraudulent conversion statute does not apply to the conversion of non-exempt property to homestead. Could it be applied to a fraudulent conversion into homestead when such conversion is followed by a transfer of all or part of the homestead to a third party in whatever form the transfer is accomplished?

8. In certain circumstances this statute may make Florida a less desirable jurisdiction to declare bankruptcy for certain debtors who want to convert non-exempt assets to exempt assets immediately prior to filing for bankruptcy. For instance, in some cases bankruptcy courts have approved such conversions. See *In re Moore*, 177 B.R. 437 (Bankr. N.D.N.Y. 1994); *Crews v. First Colony Life Ins. Co*. (*In re: Barker*), 168 B.R. 773 (Bankr. M.D. Fla. 1994); *In re Lindberg*, 735 F.2d 1087, 12 B.C.D. 81 (8th Cir. 1984), *cert. denied*, 469 U.S. 1073, 105 S.Ct. 566, 83 L.Ed.2d 507 (1984). Nonetheless, this statute would seem to preclude such a pre-bankruptcy planning opportunity.

9. *In re Menendez*, 26 Fla. L. Weekly Fed. B55a (Apr. 2016) (holding under F.S. § 222.30 that one transfer was caught by the statute pursuant to the badges of fraud as incorporated from the fraudulent transfer statute, and the other transfer was not a fraudulent conversion).

K. Florida is an Opt-Out State.

1. Under F.S. § 222.20, Florida has elected out of the Federal Bankruptcy Exemptions. Therefore, the Florida exemptions apply when an individual resident of Florida files for bankruptcy. See also 11 U.S.C. § 522(b).

2. Note that the Bankruptcy Act may limit the scope of certain state exemptions.

III. SELF-SETTLED TRUSTS.

A. A self-settled trust is a trust in which the settlor, *i.e.,* the donor, remains eligible to receive distributions of income and/or principal from the trust.

B. Restatement (Second) of Trusts Section 156(2) (1959) provides in relevant part "[w]here a person creates for his own benefit, a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit." See also Restatement (Third) of Trusts Section 25. Restatement (Third) of Trusts Section 58(2) provides "A restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid." See also Comment e to Restatement (Third) of Trusts Section 58(2).

C. This black letter rule is commonly referred to as the "**Self-Settled Trust Doctrine**." It is adopted from old English law. See *e.g.*, Stat. 3 Hen. VII, c.4. (1487),

providing, "[a]ll deeds of gift of goods and chattels, made or to be made in trust to the use of that person or persons that made the same deed or gift, be void and of none effect."

D. The Self-Settled Trust Doctrine is the majority rule in the United States.

E. Subsection (a) of Section 505 of Article of 5 of the Uniform Trust Code provides in relevant part:

> (a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:
>
> (1) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.
>
> (2) With respect to an irrevocable trust, ***a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit***. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.
>
> (3) After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and [statutory allowances] to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and [allowances].

F. A number of states have reversed the Self-Settled Trust Doctrine by statute. Alaska Laws, SLA 1997, Ch. 6 (H.B. 101), A.S. §§13.12.205(2), 13.27.050(a), 13.36.035, 13.36.310, 13.36.390, 34.40.010, 34.40.110(a), 34.40.110 (Alaska); 12 Del. Code Ann. §§ 3570-3576 (1997) (The Qualified Dispositions in Trust Act) (Delaware); Permitted Transfers in Trust Act § 554G-1, *et seq*. (Hawaii); Mississippi Qualified Disposition in Trust Act, Title 91, Chapter 9, Article 15, Miss. Code Ann. §§ 91-9-701–91-9-723 (Mississippi); M.R.S. §§428.005-428.059, 456.020, and 456.080 (Missouri); N.R.S. §166.040 (Nevada); N.H.R.S. § 56-D:1, *et seq*. (New Hampshire); Ohio Legacy Trust Act, § 5816.01, *et seq*. (Ohio); Okla. Stat. tit. 31, § 10, *et seq*. (Oklahoma); Title 18, Chapter 9.2 of the General Laws of Rhode Island (The Qualified Dispositions in Trust Act) (Rhode Island); SDCL § 55-16-1, *et seq*. (South Dakota); 35-15-505(a)(2) (Tennessee); 2003 Utah Laws Ch. 301 (H.B. 299), Utah Code §25-6-14(1)(a) (Utah); Virginia Code §§ 64.2-745.1 and 64.2-745.2 (Virginia); and W.S. 4-1-510 (Wyoming); see also §38-10-111 of the Colorado Revised Statutes (Colorado). Additionally, the Self-Settled Trust Doctrine is no longer applicable in most common law jurisdictions outside the United States. For a brief discussion of the laws in some of these jurisdictions see Rothschild & Rubin, 810 T.M., Asset Protection Planning, at p. A-31 and Working Papers. Thus, contrary to popular belief, the trend in most foreign common law jurisdictions, including the United Kingdom, Australia (See Bankruptcy Act (Commonwealth) 1966), Canada and New Zealand (See Insolvency Act 1967), is towards a public policy of

permitting self-settled trusts that protect the settlor's assets from the claims of his or her creditors.

G. In 1997, Alaska and Delaware each revised its trust laws causing the use of domestic self-settled trusts to become a popular planning technique. In such states, a settlor, regardless of his or her state of residence, can establish a self-settled trust and remain eligible to receive discretionary distributions of income or principal from the trust. If the statutory guidelines of such states are followed and the formalities of the trust relationship adhered to, it should be possible (in theory) for a settlor to protect the wealth held in such trust. The efficacy of using such a trust for asset protection purposes has yet to be tested. It is without argument, however, that a properly implemented foreign asset protection trust is a superior vehicle to use to protect assets transferred to a self-settled trust.

IV. SELF-SETTLED TRUSTS IN FLORIDA.

A. Common Law

Although there is no case law directly on point, prior to the July 1, 2007 effective date of the new Florida Trust Code (the "**FTC**"), a state court in Florida probably would have followed the Self-Settled Trust Doctrine and held that the assets of a self-settled trust are subject to the claims of the settlor's creditors.

Florida courts have defined a spendthrift trust as a trust *created and funded by one individual for the benefit of another*. See *Waterbury v. Munn*, 32 So.2d 603 (Fla. 1947) ("A spendthrift trust is one that is created with the view of providing a fund for the maintenance of another."); *Preston v. City Nat'l Bank of Miami*, 294 So.2d 11 (Fla. 3d DCA 1974); *Croom v. Ocala Plumbing and Electric Co.*, 57 So. 243 (Fla. 1911) (". . . those trusts that are created with a view of providing a fund for the maintenance of another, and at the same time securing it against his own improvidence or incapacity for self-protection."); and *Zlatkiss v. All America Team Concepts*, LLC, 38 Fla. L. Weekly D1194b (DCA 5, 2013).

Noted commentators have also examined the issue of self-settled trusts in Florida. See *e.g.*, Lowell & Grimsley, Fla. Law of Trusts, § 15-5(b) (Harrison Co. 4th ed. 1993) providing that "[a] settlor cannot create for himself a spendthrift trust to avoid creditors." Earlier in this same treatise these commentators analyze the use of trusts to avoid one's creditors stating:

> The trend has developed for physicians, attorneys and other businessman to transfer assets to a trust in expectation that such assets will be safe from creditors. There are several obstacles making it difficult to transfer assets for the purpose of protecting them from debts. First, it is clear that the transfer has to be irrevocable. If any strings of ownership are retained, then a creditor may proceed against the asset. This is very similar to the taxation of assets for federal estate tax purposes. Second, the transfer must have been made before the debt accrued. If consideration is received for the asset transferred, that would purify the transaction; however, the underlying motive for taking the step would then be nullified since the whole purpose is to protect the assets from creditors. *There are known instances where medical physicians have created*

> *trusts and then transferred assets to the trust in expectation of their being protected. The court, in exercising equity jurisdiction, will not hesitate to pierce the trust arrangement to satisfy creditors, and that is exactly the result that should occur*. (Emphasis supplied.) *Id.* at § 9-3.

A review of Florida case law also finds no decision at the appellate level regarding the efficacy of a self-settled trust, and, until the enactment of the FTC, Florida law contained no relevant statute on point. Nevertheless, based on analogous authority, it seems logical to conclude that a Florida court would have recognized the Self-Settled Trust Doctrine prior to the effective date of the FTC. Florida law provides that the common and statutory laws of England, which were of a general and not a local nature in effect on July 4, 1776, are declared the law of the state. Fla. Stat. Ch. ("**F.S.**") § 2.01. Such statutes and common law, however, cannot be inconsistent with the constitution and laws of the United States and the acts of the Florida Legislature, otherwise, such laws are not considered part of Florida law. Thus, English statutes and decisions involving the self-settled trust doctrine in existence or decided prior to July 4, 1776, unless otherwise inconsistent with Florida law or the laws of the United States, are indicative of the current status of Florida law. (See *e.g.*, Stat. 3 Hen. VII, c.4. (1487), providing, "[a]ll deeds of gift of goods and chattels, made or to be made in trust to the use of that person or persons that made the same deed or gift, be void and of none effect.")

At least one Florida case has ruled in favor of a creditor attempting to reach trust assets when a grantor transferred property in trust for his own benefit retaining the right to income for life and a testamentary general power of appointment over the principal at his death. See *First Wisconsin Nat'l Bank of Milwaukee v. Schwab*, 194 So.2d 307 (Fla. 1940).

Interpreting Florida common law, *Matter of Witlin*, 640 F.2d 661 (5th Cir. 1981), held that the self-settled trust doctrine applies when a grantor creates a trust for his or her own benefit. In *Witlin*, the court examined the common law of trusts in Florida to reach its conclusion, stating:

> While the parties cite no Florida cases for the proposition, we are satisfied that under the common law of trusts, the law is as stated by Professor Bogert in the same work which was cited in Waterbury: '[i]f a settlor creates a trust for his own benefit and inserts a spendthrift clause, it is void as far as then existing or future creditors are concerned, and they can reach his interests under the trust. Bogert, Trusts and Trustees, 2d ed. § 223, pp. 438, 439.' There is, of course, a strong public policy that will prevent any person from placing his property in what amounts to a revocable trust for his own benefit which would be exempt from the claims of his creditors.

Witlin involved a trust created under a doctor's qualified plan. It should be noted that this case was decided prior to the enactment of F.S. § 222.21 (exemption for assets in a qualified plan from the claims of creditors) and *Patterson v. Shumate*, 504 U.S. 753, 112 S.Ct. 2242, 119 L.Ed.2d 519 (1992). See also, *In re Wheat*, 149 B.R. 1003 (Bankr. S.D. Fla. 1992).

See also *In re: Brown*, 303 F.3d 1261 (11th Cir. 2002), in which a Bankruptcy Court adopted the Self-Settled Trust Doctrine in holding that the settlor's interest in a charitable

remainder trust was subject to the claims of the settlor's creditors. In *Brown*, the debtor ("**D**") suffered from chronic alcoholism. In 1993, D inherited approximately two hundred fifty thousand dollars ($250,000). To protect her inheritance from her own improvidence, D transferred it to an irrevocable trust entitled "Irrevocable Charitable Remainder Unitrust Agreement" (the "**Trust**"). Pursuant to the terms of the Trust, D was entitled to receive an annual amount equal to seven percent (7%) of the net worth of the Trust, valued as of the first day of each taxable year. The payments were due to D in monthly installments. D was unemployed and was dependent on the monthly installments from the Trust. D also served as trustee of the Trust; however, D's powers were merely limited to directing investment decisions. D did not possess the power to invade the trust corpus or to alter the amount of payments due under the Trust. The Trust also contained a spendthrift clause prohibiting D from assigning or otherwise alienating her interest in the Trust. Upon D's death, the seven percent (7%) yearly trust income payments were directed to be made to D's daughter for the remainder of her life. At the death of D's daughter, the remaining corpus of the Trust was directed to pass to four (4) charities designated in the Trust.

On February 4, 1999, D filed a petition for bankruptcy under Chapter 7. D listed secured and unsecured claims in the amount of $110,023.53. D acknowledged her interest in the Trust, however, she did not include her interest in the Trust as part of her bankruptcy estate. D claimed her interest in the Trust was exempt from her bankruptcy estate because the Trust contained a spendthrift provision that prevented her from alienating her interest in the Trust.

The bankruptcy trustee objected to D's claim that her income interest was exempt from the bankruptcy estate on the grounds that a self-settled trust was not protected from the claims of the settlor's creditors under Florida law. After an extensive review of Florida law, the court concluded that based on the definition of a spendthrift trust provided in *Croom v. Ocala Plumbing & Elec. Co.*, 32 So.2d 603 (Fla. 1911) where a spendthrift trust was defined as a "trust created with a view of providing a fund for the maintenance of another . . . .," Florida law impliedly recognized that a spendthrift provision would not protect the assets contained in a trust to the extent the settlor creates the trust for his or her own benefit. In further support of this proposition the court cited the Restatement (Second) of Trusts, Bogert's Trusts & Trustees and Griswold's Spendthrift Trusts, which are all commonly cited by Florida courts for guidance regarding the construction of spendthrift trusts and other trusts. The court noted:

> As impliedly recognized by the definition of spendthrift trusts set forth in *Croom,* Florida law will not protect assets contained within a spendthrift trust to the extent the settlor creates the trust for her own benefit, rather than for the benefit of another. *See In re Witlin,* 640 F.2d 661, 663 (5th Cir. Unit B 1981) (holding, under Florida law on spendthrift trusts, debtor's interest in his Keogh plan was not exempt from his bankruptcy estate where the debtor was both the beneficiary and the settlor of the plan); *In re Wheat,* 149 B.R. 1003, 1004-05 (Bankr.S.D.Fla.1992) (holding, under Florida law on spendthrift trusts, debtor's deferred compensation plan was not exempt from his bankruptcy estate where it was self-funded); *In re Williams,* 118 B.R. 812, 815 (Bankr. N.D. Fla.1990) (holding, under Florida law on spendthrift trusts, debtor's interests in his employer's thrift plan was not exempt from his bankruptcy estate where it was self-settled); JOHN G. GRIMSLEY, FLORIDA LAW OF TRUSTS § 15-5(b)

(4th ed. 1993) ("A settlor cannot create for himself a spendthrift trust to avoid creditors."); 55A FLA. JUR. 2D *Trusts* § 78 (2000) ("The trustee and the sole beneficiary cannot be one in the same under spendthrift trust law. A settlor cannot create a spendthrift trust for his or her own benefit.")

The court also noted:

This principle is not unique to Florida law. See, *e.g.*, *John Hancock Mut. Life Ins. Co. v. Watson* (*In re Kincaid),* 917 F.2d 1162, 1166-67 (9th Cir.1990) (stating Oregon and Massachusetts laws hold a "settlor cannot create a spendthrift trust for his own benefit"); *Herrin v. Jordan* (*In re Jordan),* 914 F.2d 197, 199-200 (9th Cir.1990) (applying Washington law and holding trust funded by beneficiary's personal injury settlement was not excludable from his bankruptcy estate as a valid spendthrift trust); *Dzikowski v. Edmonds* (*In re Cameron*), 223 B.R. 20, 24 (Bankr.S.D.Fla.1998) ("It is axiomatic that under New York Law, self-settled trusts are void against both present and future creditors and a debtor may not avoid his creditors, or future creditors, by placing his property in trust for his own benefit.") (but see *In re Yerushalmi*, 487 B.R. 98 (Bankr. E.D. N.Y. 2012)); *In re Spenlinhauer,* 182 B.R. 361, 364-65 (Bankr.D.Me.1995) (applying Maine law and holding settlor-beneficiary's interest in trust was not protected from creditors), *aff'd,*101 F.3d 106 (1st Cir.1996); *Jensen v. Hall* (*In re Hall),* 22 B.R. 942, 944 (Bankr.M.D.Fla.1982) (applying Ohio law and holding creditors could reach settlor-beneficiary's interest in spendthrift trust); *Speed v. Speed,* 263 Ga. 166, 430 S.E.2d 348, 349 (Ga.1993) (applying Georgia law, and holding spendthrift provision in trust created by quadriplegic husband from his insurance benefits was not enforceable where the husband was both settlor and beneficiary); *Bank of Dallas v. Republic Nat'l Bank of Dallas,* 540 S.W.2d 499, 501-02 (Tex.App.1976) (applying Texas law, and holding settlor who created spendthrift trust and made herself a beneficiary thereof could not protect her interest in the trust from her creditors).

As a result, the spendthrift clause was held to be ineffective to protect D's interest in the Trust against her creditors to the extent of D's interest in the Trust because the Trust was a self-settled spendthrift trust (*i.e.*, D was both the settlor and a beneficiary of the Trust). In this regard the court also noted that:

This limitation comports with the common law of trusts. *See, e.g.,* RESTATEMENT (SECOND) OF TRUSTS § 156(1) (1959) ("Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest."); GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, TRUSTS & TRUSTEES § 223 (rev.2d ed. 1992) ("If a settlor creates a trust for his own benefit and inserts a spendthrift clause, it is void as far as then existing or future creditors are concerned, and they can reach his interest under the trust."); ERWIN N. GRISWOLD, SPENDTHRIFT TRUSTS § 474 (1936) ("A spendthrift trust created by a person for his own benefit is invalid against

> creditors."); II AUSTIN WAKEMAN SCOTT, THE LAW OF TRUSTS § 114 (3d ed. 1967) ("It is to be noticed that the beneficial interest reserved to the settlor is for some purposes treated differently from a beneficial interest created in a third person. Thus, although a beneficial interest created in a third person may be inalienable by him and not subject to the claims of his creditors, a beneficial interest reserved to the settlor himself can be alienated by him or reached by his creditors even though it is otherwise provided by the terms of the trust."). Self-settled trusts may be reached by creditors, even if the settlor was solvent at the time of the trust's creation and no fraud was intended. *See* SCOTT, *supra*, at § 156 ("It is immaterial that in creating the trust the settlor did not intend to defraud his creditors. It is immaterial that he was solvent at the time of the creation of the trust. It is against public policy to permit a man to tie up his own property in such a way that he can still enjoy it but can prevent his creditors from reaching it.").
>
> Sources setting forth the common law of trusts frequently are cited by Florida courts for guidance regarding construction of spendthrift and other trusts. *See, e.g., Bacardi v. White,* 463 So.2d 218, 222 (Fla.1985) (citing RESTATEMENT (SECOND) OF TRUSTS regarding spendthrift trusts); *Waterbury,* 32 So.2d at 605 (citing Bogert's TRUSTS & TRUSTEES and Griswold's SPENDTHRIFT TRUSTS regarding spendthrift trusts); *Gilbert v. Gilbert,* 447 So.2d 299, 301 (Fla.App.1984) (citing Scott's THE LAW OF TRUSTS regarding spendthrift trusts).

The court did hold, however, that D's creditors, could only reach D's lifetime income interest because that was D's sole interest in the Trust. The corpus of the Trust could not be attached by D's creditors because it was held for the benefit of D's daughter and the charities designated in the Trust.

B. New Florida Trust Code - Part V Creditors' Claims

In 2006, Florida adopted the new FTC, which is a modified version of the UTC, that became effective on July 1, 2007. The *Ad Hoc* Committee recognized that other states have eliminated the Self-Settled Trust Doctrine and expressed no opinion on such legislation. Although the phrase "**self-settled trust**" is not used in the FTC, § 736.0505 of the Florida Statutes establishes rules related to revocable and irrevocable trusts created by a settlor where the settlor retains a beneficial interest in the trust. The inclusion of a spendthrift provision is irrelevant. F.S. § 736.0505(1).

Under Florida law, the assets of a revocable trust are subject to the claims of the settlor's creditors during the settlor's lifetime, however, only to the extent such assets would not be exempt from creditors' claims if held directly by the settlor. F.S. § 736.0505(1)(a). Therefore, a settlor's homestead held by his or her revocable trust should remain exempt under Florida law (but not necessarily Federal bankruptcy law).

With respect to the assets of an irrevocable trust, a creditor or assignee of a settlor may reach the maximum amount that can be distributed to or for the benefit of the settlor. F.S. §

736.0505(1)(b). If there is more than one settlor, the amount that may be reached may not exceed the portion of the irrevocable trust attributable to the settlor's contribution. Subsection (1)(b) conforms to the *Witlin* holding, that is, that a beneficiary who is also the settlor may not use the trust to place his or her assets beyond the reach of creditors. If the trustee has the discretion to distribute the entire income and principal to the settlor, the effect is as if the settlor had not created the trust for purposes of placing the settlor's assets beyond the reach of his or her creditors. See Uniform Trust Code Section 505, comments.

Drafting irrevocable trusts as "**wholly-owned grantor trusts**" for federal income tax purposes is a common technique used by estate planners to enhance the benefits of such trusts by effectively permitting tax-free gifts when the grantor pays income taxes attributable to trust assets. Still, it may be desirable to grant the trustee a discretionary power to pay such taxes or reimburse the settlor. Although not found in the UTC, the FTC ensures that such discretionary power will not subject an irrevocable trust to the claims of creditors under the general rule established in F.S. § 736.0505(1)(b). F.S. § 736.0505(1)(c). This provision provides in relevant part:

> the assets of an *irrevocable* trust may not be subject to the claims of an existing or subsequent creditor or assignee of the settlor, in whole or in part, solely because of the existence of a discretionary power granted to the trustee by the terms of the trust, or any other provision of law, to pay directly to the taxing authorities or to reimburse the settlor for any tax on trust income or principal which is payable by the settlor under the law imposing such tax.

As a result of this provision the state legislature may have unwittingly added Florida to the list of asset protection states. Normally such a decision is made with substantially more consideration. Issues related to this provision include:

a. **There is no time limit on reimbursement**. Thus, in theory a trustee can accrue a reimbursement account for several decades and reimburse the settlor for a tax liability incurred many years in the past. While policy arguments can be made to permit reimbursement for a tax liability incurred within the statute of limitations for a tax return, permitting reimbursement for tax liability incurred beyond that point is ridiculous unless the state has made a conscientious decision to become an asset protection trust jurisdiction. This certainly has not occurred in this instance.

b. As a result of the issue identified in the foregoing paragraph (a), Florida has unwittingly added a new exemption to its laws. Practitioners are certainly obligated to discuss the use of this potentially substantial exemption with their clients.

c. The provision could have been drafted to prevent abuse by mandating the formula for determining the maximum amount that the trustee could distribute to the settlor. Some methods of constructing such a formula might have been to mandate that the trustee can pay up to:

i. the highest marginal rate of tax. Thus, the income generated by the assets in the trust is assumed to be taxed at the highest rate applicable to the settlor.

ii. its proportional share of the tax liability. Thus, all income generated by the assets in the trust is assumed to be taxed at the settlor's average tax rate.

iii. the lowest possible tax rate applicable. Thus, the settlor's remaining income from sources other than the assets in the trust is assumed to be taxed at the higher rates applicable to the settlor.

d. Although potentially difficult under certain circumstances, the provision could have prevented abuse by directing that any tax payments be made directly to the appropriate taxing authority rather than reimbursing the settlor for such amounts. Of course, one could argue that such a provision would be too restrictive.

e. Is the payment by the settlor of the settlor's tax liability subject to the fraudulent transfer statute? The funds could one day be returned to the settlor pursuant to a discretionary distribution. At first blush it would seem that such payment should not be a fraudulent transfer, however, inequitable results will be caused to a creditor because of this provision if the fraudulent transfer statute is not applicable. How will the bankruptcy law (discussed *infra*) treat this provision?

f. Can distributions be made from the reimbursement account ***for the benefit of*** the grantor rather than having to be distributed directly to him. The statute provides no guidance in this respect.

g. Is the trustee permitted to offset the tax benefits that accrue to the settlor as a result of grantor trust status, such as deductions and tax credits, against the reimbursement account? ***Query***: Trust ("**T**") contains a discretionary tax reimbursement provision. T holds interests in limited liability companies that own substantial real estate investments. T was established and funded by A and T is a wholly owned grantor trust as to A. In calendar year *x* T's real estates generates $2,000,000 of taxable income and it also generates $1,000,0000 of depreciation. In the same year A has $2,000,000 of taxable income. Assume a thirty-five percent (35%) income tax rate applies. A includes the $2,000,000 of taxable income from T on his personal income tax return with his $2,000,000 of personal taxable income. He also includes the $1,000,000 of deduction provided by the depreciation on the assets held in T. Assume the trustee does not reimburse T for any income tax liability in year *x*. How much should be allocated to the reimbursement account? The answer is unknown. The statute does not appear to mandate the $1,000,000 of depreciation be used to offset the trust income specifically. It would seem logical to assume that it should, however, the answer remains unclear.

h. The provision applies even though the grantor trust may be designed to receive gifts that are incomplete for federal gift tax purposes. This can lead to serious abuse of the statute.

i. ***Caution***: A tax reimbursement provision is not appropriate for use in every type of grantor trust. For instance, such a provision should never be used in a general power of appointment marital trust (see §2523(e)), a QTIP trust (see §§2056(b)(7) and 2523(f)), a § 2642(c) trust or a §2503(c) trust. Additionally, if it is necessary for a trust to qualify as a skip person for GST tax purposes, a tax reimbursement provision should not be included in the trust agreement. See § 2613.

During the period a Crummey Power or other power of withdrawal may be exercised, the powerholder is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power. F.S. § 736.0505(2)(a). For a more detailed discussion of the effect of this provision, see Section XXVI below.

"Successor QTIP Inter-Vivos Trusts" (or "SQITs"™). Florida Statutes § 736.0505(3) provides:

> Subject to the provisions of s. 726.105, for purposes of this section, the assets in:
>
> (a) A trust described in s. 2523(e) of the Internal Revenue Code of 1986, as amended, or a trust for which the election described in s. 2523(f) of the Internal Revenue Code of 1986, as amended, has been made; and
>
> (b) Another trust, to the extent that the assets in the other trust are attributable to a trust described in paragraph (a),
>
> **shall, after the death of the settlor's spouse, be deemed to have been contributed by the settlor's spouse and not by the settlor**.

This provision creates **an exception** to the self-settled trust doctrine. It protects the assets in a self-settled trust from the claims of a creditor of the settlor. The exception relates to any trust for the benefit of the settlor that is established after the death of the settlor's spouse when the settler created and funded an inter vivos general power of appointment or QTIP marital trust for the initial benefit of the settlor's spouse. A settlor can fund an inter vivos QTIP trust for the settlor's spouse by gifting assets to such trust. A QTIP election **must** be made with respect to any gift to this QTIP trust. As a result of the QTIP election the trust will be includible in the estate of the settlor's spouse for estate tax purposes. See § 2044. The gift by the settlor to the trust will (must - it would seem) qualify for the unlimited marital deduction. The inter vivos QTIP trust may contain provisions that provide for the donor-settlor following the donee-spouse's death. The trust assets should not be subject to the claims of the donor's creditors although the trust is self-settled. According to F.S. § 736.0505(3), the settlor would **not be treated** as the settlor of the trust.

Queries: a. Can the reciprocal trust doctrine be applied to uncross trusts created contemporaneously by spouses for the benefit of each other? For an excellent discussion of this issue see Rothschild & Akhavan, "Creditor Protection – The Reciprocal Issue for Reciprocal Trusts (It's Not Just About Estate Taxes)," 38 Est. G. & Tr. Jrnl. 187 (Mar.-Apr. 2013). See also *Security Trust v. Sharp*, 77 A.2d 543 (Del. Ch. 1950); Ariz. Rev.

Stat. Ann. §14-10505(E)(4); and Restatement (Thrid) of Trusts, §58, cmt. f, Reporter Note's cmt. f.

b. If the reciprocal trust doctrine is applicable, what period is sufficient between one spouse establishing a funding a trust and the other spouse doing the same to avoid the application of the doctrine?

c. Query whether the federal government would be concerned about the application of the reciprocal trust doctrine in this instance.

d. If Florida courts will apply the reciprocal trust doctrine in a manner similar to the way it is applied under Federal tax law, it would seem possible to structure an arrangement with sufficient care to avoid a problem at the state level. It should be noted, however, that there is no existing guidance on this issue in Florida.

e. It may be malpractice to not recommend that spouses each establish QTIP trusts for the other. Any estate planning conference with clients should certainly now include a discussion of the benefits of creating an *inter vivos* QTIP trust under Florida Statutes § 736.0505(3) by at least one spouse.

f. The protection afforded to the successor trust or trusts is dependent upon a Federal tax election in the case of a QTIP trust and the trust containing the proper provisions to ensure it qualifies as a marital trust under either of §§ 2523(e) and 2523(f). This does not appear to be the case in other states that have or may soon have similar laws. (See discussion *infra*, regarding Arizona law, North Carolina law and Texas.)

g. See §§ 2523(f)(4) and 6075(b). These sections of the Code provide the rules and time limitations for making the QTIP election for an *inter vivos* QTIP trust.

h. Serious public policy concerns may exist regarding the application of this statute and similar to Florida Statutes § 736.0505(1)(c), it is questionable whether the Florida legislature carefully considered some of the ramifications of the statute it enacted. For example, consider the situation where A creates and funds a trust for the benefit of his spouse B. A retains a secondary life interest following B's death that can either be wholly discretionary or include a mandatory income interest for potential QTIP treatment based on a formula or a *Clayton* type QTIP election. (The decision to make the Clayton QTIP election may (should) be vested in an independent fiduciary.) Two months after the gift A and B are involved in a car crash. B dies and three unrelated individuals are severely injured in the accident. A is at fault. A's gifts to the *inter vivos* QTIP trust were not fraudulent under the applicable Florida fraudulent transfer rule. At the time of the accident B has not filed his gift tax return. The gift tax return may not be due for almost a year or more in some cases if the gifts were made in early January. Whether A's creditors from the car accident can collect on a judgment from the assets in the trust will depend on whether A makes a QTIP election. Is this a fair result? In PLR 201025021, the Service apparently mistakenly granted the taxpayer an extension to make a QTIP election for a gift to an *inter vivos* QTIP trust. Could a private letter ruling issued by the Service affect the substantive law of Florida in regards to a trust created

pursuant to Florida Statutes § 736.0505(3). For an excellent analysis of PLR 201025021 see Steiner, **LISI** Estate Planning Newsletter #1699 (September 16, 2010) at http://www.leimbergservices.com. (It should be noted that PLR 201025021 was revoked by PLR 201109012 and then reinstated in PLR 201233011, which granted the taxpayer relief pursuant to § 7805(b). Nevertheless, it should serve as a lesson to attorneys who plan in this area and to litigators attacking and defending such trusts that rulings issued by the Service and decisions in tax cases in court can affect the outcome of litigation under Florida law.)

i. What is the purpose of the specific reference to Florida Statutes § 726.105? Does this preclude the application of Florida Statutes § 726.106?

j. The extended bankruptcy fraudulent transfer period of ten (10) years applicable to transfers to self-settled trusts should apply to this trust arrangement. See §548(e)(1) of the Bankruptcy Code. Since this rule is new and little or no case law exists to provide guidance on the application of §548(e)(1) to this type of trust arrangement, all practitioners can do is speculate on this issue. (Perhaps this uncertainty simply dictates that this type of trust arrangement be established as a foreign trust structure that complies with all of the requirements of Florida law.) Furthermore, while it is likely that the ten (10) year extended bankruptcy fraudulent transfer period under §548(e)(1) of the Bankruptcy Code would apply to a transfer to a SQIT, perhaps the use of a general power of appointment trust as the lead trust would prevent this rule from applying to the successor trust. Providing a donee-spouse with a general power of appointment could vitiate the application of §548(e)(1). Perhaps an independent trustee of a SQIT could be given the authority to grant the donee-spouse a testamentary general power of appointment if it is necessary to avoid the application of the ten (10) year extended fraudulent transfer rule under §548(e)(1).

k. How will this provision be applied to property added to the QTIP trust during the donee-spouse's lifetime that cannot qualify for the marital deduction?

l. How will this provision be applied to property held in a trust for which only a partial QTIP election has been made?

m. What happens if there is a disposition of the donee-spouse's income interest in the original trust prior to the donee-spouse's death? For gift tax purposes it might be difficult to imagine a donee-spouse renouncing his or her income interest, however, it might happen for other non-tax reasons. If the assets in the original QTIP trust pass to a successor trust or trusts for the benefit of the donor-spouse, it appears that the assets in the trust will not be protected from the donor-spouse's creditors during the donee-spouse's lifetime.

n. Practitioners should carefully review Chapter 739 of the Florida Statutes (that is, the Florida Uniform Disclaimer of Property Interests Act) to see how it may benefit a client seeking to implement this type of trust arrangement.

o. Regardless of the foregoing issues, practitioners must recognize that this is not your father's type of trust. It should be designed from an asset protection point of view. A quality asset protection trust contains numerous provisions that are not typically included in more traditional trust forms.

p. It is now significantly easier and presumably less expensive for Florida residents to create asset protection trust structures. Thus, Florida Statutes § 736.0505(3) could be a game changer if used properly.

q. Florida Statutes § 736.0505(3) also presents some unique estate planning opportunities. Practitioners should carefully review *Bonner Est. v. U.S.*, 84 F.3d 196 (5th Cir. 1996) and *Mellinger Est. v. Com'r.*, 112 T.C. 26 (1999), *acq.*, AOD 1999-006 (better known as the Fredericks of Hollywood estate) and similar cases in an effort to uncover these potential planning opportunities.

r. It is important to note that the mandatory income interest in the trust remains vulnerable to attack by a creditor. While the interest itself may be protected by use of a spendthrift provision, income distributed directly to the beneficiary is certainly at risk for attachment.

s. This strategy cannot work if the donee-spouse is not a US citizen as the transfer would not qualify for the marital deduction. See § 2523(f).

t. ***Caution***: If the property transferred to the trust has a situs outside of Florida that is located in a jurisdiction that has the Self-Settled Trust Doctrine, the law of that jurisdiction would most likely apply to such property held in the trust. In such a situation the asset protection features of this trust might not be available to the settlor following the donee-spouse's death.

u. Perhaps additional planning opportunities exist if the QTIP trust is designed to permit the donee spouse to assign his or her income interest in the trust. See *e.g.*, PLR 201243004; and Bramwell and Kanaga, **LISI** Estate Planning Newsletter #2040 (December 20, 2012) at http://www.leimbergservices.com.

v. Based on the plain language of the statute, it should be possible to use this planning technique in the case of a same-sex couple who were married in a jurisdiction recognizing same sex marriage. See Rev. Rul. 2013-17; *United States v. Windsor*, 570 U.S. ____ (2013); *Obergefell v. Hodges*, 576 U.S. ___ (2015). For an excellent discussion of the issues relating to the Windsor case and Revenue Ruling 2013-17 see Karibjanian, "Revenue Ruling 2013-17 and IR-2013-72: The Service Responds to Windsor," **LISI** Estate Planning Newsletter #2137 (September 3, 2013) at http://www.LeimbergServices.com; Karibjanian, "Federal Law for Same-Sex Married Couples after Windsor: Equality for All or Only for Some?," LISI Estate Planning Newsletter #2118 (July 23, 2013) at http://www.LeimbergServices.com**;** Karibjanian, "Windsor and Perry: A Supreme Split Decision," LISI Estate Planning Newsletter # 2110, (June 26, 2013) at http://www.leimbergservices.com. But caution is warranted until more authority is available in this area. See *e.g.*, Section 27 of Article I of the Florida Constitution, which provides:

> Marriage defined.-
>
> Inasmuch as marriage is the legal union of only one man and one woman as husband and wife, no other legal union that is treated as marriage or the substantial equivalent thereof shall be valid or recognized.

See also Florida Statutes § 741.212, which provides:

> Marriages between persons of the same sex.-
>
> (1) Marriages between persons of the same sex entered into in any jurisdiction, whether within or outside the State of Florida, the United States, or any other jurisdiction, either domestic or foreign, or any other place or location, or relationships between persons of the same sex which are treated as marriages in any jurisdiction, whether within or outside the State of Florida, the United States, or any other jurisdiction, either domestic or foreign, or any other place or location, *are not recognized for any purpose in this state*. (Emphasis added).
>
> (2) The state, its agencies, and its political subdivisions may not give effect to any public act, record, or judicial proceeding of any state, territory, possession, or tribe of the United States or of any other jurisdiction, either domestic or foreign, or any other place or location respecting either a marriage or relationship not recognized under subsection (1) or a claim arising from such a marriage or relationship.
>
> (3) *For purposes of interpreting any state statute or rule, the term "marriage" means only a legal union between one man and one woman as husband and wife, and the term "spouse" applies only to a member of such a union*. (Emphasis added.)

w. In the consolidated case of *Brenner v. Scott*, 999 F.Supp.2d 1278, 1286 N.D. Fla, (2014), the plaintiffs challenged the provisions of the Florida Constitution and Florida Statutes banning same-sex marriage. Two of the plaintiffs in Brenner were an unmarried same-sex couple who were denied the issuance of a marriage license in Washington County, Florida. The other plaintiffs were individuals (and an association representing individuals) who were married in other jurisdictions and who sought recognition of their respective same-sex marriages in Florida. In each case, the plaintiffs moved for a preliminary injunction barring enforcement of the challenged provisions. A preliminary injunction was granted, holding that the Florida ban on same-sex marriage violated the due-process and equal-protection clauses of the Fourteenth Amendment. However, the court also issued a temporary stay on the injunction. The State of Florida requested further stays on the injunction from the Eleventh Circuit U.S. Court of Appeals and the Supreme Court of the United States; both requests to extend the stay were denied, and the stay on the injunction was set to expire on January 5, 2015.The Clerk of Court of Washington County filed an emergency motion on December 29, 2014 to clarify the preliminary injunction on the issue of whether the injunction required the Clerk to issue marriage licenses to all qualified same-sex applicants, or only to the two unmarried plaintiffs. On January 1, 2015, the court clarified the order announcing the issuance of the preliminary injunction to state that the Constitution of the United States required all Florida counties to issue marriage licenses to all qualified same-sex applicants. Thus, pending further developments at the federal level, effective as of January 5, 2015, qualified same-sex applicants may have marriage licenses issued in Florida, and same-sex marriages lawfully entered into elsewhere will be recognized in Florida. The ultimate outcome of these cases may determine whether a same-sex couple will be able to obtain the creditor protection benefits of Florida Statues §736.0505(3). Until this issue is clarified in favor of a same-sex couple, it may be prudent for a same-sex couple to establish a SQIT in a

jurisdiction that provides broader asset protection benefits to self-settled trusts, and to affirmatively make the QTIP election on a federal gift tax return after the trust is established. See also *Huntsman v. Heavilin*, 16th Judicial Circuit, Monroe County, Florida, Case No. 2014-CA-305-K.; Gassman and Arango, LISI Estate Planning Newsletter #2236, (July 29, 2014) at http://www.leimbergservices.com; *In re the Marriage of Brassner*, 17th Judicial Circuit, Broward County, Florida, Case No. 13-012058 (37); *Pareto v. Ruvin*, 11th Judicial Circuit, Miami-Dade County, Florida, Case No. 14-1661 CA 24; *In re Estate of Bangor*, 15th Judicial Circuit, Palm Beach County, Florida, Case No. 502014CP001857XXXXMB.

x. In *Brandon-Thomas v. Brandon-Thomas*, No. 2D14-761 (Fla. 2d DCA Apr. 24, 2015), the Florida Second District Court of Appeal held that Florida courts have jurisdiction to dissolve the marriages of same-sex couples, even though such marriage was legally entered into in another state.

y. But see *Obergefell v. Hodges*, 576 U.S. ___ (2015), where the Supreme Court of the United States held that the Fourteenth Amendment requires a State to license a marriage between two people of the same sex and to recognize a marriage between two people of the same sex when their marriage was lawfully licensed and performed out-of-State.

z. For an excellent discussion of post divorce income tax issues and strategies to address those issues during a divorce, see Nelson & Franklin, "*Inter Vivos* QTIP Trusts Could Have Unanticipated Income Tax Results to Donor Post-Divorce," LISI Estate Planning Newsletter #2244, (Sept. 15, 2014) at http://www.leimbergservices.com.

V. NEVIS TRUST LAW.

A. The law of Nevis contains specific legislation permitting the establishment of a self-settled trust. The legislation in Nevis contains all of the "bells and whistles" that a lawyer trained in the United States legal system should want included in a trust act of this type.

B. On May 27, 2015, the Nevis Island Assembly enacted the Nevis International Exempt Trust (Amendments) Ordinance, 2015 (the "**Trust Amendments**"). The Trust Amendments are effective July 1, 2015. The Nevis International Exempt Trust (Amendment) Ordinance, 2015 (the "**Ordinance**"), modernizes the Nevis International Exempt Trust Ordinance, 1994 (the "**Original Ordinance**") and makes it more competitive in the trust services market.

C. Section 2 was amended to revise and add various definitions, including: attorney-at-law, ascertainable standard, authenticated translation, bankrupt, beneficiary, breach of trust, business entity, charitable purpose, charitable remainder annuity trust, charitable remainder unitrust, Court, creditor, deputy registrar, Dollars, endorsement, foreign court, formalities, functions, Gazette, general power of appointment, governing law, grantor retained annuity trust, grantor retained unitrust, heirship rights, insolvency, intent to defraud, interest, international trust, Minister, minor, non-resident, person, personal representative, power of withdrawal, profit, property, protector, provisions of this ordinance, purpose, qualified foreign trust, registrar, relatives, revocable, settlor, spouses, terms, trustee and trust property.

1. The terms charitable remainder annuity trust ("**CRAT**"), charitable remainder unitrust ("**CRUT**") (a CRAT and CRUT may collectively be referred to as a "**CRT**"), grantor retained annuity trust ("**GRAT**") and grantor retained unitrust ("**GRUT**") are defined to clarify that such trusts can be formed in Nevis with the settlor's retained interest in such trusts also being protected under Nevis law.

2. The definition of international trusts was broadened to include that at least one of the trustees could be a Nevis LLC, a Nevis law firm and a Nevis multiform foundation.

3. The definition of non-residents was broadened to include a natural person who obtains his or her citizenship in St. Kitts and Nevis by way of the citizenship investment program, a Nevis Business Corporation, a Nevis LLC and a business entity incorporated, formed or established under the laws of any jurisdiction other than St. Kitts and Nevis, and which does not ordinarily engage in any trade or business within St. Kitts and Nevis.

4. A U.S. citizen would want to consider creating a CRT in the U.S. as opposed to Nevis. The settlor of a CRT would generally fund such trust with property that he or she expects to appreciate, with the goal of not paying tax on the gain. Under Section 679(a)(1) of the Internal Revenue Code ("**§**"), a U.S. person who directly or indirectly transfers property to a foreign trust is treated as the owner for his taxable year of the portion of the trust attributable to such property if for such taxable year there is a U.S. beneficiary of any portion of such trust. Since the charitable beneficiaries of a CRT must be U.S. charities, a Nevis CRT established by a U.S. settlor, with a U.S. charitable remainder beneficiary, would be subject to the provisions of § 679 because the domestic charity is a U.S. person with an interest in the trust. This would cause unnecessary tax consequences to the U.S. citizen settlor. The exception to the application of § 679 for foreign charitable trusts only applies to trusts that are exclusively devoted to charitable purposes under § 501(c)(3), not to CRTs that gain their U.S. tax exemption under § 664(c). See discussion in Galligan, "International Charitable Giving and Planning Under U.S. Tax Law," 29 Est., Gft. & Tr. J. 151 (May 13, 2004). According to Treas. Regs. § 1.664-1(a)(4):

> In order for a trust to be a charitable remainder trust, it must meet the definition of and function exclusively as a charitable remainder trust from the creation of the trust. Solely for the purposes of section 664 and the regulations thereunder, the trust will be deemed to be created at the earliest time that neither the grantor nor any other person is treated as the owner of the entire trust under subpart E, part 1, subchapter J, chapter 1, subtitle A of the Code (relating to grantors and others treated as substantial owners), but in no event prior to the time property is first transferred to the trust. For purposes of the preceding sentence, neither the grantor nor his spouse shall be treated as the owner of the trust under such subpart E merely because the grantor or his spouse is named as a recipient.

While this provision prevents the interest of the U.S. settlor or settlor's spouse from causing a foreign trust to fail to qualify as a CRT, the requirement that the charitable beneficiary be domestic would cause any otherwise eligible CRT to fail to qualify if the CRT

were set up as a foreign trust because § 679 would still apply. *See* Rev. Rul. 77-285, 1977-2 C.B. 213.

An additional consideration for foreign CRTs is warranted under § 684. Section 684 is an income recognition provision for a taxpayer who transfers appreciated property to certain foreign trusts. Absent § 684, appreciated property could be transferred to a foreign nongrantor trust without any gain recognition, and the asset subsequently sold without any U.S. income taxation being imposed on that asset's built-in gain at the time of transfer. Section 684(a) provides that a transfer of appreciated property by a U.S. person to a foreign non-grantor trust is not subject to gain recognition. The transferor is treated as recognizing a capital gain with respect to the transferred property. The capital gain is then included on the U.S. person's income tax return for the year of the transfer and subject to U.S. income taxation at that time.

Under § 684(b), § 684(a) does not apply to the extent a U.S. person is treated as the owner of such trust under § 671, referring to the grantor trust rules of §§ 671-679. As previously discussed, § 679 specifically applies to foreign trusts, which have one or more U.S. beneficiaries. If § 679 ceases to apply due to a change in circumstances, then § 684 could apply at the change in circumstances, even if the change occurred years later.

If § 679 were to apply and the appreciated property contributed to the foreign trust is subsequently sold, any built-in gain with respect to the appreciated property contributed to the foreign trust would be recognized and subject to U.S. income taxation. Consequently, the income recognition provision of § 684(a) would not be necessary. In this case, there is no reason to accelerate the taxation of the built-in gain in those cases where §679 applies. *See* Levin, "Transfers to Foreign Trusts Could Trigger Gain Recognition," 37 Est. Plan J. 14 (Oct. 2010). Under Regs. §1.684-3(c), if the settlor ceases to be treated as the §679 owner because of the settlor's death but the trust is includible in the settlor's taxable estate, making it eligible for a step-up in basis, § 684 is not triggered. Under Regs. §1.684-3(b), § 684 is not triggered if property is transferred to a foreign trust devoted exclusively to charitable purposes as described in § 501(c)(3), even if the trust has not applied for recognition of its exempt status or given notice of its intent to do so

D. Section 3 was amended to provide that an international trust registered under the Ordinance is valid and enforceable even if it is invalid according to the law of settlor's domicile, residence, place of current incorporation, place of formation or establishment.

"**3. Validity of international trusts**

(1) An international trust registered under this Ordinance shall be valid and enforceable notwithstanding that it may be invalid according to the law of the settlor's domicile or residence or place of current incorporation, formation or establishment.

(2) An international trust shall be invalid and unenforceable to the extent that -

(a) it purports to do anything contrary to the laws of St. Christopher and Nevis;

(b) it purports to confer any right or power or impose any obligation the exercise of which or the carrying out of which is contrary to the laws of St. Christopher and Nevis; or

(c) the property of the trust, or any part thereof, are the proceeds of a crime for which the settlor has been convicted."

This amendment is practical since most trusts are formed or established in jurisdictions other than a settlor's domicile or residence.

E. Section 5(1) eliminates the Rule Against Perpetuities and permits a trust to continue forever if the terms of the trust provide that the trustee has the unlimited power to sell all trust assets or if one or more persons, one of whom may be the trustee has the unlimited power to terminate the trust:

"**5. Unlimited duration of international trusts and accumulation of income**

(1) No rule of law against perpetuities or suspension of the power of alienation of the title to property, any other existing law against perpetuities, or any law restricting or limiting the duration of an international trust shall apply with respect to any interest in real or personal property held in trust if the terms of an international trust specifically state that the trustee of the trust has the unlimited power to sell all trust assets or if one or more persons, one (1) of whom may be the trustee, has the unlimited power to terminate the entire trust.

(2) The rule of law known as the rule against perpetuities shall not apply to an international trust and unless otherwise provided in its terms, an international trust shall have an unlimited duration."

Sections 5(3) and (4) eliminates the Rule Against Accumulations.

"**(3)** Notwithstanding any rule of law or equity to the contrary, where a trust instrument empowers a trustee to accumulate income, or to refrain from making any distribution of capital or income until a specified date or event, or where any provision of the instrument otherwise prevents the making of any distribution of capital or income, notwithstanding that a beneficiary may, but for this section, otherwise be entitled to that accumulation or distribution, the trustee may, in his absolute discretion, subject to any other terms of the instrument, give effect to that direction as he thinks fit notwithstanding that a beneficiary shall request the trustee to immediately distribute the accumulation or distribution and will give a valid discharge to the trustee for such distribution.

(4) The income arising from any international trust may be accumulated in accordance with the terms of the trust for as long a time as is necessary to accomplish the purposes for which the trust was created, notwithstanding any law limiting the period during which trust income may be accumulated."

F. Section 8A was added to better define the rights of a creditor of a beneficiary (including the settlor) of a discretionary trust.

"**8A. Discretionary interests in international trusts**

(1) This section applies to a creditor's claim with respect to a discretionary interest of any beneficiary (including a settlor) in an international trust unless the trust deed provides explicitly otherwise.

(2) A discretionary interest in an international trust is not a property interest or an enforceable right rather is a mere expectancy that a creditor of a beneficiary (including the settlor) may not attach, garnish or otherwise reach.

(3) A creditor of a beneficiary (including the settlor) may not compel or force a distribution with regard to a discretionary interest in an international trust, nor compel or force a trustee to exercise the trustee's discretion to make a distribution with regard to a discretionary interest in an international trust.

(4) A creditor of a beneficiary (including the settlor) may not compel or force a protector to exercise a power to direct a trustee to make a distribution to any beneficiary of an international trust.

(5) In the case of a discretionary interest in an international trust, a trustee who has the authority to pay income or principal to a beneficiary (including the settlor) may pay it to a third party if the payment is for the benefit of the beneficiary (including the settlor), and the trustee of an international trust shall not be liable to any creditor of a beneficiary (including the settlor) for paying income or principal on behalf of such beneficiary.

(6) A creditor of a beneficiary (including the settlor) may not maintain an action or a proceeding in Court that interferes with the trustee's discretion to apply income or principal on behalf of the beneficiary of an international trust.

(7) A creditor of a beneficiary (including the settlor) may not obtain an order of attachment, garnishment or similar relief that would prevent a trustee from making a discretionary payment to a third party on behalf of the beneficiary (including the settlor) of an international trust.

(8) In this section, a beneficiary's entitlement (or lack thereof) to a distribution is within the discretion of a trustee, whether or not the trust deed states the purposes for the distribution, is expressed in the form of a standard of distribution or uses the terms 'may,' 'shall,' 'sole and absolute,' 'uncontrolled,' 'unfettered,' or similar words and whether or not the trustee has abused the discretion.

(9) Regardless of whether a beneficiary of an international trust has any outstanding creditor, a trustee of a discretionary interest may directly pay any expense on behalf of such beneficiary and may exhaust the income and principal of the trust for the benefit of such beneficiary. No trustee is liable to any creditor for paying the expenses of a beneficiary (including the settlor) who holds a discretionary interest.

(10) (a) In this section, 'discretionary interest' means a beneficiary's interest in an international trust if the beneficiary's entitlement to a distribution is within the discretion of the trustee."

(b) This section shall not prevent a creditor from obtaining relief from under Section 23 of this Ordinance that is not inconsistent with this Section 8A."

Section 8A greatly limits the rights of a creditor to reach a beneficiary's interest in such a trust. In the absence of such a provision, a creditor of a beneficiary might attempt to obtain a court order to garnish future distributions made to or for the benefit of a beneficiary. Such garnishment could result in a trustee being unable to make any distributions for the benefit of a beneficiary. This section also specifically permits a trustee to make payments to third parties on behalf of the beneficiary without incurring any liability to a creditor and prevents even the remote possibility of any such attachment, garnishment or interference.

G. Section 9 was amended in its entirety. Most notably, subsection (3) of Section 9 now allows a trust protector to be granted the authority to direct a trustee to make distributions; approve distributions made by a trustee; and direct the trustee to make investments. By giving a protector authority to direct the trustee to make distributions and investments, in conjunction with giving trustees an indemnity for following the directions of the protector, a trustee has the ability to administer trusts it might not otherwise be willing to administer and it will facilitate the administration of a trust because the trustee is exonerated from liability for acting at the direction of a protector.

"**9. Protector of a trust**

(1) The terms of an international trust may provide for the office of protector of the trust. Where a person is given authority by the terms of an international trust to direct, consent to or disapprove a trustee's actual or proposed investment decisions, distribution decisions or other decision of the trustee, such person shall be considered to be a protector when exercising such authority (unless the terms of the trust shall otherwise provide).

(2) The protector of an international trust shall have the power to:

(a) (unless the terms of the trust shall otherwise provide) remove a trustee and appoint a new or additional trustee; and

(b) exercise such further powers as are conferred on the protector by the terms of the international trust or by the provisions of this Ordinance.

(3) The terms of an international trust may grant the protector the power to:

(a) direct the trustee to make distributions from the trust;

(b) consent to or approve any distributions made by the trustee from the trust; and

(c) direct the trustee regarding any or all investment decisions of the trust, which includes the power to direct a trustee to retain, purchase, sell or exchange property held in the trust or to engage in any other transaction affecting the ownership or rights over such property. [*emphasis added*]

(4) If the terms of an international trust provide that a trustee shall follow the direction of the protector and the trustee acts in accordance with such a direction, then except in cases of willful misconduct on the part of the trustee so directed, the trustee shall not be liable for any loss resulting directly or indirectly from any such act.

(5) If the terms of an international trust provide that a trustee shall make decisions with the consent of the protector, then except in cases of willful misconduct or gross negligence on the part of the trustee, the trustee shall not be liable for any loss resulting directly or indirectly from any act taken or omitted as a result of such protector's failure to provide such consent after having been requested to do so by the trustee.

(6) Whenever the terms of an international trust provide that a trustee shall follow the direction of the protector with respect to investment decisions of the trustee, then, except to the extent that the international trust provides otherwise, the trustee shall have no duty to:

(a) monitor the conduct of the protector;

(b) provide advice to the protector or consult with the protector; or

(c) communicate with or warn or apprise any beneficiary or third party concerning instances in which the trustee would or might have exercised the trustee's own discretion in a manner different from the manner directed by the protector.

Absent clear and convincing evidence to the contrary, the actions of the trustee pertaining to matters within the scope of the protector's authority (such as confirming that the protector's directions have been carried out and recording and reporting actions taken at the protector's direction), shall be presumed to be administrative actions taken by the trustee solely to allow the trustee to perform those duties assigned to the trustee under the governing instrument and such administrative actions shall not be deemed to constitute an undertaking by the trustee to monitor the protector or otherwise participate in actions within the scope of the protector's authority.

(7) Unless the terms of the trust shall otherwise provide the protector of an international trust may also be a settlor or a beneficiary of the trust.

(8) Subject to the terms of the international trust, in the exercise of his office a protector shall owe a fiduciary duty to the beneficiaries of the trust or to the purpose for which the trust is created.

(9) Where there is more than one (1) protector of a trust then, subject to the terms of the trust, any functions conferred on the protectors may be exercised if a majority of the protectors for the time being agree on its exercise.

(10) A protector who dissents from a decision of the majority of protectors may require his dissent to be recorded in writing.

(11) (a) A protector may delegate duties and powers with regard to investment decisions. The protector shall exercise reasonable care, skill, and caution in:

(i) selecting an agent such as an investment advisor;

(ii) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and

(iii) reviewing the agent's actions periodically to monitor the agent's performance and compliance with the terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the protector/trustee/beneficiary or purpose for which the trust was created to exercise reasonable care to comply with the terms of the delegation.

(c) A protector who complies with subsection (a) and, when investment functions are delegated, is not liable to the beneficiaries or to the trust for an action of the agent to whom the function was delegated."

Section 45(1) coincides with the amendment to Section 9 by expanding the list of authorized trust investments to include such assets approved by the protector.

"**(1)** A trustee shall not invest any of the trust funds other than in securities, assets, or property authorized expressly or by necessary implication for the investment of the trust funds by and under the instrument by which the trust is established or created or in such securities, assets, or property authorized and approved by the protector pursuant to Section 9 (2) and (6) of this Ordinance."

H. Section 9A was added to the Ordinance to clarify that creditors will only have a right to a beneficiary's interest in a trust if that beneficiary has either a lifetime or testamentary general power of appointment, that is, a power to appoint the trust property to the beneficiary, the beneficiary's estate, the beneficiary's creditors, or the creditors of the beneficiary's estate, however, only to the extent that the beneficiary exercises such power of appointment.

"**9A. General power of appointment granted to a beneficiary**

A creditor shall have no right against the interest of a beneficiary of an international trust or against the beneficiary or trustee of the trust with respect to such interest unless.

(1) The beneficiary (other than the settlor) has a power to appoint all or part of the trust property to the beneficiary, the beneficiary's estate, the beneficiary's creditors, or the creditors of the beneficiary's estate by will or other instrument such that the appointment would take effect only upon the beneficiary's death and the beneficiary actually exercises such

power in favor of the beneficiary, the beneficiary's creditors, the beneficiary's estate, or the creditors of the beneficiary's estate but then only to the extent of such exercise.

(2) The beneficiary (other than the settlor) has a power, including a power of withdrawal, to appoint all or part of the trust property to the beneficiary, the beneficiary's creditors, the beneficiary's estate, or the creditors of the beneficiary's estate during the beneficiary's lifetime and the beneficiary actually exercises such power in favor of the beneficiary, the beneficiary's creditors, the beneficiary's estate, or the creditors of the beneficiary's estate but then only to the extent of such exercise."

This provision codifies the common law rule regarding general powers of appointment and further provides that the amount subject to a creditor's reach could never exceed the amount subject to the exercise of the beneficiary's power.

Additionally, Section 9B was added to clarify that creditors only have a right to a settlor's interest in a trust if the settlor retains a power to revoke the trust and to appoint the trust property to the settlor, the settlor's estate, the settlor's creditors, or the creditors of the settlor's estate, however, only to the extent the settlor exercises such power.

"**9B. Right of revocation retained by settlor**

A creditor shall have no right against the interest of a beneficiary of an international trust who is the settlor or against the settlor or trustee of the trust with respect to such interest unless the settlor has a power to revoke the trust and appoint all or part of the trust property to the settlor, the settlor's creditors, the settlor's estate, or the creditors of the settlor's estate during the settlor's lifetime and the settlor actually exercises such power in favor of the settlor, the settlor's creditors, the settlor's estate, or the creditors of the settlor's estate but then only to the extent of such exercise."

Section 9B will enhance the asset protection provided by an international trust by giving creditors the right to a settlor's interest only in the limited circumstances where the settlor has unfettered control of the trust property and exercises such control, however, only to the extent of such exercise. The additions of Sections 9A and 9B were in direct response to the holding in *Tasarruf Mevduati Sigorta Fonu v. Merrill Lynch Bank and Trust Company, et al.*, Privy Council of the Cayman Islands, Appeal No. 0036 of 2010, decided June 21, 2010. *Fonu v Merrill Lynch Bank and Trust Company (Cayman) Ltd & Ors (Cayman Islands)*, [2012] 1 WLR 1721, [2011] 4 All ER 704, 14 ITELR 102, [2011] UKPC 17, [2011] BPIR 1743, [2011] WTLR 1249. In *Tasarruf*, the Privy Council held that a power to revoke retained by the settlor of two trusts established and funded in the Cayman Islands was tantamount to a property interest because it was a personal power, not a fiduciary power, *i.e.*, the settlor owed no duty of trust or confidence to any other person, and no act personal to the settlor was required to be performed. Therefore, the power could be delegated and/or assigned by the settlor to another person. Thus, the court in *Tasarruf* allowed the settlor's creditors to reach the assets in held in two revocable trusts. The holding in *Tasarruf* was in direct conflict with existing Cayman law and represented a rare instance where the Privy Council overturned the holding of the trial court and the Eastern Caribbean Court of Appeals where underlying common law in the jurisdiction was clear. The codification of this rule should preclude a creditor of the settlor of

an international trust who has retained a power of revocation from reaching the assets held in such trust and subject to the power of revocation notwithstanding the holding in *Tasarruf*. Likewise, Section 9A should preclude creditors of a beneficiary possessing a power of withdrawal from attaching the trust property. Even though the Ordinance contains these specific provisions, it is recommended that U.S. clients refrain from including such powers in an international trust, as a U.S. court would almost certainly have serious problems with a settlor's unfettered control of the trust property.

Section 13 was amended to provide a statutory duress provision applicable to all international trusts.

"**13. Duress; Termination by beneficiaries**

To the extent any person is granted the power under the terms of a trust to demand or request any act on the part of a settlor, beneficiary, trustee, protector, or other person, or has the authority to approve, veto, or compel any action or exercise any power which affects or will affect an international trust or any interest therein, each such person is directed, to the extent such person would not be subject to personal liability or personal exposure:

(1) to accept or recognize only demands or requests, or the effects of any approval, veto, or compelled action or the exercise of any power, which are given by or are the result of persons acting of their own free will and not under compulsion or pursuant to any legal process, directive, order, or like decree of any court, administrative body, or other tribunal or like authority; and

(2) to ignore any demands or requests, or the effects of any approval, veto, or compelled action or the exercise of any power, where the person attempting to demand, request, approve, veto, compel the act, or exercise the power is not a person either appointed or so authorized pursuant to the terms of such trust."

The amendment provides that when any person granted the power under the terms of a trust to demand or request any act on the part of a settlor, beneficiary, trustee, protector, or other person, or who has the authority to approve, veto or compel any action or exercise any power that could affect an international trust, he, she or it may ignore demands or requests given by or the result of persons acting under duress, including pursuant to any legal process, court, administrative body, etc.

Section 22 was amended to clarify that the Court may not issue a *Mareva* injunction, *Anton Piller* order, or any similar remedy.

"**(4)** No action or proceeding (whether substantive or interlocutory in nature) shall be heard, and no injunction, order of any kind, or any other relief or remedy, whether legal or equitable, shall be made, issued, granted or ordered, by the Court concerning an international trust where the purpose of such action or proceeding would be to detain, inspect, garnish, attach or otherwise interfere in any manner whatsoever or possible with:

(a) any trust property wherever situated whether in St. Christopher and Nevis or elsewhere, or

(b) any right, duty, discretion, obligation or power which a trustee may have in respect of any trust property."

The purpose of the amendment was to prevent a claimant from circumventing the limitations on remedies contained elsewhere in the Ordinance, such as under Section 24 concerning creditor claims. The main purpose of an asset protection trust is to protect its settlor in a time of great need. In *Federal Trade Commission v. Affordable Media, LLC*, 179 F.3d 1228 (9th Cir. 1999), the court in the Cook Islands issued a *Mareva* injunction freezing the assets of the trust (i.e., cash in a bank account at a bank in the Cook Islands). Then, while frozen, such funds were not available for use by the settlors to pay their basic living expenses. Such action frustrated the purpose of the trust until the creditors settled.

Section 35A automatically removes a trustee or protector of an international trust that is subject to any other court's jurisdiction, except the High Court of St. Christopher and Nevis.

"**35A. Removal of trustee and protectors**

(1) If, in any action is brought against a trustee of an international trust in a foreign court, such foreign court fails to dismiss such action, or orders such trustee to take any action in regards to such trust, such trustee shall immediately upon such court's action and without the further order of any court, cease in all respects to be trustee of such trust and a successor trustee shall thereupon succeed as trustee in accordance with the terms of the trust instrument or, if the trust instrument does not provide for a successor trustee and the trust would otherwise be without a trustee, the Court, upon the application of any beneficiary of such trust, shall appoint a successor trustee upon such terms and conditions as it determines to be consistent with the purposes of such trust and this statute.

Upon such trustee ceasing to be trustee, such trustee shall have no power or authority other than to convey the trust property to the successor trustee named in the trust instrument or appointed by the Court in accordance with this section. The trustee shall, within fourteen (14) days of its removal, give notice in writing to the Registrar of such removal.

(2) If, in any action is brought against a protector of an international trust in a foreign court, such foreign court fails to dismiss such action, or orders such protector to take any action in regards to such trust, such protector shall immediately upon such court's action and without the further order of any court, cease in all respects to be a protector of such trust. Upon such protector ceasing to be a protector, such protector shall have no power or authority in regards to the trust. The protector shall, immediately following its removal hereunder, give notice in writing to the trustee of the international trust of such removal."

This statutory duress provision is unique among jurisdictions. It has its origins in the Delaware Trust Code (§3327), however, it is a vastly improved provision. Together, Sections 13, 22 and 35A make Nevis the strongest jurisdiction in the world to establish an asset protection trust.

I. Section 17(1) was amended to allow the terms of an international trust to indemnify the trustee against liability.

"**(1)** A beneficiary may relieve a trustee of liability for a breach of trust or indemnify a trustee against liability for a breach of trust and the terms of the trust may relieve a trustee of liability for a breach of trust or indemnify a trustee against liability for a breach of trust."

This is an expansion of the previously drafted Section 17 which only permitted a beneficiary to indemnify the trustee.

J. Section 24 was amended to clarify the fraudulent transfer rule.

"(a) deleting the phrase "a settled or established or property disposed to a trust" and replacing it with the phrase "a trust settled or established, or property disposed or transferred to a trust,";

(b) deleting the phrase "in the event that" in subsection (2) and replacing it with the word "if";

(c) deleting subsection (3) in its entirety and replacing it with the following subsection (3) to read as follows:

"(3) A trust settled or established, or a disposition or transfer of property to such trust, shall not be fraudulent as against a creditor of a settlor if such settlement, establishment, disposition or transfer occurs after the expiration of one year from the date that such creditor's cause of action accrued or originated."

(d) deleting subsection (4) in its entirety and replacing it with the following subsection (4) to read as follows:

"(4) A trust settled or established, or a disposition of property to such trust, shall not be fraudulent as against a creditor of a settlor if such settlement, establishment or disposition took place before the creditor's cause of action against the settlor had accrued or had arisen."

(e) deleting subsection (5) (b) in its entirety and replacing it with the following subsection (5) (b) that shall read as follows:

"(b) has retained, possesses or acquires any of the powers or benefits referred to in Subsections (a) to (i) of Section 47;"

(f) deleting subsection (7) in its entirety and replacing it with the following subsection (7) that shall read as follows:

"(7) The burden of proof regarding the settlor's intent to defraud the creditor shall be borne by the creditor."

(g) adding the phrase "action or" subsection (8) (c) after the word "any" and before the word "proceeding"; and

(h) deleting subsection (9) in its entirety and replacing it with the following subsection (9) that shall read as follows:

(9) The provisions of this section shall apply to all actions and proceedings brought into the Court, however described, against the person (whether a party to the action or proceedings or not) with regard to the settlement of an international trust or the disposition of property to such a trust, or receipt of property by or for such a trust and the remedy conferred by subsection (1) shall be the sole remedy available in such an action or proceedings to the exclusion of any other relief or remedy against any party to the action or proceeding."

The original text was modeled after Section 13B(3) and (4) of the Cook Islands International Trusts Act ("**ITA**"). The ITA deems a transfer in trust to be not fraudulent as against a creditor if the transfer takes place two years from when the creditor's cause of action accrues. If the transfer takes place within two years of the cause of action accruing, the ITA deems the transfer to be not fraudulent if the creditor fails to commence a court action within one year. Similarly, the ITA deems a transfer in trust to be not fraudulent as against a creditor if the transfer takes place before the creditor's cause of action accrues.

As described above, subsection (3) was revised to eliminate what arguably may have given a creditor a three-year window to file a fraudulent transfer claim against an international trust. This "sliding window" was introduced in § 13B(3) of the Cook Islands ITA, after which subsection (3) of Section 24 was modeled. While paragraph 13B(3)(a) of the ITA is intended to protect a transfer in trust made more than two years after a creditor's cause of action accrues, paragraph (b) gives the creditor one more year to bring a claim if the creditor's claim happens to arise right before the expiration of the two year period referenced in paragraph (a). The revision to subsection (3) of Section 24 implements a fixed one year window beginning with the date on which the creditor's cause of action accrues. Further, subsection (5)(b) of Section 24 was revised to expand the list of powers that a settlor can retain without having an intent to defraud a creditor imputed to the settlor.

In its entirety following amendment, Section 24 reads as follows:

"**24. Avoidance of fraud.**

(1) Where it is proven beyond reasonable doubt by a creditor that a trust settled or established, or property disposed or transferred to a trust-

(a) was so settled established or disposed by or on behalf of the settlor with principal intent to defraud that creditor of the settlor; and

(b) did at the time such settlement establishment or disposition took place render the settlor insolvent or without property by which that creditors claim (if successful) could have been satisfied, then such settlement establishment or disposition shall not be void or voidable and the international trust shall be liable to satisfy the creditor's claim and such liability shall only be to the extent of the interest that the settlor had in the property prior to

settlement establishment or disposition and any accumulation to the property (if any) subsequent thereto.

(2) In determining whether a trust, settled or established or a disposition, has rendered the settlor insolvent or without property by which a creditor's claim (if successful) may be satisfied, regard shall be had to the fair market value of the settlor's property, (not being property of or relating to the trust) at the time immediately after the settlement establishment or the disposition referred to in subsection (1) (b) and if the fair market value of such property exceeded the value of the creditor's claim, at that time, after the settlement establishment or disposition, then the trust so settled or established or the disposition shall for the purposes of this Ordinance be deemed not to have been so settled or established or the property disposed of with intent to defraud the creditor.

(3) A trust settled or established, or a disposition or transfer of property to such trust, shall not be fraudulent as against a creditor of a settlor if such settlement, establishment, disposition or transfer occurs after the expiration of one year from the date that such creditor's cause of action accrued or originated.

(4) A trust settled or established, or a disposition of property to such trust, shall not be fraudulent as against a creditor of a settlor if such settlement, establishment or disposition took place before the creditor's cause of action against the settlor had accrued or had arisen.

(5) A settlor shall not have imputed to him an intent to defraud a creditor, solely by reason that the settlor-

(a) has settled or established a trust or has disposed of property to such trust within two years from the date of that creditors cause of action accruing;

(b) has retained, possesses or acquires any of the powers or benefits referred to in Subsections (a) to (i) of Section 47;

(c) is a beneficiary.

(6) Where a trust is liable to satisfy a creditor's claim in the manner provided for in subsection (1), that creditors right to recovery shall be limited to the property referred to in subsection (1) , or to the proceeds of that property, to the exclusion of any claim right or action against any trustee or any other property of the trust.

(7) The burden of proof regarding the settlor's intent to defraud the creditor shall be borne by the creditor.

(8) For the purpose of this section-

(a) the date of the cause of action accruing shall be, the date of that act or omission which shall be relied upon to either partly or wholly establish the cause of action, and if there is more than one act or the omission shall be a continuing one, the date of the first act

or the date that the omission shall have first occurred, as the case may be, shall be the date that the cause of action shall have accrued;

(b) the term "cause of action" means the earliest cause of action capable of assertion by a creditor against the settlor of a trust or, as the case may be against the settlor of property upon a trust by which that creditor has established (or may establish) an enforceable claim against that settlor;

(c) the entry of judgment in any action or proceeding shall not constitute a separate cause of action.

(9) The provisions of this section shall apply to all actions and proceedings brought into the Court, however described, against the person (whether a party to the action or proceedings or not) with regard to the settlement of an international trust or the disposition of property to such a trust, or receipt of property by or for such a trust and the remedy conferred by subsection (1) shall be the sole remedy available in such an action or proceedings to the exclusion of any other relief or remedy against any party to the action or proceeding.

(10) Failure by a creditor to present all claims arising out of any controversy and join all parties with a material interest shall prevent that creditor from presenting such claims and bringing an action against such parties in a subsequent proceeding.

(11) For the purposes of this section the term "creditor" means a creditor of the settlor, including a judgment creditor and an assignee from such creditor of any claim and includes any person who alleges a cause of action against a settlor."

Section 46 was amended to clarify that an international trust may be void or voidable in the event of a settlor's bankruptcy, insolvency or liquidation, including if a corporation or limited liability company is in liquidation.

"**46. Bankruptcy**

Notwithstanding any provision of the law of the settlor's domicile or place of ordinary residence or the settlor's current place of incorporation, formation or establishment and notwithstanding further that an international trust is voluntary and without valuable consideration being given for the same or is made for the benefit of the settlor's spouse or children, an international trust shall not be void or voidable in the event of the settlor's bankruptcy, insolvency, or liquidation or in any action or proceeding at the suit of creditors of the settlor, but shall remain valid and subsisting and take effect according to its tenor subject to sections 23 and 24 of this Ordinance."

K. Section 32(5) was amended by expanding the list of beneficiaries of an international trust.

"**(5)** A Nevis Company, a corporation, a limited liability company or a multiform foundation may also be a beneficiary of the trust."

L. Section 35B allows the trustee of an international trust to combine two or more separate trusts into a single trust or divide a single trust into two or more separate trusts

provided that such action does not impair the rights of any beneficiary or adversely affect the purpose of the trust or trusts. This provision permits the trustee to segregate the assets of a trust for greater protection and liability purposes, and to combine the assets of separate trusts where administratively more convenient or efficient.

"**35B. Combination and division of trusts**

(1) Unless otherwise provided in the trust instrument, after notice to the beneficiaries, a trustee may combine two or more trusts into a single trust or divide a trust into two or more separate trusts, if the result does not impair rights of any beneficiary or adversely affect achievement of the purposes of the trusts or trust, respectively.

(2) Subject to the terms of the trust instrument, the trustee may take into consideration the difference in tax attributes and other pertinent factors in administering the trust property of any separate trust, in making applicable tax elections, and in making applications or distributions.

(3) A separate trust created by severance must be treated as a separate trust for all purposes from the date on which the severance is effective, including, but not limited to any and all issues related to the liability of a trustee or the trust assets pursuant to a contract, in tort or otherwise.

(4) The effective date of the severance may be retroactive to a date before the date on which the trustee exercises such power and any such action under this provision shall be made only pursuant to a written instrument filed with the records of the trust.

(5) In dividing a trust into two (2) or more separate trusts, a trustee shall accomplish the division by severing the trusts on a fractional basis and funding the separate trusts either (a) with a pro rata portion of each asset held by the undivided trust; or (b) on a non-pro rata basis based on either the fair market value of the assets on the date of funding or in a manner that fairly reflects the net appreciation or depreciation in the value of the assets measured from the valuation date to the date of funding.

(6) An international trust may be established to simultaneously benefit beneficiaries and to fulfill a purpose."

It also provides rules governing any such combination or severance.

Section 36 was amended to allow a trustee to act pursuant to a resolution and to appoint an agent to act on its behalf.

"**36. Trustee resolutions.**

A trustee which is a either a Nevis trust company, a corporation, a limited liability company or a multiform foundation, may–

(a) act in connection with a trust pursuant to its board of directors, board of managers, management board or other governing body; and

(b) appoint an officer, employee or agent to act on its behalf in connection with the trust."

Section 42(1) was amended to add limited liability companies and multiform foundations to a list of entities where an international trustee may have its registered office.

"(1) The registered office of an international trust shall be the office of the Nevis Company, attorney-at-law, corporation, limited liability company or multiform foundation which is the trustee."

M. Section 35C was added as follows:

"**35C. Effect of provisions of instrument**

(1) Notwithstanding any other provision of this Ordinance or other law, the terms of a governing instrument may expand, restrict, eliminate, or otherwise vary the rights and interests of beneficiaries, including, but not limited to, the right to be informed of the beneficiary's interest for any period, the grounds for removal of a trustee, the circumstances, if any, in which the trustee must diversify investments, and a trustee's powers, duties, standard of care, rights of indemnification and liability to persons whose interests arise from that instrument."

Section 35C(1) provides that the terms of a trust deed may expand, restrict, eliminate, or otherwise vary the rights and interests of beneficiaries, including the right of beneficiaries to be informed of their interests in the trust for any period, the grounds for removal of a trustee, the circumstances, if any, in which the trustee must diversify investments, and a trustee's powers, duties, standard of care, rights of indemnification and liability to persons who are granted interests under the trust instrument. The change to Section 35C(1) provides that a trustee has no duty to account and changes a longstanding rule under English law. See *e.g., Armitage v. Nurse* [1997] EWCA Civ 1279, [1998] Ch 241, [1997] 3 WLR 1046, [1997] 2 All ER 705. In *Armitage v Nurse* [1998] Ch. 241 at 261, the court provided in *dicta*:

> The respondents submit that the policy to which section 21(3) of the Act of 1980 gives effect is that it would be unfair to bar a plaintiff from bringing a claim unless and until he is of full age and entitled to see the trust documents and so has the means of discovering the injury to his beneficial interest. The difficulty with this argument, in my judgment, is that it proves too much. Every beneficiary is entitled to see the trust accounts, whether his interest is in possession or not. The rationale of section 21(3) appears to me to be different. It is not that a beneficiary with a future interest has not the means of discovery, but that he should not be compelled to litigate (at considerable personal expense) in respect of an injury to an interest which he may never live to enjoy. Similar reasoning would apply to exclude a person who is merely the object of a discretionary trust or power which may never be exercised in his favor.

Section 35C(2)-(4) provides:

"(2) Nothing contained in this section shall be construed to permit the exculpation or indemnification of a trustee for the trustee's own willful misconduct or preclude the Court from removing a trustee on account of the trustee's willful misconduct.

(3) The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this provision.

(4) This section shall give maximum effect to the principle of freedom of disposition and to the enforceability of governing instruments."

N. Section 47 was amended to expand the list of interests and powers that a settlor could retain over an international trust without a trust being declared invalid. The list was expanded to incorporate many of the types of trusts used in the United States for estate planning purposes, such as GRATs and GRUTs which are permitted under the statutes of most of the states that allow self-settled asset protection trusts.

"**47. Retention of control by settlor**

(1) An international trust shall not be declared invalid or otherwise be affected in any manner if the settlor, and if more than one (1), any of them either retains, possesses or acquires -

(a) the power to revoke the trust;

(b) the power to veto a distribution of income or principal by the trustee;

(c) the power to amend the trust;

(d) any benefit, interest or property from the trust, including, but not limited to the following:

(i) the settlor's potential or actual receipt of income or principal from the trust, including rights to such income or principal retained in the trust deed;

(ii) the settlor's potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust and the settlor's right, at any time and from time to time by written instrument delivered to the trustee, to release such settlor's retained interest in such a trust, in whole or in part, in favor of a charity that has or charities that have a succeeding beneficial interest in such trust;

(iii) the settlor's potential or actual receipt of income or principal from a grantor retained annuity trust or grantor retained unitrust;

(iv) the settlor's receipt each year of a percentage (as specified in the trust deed) of the initial value of the trust assets (which may be described either as a percentage or a fixed amount) or the value determined from time to time pursuant to the trust deed;

(v) the settlor's potential or actual receipt or use of principal if such potential or actual receipt or use of principal would be the result of a trustee acting:

A. in such trustee's discretion;

B. pursuant to a standard that governs the distribution of principal and does not confer upon the settlor a substantially unfettered right to the receipt or use of the principal; or

C. at the direction of a protector who is acting:

1. in such protector's discretion; or

2. pursuant to a standard that governs the distribution of principal and does not confer upon the settlor a substantially unfettered right to the receipt of or use of principal;

(vi) a settlor's potential or actual use of real property, chattels or tangible assets held either directly or indirectly in the trust;

(vii) the settlor's potential or actual receipt of income or principal to pay, in whole or in part, income taxes or other levies due on income or principal of the trust to any taxing authority located in any jurisdiction if such potential or actual receipt of income or principal is pursuant to a provision in the trust deed that expressly provides for the payment of such taxes and if such potential or actual receipt of income or principal would be the result of a trustee acting in such trustee's discretion or pursuant to a mandatory direction in the trust deed; or at the direction of a protector who is acting in such protector's discretion. Distributions to pay income taxes made under a discretionary or mandatory provision included in a settlement establishing an international trust may be made by direct payment to a taxing authority;

(e) the power to remove or appoint a trustee or protector;

(f) the power to direct a trustee or protector on any matter;

(g) except as provided in subsection (1)(h), an inter vivos or testamentary power of appointment (other than a power to appoint to the settlor, the settlor's creditors, the settlor's estate or the creditors of the settlor's estate) exercisable by will or other written instrument of the settlor;

(h) the ability, whether pursuant to discretion granted to the trustee, a direction in the trust deed or the settlor's exercise of a testamentary power of appointment, of a trustee to pay, after the death of the settlor, all or any part of the debts of the settlor outstanding at the settlor's death, the expenses of administering the settlor's estate, or any estate or inheritance tax or other levies imposed on or with respect to the settlor's estate; and

(i) the ability to serve as investment adviser to the trust.

(2) An international trust is not invalid even though the settlor may be the only beneficiary of the trust or the settlor is one of multiple beneficiaries. Except as provided in this Section, a settlor shall have no other rights or authority with respect to property held in an

international trust or the income therefrom, and any agreement or understanding purporting to grant or permit the retention of any greater rights or authority shall be void and of no effect."

The revisions broaden the circumstances where the validity of an international trust will be upheld. Thus, the settlor can retain various rights and/or benefits over the trust and from the income and/or principal of the trust and the terms of a trust deed can provide for an expanded array of powers to be granted to a protector.

O. Section 54 was amended to clarify that the Minister (as defined above) may establish an advisory body for matters affecting the Ordinance.

"**54. Power to establish the Nevis International Exempt Trust Ordinance Advisory Committee.**

(1) The Minister may establish an advisory body for matters affecting this Ordinance; and such body so established, shall consist of such members as the Minister may from time to time appoint.

(2) In establishing the body under sub-section (1) above, the Minister shall have regard to the desirability of having members who have the expertise and knowledge of the Ordinance and the law of trusts.

(3) It shall be the duty of the Nevis International Exempt Trust Ordinance Advisory Committee established under this section to:

(a) advise the Minister on any matter that the Nevis International Exempt Trust Ordinance Advisory Committee believes that the Minister should be aware of, on an annual basis by September 30th or on such more frequent occasions as may be necessary;

(b) provide recommendation regarding possible amendments to this Ordinance; and

(c) advise the Minister on any matter which is referred to it by the Minister.

(4) The Minister may defray or contribute towards the expenses of an advisory body established under this section."

P. Section 55 was amended to increase the amount of the bond required by a creditor before the creditor is permitted to bring an action governed by the Ordinance. The bond requirement was increased to Two Hundred Seventy Thousand Eastern Caribbean Dollars. The previous bond requirement was only One Hundred Thousand Eastern Caribbean Dollars. This increase was made to eliminate frivolous or nuisance claims against the trustees of international trusts. The bond requires that a creditor will pay the trustee's legal fees expended to defend and protect the assets held in a trust.

Q. Section 56 was amended in its entirety. A slight technical glitch was corrected in the language in Section 56(1).

"**56. Community property and tenancy by the entireties property**

(1) Where spouses transfer property to one or more trusts established under an international trust or a trust that subsequently becomes an international trust and, immediately before being transferred, such property or any part thereof or any accumulation thereto is, pursuant to the law of its location or the law of either of the transferring spouses' domicile or residence, determined to be community property, then notwithstanding such transfer and except where the provisions of the trust deed may provide to the contrary, that property and any accumulation thereto shall, for the purpose of giving effect to that law, be deemed to be community property and be dealt with in a manner consistent with that law but in every other respect shall be dealt with in accordance with the trust deed and the governing law of that deed."

A new Section 56(2) was added permitting married settlors of an international trust to establish a STET. Following funding the settlors' interest in such trust with tenancy by the entireties property, the underlying property of the international trust will remain tenancy by the entireties property.

"**(2)** Where spouses transfer property to one or more trusts established under an international trust or a trust that subsequently becomes an international trust and, immediately before such transfer, such property or any part thereof or any accumulation thereto was, pursuant to applicable law, owned by them as tenants by the entireties, then notwithstanding such transfer and except where the provisions of the trust deed may expressly provide to the contrary, that property and any accumulation thereto shall be tenancy by the entireties property while held in trust during the lifetime of both spouses and shall be dealt with in a manner consistent with that applicable law however in every other respect shall be dealt with in accordance with the terms of the trust deed. Furthermore, in any action concerning whether a creditor of either or both spouses may recover the debt from the trust, upon avoidance of the transfer, if at all, the sole remedy available to the creditor with respect to trust property that is tenancy by the entireties property shall be an order directing the trustee to transfer the property to both spouses as tenants by the entireties."

R. To download a complete version of the Nevis Act go to www.meridiannev.com.

VI. COOK ISLANDS TRUST LAW.

A. The law of the Cook Islands contains specific legislation permitting the establishment of a self-settled trust. The legislation in the Cook Islands contains all of the "bells and whistles" that a lawyer trained in the United States legal system should want included in a trust act of this type.

B. The act is referred to as the International Trusts Act 1984 (the "**Cook Islands Act**").

C. Subsection (1) of Section 13F of the Cook Islands Act contains a provision specifically recognizing the validity and enforceability of a spendthrift provision in the trust.

D. Subsection (g) of Section 13C of the Cooks Islands Act provides that a settlor may also be a beneficiary of the trust and the settlor's interest will not affect the validity of the trust. The settlor can be either the sole beneficiary of the trust or one of multiple beneficiaries.

E. Under Section 13C of the Cook Islands Act an international trust will not be declared invalid or otherwise be affected in any manner if the settlor retains, possesses or acquires (1) the power to revoke the trust; (2) the power to amend the trust; (3) any benefit, interest or property from the trust; (4) the power to remove or appoint a trustee or protector; and (5) the power to direct a trustee or protector on any matter. Further, Subsection (g) of Section 13C of the Cook Islands Act provides that an international trust is not invalid even though the settlor may be the only beneficiary of the trust or the settlor is one of multiple beneficiaries. Although the Cook Islands Act permits a settlor to retain the right to revoke and/or amend the trust, it is not recommended that the settlor retain such authority. Such a power might cause even a court in the United Kingdom to rule against the efficacy of such trust for asset protection purposes. See *e.g.*, *Fonu v. Merrill Lynch Bank and Trust Company (Cayman) Limited*, Privy Council Appeal No 0036 of 2010 (Lord Collins, June 2011); *JSC VTB Bank v. Skurikhin*, EWHC 2131 (Comm) (21 July 2015); *JSC Mezhdunarodniy Promyshlenniy Bank v. Pugachev*, EWCA Civ 139 (27 February 2015).

F. Section 2 of the Cook Islands Act defines the term "**International Trust**." Under this section an International Trust is a trust registered under the Cook Islands Act that has at least one trustee that is either a registered foreign company, an international company or a trustee company. Furthermore, all beneficiaries of the trust must be "**nonresident**." According to Section 2 of the Cook Islands Act, nonresident means an individual who is not domiciled in the Cook Islands and is not ordinarily resident in the Cook Islands.

G. The issue of what constitutes a fraudulent transfer is addressed in Section 13B of the Cook Islands Act.

1. The burden of proof is on the creditor.

2. The standard of proof is "**beyond a reasonable doubt**" (that is, the highest standard in a common law system).

3. A creditor must meet a **conjunctive** test to prove a transfer was fraudulent:

a. The creditor must prove that the trust was settled, established or disposed of by the settlor with the principal intent to defraud the particular creditor questioning the transfer; **and**

b. The creditor must prove that the transfer rendered the settlor insolvent or without assets that such creditor's claim (if successful) could have been satisfied.

Assuming a creditor is successful in proving a fraudulent transfer it is important to note that the trust is **not** void or voidable.

4. If immediately following the transfer of property to the trust the settlor retained property with a fair market value that exceeded the value of the creditor's claim, the transfer to the trust shall be deemed not to have been made with the principal intent of the settlor to defraud his creditor.

5. There is a two year-one year statute of limitations. A transfer to a trust is not fraudulent if settled, established or the disposition occurs after the expiration of two years from the date such creditor's cause of action accrued. (This time limit will not apply, however, in situations where a creditor has already commenced proceedings in respect of his cause of action.) Furthermore, a transfer to a trust is not fraudulent if settled, established or a disposition occurs before the expiration of two (2) years from the date that a creditor's cause of action accrued and that creditor fails to commence such action before the expiration of one (1) year from the date that such settlement, establishment or disposition occurs.

H. Under Section 13K of the Cook Islands Act, no action may be brought in the Cook Islands to set aside an international trust or a transfer to an international trust or to seek relief under Section 13B of the act (for fraudulent transfers) unless the action is brought within two (2) years of the date of the settlement or disposition.

I. Under Section 13D of the Cook Islands Act, foreign judgments against settlors, donors, trustees, protectors or beneficiaries of international trusts will not be recognized.

J. Section 14 of the Cook Islands Act provides that a trust established under the act must be registered with the Registrar of International Trusts within forty-five (45) days after it is established.

K. Section 23(1) of Cook Islands Act contains a privacy provision that mandates that matters related to an International Trust must kept confidential and not be disclosed. It provides:

> Except where the provisions of this Act require and subject to this section, it shall be an offence under this Act for a person to divulge or communicate to any other person information relating to the establishment, constitution, business undertaking or affairs of an international trust.

Section 23(2) of the Cook Islands Act contains limited exceptions to this privacy rule providing that it will not apply if disclosure is required or authorized by the "**Court**," is made to discharge any duty, perform any function or exercise any power under the Act or is required by a search warrant. (The term "Court" refers to the High Court of the Cook Islands. See Section 2 of the Cook Islands Act.)

Section 23(5) of the Cook Islands Act also contains a limited exception to this privacy rule permitting disclosure for administrative purposes and when the trustee needs to seek the advice of legal counsel in administering the trust.

Section 28 of the Cook Islands Act provides penalties for any person who violates this privacy rule, including the imposition of a fine not to exceed $10,000 or imprisonment for up to one (1) year.

L. Under Section 92 of the Judicature Act 1980-81 (Cook Islands) the court can mandate that an unsuccessful creditor who attacks an International Trust must pay the legal costs of the trust. Furthermore, under the Code of Civil Procedure in the Cook Islands a court can order a defendant to provide security for payment of the costs of an International Trust if the creditor is not successful in attacking the trust.

M. For a non law review level article on the Cook Islands as a trust jurisdiction, see Leslie Wayne, Cook Islands, a Paradise of Untouchable Assets, N.Y. TIMES, Dec. 14, 2013, available at http://www.nytimes.com/2013/12/15/business/international/paradise-of-untouchable-assets.html. For a discussion of Cook Islands law, see Patricia Donlevy-Rosen, "Offshore Trusts: Why They Work Well," LISI Asset Protection Planning Newsletter #306 (September 16, 2015) at http://www.leimbergservices.com.

N. To download a complete version of the Cook Islands Act go to www.asiaciti.com.

VII. BELIZE TRUST LAW.

A. The act is referred to as the Belize Trusts Act of 2000. The act was amended by the Trusts (Amendment) Act, 2007 (collectively the "**Belize Acts**").

B. Under Section 6 of the Belize Acts, the maximum duration of a non-charitable trust is 120 years from the date of the trust's creation and a trust shall terminate on the 120th anniversary of the date of the trust's creation. However, under Subsection (3) of Section 6, the rule against perpetuities shall not apply to any trust.

C. Under Section 7 of the Belize Acts, without any waiting period the Belizian Court cannot set aside a trust created under its laws, recognize any claim against the assets of the trust, or the order of a court of another jurisdiction respecting the trust, with regard to marriage, divorce, forced heirship, and creditor claims in the event of a settlor's insolvency. This applies notwithstanding Belizian fraudulent transfer laws, bankruptcy laws, and international reciprocity laws according to the Law of Property Act Section 149, the Belizian Bankruptcy Act Section 42 and the Belizian Reciprocal Enforcement of Judgments Act

D. Section 12 of the Belize Acts contains a provision specifically recognizing the validity and enforceability of a spendthrift provision in the trust.

E. Subsection (2) of Section 9, Part II of the Belize Acts provides that a settlor may also be a beneficiary, trustee or protector of the trust.

F. Part XA, Section 64 of the Belize Acts defines the term "**international trust**" or "**offshore trust**." Under this section an international trust or offshore trust means a trust where the settlor is not a resident in Belize, none of the beneficiaries are residents of Belize, the trust property does not include land situated in Belize, the trust is governed by the law of Belize and in the case of a purpose trust, the purpose or object of the trust is to be performed or pursued outside of Belize.

G. Under Subsection (1) of Section 149 of the Belize Law of Property Act, every transfer of property made, whether before or after the commencement of Section 149, with intent to defraud creditors, shall be voidable, at the instance of any person thereby prejudiced. There are two exceptions: the operation of a disentailing assurance, or the law of bankruptcy for the time being in force; and any estate or interest in property transferred for valuable consideration and in good faith or upon consideration and in good faith to any person not having, at the time of the transfer, notice of the intent to defraud creditors

H. Under Subsection (2) of Section 7 of the Belize Acts, a trust shall be invalid and unenforceable if:

1. (i) it purports to do anything contrary to the law of Belize; or

2. (ii) it purports to confer any right or power or impose any obligation the exercise of which or the carrying out of which is contrary to the law of Belize; or

3. (iii) it has no beneficiary identifiable or ascertainable (unless the trust was created for a valid charitable or non-charitable purpose).

I. Additionally under Subsection (2) of Section 7 of the Belize Acts, a trust shall be invalid and unenforceable to the extent that the Court declares that—

1. (i) the trust was established by duress, fraud, mistake, undue influence or misrepresentation; or

2. (ii) the trust is immoral or contrary to public policy; or

3. (iii) the terms of the trust are so uncertain that its performance is rendered impossible (provided that a charitable purpose shall be deemed always to be capable of performance); or

4. (iv) the settlor was, at the time of its creation, incapable under the law in force in Belize of creating such a trust.

J. Under Section 50 of the Belize Acts, a trustee who commits or concurs in a breach of trust is liable for any loss or depreciation in value of the trust property resulting from the breach and any profit which would have accrued to the trust had there been no breach. Where trustees are liable for a breach of trust, they are joint and severally liable.

K. However, under Section 54 of the Belize Acts, the court may relieve a trustee of liability for a breach of trust where it appears that the trustee acted honestly and reasonably and ought fairly to be excused for the breach of trust.

L. Under Section 55 of the Belize Acts, where a trustee commits a breach of trust at the instigation, at the request or with the concurrence of a beneficiary, the Court may impound all or part of his interest by way of indemnity to the trustee or any person claiming through him.

M. Under Section 56 of the Belize Acts, no period of limitation or prescription applies to an action brought against a trustee for the following: any fraud to which the trustee was a party or was privy; or to recover from the trustee trust property or the proceeds thereof: held by or vested in the trustee or otherwise in the trustee's possession or under his control; or previously received by the trustee and converted to the trustee's use.

N. Also under Section 56 of the Belize Acts, the period to bring an action founded on breach of trust may be brought against a trustee within **3** years from delivery of the final accounts of the trust or **3** years from the date on which the plaintiff first has knowledge of the breach of trust… whichever period begins first to run.

O. Under Section 65C of the Belize Acts, trusts registered in the "**International Trusts Registry**" shall not be open for public inspection except that the trustee or the trust agent of a trust may in writing authorize a person to inspect the entry of that trust on the Register.

P. Under Section 65D of the Belize Acts, where an international trust is duly registered, the trust shall be exempt from taxes and duties.

VIII. BERMUDA TRUST LAW.

A. Unlike the Cook Islands or Nevis, Bermuda's trust laws are not contained in one act. Laws governing Bermuda trusts are The Trusts (Special Provisions) Act 1989 (as amended by the 1998 and 2004 Amending Acts) (collectively the "**Bermuda Special Provisions Act**"); Perpetuities and Accumulations Act 1989 (as amended by the Perpetuities and Accumulations Act of 2009); Bankruptcy Act of 1989; Judgment (Reciprocal enforcements) 1976; Bermuda Conveyancing Act of 1983 and the Trustee Act (as amended by the 1999 Amending Act).

B. Under Section 2 of the Bermuda Special Provisions Act, the expressions "**trust**" and "**trustee**" extend to cases where the trustee has a beneficial interest in the trust property.

C. Section 12A of the Bermuda Special Provisions Act defines a **purpose trust** as a trust created for a non-charitable purpose or purposes provided that the following conditions are that the purpose or purposes are:

1. sufficiently certain to allow the trust to be carried out;

2. lawful; and

3. not contrary to public policy.

D. Under Section 11 of the Bermuda Special Provisions Act, a Bermuda trust shall not be varied or set aside (neither shall the capacity of any settlor be questioned nor shall any trustee, beneficiary or other person be subject to any liability or deprived of any rights) by reason that:

1. the law of any another jurisdiction prohibits or does not recognize the concept of a trust;

2. the trust or disposition avoids or defeats rights, claims or interests conferred by the law of another jurisdiction upon any person by reason of a personal relationship to the settlor or any beneficiary or by way of heirship rights; or

3. the trust or disposition avoids or defeats rights, claims or interests conferred by the law of another jurisdiction upon any person in respect of the protection of creditors in matters of insolvency.

E. Under Subsection (2) of Section 11 of the Bermuda Special Provisions Act, a foreign judgment shall not be recognized, enforced or give rise to any estoppels.

F. Section 12B of the Bermuda Special Provisions Act provides that the Supreme Court may make such order as it considers expedient for the enforcement of a purpose trust, provided that under subsection (3), the Supreme Court, with regards to costs incurred in connection with any application under Section 12B, may make such order as it considers just as to payment of any costs incurred.

G. The Perpetuities and Accumulations Act of 2009 repealed Section 12A(5) of the Trusts (Special Provisions) Act of 1989 (which applied the rule against perpetuities to a purpose trust). Under Section 3 of the Perpetuities and Accumulations Act of 2009, the rule against perpetuities applies to each of the estate or interests only to the extent that the property is *land* in Bermuda.

H. Under Subsection 1 of Section 22 of the Trustee Act, a trustee is not liable for loss except where arising through deliberate, reckless or negligent breach of an equitable duty.

I. Under Section 36A of the Conveyancing Act of 1983, a disposition means any disposition of property including the exercise of a power of appointment, any trust, gift, transfer, sale, exchange, etc; an **eligible creditor** is a person to whom

1. on, or within **two years after**, the material date the transferor owed an obligation and on the date of the action or proceeding to set aside the relevant disposition that obligation remains unsatisfied;

2. on the material date the transferor owed a contingent liability and since that date the contingency giving rise to the obligation has occurred and on the date of the action or proceeding to set aside the relevant disposition that obligation remains unsatisfied; or

3. on the date of the action or proceeding to set aside the relevant disposition, the transferor owes an obligation in consequence of a claim, made by that person against the transferor, arising from a cause of action which accrued prior to, or within two years after, the material date.

The "material date" means the date on which a relevant disposition is made.

The "obligation" means any obligation or liability, other than a contingent liability, to pay a sum of money or to transfer property.

Property includes money goods, things in action, land and every description of property wherever situated and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property.

Requisite intention means an intention of a transferor to make a disposition the dominant purpose of which is to put the property which is the subject of that disposition beyond the reach of a person or a class of persons who is making, or may at some time make, a claim against him.

J. Under Section 36C of the Conveyancing Act of 1983, every disposition of property made with the requisite intention and at an undervalue shall be voidable at the instance of an eligible creditor; where a person seeking to set aside a relevant disposition was not, on the material date, a person to whom an obligation was owed by the transferor, the Court shall not set aside that disposition unless the Court is satisfied that the person was, on the material date, reasonably foreseeable by the transferor as a person to whom an obligation might become owed by him.

K. Under Subsection (3) of Section 36C of the Conveyancing Act of 1983, no action or proceeding to set aside a disposition shall be commenced unless such action or proceeding is commenced:

1. in the case of an eligible creditor, within 6 years after the material date or within 6 years after the date when the obligation became owed, which is the later date;

2. in the case of an eligible creditor, within 6 years after the material date;

3. in the case of eligible creditor, within 6 years after the material date, or within 6 years after the date when the cause of action accrued, whichever is the later date.

L. Under Subsection (2) of Section 36(D) of the Conveyancing Act of 1983, the burden of proving that a transferee or any person through whom the transferee claims has not acted in good faith shall be upon the person making the allegation.

M. However, Section 36G of the Conveyancing Act of 1983 states that nothing in Section 36 shall be construed as creating or enable any right, claim or interest on behalf of a creditor or person which right, claim or interest would be avoided or defeated by Section 11 of the Bermuda Special Provisions Act.

N. The United States and Bermuda have a treaty providing for an exchange of information and assistance in collection issues against non-Bermuda residents with regard to both criminal and civil tax cases. *See* U.S. – Bermuda Income Tax Treaty 1986, art. 5; *see also* Agreement between the Government of the U.S.A. and the Government of Bermuda for Cooperation to Facilitate the Implementation of FATCA, Dec. 19, 2013, *available at* http://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-AgreementBermuda-12-19-2013.pdf (illustrating the intergovernmental agreement between the U.S. Treasury Department and Bermuda that will require financial institutions in Bermuda to report on the holdings of U.S. taxpayers to the IRS or face penalties).

IX. BAHAMAS TRUST LAW.

A. The act is referred to as the Trustee Act, 1998 (the "**Bahamian Act**").

B. Subsection i of Section 2 of the Bahamian Act provides that the term "trust" shall not include the duties incident to property subject to a mortgage but with this exception "trust" and "trustee" extend to implied, constructive and resulting trusts.

C. Subsection 1 of Section 3 of the Bahamian Act provides, however, that the retention, possession or acquisition by the settlor of any one or more powers and provisions referred to in subsection (2) of Section 3 shall not invalidate a trust or the trust instrument or cause a trust created inter vivos to be a testamentary trust or disposition or the trust instrument creating it to be a testamentary document, including:

1. power to revoke the trust or withdraw property from the trust;

2. powers of appointment or disposition over any of the trust property;

3. powers to amend the trust;

4. powers to appoint, add or remove trustees, protectors or beneficiaries;

5. powers to give directions to trustees in connection with said trustee's exercise of any of the trustee's powers or discretions;

6. any provisions requiring the consent of the settlor to any act or abstention of trustees;

7. the appointment of the settlor as protector of the trust;

8. any beneficial interests of the settlor; and

9. any interests of the settlor in any companies or assets underlying the trust property.

D. Subsection 1 of Section 40 of the Bahamian Act provides that it shall be lawful for an instrument or disposition to provide that any estate or interest in any property given or to be given to any individual as a beneficiary shall not during the life of the beneficiary, or such lesser period as may be specified in the instrument or disposition, be alienated or pass by bankruptcy, insolvency or liquidation or be liable to be seized, sold, attached, or taken in execution by process of law and where so provided such provision shall take effect accordingly. However, Subsection 5 of Section of the Bahamian Act provides that Subsection 1 does **not** apply to the settlor nor to any other person donating property to a Bahamian trust.

Subsection 5 of Section 40 of the Bahamian Act, taken in conjunction, with Subsection 1 of Section 3 and Subsection i of Section 2, indicate that although a settlor may be a beneficiary of a Bahamian trust, said settlor may not benefit from a spendthrift provision of such Bahamian

Trust. See Rothschild & Rubin, *Asset Protection Planning*, BNA EST. GIFT & T. PORT. 810-3d at §VII, B.5 (2013).

E. Subsection 7 of Section 83 of the Bahamian Act provides that when disclosing any documents or information to any beneficiary or other person the trustees shall, if other beneficiaries have requested confidentiality or if the trustees in their absolute discretion determine confidentiality to be in the best interest of such other beneficiaries, take all reasonable steps to secure the right to confidentiality of the other beneficiaries by providing such beneficiary or other person only with such documents or information as shall enable that beneficiary's own true entitlement and actual interest or benefits under the trust to be determined.

F. In addition, Subsection 8 of Section 83 provides that trustees shall not be bound or compelled by any process of discovery or inspection or under any equitable rule or principle to disclose or produce to any beneficiary or other person any of the following documents:

1. any memorandum or letter of wishes issued by the settlor or any other person to the trustees, or any other document recording any wishes of the settlor;

2. any document disclosing any deliberations of the trustees as to the manner in which the trustees should exercise any discretion of theirs or disclosing the reasons for any particular exercise of any such discretion or the material upon which such reasons were or might have been based; or

3. any other document relating to the exercise or proposed exercise of any discretion of the trustees (including legal advice obtained by them in connection with the exercise by them of any discretion).

G. Section 93 of the Bahamian Act exempts non-Bahamian trust beneficiaries from taxes, including income tax, capital gains tax, estate tax, or inheritance tax.

H. Section 94 of the Bahamian Act exempts trusts and other deeds executed by the trustees, settlors, beneficiaries or protectors of a trust from registration under the provisions of the Bahamian Registration of Records Act.

I. Section/Subsection 16 of Section 90 (First Schedule) of the Bahamian Act provides that the trustees of a Bahamian trust shall not be required to give a bond or security for the administration of a "Trust Fund" or for the discharge of a Bahamian trust.

J. Under Section 5 of the Trusts (Choice of Governing Law) Act of 1989, a Bahamian trust may be moved from the jurisdiction of the Bahamas or moved to the jurisdiction of the Bahamas; the governing law being Bahamas (moving to) or the law of the new jurisdiction (moving from).

K. Under Section 8 of the Trusts (Choice of Governing Law) Act of 1989, no trust governed by Bahamian law and no disposition of property to be held by a Bahamian trust shall is void, voidable, liable to be set aside or defective in any manner by reference to a foreign

law; nor is the capacity of any settlor to be questioned nor is the trustee or any beneficiary or any other person to be subjected to any liability or deprived of any right by reason that:

1. the laws of any foreign jurisdiction prohibit or do not recognize the concept of a trust; or

2. the trust or disposition avoids or defeats rights, claims or interest conferred by foreign law upon any person by reason of a personal relationship to the settlor or by way of heirship rights or contravenes any rule of foreign law or any foreign, judicial or administrative order or action intended to recognize, protect, enforce or give affect to any such rights, claims or interest.

L. Under Section 4 of the Bahamian Fraudulent Disposition Act of 1991, a 2 year statute of limitations is placed on the commencement of any action related to a fraudulent transfer. The burden of establishing a settlor's fraudulent intent is on the creditor seeking to set aside the transfer.

M. Under Section 6 of the Bahamian Perpetuities Act of 1995 and Section 2 of the Perpetuities Act of 2004, trusts are limited in duration to a period measured by the lives of persons alive at the time when the perpetuity period beings to run, plus 21 years or, alternatively, a period of years not to exceed 150 years. f

N. Note that the Bahamas has entered into mutual assistance agreements regarding disclosure of information in connection with suspected criminal activities, including a tax information exchange with the United States. See *Agreement for the Provision of Information with Respect to Taxes*, U.S.-Bah., Jan. 25, 2002, *available at* http://www.oecd.org/unitedstates/35514646.pdf.

X. DELAWARE LAW.

A. Delaware permits residents and non-residents to create wealth protection trusts under its "**Qualified Dispositions in Trust Act**" (the "**QDTA**"). See Subchapter VI of Chapter 35 of Part V of Title 12 of the Delaware Code.

B. According to the QDTA, a "**qualified disposition**" is a disposition by a donor to one or more "**qualified trustees**" through the use of a "**trust instrument**." QDTA §3570(6). The disposition can be made *with or without* consideration. *Id*. Under §3570(4) of the QDTA a "**disposition**" is:

1. a transfer, conveyance or assignment of "**property**" (that includes a change in legal ownership of property that occurs if a trustee is substituted for another trustee or one or more new trustees are added); or

2. the exercise of a power that causes a transfer of property to one or more trustees.

Nevertheless, the term disposition does not include the release or relinquishment of an interest in property that was previously the subject of a qualified disposition. *Id*.

C. Under §3570(5) of the QDTA, the term "**property**" means and includes real property, personal property, and interests in either.

D. Under §3570(8) of the QDTA, a "**transferor**" is any "**person**" who as:

1. an owner of property;

2. as a holder of a power of appointment that authorizes the donee of the power to appoint property subject to the power in his or her favor, to his or her creditors, to his or her estate or to the creditors of his or her estate; or

3. as a trustee -

directly or indirectly makes or causes a disposition to be made.

E. Under §3570(9) of the QDTA, the term "**qualified trustee**" means:

1. an individual who is a resident of Delaware (except for a transferor); or

2. a person who is authorized under the law of Delaware to act as a trustee if such person's activities are subject to supervision by the Delaware Bank Commissioner ("**DBC**"), the Federal Deposit Insurance Corporation ("**FDIC**"), the Comptroller of the Currency ("**CC**"), or the Office of Thrift Supervision ("**OTS**").

Furthermore, to be a qualified trustee the foregoing individual or person *must maintain or arrange for the custody of some or all of the property that is the subject of a qualified disposition in Delaware, maintain records for the trust on an exclusive or nonexclusive basis, prepare or arrange for the preparation of fiduciary income tax returns for the trust, or otherwise materially participate in the administration of the trust*.

F. Under §3570(9) of the QDTA, neither the donor, any individual who is not a resident of Delaware, nor any entity that is not authorized under Delaware law to act as a trustee or whose activities are not supervised by the DBC, the FDIC, the CC, or the OTS can be considered a qualified trustee. Nonetheless, §3570(9) of the QDTA specifically permits a donor to appoint one or more advisers for the donor's Delaware wealth protection trust who:

1. can remove and appoint qualified trustees and trust advisors;

2. can direct the trustee to make distributions from the trust;

3. must consent to or approve any distributions made by the trustee from the trust; and

4. direct the investment decisions of the trust. (For this purpose, an investment decision includes the power to direct a trustee to retain, purchase, sell or exchange property held in the trust or to engage in any other transaction affecting the ownership or rights over such property. See §3313(d) of the Del. Code.)

G. The term "**adviser**" encompasses a "**trust protector**" or any other person who is given one or more trust powers. QDTA §3570(8).

H. If a trustee ceases to qualify as a qualified trustee, such trustee is deemed to have resigned at that time and is replaced with a successor trustee appointed in the trust instrument or by court order. *Id*.

I. The QDTA also permits a donor-settlor to appoint one or more trustees of a Delaware wealth protection trust who are not qualified trustees. *Id*.

J. Under §3570(10), the term "**trust instrument**" refers to an agreement that appoints one or more qualified trustees to hold property that is the subject of a qualified disposition. The agreement must:

1. expressly incorporate Delaware law to govern the validity, construction and administration of the trust;

2. be irrevocable. *Id*.;

3. provide that the interest of a donor-settlor or other beneficiary in the trust income and assets may not be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily, before it is actually distributed by a qualified trustee to a beneficiary. *Id*. The QDTA specifically provides that such a spendthrift provision in a trust agreement is deemed a restriction on the transfer of the donor-settlor's beneficial interest in the trust that is enforceable under applicable nonbankruptcy law (within the meaning of § 541(c)(2) of the Bankruptcy Code). *Id*.

K. A trust instrument (or agreement) is considered irrevocable under §3570(10)b. of the QDTA even though it includes one or more of the following provisions:

1. a provision permitting the donor-settlor to veto a distribution from the trust;

2. a provision providing that the donor-settlor retains a power of appointment exercisable by will or other written instrument, *however, the power can be effective only upon the donor-settlor's death*. Furthermore, the power of appointment cannot be exercisable by the donor-settlor in his or her favor or in favor of his or her creditors, his or her estate or the creditors of his or her estate;

3. a provision permitting a donor-settlor's potential or actual receipt of trust income, *including a retained right to receive such income*;

4. a provision permitting a donor-settlor's potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust (as such trusts are defined in §664 of the Code);

5. a provision permitting a donor-settlor's potential or actual receipt of income or principal from a grantor-retained annuity trust or grantor-retained unitrust as defined

in §2702 of the Code or the donor-settlor's receipt each year of no greater than five percent (5%) of the initial value of the trust or its value determined from time to time under the trust agreement;

6. a provision permitting a donor-settlor's potential or actual receipt or use of trust assets if such would be the result of a qualified trustee acting in its own discretion; pursuant to a standard governing such distribution that does not confer upon the donor-settlor a substantially unfettered right to the receipt or use of the principal; or is at the direction of an advisor (see paragraph G above);

7. a provision permitting a donor-settlor to remove a trustee or adviser and appoint a successor or replacement trustee or adviser, except such successor or replacement trustee must be a person who is not related or subordinate to the donor-settlor (within the meaning of §672(c) of the Code;

8. a provision permitting a donor-settlor to potentially or actually use a residence held in a qualified personal residence trust (within the meaning of §2702(c) of the Code);

9. a provision providing for the transferor's potential or actual receipt of income or principal to pay, in whole or in part, income taxes due on income of the trust if such potential or actual receipt of income or principal is pursuant to a provision in the trust instrument that provides for the payment of such taxes and if such potential or actual receipt of income or principal would be the result of the exercise of a qualified trustee's discretion, pursuant to a mandatory direction in the trust instrument or qualified trustee acting at the direction of an adviser or trust protector; and

10. a provision giving a qualified trustee the ability, whether pursuant to discretion, direction or the grantor's exercise of a testamentary power of appointment, to pay, after the death of the transferor, all or any portion of the debts of the transferor outstanding at the transferor's death, the expenses of administering the transferor's estate, or any estate or inheritance tax imposed on or with respect to the transferor's estate.

L. Under § 302 of the Delaware Code, the term "**person**" includes an individual, a corporation, company, association, firm, partnership, society or joint-stock company. Under this definition it should be possible for a business entity to establish a wealth protection trust under the QDTA.

M. Under § 3571 of the QDTA, a donor-settlor has no right or authority with respect to assets that are the subject of a qualified disposition and any agreement or understanding that purports to grant or permit the retention of any greater rights or authority is void. The foregoing does not prevent the donor from retaining the right to veto distributions from a Delaware wealth protection trust or from serving as an investment advisor to the trust. Additionally, a qualified disposition is subject to § 3572 of the QDTA although a transferor retains any or all of the powers and rights described in § 3570(11)b. of the QDTA and a transferor serves as investment adviser pursuant.

N. The provisions of the QDTA do not apply to any person to whom a donor-settlor owes a debt because of an agreement or a court order for the payment of support or alimony to such donor's spouse, former spouse or children, or for a division or distribution of property in favor of a donor-settlor's spouse or former spouse (but only to the extent of such debt). QDTA § 3573(1). Furthermore, the provisions of the QDTA do not apply to any person who suffers death, personal injury or property damage on or before the date of a qualified disposition by a donor-settlor if such death, injury or damage is at anytime determined to have been caused in whole or in part by the actions or an omission of either a donor-settlor or another person for whom a donor is or was vicariously liable (but only to the extent of such claim). QDTA § 3573(2). Notwithstanding the foregoing, the provisions of § 3573 of the QDTA do not apply to a claim for forced heirship or legitime.

O. 1. No type of action, including an action to enforce a judgment entered by a court or other adjudicative authority, may be filed at law or in equity for attachment or any other remedy against any asset that is the subject of a qualified disposition unless such action is filed pursuant to Delaware's fraudulent transfer laws set forth in §§1304 and 1305 of Title 6 of the Delaware Code and, in the case of a creditor whose claim originated after a qualified disposition, unless the qualified disposition was made with actual intent to ***defraud*** such creditor. QDTA §3572(a). This includes an action to avoid a qualified disposition. *Id*. The Delaware Court of Chancery is vested with exclusive jurisdiction over any such action. *Id*. With respect to claims that originated after a qualified disposition, the exception under the original statutory language included transfers that would *hinder* or *delay* a creditor.

2. Pursuant to §3572(b) of the QDTA a creditor's claim is extinguished unless it accrued:

a. prior to the qualified disposition and the action is filed within the period set forth in §1309 of Title 6 of the Delaware Code to avoid fraudulent transfers, that is, within four (4) years after the transfer or the obligation was incurred.

b. concurrently or subsequently to the qualified disposition and the action is filed within four (4) years after the qualified disposition, despite the provisions of §1309 of Title 6 of the Delaware Code.

3. In any action filed under §3572(a) of the QDTA the burden of proof is on the creditor who must prove his, her or its case **by clear and convincing evidence**.

4. If the situs of a wealth protection trust in another jurisdiction is moved to Delaware, for purposes of the Delaware fraudulent transfer rule the transfer will be considered made when assets were originally transferred to such trust. QDTA §3572(c).

5. A creditor's rights with respect to a qualified disposition are limited to the rights granted under §§3572, 3573 and 3574 of the QDTA. Furthermore, a creditor has no claim or cause of action against:

a. a trustee or trust advisor of a trust that is the subject of a qualified disposition. *Id*.

b. any person who counsels, drafts, prepares or assists with the execution or funding of a trust that is the subject of a qualified disposition. *Id*.

6. Additionally, all actions involving a qualified disposition to a trust are barred unless filed against a trustee, advisor or any other person involved with counseling, drafting, preparing, executing or funding the trust within the period permitted under §3572 of the QDTA.

7. Delaware appears to have its own statutory version of a duress provision. See §3572(g) of the QDTA, providing:

> If, in any action brought against a trustee of a trust that is the result of a qualified disposition, a court takes any action whereby such court declines to apply the law of this State in determining the validity, construction or administration of such trust, or the effect of a spendthrift provision thereof, such trustee shall immediately upon such court's action and without the further order of any court, cease in all respects to be trustee of such trust and a successor trustee shall thereupon succeed as trustee in accordance with the terms of the trust instrument or, if the trust instrument does not provide for a successor trustee and the trust would otherwise be without a trustee, the Court of Chancery, upon the application of any beneficiary of such trust, shall appoint a successor trustee upon such terms and conditions as it determines to be consistent with the purposes of such trust and this statute. Upon such trustee's ceasing to be trustee, such trustee shall have no power or authority other than to convey the trust property to the successor trustee named in the trust instrument in accordance with this section.

P. 1. Section 3574(a) of the QDTA provides that a qualified disposition will be avoided only to the extent necessary to satisfy a donor-settlor's debt to a creditor (plus any costs, including legal fees, permitted by a court) who successfully filed an action to have the qualified disposition avoided.

2. If a qualified disposition is avoided under §3574(a) of the QDTA and a court concludes that a qualified trustee did not act in bad faith in accepting or administering property that is the subject of the qualified disposition, such trustee will be given a first lien against the property that is the subject of the qualified disposition equal to the amount of the costs (including attorneys' fees) properly incurred in defending the action or proceedings to avoid the qualified disposition. Furthermore, the disposition will be avoided subject to the proper fees, costs, preexisting rights, claims and interests of the qualified trustee (and any predecessor qualified trustee that did not act in bad faith). Under §3574 of the QDTA it is presumed that a qualified trustee did not act in bad faith by merely accepting property that is the subject of a qualified disposition.

3. If a qualified disposition is avoided under §3574(a) of the QDTA and a court determines that a beneficiary of a trust did not act in bad faith, the beneficiary will be permitted to retain any distribution received by him, her or it as a result of the exercise of discretion granted to the qualified trustee provided such power or discretion was properly

exercised before the creditor commenced an action to avoid the qualified disposition. Under §3574 of the QDTA it is presumed that a beneficiary (including a donor-settlor) did not act in bad faith in settling the trust or accepting a distribution permitted by the trust.

Q. When two spouses make a qualified disposition of property and, immediately before such qualified disposition, such property or any part thereof or any accumulation thereto was, pursuant to applicable law, owned by them as tenants by the entireties, then notwithstanding such qualified disposition and except where the provisions of the trust instrument may expressly provide to the contrary, that property and any accumulation thereto shall, while held in trust during the lifetime of both spouses, be treated as though it were tenancy by the entireties property and be dealt with in a manner consistent with that applicable law but in every other respect shall be dealt with in accordance with the terms of the trust instrument. Furthermore, in any action concerning whether a creditor of either or both spouses may recover the debt from the trust, upon avoidance of the qualified disposition, **the sole remedy available to the creditor with respect to the trust property treated as though it were tenancy by the entireties property shall be an order directing the trustee to transfer the property to both spouses as tenants by the entireties**. QDTA § 3574(f).

Delaware also has two statutes that appear to provide substantial flexibility in dealing with tenancy by the entireties property ("**T by E**") in the context of asset protection planning. Florida law and the law of several other states recognize tenancy by the entireties. See *e.g.*, *Estate of Berlin v. Pecora*, 968 So.2d 47 (Fla. 4th D.C.A. 2007); *In re McRae*, 282 B.R. 704 (2002); *In re Koesling*, 210 B.R. 487 (1997); and *Amsouth Bank of Florida v. Hepner*, 647 So.2d 907 (Fla. 1st D.C.A. 1994). T by E is a form of ownership that can only exist between two individuals who are married to each other. *Id*. Although the rules relating to T by E property can vary greatly between the states that recognize it as a form of ownership, generally property owned in T by E cannot be reached to satisfy the claims of a creditor of only one spouse. See *e.g.*, *Beal Bank, SSB v. Almand and Associates*, 780 So.2d 45 (Fla. 2001); *Neu v. Andrews*, 528 So. 2d 1278 (Fla. 4th D.C.A. 1988); and *Winters v. Parks*, 91 So.2d 649 (Fla. 1956). Every state that recognizes T by E as a form of ownership permits real estate (or certain types of real estate, *e.g.*, a homestead) to be owned by married individuals in T by E. A few of the states that recognize T by E as a form of ownership, however, such as Delaware, Florida, Michigan and Pennsylvania, also permit ownership of personal property in T by E. See *e.g.*, *Cohen v. Mathews*, 307 Fed. Appx. 266, (11th Cir. 2009); *Estate of Berlin v. Pecora*, 968 So.2d 47 (Fla. 4th D.C.A. 2007); *In re McAnany*, 294 B.R. 406 (Bankr. M.D. Fla. 2003); *Beal Bank, SSB v. Almand and Associates*, 780 So.2d 45 (Fla. 2001); *Cacciatore v. Fisherman's Wharf Realty Ltd. Partnership ex rel. Emalfarb Investment Corp.*, 821 So.2d 1251 (Fla. D.C.A. 2002); *In re Bundy*, 235 B.R. 110 (Bankr. M.D. Fla. 1999); *In re Campbell*, 214 B.R. 411 (Bankr. M.D. Fla. 1997); *Lapp v. U.S.*, 316 F. Supp. 386 (S.D. Fla. 1970); *Bailey v. Smith*, 89 Fla. 303, 103 So. 833 (1925); *Winters v. Parks*, 91 So.2d 649 (Fla. 1956); *Lauderdale v. Lauderdale*, 96 So.2d 663 (Fla. 3rd D.C.A. 1957); *Anderson v. Carter*, 100 So.2d 831 (Fla. 2nd D.C.A. 1958); *Lacker v. Zuern*, 109 So.2d 180 (Fla. 2nd D.C.A.1959); *Tingle v. Hornsby*, 111 So.2d 274 (Fla. 1st D.C.A. 1959); *Lacker v. Zuern*, 109 So.2d 180 (Fla. 2nd D.C.A. 1959); *Lerner v. Lerner*, 113 So.2d 212 (Fla. 2nd D.C.A. 1959); *Crawford v. U.S. Fidelity & Guaranty Co.*, 139 So.2d 500 (Fla. 1st D.C.A. 1962); *Colclazier v. Colclazier*, 89 So.2d 261 (Fla. 1956); and *Doing v. Riley*, 176 F.2d 449 (5th Cir. 1949).

In many instances Jonathan E. Gopman has met and advise a number of married couples who were resident or owned property in states that recognize T by E as a form of ownership. The conversation in many of these meetings included an extensive discussion of the fundamental principles of ownership of property in T by E. The discussion also included the potential pitfalls of continuing to own property in T by E and relying on this form of ownership as an asset protection strategy. Although the unexpected loss of the protection provided by ownership of property in T by E could be disastrous, for example, as the result of an untimely death, many of these couples desired to continue to use T by E as their primary asset protection strategy. Often, only one spouse would resist the changes we would recommend in structuring the ownership of assets held in T by E, however, the reasons these couples provided for not doing the planning varied in many cases.

As an asset protection strategy T by E has its limitations and it is important for planners to understand these limitations. The limitations include the following:

1. Divorce severs the T by E estate.

2. Death severs the T by E estate. See *e.g.*, *Estate of Berlin v. Pecora*, 968 So.2d 47 (Fla. 4th D.C.A. 2007); *Cacciatore v. Fisherman's Wharf Realty Ltd. P'ship*, 821 So.2d 1251 (Fla. 4th D.C.A. 2002); *Colclazier v. Colclazier*, 89 So.2d 261 (Fla. 1956); *Baumgardner v. Kennedy*, 343 So.2d 1323 (Fla. 3rd D.C.A. 1977); *Menendez v. Rodriguez*, 106 Fla. 214, 143 So. 223 (1932); *Knapp v. Fredricksen*, 148 Fla. 311, 4 So. 2d 251 (1941); *Bamber v. Bamber*, 216 So.2d 806 (Fla. 3rd D.C.A. 1968); *Bendl v. Bendl*, 246 So.2d 574 (Fla. 3rd D.C.A. 1971); *Anderson v. Trueman*, 100 Fla. 727, 130 So. 12 (1930); *Logan Moore Lumber Co. v. Legato*, 100 Fla. 1451, 131 So. 381 (1930); and *Winters v. Parks*, 91 So.2d 649 (Fla. 1956). No one can predict when another individual might die. An unexpected death could lead to disastrous results for an asset protection plan that relies on property continuing to be owned in T by E property.

3. In *U.S. v. Craft*, 122 S.Ct. 1414 (2002), the Service successfully argued that T by E does not protect an interest in T by E property of a debtor-spouse from a Federal tax lien under § 6321 of the Code. (See also, *Howard D. Popky et ux. v. United States*) (No. 04-2798) (United States Court of Appeals for the Third Circuit) and *U.S. v. Hatchett*, 330 F.3d 875 (6th Cir. 2003). Thus, case law in both Federal and state court can have a profound and unexpected effect on the ability of T by E to protect wealth. But see *U.S. v. Adent*, 821 F.3d 911 (2d Cir. 2016) (describing some of the factors in avoiding a forced sale for property owned as joint tenancy with right of survivorship). Chuck Rubin's, "*US v. Adent*: Jointly Owned Property and IRS Liens and Foreclosures," **LISI** Estate Planning Newsletter #97 (July 25, 2016) at http://www.leimbergservices.com provides a brief but thorough discussion of the considerations at stake in *Adent.*

While estate planners could offer advice to clients regarding the use of strategies to "hedge" against all of the foregoing risks, in many instances the use of such strategies will prove impractical, costly or unworkable for clients. For example, one such strategy might include the spouse which has little risk of incurring significant liability (that is, the low risk spouse or "**LRS**"), if any, establishing an irrevocable life insurance trust ("**ILIT**") that could hold life insurance with a face value that approximated the value of the T by E property that

could be lost to creditors if the LRS died unexpectedly. In such a case, the spouse with a greater likelihood of incurring significant liability (that is, the high risk spouse or the "**HRS**") would be a discretionary beneficiary of the ILIT. If the ILIT is drafted properly, there would be little or no risk of a creditor of the HRS ever reaching the trust assets in satisfaction of a judgment against the HRS.

Another example of a strategy to deal with the potential problems of T by E ownership as an asset protection strategy would be to advise the HRS to transfer such spouse's interest in such property to the LRS. In this case the LRS could revise such spouse's estate plan to ensure that should the HRS survive all of this property would pass for the benefit of the HRS through trust arrangements designed to maximize the protection of such wealth. Alternatively, the LRS could take such spouse's interest in this property and contribute it to a properly structured wealth protection trust arrangement. To ensure full use of the Federal estate tax exemption (when the estate tax is effective) the LRS might consider establishing a QTIP trust for the benefit of the HRS. Of course, this might subject all or a portion of the mandatory income stream to seizure by the creditors of the HRS.

In many instances the foregoing solutions to the potential creditor protection problems of owning property T by E are not acceptable to one or both spouses. For example, the cost of insurance might be expensive, one spouse might be concerned that transferring ownership of such spouse's interest to the other spouse could be the impetus for a surprise divorce or the other spouse might not be cooperative with further planning with the property after such spouse is given full ownership.

Through an idea propounded by Jonathan E. Gopman and the efforts of Thomas R. Pulsifer, an attorney with Morris, Nichols, Arsht & Tunnell LLP in Wilmington, Delaware, Delaware law now provides an additional and perhaps more flexible solution to this problem. Delaware provides this new strategy through an innovative type of trust known as a statutory tenancy by the entireties trust (or a "**STET**"). The statutes authorizing a STET are set forth in the Delaware Qualified Dispositions in Trust Act, 12 Del. C. § 3574(f) for T by E property contributed to an asset protection trust and in § 3334 of Delaware's general trust laws, 12 Del. C. § 3334, for T by E property contributed to a revocable trust. Both statutes became effective on August 1, 2010. Section 3574(f) provides:

> Where a husband and wife make a qualified disposition of property to 1 or more trusts and, immediately before such qualified disposition, such property or any part thereof or any accumulation thereto was, pursuant to applicable law, owned by them as tenants by the entireties, then notwithstanding such qualified disposition and except where the provisions of the trust instrument may expressly provide to the contrary, that property and any accumulation thereto shall, while held in trust during the lifetime of both spouses, be treated as though it were tenancy by the entireties property to the extent that, in any action concerning whether a creditor of either or both spouses may recover the debt from the trust, upon avoidance of the qualified disposition, the sole remedy available to the creditor with respect to trust property that is treated as though it were tenancy by the entireties property shall be an order directing the trustee to transfer the property to both spouses as tenants by the entireties.

Section 3334 of the Delaware Code provides substantially similar rules regarding creditor rights with respect to T by E property contributed to a revocable trust.

The Delaware Civil Union and Equality Act of 2011 (the "**2011 Act**"), codified in Title 13, Chapter 2 of the Delaware Code, provides that parties to a civil union shall have the same rights, protections and benefits under Delaware law that are provided to spouses in a traditional marriage. Under the 2011 Act, a party to a civil union is included in any definition or use of the terms "husband and wife," "spouse," "tenants by the entireties" and any other terms that denote a spousal relationship as these terms are used throughout the Delaware Code or in judicial decisions Furthermore, the 2011 Act provides that a same-sex union validly formed under the laws of another jurisdiction shall be recognized as a validly established civil union for all purposes under Delaware law.

Additionally, the Civil Marriage Equality and Religious Freedom Act of 2013 (the "**2013 Act**"), signed into law on May 7, 2013 and effective as of July 1, 2013, (i) legalizes same-sex marriage in Delaware, (ii) gives parties to an existing civil union the ability to convert the civil union to a marriage by petition, (iii) provides that same-sex unions formed under the laws of another jurisdiction shall be recognized for all purposes under Delaware law as a marriage, (iv) provides that all laws of Delaware applicable to married couples shall apply equally to same gender married couples and (v) stipulates that on July 1, 2014 all remaining Delaware civil unions will automatically convert to marriages.

As a result of the 2011 Act and the 2013 Act, a Delaware STET is an asset protection option for not only parties to a civil union and same-sex married couples in Delaware, but also parties to same-sex unions and same-sex marriages performed in other jurisdictions.

The STET provides an additional weapon in an estate planner's arsenal to deal with the pitfalls of T by E ownership as an asset protection strategy. Of course, the client must be domiciled or own property in a jurisdiction that recognizes T by E as a form of ownership and also recognizes it in regards to the ownership of personal property. Furthermore, in the jurisdictions that recognize this extended form of T by E ownership such as Florida, it should be possible to use a STET even though there is an existing creditor with a claim or a judgment against one spouse. This is because the Uniform Fraudulent Transfer Act ("**UFTA**") specifically exempts the transfer of property held in T by E that cannot be reached by a creditor of only one spouse from the application of the fraudulent transfer rules. UFTA provides that "[a]n interest in property that is owned in tenancy by the entireties to the extent such property is not subject to process by a creditor who possesses a claim against only one tenant" is not subject to the application of the statute. For additional analysis of the STET see Ruben & Gopman, "The Delaware Statutory Tenancy by the Entireties Trust: Potentially Powerful Asset Protection for Couples Across the Country," LISI Asset Protection Planning Newsletter #233 (December 19, 2013); Gopman, "STET: Delaware Introduces New Asset Protection Trust for Tenancy by the Entireties Property," LISI Asset Protection Planning Newsletter #161 (September 8, 2010).

R. Delaware had a test case pending in its system, that is, *Parrott v. Sasaki*, Del. Ch., C.A. No. 7227-VCL (Filed Feb. 7, 2012). The case settled rather quickly and favorably for the creditor accomplishing no cognizable benefit to the grantor. The trust was arguably

detrimental to the debtor in this case. In *Parrott*, a creditor filed suit against a defendant who was the grantor of a Delaware asset protection trust ("**APT**") alleging the fraudulent transfer of assets to the trust. Unfortunately, *Parrott* did serve as the initial test case regarding the efficacy of using a domestic APT in an asset protection plan because it settled so quickly. Nevertheless, it did offer some valuable lessons to those counseling clients to form domestic asset protection trusts. The APT in *Parrott* was being attacked under the fraudulent transfer rules by potential creditors who had not yet secured a judgment against the grantor-defendant in a case pending New York state court.

Timothy Parrott and Bradley Reifler (collectively, the "**Plaintiffs**") filed suit in a Delaware state court against Peter G. Sasaki ("**Sasaki**"), the grantor of the APT, Edward A. Renn ("**Renn**"), the independent trustee of the APT, and Wilmington Fund Savings Bank, FSB ("**Wilmington**"), the administrative trustee of the trust. (Sasaki, Renn and Wilmington are collectively referred to herein as the "**Defendants**"). The Delaware action was filed in an effort to remediate alleged fraudulent transfers of assets from Sasaki's limited liability companies, Logos Capital Management, LLC and Quix Partners, LLC (collectively, the "**LLCs**") to Sasaki and thereafter to the APT.

Prior to initiating the suit in Delaware, the Plaintiffs sued Sasaki and the LLCs in New York state court for breach of contract, anticipatory repudiation, and breach of implied covenant of good faith and fair dealing. According to the complaint, the Plaintiffs agreed to raise funds for the LLCs in exchange for interests in the LLCs. The Plaintiffs allege that such funds were raised, however, Sasaki refused to recognize the Plaintiffs' interest in the LLCs. When the Plaintiffs attempted to sell their interests in the LLCs, Sasaki allegedly threatened to terminate the LLCs and liquidate each company. Thereafter, the Plaintiffs commenced an action in New York state court and alleged that Sasaki purportedly caused the LLCs to distribute approximately $9 million to him. Such distributions were labeled as "partner distributions." The Plaintiffs allege that they were entitled to receive 20% of those distributions if Sasaki had properly recognized their interests in the LLCs in accordance with their agreements.

During the course of the litigation in New York, Sasaki retained Renn and his law firm, Withers Bergman, to assist him in establishing and funding the APT. Sasaki was the grantor of the APT and was also included in the class of trust beneficiaries together with his spouse and his grandparents' descendants. Renn was appointed as the initial independent trustee of the APT and Christiana Bank & Trust Company (which was subsequently acquired by Wilmington) was appointed as the initial administrative trustee to provide the proper nexus with Delaware so as to comply with the Qualified Dispositions in Trusts Act ("**QDTA**"), Delaware's asset protection trust statutory regime. Sasaki's mother was appointed as the initial trust protector. As trust protector she was given the power to remove and replace the independent trustee and the administrative trustee.

The complaint alleged that Sasaki transferred all or part of the approximately $9 million he received as "partner distributions" from the LLCs to the APT. In the case pending in New York, Sasaki's litigation counsel apparently represented to the Plaintiffs that Sasaki had no ability to pay the judgment if the Plaintiffs were successful with their lawsuit in obtaining a judgment against Sasaki for the full amount possible. (The action in New York sought

"millions of dollars in damages.") During the course of pre-trial discovery the Plaintiffs became aware of the existence of the APT. Sasaki claimed that the assets in the APT were not within his control.

The Plaintiffs asked the court in Delaware to enjoin Sasaki from transferring any further assets to the APT and enjoin the trustees from accepting any further contributions from Sasaki or making any distributions from the trust to any beneficiaries. The Plaintiffs also asked the court to avoid Sasaki's transfers to the APT to extent necessary to satisfy their judgment.

It should be noted from the face of the complaint that it appears Saski created and funded the trust during the course of defending the underlying lawsuit against the Plaintiffs in New York. This case was the first case filed in Delaware where a private plaintiff was attempting to pursue a fraudulent transfer action against a defendant who established a Delaware asset protection trust.

Parrott followed just after the decision in *Battley v. Mortensen, et al*., (*In re Mortensen*), 2011 WL 5025249 (Bankr. D. Alaska) a recent decision by a bankruptcy court in Alaska involving an APT established under the Alaska asset protection trust statutory regime. *Mortensen* involved the application of the ten (10)-year fraudulent transfer rule related to self-settled trusts in bankruptcy cases under Section 548(e)(1) of the Bankruptcy Code. Unlike *Mortensen*, however, *Parrott* would have applied underlying principles of state law rather than bankruptcy rules. *Mortensen* involved a number of bad facts and had an adverse result for the debtor.

As the initial pleadings in *Parrott* illustrated, it is important for attorneys and trust companies to conduct proper due diligence prior to assisting any client with the preparation and implementation of an APT structure. In many cases it may be imprudent for an attorney and a trust company to assist with the implementation of such a structure while the proposed grantor is defending a pending lawsuit. All of the facts of *Parrott* never become public. Thus, one must be cautious to reach any conclusions regarding the propriety of the attorney and trust company assisting the defendant in *Parrott* with the creation of the APT.

In addition to the issue of whether estate planning counsel and the trust company acted appropriately in assisting the grantor in creating this trust structure, there are a number of other interesting questions that never got answered. For instance, questions regarding the appropriateness of the Delaware trust company's decision to accept this trust with the litigation pending in New York would have certainly been a hot topic of discussion as the case progressed. Of course, it is equally important to note that the ultimate result of the underlying litigation in New York was also unknown when the APT was established. During the short course of this proceeding, however, the Plaintiffs were highly successful in disrupting and interferring with the the free administration of the APT and Sasaki's (or any other beneficiary's) access to trust assets through discretionary distributions. It is important to note that such pre-judgment interference would have been highly unlikely to ever occur if this trust was established in an appropriate foreign asset protection jurisdiction.

Finally, it would have also been interesting to see how the Plaintiffs' litigation strategy developed as the case progressed and whether §3572(g) of the QDTA (the statutory duress provision) would have become a factor. This statute provides:

> If, in any action brought against a trustee of a trust that is the result of a qualified disposition, a court takes any action whereby such court declines to apply the law of this State in determining the validity, construction or administration of such trust, or the effect of a spendthrift provision thereof, such trustee shall immediately upon such court's action and without the further order of any court, cease in all respects to be trustee of such trust and a successor trustee shall thereupon succeed as trustee in accordance with the terms of the trust instrument or, if the trust instrument does not provide for a successor trustee and the trust would otherwise be without a trustee, the Court of Chancery, upon the application of any beneficiary of such trust, shall appoint a successor trustee upon such terms and conditions as it determines to be consistent with the purposes of such trust and this statute. Upon such trustee's ceasing to be trustee, such trustee shall have no power or authority other than to convey the trust property to the successor trustee named in the trust instrument in accordance with this section.

Similar to *Mortensen*, *Parrott* demonstrated that the implementation of a properly structured offshore APT structure is always superior to using a domestic APT. Unlike *Parrott*, for instance, any attempt to attack an offshore APT will result in complex jurisdictional issues that need to be addressed, extremely high costs to the creditor seeking to breach the APT and payment of all legal fees incurred by the trust in its defense by the creditor if the creditor is unsuccessful in its assault on the APT. As a result, offshore APTs offer far more certainty to those seeking to shelter wealth from the claims of future creditors assuming such a trust is created at an appropriate time and under appropriate circumstances.

Another interesting issue that may have been considered in *Parrott* was the differences in the burden of proof related to the fraudulent transfer rules in Delaware and New York. In Delaware the burden is on the plaintiff to prove a fraudulent transfer occurred and the plaintiff must prove its case by clear and and convincing evidence. The burden of proof is lower under the applicable fraudulent transfer rule in New York.

S. To access the QDTA online go to: www.findlaw.com. For an excellent article on creditors' rights and the QDTA see Flubacher & Randolph, "Delaware Asset Protection Trusts and Creditors' Rights," 37 EP 9 (Sept. 2010).

XI. ALASKA LAW.

A. Alaska law permits residents and non-residents to create asset protection trusts. See Alaska Stat. § 34.40.110. Alaska was the first state to enact extensive legislation permitting the creation of domestic asset protection trusts.

B. 1. According to § 34.40.110(a) of the Alaska Statutes, a person who in writing makes a "**transfer**" of "**property**" in trust may provide that the interest of a

beneficiary, including the "**settlor**," may not be voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee.

2. The phrase payment or delivery of the interest to the beneficiary does not include the beneficiary's use or occupancy of real property or tangible personal property owned by the trust if the use or occupancy is in accordance with the trustee's discretionary authority under the trust. *Id.*

C. 1. The term "**property**" means real property, personal property, and interests in real or personal property. *Id.*

2. The term "**transfer**" means any form of transfer, including deed, conveyance or assignment. *Id.*

3. The term "**settlor**" means a person who transfers real property, personal property or an interest in real or personal property, in trust. Alaska Stat. § 34.40.110(m)(2).

D. 1. A provision in a trust that states the laws of Alaska govern the validity, construction and administration of the trust and that the trust is subject to the jurisdiction of Alaska is valid, effective and conclusive for the trust if:

a. some or all of the trust assets are "**deposited in this state**" and are being administered by a "**qualified person**;"

b. a trustee of the trust is a qualified person who is either designated as trustee under the trust or by a court having jurisdiction over the trust;

c. the powers of the qualified trustee include or are limited to:

i. maintaining records for the trust on an exclusive basis or a nonexclusive basis; and

ii. preparing or arranging for the preparation of, on an exclusive basis or a nonexclusive basis, an income tax return that must be filed by the trust; and

d. part or all of the administration of the trust occurs in Alaska, including physically maintaining trust records in Alaska.

Alaska Stat. § 13.36.035(c).

2. The term "**deposited in this state**" includes property that is held in a checking account, time deposit, certificate of deposit, brokerage account, trust company fiduciary account, or similar account or deposit that is located in Alaska. *Id*.

3. The term "**qualified person**" means:

a. an individual who, except for brief intervals, military service, attendance at an educational or training institution, or for absences for good cause shown:

i. resides in Alaska;

ii. whose true and permanent home is in Alaska;

iii. who does not have a present intention of moving from Alaska; and

iv. who has the intention of returning to Alaska when absent from the state.

b. a trust company that is organized under the Revised Alaska Trust Company Act and has its principal place of business in Alaska;

c. a bank that is organized under Alaska Banking Code, or a national banking association that is organized under 12 U.S.C. 21-216d, if the bank or national banking association possesses and exercises trust powers and has its principal place of business in Alaska.

Alaska Stat. § 13.36.390(2).

4. If at least one (1) qualified person serves as trustee of a trust whose Alaska jurisdiction provision is valid, effective and conclusive, any one or more of the following persons may also serve as trustees though not qualified persons:

a. individuals who do not reside in Alaska;

b. trust companies that have their principal place of business outside of Alaska and that are not organized under the Revised Alaska Trust Company Act; and

c. banks that have their principal place of business outside Alaska or that are not organized under Alaska Banking Code.

Alaska Stat. § 13.36.320.

5. Notwithstanding any contrary law, a trustee who is not a qualified person is not considered to be engaging in business in Alaska solely by reason of serving as trustee of a trust whose Alaska jurisdiction provision is valid, effective and conclusive. *Id.*

E. If a trust contains a transfer restriction as provided for in § 34.40.110(a) of the Alaska Statutes, such restriction will preclude an existing creditor or a person who subsequently becomes a creditor from satisfying such claim from the beneficiary's interest in the trust. Notwithstanding the foregoing, a creditor may satisfy his, her or its claim from the beneficiary's interest in the trust if the creditor is a creditor of the settlor and:

1. the settlor's transfer of property was made with intent to defraud that creditor;

2. the trust provides that the settlor may "**revoke or terminate**" all or part of the trust without the consent of a person who has a substantial beneficial interest in the trust and the interest would be adversely affected by the exercise of the power held by the settlor to revoke or terminate all or part of the trust. The term "**revoke or terminate**" does not include any one or more of the following rights or powers:

a. a power to veto a distribution from the trust;

b. a testamentary nongeneral power of appointment or similar power;

c. the right to receive a distribution of income, principal or both in the discretion of a person, including a trustee, other than the settlor;

3. the trust mandates that all or a part of the trust's income or principal or both, be distributed to the settlor. The foregoing shall not apply to a settlor's right to receive any of the following types of distributions, which remain subject to the restriction provided in § 34.40.110(a) of the Alaska Statutes until such distributions occur:

a. income or principal from a charitable remainder annuity trust or charitable remainder unitrust (within the meaning of Section 664 of the Code);

b. a percentage of the value of the trust each year as determined form time to time under the trust instrument, but not exceeding the amount that may be defined as income under § 13.38 of the Alaska Statutes or under § 643(b) of the Code;

c. the settlor's potential or actual use of real property under a qualified personal residence trust (within the meaning of § 2702(c) of the Code); and

d. income or principal from a grantor retained annuity trust or grantor retained unitrust that is allowed under § 2702 of the Code.

4. when the transfer is made, the settlor is in default by thirty (30) or more days of making a payment due under a child support judgment or order.

Alaska Stat. § 34.40.110(b)(1)-(4).

F. 1. The satisfaction of a claim as provided in paragraph E above is limited to the part of the trust a transfer restriction is not allowed under paragraph E above. Alaska Stat. § 34.40.110(c).

2. An attachment or other order may not be made against the trustee with respect to a beneficiary's interest in the trust or against property that is subject to a transfer restriction; however, such an order can be made to the extent that a transfer restriction is not permitted as provided in paragraph E above. Alaska Stat. § 34.40.110(c).

3. a. A transfer restriction permitted under Alaska Stat. § 34.40.110(a) applies to a settlor-beneficiary of the trust even if the settlor serves as a co-trustee or as an advisor to the trustee so long as the settlor does not possess the power to make discretionary distributions. Alaska Stat. § 34.40.110(f).

b. A transfer restriction permitted under § 34.40.110(a) of the Alaska Statutes applies to a beneficiary who is not the settlor of the trust even though such beneficiary is the sole trustee, co-trustee or an advisor to the trustee. Alaska Stat. § 34.40.110(g).

c. A transfer restriction permitted under § 34.40.110(a) of the Alaska Statutes applies although the settlor has the authority under the trust agreement to appoint a trust protector or an advisor to the trustee. Alaska Stat. § 34.40.110(h).

G. 1. A settlor whose beneficial interest in a trust is subject to a transfer restriction permitted under § 34.40.110(a) of the Alaska Statutes may not benefit from, direct a distribution of or use trust property except as provided in the terms of the trust. Alaska Stat. § 34.40.110(i).

2. An express or implied agreement or understanding between the settlor and trustee that purports to grant or permit the retention of greater rights or authority than provided by the terms of the trust is void. *Id.*

H. A cause of action or claim for relief with respect to a fraudulent transfer of a settlor's assets is extinguished unless the action is filed by a creditor of the settlor who:

1. was the settlor's creditor before the settlor transferred assets to the trust and an action to set aside the settlor's transfer of property to the trust with intent to defraud the creditor is filed within the later of:

a. four (4) years after the transfer is made; or

b. one (1) year after the transfer is or reasonably could have been discovered by the creditor if the creditor:

i. demonstrates, by a preponderance of the evidence, that the creditor asserted a specific claim against the settlor before the transfer; or

ii. files another action against the settlor in which the creditor assets a claim based on an act or omission of the settlor that occurred prior to the transfer and such action is filed within four years after the transfer; or

2. becomes a creditor subsequent to the transfer into trust and an action is filed to set aside the transfer or property because such transfer was made with intent to defraud that creditor.

Alaska Stat. § 34.40.110(d).

I. 1. According to § 34.40.110(e) of the Alaska Statutes, a trust containing a restriction described in § 34.40.110(a) of the Alaska Statutes prevents anyone from asserting any cause of action or claim for relief against a trustee or anyone involved in the preparation or funding of the trust for:

a. conspiracy to commit a fraudulent conveyance;

b. aiding and abetting a fraudulent conveyance; or

c. participating in the trust transaction.

2. The preparation and funding of the trust includes the preparation and funding of a limited partnership or a limited liability company if interests in such entities are transferred to the trust. *Id.*

J. 1. A settlor who creates a trust in which the settlor is a beneficiary and the settlor's beneficial interest is subject to a transfer restriction as provided in § 34.40.110(a) of the Alaska Statutes shall execute a sworn affidavit prior to the settlor's transfer of assets to such trust. Alaska Stat. § 34.40.110(j).

2. The affidavit must state that the settlor:

a. has full right, title and authority to transfer the assets to the trust;

b. will not be rendered insolvent by the transfer of the assets to the trust;

c. does not intend to defraud a creditor by transferring the assets to the trust;

d. does not have any pending or threatened court actions against him or her, except for those identified on an attachment to the affidavit;

e. is not involved in any administrative proceedings, except for those identified on an attachment to the affidavit;

f. is not currently in default of a child support obligation by more than thirty (30) days at the time of the transfer of the assets to the trust;

g. does not contemplate filing for bankruptcy relief; and

h. did not derive the assets being transferred to the trust from unlawful activities. *Id.*

i. For a discussion of the purpose of providing an affidavit of solvency, see "Gassman & Daniels, The Affability of Affidavits in Domestic Asset Protection Trust Planning," Steve Leimberg's Asset Protection Planning Newsletter #293 (Apr. 28, 2015).

K. 1. No type of action, including an action to enforce a judgment entered by a court or other adjudicative authority, may be filed at law or in equity for attachment or any other remedy against any property of a trust with a transfer restriction as provided in § 34.40.110(a) of the Alaska Statutes or to avoid a transfer of property to a trust with a transfer restriction as provided in § 34.40.110(a) of the Alaska Statutes unless the action is brought pursuant to § 34.40.110(b)(1) of the Alaska Statutes within the limitations period provided in § 34.40.110(d) of the Alaska Statutes. Alaska Stat. § 34.40.110(k).

2. A court in Alaska has exclusive jurisdiction over a cause of action or claim for relief that is based on a transfer of property to a trust with a transfer restriction as provided in § 34.40.110(a) of the Alaska Statutes. *Id.*

L. 1. If a trust has a transfer restriction as provided in § 34.40.110(a) of the Alaska Statutes and a beneficiary of such trust divorces or dissolves his or her marriage, such beneficiary's interest in the trust will not be considered property subject to division under § 25.24.160 of the Alaska Statutes or § 25.24.230 of the Alaska Statutes or a part of a property division under § 25.24.160 of the Alaska Statutes or § 25.24.230 of the Alaska Statutes. Alaska Stat. § 34.40.110(l).

2. Unless otherwise agreed in writing by the parties to the marriage, the foregoing shall not apply to a settlor's interest in a self-settled trust with respect to assets transferred to the trust. *Id.*

M. *Battley v. Mortensen, et al*., (*In re Mortensen*), 2011 WL 5025249 (Bankr. D. Alaska), was a case of first impression involving an Alaska Bankruptcy Court's interpretation of Section 548(e) of the Bankruptcy Code. In *Mortensen*, Thomas Mortensen ("**D**") was a resident of Alaska and a self-employed project manager who held a master's degree in geology. He did not work in geology, however, instead managing the environmental aspects of construction projects. D purportedly contracted with major oil companies for work.

In 1994, D and his spouse (now his former spouse) acquired 1.25 acres of real property located in a remote area near Seldovia, Alaska (the "**Seldovia Property**") for $50,000. When D and his former spouse divorced D received his former spouse's interest in the Seldovia Property. Following the divorce D added some improvements to the Seldovia Property. On February 1, 2005, D deeded his interest in the Seldovia Property to a "self-settled trust," which became the "focal point" of this case.

D's divorce was apparently a bitterly contested matter. Additionally, D's income "fluctuated substantially" following his divorce. Both the divorce and the economy adversely affected D's financial situation.

Through "casual conversation" D learned about Alaska's laws providing an individual with asset protection over property transferred to a self-settled trust. (The court inappropriately referred to such laws using the derogatory term "scheme.") D investigated the subject further and using a form he uncovered in his research (one he probably located searching the internet) drafted a trust document he called the Mortensen Seldovia Trust (the "**Trust**"). D intended the Trust to qualify as an asset protection trust under Alaska's asset protection trust law. D

purportedly asked an attorney to review the Trust and represented that the attorney only suggested "minor changes" be made to the document following the attorney's review.

The court noted:

> The express purpose of the trust was "to maximize the protection of the trust estate or estates from creditors' claims of the Grantor or any beneficiary and to minimize all wealth transfer taxes." The trust beneficiaries were Mortensen and his descendants. Mortensen had three children at the time the trust was created.

Mortensen appointed his brother and a friend as trustees and designated his mother as the protector. The protector was given the power to remove trustees and appoint successor trustees and could designate a successor protector. The protector could not designate herself as a trustee.

As required by Alaska law, the Trust was registered with the state on February 1, 2005 and Mortensen provided an affidavit that stated:

> 1) he was the owner of the property being placed into the trust, 2) he was financially solvent, 3) he had no intent to defraud creditors by creating the trust, 4) no court actions or administrative proceedings were pending or threatened against him, 5) he was not required to pay child support and was not in default on any child support obligation, 6) he was not contemplating filing for bankruptcy relief, and 7) the trust property was not derived from unlawful activities.

D transferred the Seldovia Property to the Trust by executing a quite claim deed on the same date the Trust was registered with the state. According to the terms of the Trust the Seldovia Property was "a special family place that should not be sold and should remain in the family."

The Seldovia property was worth approximately "$60,000" when it was deeded into the Trust by D. Interestingly, D's mother sent him checks totaling $100,000 following the transfer of the Seldovia Property into the Trust. D argued that he and his mother had entered into an agreement for him to transfer the Seldovia Property to the Trust to preserve it for his children and that the payment was made in consideration for the transfer. The foregoing testimony was corroborated by certain notes that D's mother sent to him with two checks. D's mother sent him two checks for $50,000 each on February 22, 2005 and April 8, 2005.

D claimed he used some of the funds his mother paid him to pay existing debts and transferred approximately $80,000 to a brokerage account in the name of the Trust as "seed money" for operating expenses related to the property. According to D he lent the $80,000 to the Trust, however, no promissory note was ever entered into evidence.

According to D, the Seldovia Property was recreational property used by him and his children and sometimes by other family members. Prior to creating and funding the Trust D lived on the property full time and argued that he could have claimed the property was exempt from seizure to satisfy his creditors at that time by claiming the state's homestead exemption.

Following the creation and funding of the Trust D's financial condition deteriorated and his income was "sporadic." According to the court:

> [D] used the cash he received from his mother and his credit cards to make speculative investments in the stock market and to pay living expenses. His credit card debt ballooned after the trust was created. In 2005, total credit card debt ranged from $50,000 to $85,000. When he filed his petition in August of 2009, Mortensen had over $250,000 in credit card debt. The $100,000 he received from his mother has been lost.

D claimed that he always had the ability to make the minimum payments required on his credit card debt until he became sick in April of 2009. At that time he required surgery and hospitalization for two weeks followed by a prolonged period of convalescence. Following his illness D stated that he attempted to return to work, however, he was on medication that inhibited his cognitive abilities which in turn caused him to lose several contracts.

D filed for bankruptcy on August 18, 2009. He did not list the Seldovia Property as part of his assets and he listed $251,309.16 in debt from twelve separate credit cards. He also listed $8,140.84 in medical debt.

The bankruptcy trustee alleged that D failed to create a valid asset protection trust because he was not solvent when the Trust was established and funded. After some analysis regarding this issue the court concluded that D was solvent when he established and funded the Trust and therefore recognized the validity of the Trust.

The court then turned its analysis to the bankruptcy trustee's claim that the transfer of the Seldovia Property to the Trust violated Section 548(e) of the Bankruptcy Code. The fraudulent transfer rule under Section 548(a) and (b) of the Bankruptcy Code was modified by Section 548(e)(1) in the case of a "**self-settled trust**." Section 548(e) was added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("**BAPCPA**"). It addresses the transfer of assets to an asset protection trust providing:

> In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if-(A) such transfer was made to a self-settled trust or similar device; (B) such transfer was by the debtor; (C) the debtor is a beneficiary of such trust or similar device; *and* (D) ***the debtor made such transfer with actual intent to hinder, delay, or defraud*** any entity to which the debtor was or became, on or after the date that such transfer was made, indebted. (Emphasis supplied.)

The court held that D's transfer to the Trust violated the extended ten (10) year fraudulent transfer rule under Section 548(e). Some practitioners have been quick to reach the conclusion that *Mortensen* should be read broadly as enabling a bankruptcy trustee to reach any assets transferred to a self-settled trust during the ensuing ten year period. Caution is warranted, however, for anyone quick to reach this conclusion for the following reasons:

1. The court's holding in *Mortensen* can be read narrowly. The court appeared to reach the proper conclusion (assuming D was actually the settlor of the portion of the Trust relating to the Seldovia Property).

2. D's counsel appears to have missed an important argument in this case. D's counsel could have argued with credibility that D's mother was the grantor of the portion of the trust attributable to the Seldovia Property. This argument is consistent with the record. Of course, had D and his mother sought the advice of competent counsel to assist in originally structuring this transaction such counsel would have certainly advised D's mother to purchase the land from D and then contribute it to the Trust herself or some variation of this structure. On motion for rehearing in the case D did in fact argue that his mother was the settlor of the Trust, however, the court declined to accept this argument.

3. The debtor could have argued Section 548(e) is unconstitutional because it violates the 10th Amendment of the Constitution of the United States which provides "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." Until the BAPCPA was enacted the fraudulent transfer rule in the Bankruptcy Code was only two (2) years and in certain cases the trustee could use the longer period provided by applicable state law. The two (2) year period did not exceed the shortest period provided to question fraudulent transfers under the laws of any state at that time. Defining property rights and how such rights are governed (including rules related to avoiding the transfer of assets) is traditionally considered reserved to the states.

4. The judge's ruling is too broad. Except for a small portion of D's debt, the creditors in question, that is, under D's twelve credit cards, existed and *were contemplated* when the Trust was created and funded, regardless of whether D was solvent when the Trust was created. This appears to be the most important fact and supports the court's decision under Section 548(e). D gave away a substantial portion of his net worth in this case. Such action was certainly odd for someone in his financial situation who was not contemplating placing such assets beyond the reach of a foreseeable creditor. D does not represent the typical client most estate planning attorneys who specialize in asset protection assist in their practice. In fact, D did not even retain counsel to assist in structuring this transaction, rather only to review a trust he drafted himself. Section 548(e) should not reach a future creditors who are not contemplated when a trust is created and funded. No existing fraudulent transfer statute is that broad nor should it be interpreted that broadly. Accepting such a broad interpretation would bring into question the finality of too many transactions and is not good policy. One would also have to question why congress would choose to enact a fraudulent transfer rule as opposed to simply enacting a blanket limitation that captures all transfers to a self-settled trust for the ten (10) year period.

In this regard, the law regarding fraudulent transfers generally characterizes a creditor as either a present creditor or a future creditor.

Present creditors are those creditors whose claims arose before the transfer. They are also referred to as "**existing creditors**." A debtor is aware of a present creditor when the debtor effectuates a transfer. A creditor does not have to possess a judgment to constitute a present

creditor. In *Mortensen*, D was clearly aware that he was indebted to certain credit card companies.

Future creditors are those creditors whose claims arose after the transfer. They are also referred to as "**subsequent creditors**." For clarification, possible future creditors should be further divided into two distinct categories, only one of which is protected:

Foreseeable future creditors. Foreseeable future creditors are those creditors whose specific claims did not exist prior to the transfer, but were anticipated or should have been anticipated. Such creditors include a creditor whose rights originated following a transfer where a debtor intended to conduct the debtor's activities or business in a fraudulent way or with reckless disregard for the rights of a potential creditor. In *Mortensen*, D was clearly contemplating that he would continue to be indebted to certain credit card companies and it can be inferred from the facts that he intended to increase such debt following the creation and funding of the Trust. In fact, the court noted that his annual expenses exceeded his annual income.

Unforeseeable future creditors. An unforeseeable future creditor is an unidentifiable person or entity who a debtor was not aware existed at the time the debtor effectuated a transfer. An unforeseeable future creditor cannot possess a claim against a debtor. Thus, a transfer made by a debtor should not be avoidable by an unforesseable future creditor under any existing fraudulent transfer rule including Section 548(e).

5. The judge's references to Senator Charles Schumer's statement in the legislative history of Section 548(e) is misplaced because it is not relevant to the provision that was ultimately passed by the senate. Senator Schumer lobbied for the BAPCPA to include a significant dollar limitation on the amount that a settlor could protect by transferring assets to an asset protection trust. Senator Schumer's proposed amendment was defeated and his commentary on the issue was thus rendered completely irrelevant (along with Charles Shumer).

6. Section 522(o) of the Bankruptcy Code contains a substantially similar ten (10) year fraudulent conversion rule applicable to debtors who convert non-exempt wealth to homestead. This rule provides that if within the ten (10) years prior to filing a petition a debtor converts non-exempt property to homestead with the actual intent to hinder, delay, or defraud a creditor, the value of the homestead is reduced by the value of such converted property. The existing cases involving this rule have not applied it as broadly as some commentators suggest Section 548(e) should be applied. See *e.g.*, *In re Addison*, 8th Cir., Nos. 07-2064, 07-2727, 8/7/08 and *In re Osejo*, U.S. Bankruptcy Court, S.Dist. Florida, Case No. 10-31218-BKC-JKO, Chapter 7, 22 Fla. L. Weekly Fed. B727a (2011). It would seem highly unlikely that congress intended to pass two substantially similar statutes involving fraudulent transfers and conversions with each statute to be applied in a completely different manner. Arguably, use of a homestead exemption to shelter wealth in this context is significantly more "abusive" than the use of a self-settled trust. The ten (10) year fraudulent transfer rule applicable to the homestead exemption is not interpreted so broadly and neither should the substantially similar rule for self-settled trusts.

One has to question the necessity of a legislative body enacting a fraudulent transfer rule rather than a rule with a blanket limitation if it is to be interpreted so broadly. No other existing fraudulent transfer rule in the United States has been applied in such a broad manner. The result in *Mortensen* can certainly be reconciled with a more appropriate and narrow interpretation of Section 548(e). While the authors are not proponents of using domestic asset protection structures, they do not believe that Section 548(e) will be applied in a manner that will vitiate the use of domestic asset trusts if such trusts are created and funded under appropriate circumstances.

Mortensen does, however, strengthen the argument that practitioners should advise clients to implement and use properly structured foreign trust structures. This is because of the uncertainty of the immediate application of Section 548(e). Where such uncertainty is immediately removed by using a foreign trust structure it can only be removed through case law or legislative mandate with domestic trusts. Such is unacceptable in asset protection planning where certainty is a necessity. Nevertheless, planners who assist clients in implementing foreign asset protection trusts should never assist those clients in making transfers that violate any fraudulent transfer rules. A significantly broader interpretation of Section 548(e) would seem to be problematic for ethical planners who desire to avoid knowingly contravening this rule. It is doubtful, however, that Section 548(e) will be interpreted in such a manner. Offshore trust structures are superior because such structures remove significant legal uncertainty that may exist for the next several decades when using a domestic trust and because there is such a significant difference in the economics of using a foreign asset protection structure versus a domestic structure. Defending a domestic structure will almost certainly prove much more costly.

It is clear that we are in a different period in regards to asset protection trusts. No longer is a bankruptcy court permitted to dismiss such a trust as a sham when faced with questionable facts. As has been pointed out in prior commentaries, the bankruptcy court is now forced to consider the validity of the trust because of the addition of Section 548(e). This is true regardless of how this provision is ultimately interpreted. It also means we should absolutely counsel our clients to create and fund asset protection trusts. The earlier the better because ten (10) years later that fund should be safe from even the reach of a bankruptcy court.

Also important to the general estate planning community, a broad interpretation of Section 548(e) could have a devastating effect on many new and now commonly used estate planning techniques such as the use of a discretionary tax reimbursement provision that is included in a wholly owned grantor trust and a successor-backend ("**SQIT**"™) self-settled trust used in an *inter vivos* QTIP trust to benefit a donor-spouse who survives the donee-spouse. Many states have laws that specifically provide for a special exception to the self-settled trust doctrine related to these trusts. See *e.g.*, F.S. § 736.0505(1)(c) and § 736.0505(3). Finally, many individuals are contemplating or have established self-settled completed gift dynasty trusts as a vehicle to take advantage of the increased gift tax exemption of $5,000,000. The overwhelming majority of these trusts are taxed as wholly owned grantor trusts. In the same manner as a trust with a discretionary tax reimbursement provision, each payment by a grantor of the income tax liability attributable to the income generated by the assets held in such a trust is arguably an additional contribution and transfer of wealth to the trust. Each such contribution

raises the possibility of the application of Section 548(e) to at least a portion of the trust for an additional ten (10) year period.

7. For an excellent analysis of *Mortensen*, see Shaftel, "Court Finds Fraudulent Transfer to Alaska Asset Protection Trust," 39 EP 15 (April 2012); Sulivan, Merric, Gillen, Bove & Nenno, "Fraudulent Transfer Claims," * Trusts & Estates 43 (Dec. 2011); and "Gopman & Rubin: Further Analysis on *In re Mortensen*," LISI Asset Protection Planning Newsletter #187 (November 7, 2011) at http://www.leimbergservices.com. See also, "Oshins & Keebler on Mortensen: No, the Sky Isn't Falling for DAPTs!," LISI Asset Protection Planning Newsletter #186 (October 31, 2011) at http://www.leimbergservices.com and "Adkisson & Riser on Mortensen: Alaska Asset Protection Trust Fails To Protect Future Assets in Bankruptcy under New Section 548(e) Against Future Creditors," LISI Asset Protection Planning Newsletter #185 (October 20, 2011) at http://www.leimbergservices.com.

N. *In re Huber*, 493 B.R. 798 (Bankr. W.D. Wash 2013), the Bankruptcy Court for the Western District of Washington held that a debtor's prepetition transfer of assets to a self-settled Alaska trust for the benefit of himself and his children was void under Washington law.

The debtor, Donald G. Huber ("**D**"), was involved in real estate development and management in Washington for over forty (40) years. In 1968, D founded United Western Development, Inc. ("**UWD**") in Washington. D invested in and developed real estate through UWD. D served as the President of UWD, however, beginning in 2001, D's oldest son, Kevin ("**Kevin**"), served as a Vice President of UWD and had become primarily responsible for the operations of UWD prior to the time that D petitioned for bankruptcy.

Generally, D would own real estate through a corporation or limited liability company separate and apart from UWD, with D owning all, or a portion, of such entity. D was required to sign as guarantor on loans in favor of third party lenders on many projects. Many of the lenders were local banks. All of the real estate held in D's various entities was located in Washington.

D established the Donald Huber Family Trust on September 23, 2008 (the "**Trust**"). The record before the Court demonstrated that the Trust was established to "protect a portion of [D's] assets from [D's] creditors." The beneficiaries of the Trust were D, D's eight children and stepchildren, and D's grandchildren. The Trustees of the Trust were Kevin, D's stepdaughter, Amber Haines, and the Alaska USA Trust Company ("**AUSA**"). The Trust was created in Alaska and designated Alaska law to govern the Trust.

At the time D established the Trust, UWD was in default on numerous loans of which D was a guarantor. The Court gave four examples of loans that were described by the Court as "fragile at best" which were in existence when D established the Trust. Those loans all came due prior to February 10, 2011, when D petitioned for bankruptcy. At the time of the Court's decision, those loans remained outstanding in the amounts of $1,659,245.46, $1,706,000, $588,250, and $1,101,750, respectively.

D transferred $10,000 in cash and his ownership interests in over twenty-five (25) entities to DGH, LLC ("**DGH**"), an Alaska limited liability company, established on

September 4, 2008. D transferred ninety-nine percent (99%) of DGH to the Trust and Kevin owned one percent (1%), who also served as its manager. D also transferred his shares of UWD to the Trust. D's residence in Washington was conveyed to an Alaska corporation, the shares of which were then transferred by D to DGH. D then leased the residence back from the corporation, and the Trust made the mortgage payments for the residence. In sum, most of D's valuable assets were transferred to the Trust.

The Court noted that there was only one asset held in the Trust in Alaska, which was a certificate of deposit of $10,000 transferred by D to a bank account in Alaska held in the name of the Trust. The Court stated that all other assets were located in Washington. The Court may be wrong on this point. D transferred real estate located in Washington to an Alaska corporation and a limited liability company. Generally, the situs of intangible assets, such as stock or a membership interest in a limited liability company, is deemed ot be located where its owner is domiciled. Therefore, the stock or membership interest that was transferred to the trustee of the Trust should have been deemed to have a situs in Alaska under basic conflicts of law rules. The Court ignored any discussion of this question.

The Trust generated $345,248 in net income in 2010, and $360,000 in 2009. The total amount distributed from the Trust to the beneficiaries of the Trust between October 1, 2010, and July 30, 2012, was $571,332.81. From the date of the filing of the petition on February 10, 2011, through July 30, 2012, the amount of the distributions to the beneficiaries of the Trust totaled $406,837.27.

The Bankruptcy Trustee ("**T**") contended that D made requests for disbursements from Kevin, who then prepared a request for a payment, and AUSA approved the disbursement, without any inquiry. D asserted, however, that Kevin at times refused D's requests for disbursements. The Court stated that the record indicated that AUSA did nothing to become involved with the preservation or protection of the assets of the Trust and acted merely as a "straw man," approving all distributions of assets.

D filed a voluntary petition for bankruptcy on February 10, 2011. The Court examined two principal issues related to whether the assets of the Trust were part of the estate and should be distributable to D's creditors. First, whether the Trust should be invalidated under Washington law, and second, whether D's transfer of assets to the Trust should be avoided under 11 U.S.C. § 548(e)(1) and/or under 11 U.S.C § 544(b)(1). Clearly, the Court could have based its decision solely on a fraudulent transfer analysis.

T contended that D's transfers to the Trust should be invalidated under Washington State law. Although the Trust was established under Alaska law, Washington did not recognize the efficacy of a self-settled trust for asset protection purposes. See RCW 19.36.020. Under RCW 19.36.020 all transfers made by a person in trust for the use of the transferor are void as to "the existing or subsequent creditors of such person." The Court (inappropriately) examined choice of law rules to determine which state law applied.

The Court examined Section 270 of the Restatement (Second) of Trusts ("**Restatement 270**") to address the validity of the Trust. Restatement 270 states:

> "[a]n inter vivos trust of interests in movables is valid if valid . . . under the local law of the state designated by the settlor to govern the validity of the trust, provided that this state has a substantial relation to the trust and that the application of its law does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6."

Furthermore, comment b of Restatement 270 provides certain criteria for determining if a state has a substantial relation to the trust. According to comment b:

> "A state has a substantial relation to a trust when it is the state, if any, which the settlor designated as that in which the trust is to be administered, or that of the place of business or domicil of the trustee at the time of the creation of the trust, or that of the location of the trust assets at that time, or that of the domicil of the settlor, at that time, or that of the domicil of the beneficiaries."

The Court stated that, under Restatement 270, D's choice of Alaska law designated in the Trust should be upheld if Alaska had a substantial relation to the Trust. The Court noted that D and the Trust beneficiaries were not domiciled in Alaska. The Trust was to be administered in Alaska and the location of one of the trustees, AUSA, was in Alaska, however, the Court noted that, except for a $10,000 certificate of deposit, all of the assets of the Trust were located in Washington. (Although this conention was questionable.) Therefore, the Court held that Alaska did not have a substantial relation to the Trust, applying the standards set forth in Comment b.

The Court also held that, pursuant to RCW 19.36.020, Washington had a "strong public policy" against self-settled asset protection trusts.

As a result of the foregoing, the Court disregarded D's choice of Alaska law, and applied Washington law to determine the validity of the transfers to the Trust. Under RCW 19.36.020, the assets of the Trust could be reached by D's creditors.

The Court also held that D's transfers were fraudulent under 11 U.S.C. § 548(e)(1), which provides that a trustee may avoid any transfer of an interest of a debtor made on or within ten (10) years of the date of the filing of the petition, if (A) such transfer was made to a self-settled trust or similar device; (B) such transfer was by the debtor; (C) the debtor is a beneficiary of such trust or similar device; and (D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted. Under the facts of this case, it seems far more appropriate for the Court to have based its decision under §548(e)(1) rather than under its alternative choice of law analysis (that rests on rather dubious grounds).

Under its fraudulent transfer analysis, the Court found that five badges of fraud existed. First, at the time D transferred his assets into the Trust, there was threatened litigation against D. The Court stated that it appeared that "foreclosure of several properties for which D had guaranteed the bank loans was becoming increasingly certain" and D was not making timely payments on those loans. Second, D transferred all or substantially all of his property into the

Trust. Third, D was significantly in debt at the time of the transfers to the Trust. Fourth, the Court held that there was a special relationship between D and the Trust in that D was both the grantor and a beneficiary of the Trust. Fifth, the Court held that D effectively retained the property transferred into the Trust. Substantially all of D's requests for distributions were granted. On average D received approximately $14,500 per month in distributions from the Trust. The only party to review D's requests for distributions was his son Kevin. The Court stated that, based on the evidence, the only reasonable conclusion was that D continued to use and enjoy the assets of the Trust as he did before the transfers. Based on these badges of fraud, the Court held that D had the actual intent to hinder, delay, or defraud his current or future creditors, and therefore D's transfers to the Trust should be avoided.

Additionally, under Section 544(b)(1) of the Bankruptcy Code, T could avoid fraudulent transfers under state law. Under Washington's version of the Uniform Fraudulent Transfer Act ("**UFTA**"), a transfer is fraudulent if the debtor acts with actual intent to hinder, delay, or defraud a creditor, or transfers "[w]ithout receiving a reasonably equivalent value in exchange for the transfer or obligation." RCW 19.40.041(a)(1)–(2). The Court held that D had actual fraudulent intent to hinder, delay, or defraud his current or future creditors under UFTA, and therefore D's transfers to the Trust should be avoided based on UFTA.

For a discussion of the *Huber* case see, Blattmachr, "*In re Huber*: Alaska Self-Settled Trust Held Subject to Claims of Creditors of Grantor-Beneficiary," **LISI** Asset Protection Planning Newsletter #225 (May 22, 2013) at http://www.leimbergservices.com; and Riser & Adkisson, "On *In re Huber*," **LISI** Asset Protection Planning Newsletter #226 (June 18, 2013) at http://www.leimbergservices.com.

XII. OKLAHOMA LAW.

A. The state of Oklahoma passed the Family Wealth Preservation Trust Act (the "**FWPTA**") which became effective on November 1, 2004. See Okla. Stat. tit. 31, § 10. & H.R. 2135, 49th Leg., 2d Reg. Sess. § 8 (Okla. 2004). The FWPTA provides significant wealth protection benefits. See Okla. Stat. tit. 31, § 12. According to the FWPTA, the income and corpus of a "**preservation trust**" will be exempt from the claims of creditors of a "**grantor**" up to an amount equal to **$1,000,000** in value. *Id*. Furthermore, any "**incremental growth derived from income retained by the trustee**" of such a trust in excess of the $1,000,000 amount is also considered exempt from the claims of the grantor's creditors. *Id*. Of extraordinary interest, the preservation trust can be *revocable* by the grantor, however, the grantor would forfeit the exemption if the grantor revokes the trust. FWPTA § 13.

B. For a trust to qualify as a preservation trust it must be established by the grantor under Oklahoma law and at "**all times**" must have an Oklahoma-based bank that maintains a trust department or an Oklahoma-based trust company" serving as its trustee. FWPTA § 11.5.a., b. The preservation trust can designate only certain individuals and charities as beneficiaries who are referred to as "**qualified beneficiaries**." FWPTA § 11.5.c. Additionally, the corpus of the trust must consist solely of "**Oklahoma assets**," and the terms of the trust must provide that the income produced by its corpus is subject to tax under the income tax laws of Oklahoma. FWPTA § 11.5.d., e.

C. An Oklahoma-based bank or trust company is a bank or a trust company chartered under Oklahoma law or a nationally chartered bank or trust company that has its principal place of business in Oklahoma. FWPTA § 11.3. The principal place of business must be a physical location in Oklahoma. *Id*.

D. According to the Act, a grantor is an individual "**establishing or creating**" a preservation trust. FWPTA § 11.1. "**Oklahoma assets**" are stocks, bonds, or debentures issued by an Oklahoma-based company, bonds or other obligations issued by the state of Oklahoma or subdivisions of the state, bonds or other obligations issued by a county or municipal government located in Oklahoma, accounts at Oklahoma-based banks or trust companies, and real property in Oklahoma. FWPTA § 11.2.

E. An Oklahoma-based company is a corporation, limited liability company, limited partnership, or limited liability partnership formed or domesticated in Oklahoma. FWPTA § 11.4. Furthermore, the Oklahoma based company must have its principal place of business in Oklahoma. *Id*. The principal place of business must be a physical location in Oklahoma. *Id*.

F. Qualified beneficiaries include the grantor's natural children and grandchildren, or the descendants of deceased natural children or grandchildren of the grantor. FWPTA § 11.6.a. A spouse of the grantor can also be a qualified beneficiary as well as a nonprofit organization within the meaning of § 501(c)(3) of the Code. FWPTA § 11.6.b. & c. Curiously, the grantor is not included in the class of individuals who can qualify as a qualified beneficiary. FWPTA § 11.6. Presumably, however, the grantor could exercise the grantor's power to revoke the trust in the grantor's favor. FWPTA § 13.

G. The FWPTA also provides that no judicial body will have the authority to compel a person holding the power to revoke a preservation trust to exercise that power. FWPTA § 16.

H. Interestingly, the FWPTA refers to the protection afforded to the assets held in the preservation trust as an "**exemption**." FWPTA §§ 12, 14. **Note that this appears fundamentally different from the self-settled asset protection trust acts in states such as Alaska, Delaware, Nevada, Rhode Island and Utah**.

I. It is probably not yet time to run to Oklahoma to assist with the formation of a preservation trust. There appear to be numerous interpretation questions that cause uncertainty in the application of the provisions of the FWPTA. Among the issues:

1. Can a resident of another state create a preservation trust in Oklahoma? It is not specifically permitted in the FWPTA, however, it is not prohibited either. FWPTA § 11.1. Under general trust law principals, non-residents should be able to establish such a trust, however, specific legislation inviting non-residents to establish such trusts would be comforting. It is also worth noting that the other exemptions under Title 31 of the Oklahoma Statutes appear to apply only to residents of Oklahoma. FWPTA §§ 1-3, 7.

2. Can the preservation trust have a co-trustee and if so who can serve as the co-trustee? FWPTA § 11.5.b.

3. Does "**incremental growth derived from income**" include capital gain? FWPTA § 12.

4. Does the $1,000,000 limitation take into consideration valuation discounts that are commonly used in estate planning? If it does, this will encourage litigation between debtors and creditors regarding valuation issues?

J. In addition to the foregoing, the legal and practical limitations of the FWPTA must be understood. Drafting a preservation trust could also be tricky. For example, use of generic language permitting the trustee to make distributions to the grantor's "descendants" may disqualify the trust under the FWPTA. See FWPTA § 11.6.a. Also, the FWPTA does not permit the creation of a classic self-settled asset protection trust as the laws in states such as Alaska, Delaware, Nevada, Rhode Island and Utah permit. See *e.g.*, 1997 Alaska Sess. Laws, Ch. 6 (H.B. 101), Alaska Stat. §§ 13.12.205(2), 13.36.035, 13.36.310, 13.36.390, 34.40.010, 34.40.110(a), 34.40.110 (Michie 2003); Col. Rev. Stat. § 38-10-111 (2003); The Qualified Dispositions in Trust Act, Del. Code Ann. tit. 12, §§ 3570-3576 (2003); Mo. Rev. Stat. §§ 428.005-428.059, 456.020, 456.080 (2003); Nev. Rev. Stat. 166.040 (2003); The Qualified Dispositions in Trust Act, R.I. Gen. Laws § 18-9.2 (2003); 2003 Utah Laws Ch. 301 (H.B. 299), Utah Code Ann. § 25-6-14(1)(a) (2003). To the contrary, other than the power to revoke the trust (presumably in the grantor's favor), the grantor apparently is not permitted to retain a discretionary interest in a preservation trust. See Okla. Stat. tit. 31, § 11.6. Although the power to revoke or maintain ultimate control over the wealth in this type of trust is superior in many respects to some of the powers or interests permitted by the acts of states such as Alaska and Delaware, the FWPTA clearly states that the exemption is forfeited immediately upon the exercise of such power. FWPTA § 13. Thus, not permitting the grantor to be a discretionary beneficiary could be problematic from a practical perspective. At least three offshore jurisdictions expressly allow a settlor to retain the power to revoke a trust and remain a discretionary beneficiary of both income and principal. See, *e.g.*, Nevis International Exempt Trust Ordinance, 1994, § 47(a), (b) (Nevis); International Trusts Act 1984, § 13C(a), (c) (Cook Is.); Trusts Act, § 43(1) (Belize). From a practical planning perspective, such a power should rarely be used because it can undermine the protection that a settlor is seeking to achieve. Assuming an asset protection trust established in states such as Delaware or Alaska can accomplish its objectives of protecting the wealth held in the trust, the terms of such a trust can give the trustee the authority to use the trust assets for the benefit of the grantor at any time. See Alaska Stat. § 34.40.110 (Michie 2003); Col. Rev. Stat. § 38-10-111 (2003); Del. Code Ann. tit. 12, § 3570(10) (2003); Mo. Rev. Stat. § 456.040(2) (2003); Nev. Rev. Stat. 166.040 (2003); R.I. Gen. Laws § 18-9.2-2 (2003); Utah Code Ann. § 25-6-14(1)(a) (2003). A preservation trust may be much more limiting. Consider the following practical examples:

> **Example 1**: DD creates a preservation trust in Oklahoma retaining the power to revoke the trust at any time for any reason. The Oklahoma trust company sole trustee is given the power to distribute income and principal to any one or more of the grantor's children and grandchildren. DD cannot be included in the class of beneficiaries eligible to receive a distribution from the trust. Okla. Stat. tit. 31, § 11.6. DD commits an act of malpractice in his professional practice some time following the creation of the trust and his client obtains a $2,000,000 judgment against him. DD has no assets that this creditor can attach or other

liquid wealth except the assets in the preservation trust. If DD exercises his power to revoke the trust to access such wealth his creditor can attach that wealth. FWPTA § 13. Nonetheless, the trustee has no authority to distribute any part of the assets in the trust to DD. FWPTA § 11.6. This situation can create serious problems for DD if he needs to access such wealth for his daily subsistence. Of course, DD's spouse, if any, can be a designated beneficiary of such trust perhaps building in some additional flexibility. FWPTA § 11.6.b.

Example 2: MM creates a preservation trust in Oklahoma retaining the power to revoke the trust at any time for any reason. The Oklahoma trust company sole trustee is given the power to distribute income and principal to any one or more of the grantor's children and grandchildren. MM cannot be included in the class of beneficiaries eligible to receive a distribution from the trust. FWPTA § 11.6. MM is declared incompetent by a state court, therefore, he can no longer exercise his power to revoke the trust and access the wealth for his personal consumption. Unless the revocation power can be exercised by MM's guardian or for some other reason under state law, the wealth in the trust cannot be used for MM's benefit.

K. Finally, three more points about the Act are worth mentioning. Potentially subjecting assets in the preservation trust to a state income tax that might not otherwise be subject to the tax does not seem prudent. This could be an open-ended invitation for abusive taxation. Is the tradeoff for the wealth protection worth incurring the future tax liability - whatever that may be? Also, the "principal place of business" and "physical location" requirements to qualify as an Oklahoma-based company seem problematic. What constitutes a "physical location?" Mere formation of an entity in Oklahoma or qualifying a foreign entity to do business in the state will not be enough for the company to qualify as an Oklahoma-based company. What type of physical location will qualify under the statute? From a practical perspective these two requirements may prove too expensive to initially protect only a $1,000,000 of wealth, especially after considering annual trustee's fees and expenses. Furthermore, there is no significant benefit available to a grantor who creates an *irrevocable* trust under the Act that is not available in any other common law jurisdiction.

L. After many of the foregoing issues are resolved by additional legislation, "**Sooner Trusts**" or "**Cowboy Trusts**" may become an attractive wealth protection option for non-residents of Oklahoma. In appropriate circumstances and understanding the present limitations of the Act, Oklahoma residents should certainly take advantage of this legislation. For now it is not worth the risk for non-residents to play a guessing game as a quality wealth protection plan should mandate certainty.

M. For a discussion of the Act, see Rod Yancy, Sooner (Or Is It Cowboy...It's Definitely Sooner) Trusts Under Oklahoma Law, LISI Asset Protection Planning Newsletter #289, (April 2, 2015) at http://www.LeimbergServices.com.

XIII. UTAH LAW.

A. Utah allows for the creation of asset protection trusts by both residents and non-residents. However, compared to the other asset protection states, Utah's law is more limited in application and contains numerous exceptions to the protection provided in the wealth protection legislation. See Utah Code Ann. § 25-6-14.

B. 1. Pursuant to § 25-6-14(1) of the Utah Code, a settlor who in writing irrevocably transfers property to a trust having a "**Trust Company**" (as defined in Utah Code Ann. § 7-5-1(1)(d)) as a trustee and such trust holds some or all of the trust assets in Utah in one or more of the following forms:

a. a savings account;

b. a certificate of deposit;

c. a brokerage account;

d. a trust company fiduciary account; or

e. an account or deposit located in Utah that is similar to the accounts listed in a through d;

such a trust may provide that the income or principal interest of the settlor as beneficiary of the trust may not, voluntarily or involuntarily, be transferred before payment or delivery by the trustee to the settlor as beneficiary.

2. This provision shall be considered a restriction on the transfer of the settlor-beneficiary's interest in the trust that is enforceable under applicable nonbankruptcy law within the meaning of Section 541(c)(2) of the Bankruptcy Code. Utah Code Ann. § 25-6-14(1).

C. 1. The term "**Trust Company**" means:

a. a Utah depository institution or its wholly owned subsidiary;

b. an out-of-state depository institution authorized to engage in business as a depository institution in Utah or its wholly owned subsidiary;

c. a corporation, including a credit union service organization, owned entirely by one or more federally insured depository institutions;

d. a direct or indirect subsidiary of a depository institution holding company that also has a direct or indirect subsidiary authorized to engage in business as a depository institution in Utah; and

e. any other corporation continuously and lawfully engaged in the trust business in this state since before July 1, 1981. Utah Code Ann. § 6-5-1(1)(d).

2. Additionally, if at least one trustee is a Trust Company, then individuals may also serve as co-trustees of the trust. Utah Code Ann. § 25-6-14(10).

D. Section 25-6-14(1) of the Utah Code applies to any form of transfer in trust including conveyances and/or assignments and transfers of personal property and interests in personal property, real property and interests in real property. Utah Code Ann. § 25-6-14(1)(b).

E. 1. If a trust has a restriction described in U.C. § 25-6-14(1), a creditor or other claimant of the settlor may not satisfy a claim or liability, in either law or equity, out of the settlor's transfer or settlor-beneficiary's interest in the trust. Utah Code Ann. § 25-6-14(2)(a).

2. However, a creditor may satisfy a claim or liability out of the settlor's beneficial interest in or transfer into trust in any one or more of the following instances:

a. the claim is a judgment, order, decree or other legally enforceable decision or ruling resulting from a judicial, arbitration, mediation or administrative proceeding commenced prior to or within three (3) years after the trust is established;

b. the settlor's transfer into the trust is made with actual intent to hinder, delay or defraud that creditor;

c. the trust provides that the settlor may "**revoke or terminate**" all or part of the trust without the consent of a person who has a substantial beneficial interest in the trust and the interest would be adversely affected by the exercise of the settlor's power to revoke or terminate the trust;

d. the trust calls for mandatory income or principal distributions to the settlor;

e. the settlor owes the debt under a child support judgment or order;

f. the transfer is made when the settlor is insolvent or the settlor is made insolvent as a result of the transfer;

g. the claim is for recovery of public assistance the settlor received and such recovery is allowed under Title 26, Chapter 19, Medical Benefits Recovery Act;

h. the claim is a tax or other amount owed by the settlor to any governmental entity;

i. the claim is by a spouse or former spouse of the settlor on account of an agreement or order for the payment of support or alimony or for a division or distribution of property;

j. the settlor transferred assets into the trust that:

i. were listed in a written representation of the settlor's assets given to a claimant to induce the claimant to enter into a transaction or agreement with the settlor;

ii. were transferred from the settlor's control in breach of any written agreement, covenant or security interest between the settlor and claimant.

iii. the claimant's right to pursue assets in the trust is limited to only the assets listed in the written representation or transferred in beach of a written agreement, covenant or security interest.

k. the claim is a judgment, award, order, sentence, fine, penalty or other determination of liability of the settlor for conduct of the settlor constituting fraud, intentional infliction of harm or a crime. Utah Code Ann. § 25-6-14(2)(c).

3. The statute of limitations for actions to satisfy a claim or liability from the settlor-beneficiary's interest in or transfer into trust is the statute of limitations for the underlying action. Utah Code Ann. § 25-6-14(2)(d).

4. The phrase "**revoke or terminate**" does not include:

a. a power to veto a distribution from the trust;

b. a testamentary special power of appointment;

c. the right to receive a distribution of income, principal or both in the discretion of another, including a trustee other than the settlor, an interest in a charitable remainder unitrust or charitable remainder annuity trust as defined (as defined within § 664 of the Code) or a right to receive principal subject to an ascertainable standard; or

d. the power to appoint nonsubordinate advisers or trust protectors who can remove and appoint trustees, who can direct, consent to or disapprove distributions or have the power to serve as an investment director or appoint an investment director. Utah Code Ann. § 25-6-14(2)(e).

F. A trust containing a restriction described in Utah Code Ann. § 25-6-14(1) prevents anyone from asserting any cause of action or claim for relief against a trustee or anyone involved in the counseling, drafting, preparation, execution or funding of the trust for:

1. conspiracy to commit a fraudulent conveyance;

2. aiding and abetting a fraudulent conveyance; or

3. participating in the trust transaction.

Utah Code Ann. § 25-6-14(4)(a).

G. In any action brought by a creditor to pursue property held in a trust satisfying the requirements as set forth in Utah Code Ann. § 25-6-14(1), the creditor has the burden to prove its case by clear and convincing evidence. Utah Code Ann. § 25-6-14(5).

H. At any time the settlor transfers any assets to the trust, the settlor shall sign a sworn affidavit stating that:

1. the settlor has full right, title, and authority to transfer the assets to the trust;

2. the transfer of the assets to the trust will not render the settlor insolvent;

3. the settlor does not intend to hinder, delay, or defraud a known creditor by transferring the assets to the trust;

4. there are no pending or threatened court actions against the settlor, except for those court actions identified by the settlor on an attachment to the affidavit;

5. the settlor is not involved in any administrative proceedings, except those administrative proceedings identified on an attachment to the affidavit;

6. at the time of the transfer of the assets to the trust, the settlor is not in default of a child support obligation;

7. the settlor does not contemplate filing for relief under the provisions of the Bankruptcy Code; and

8. the assets being transferred to the trust were not derived from unlawful activities. Utah Code Ann. § 25-6-14(5)(m)(i)-(viii).

a. For a discussion of the purpose of providing an affidavit of solvency, see "Gassman & Daniels, The Affability of Affidavits in Domestic Asset Protection Trust Planning," Steve Leimberg's Asset Protection Planning Newsletter #293 (Apr. 28, 2015).

I. 1. A trust or a property transfer to a trust will be avoided only to the extent necessary to satisfy a transferor's debt to a creditor (including any costs if authorized by a court) who successfully filed an action to have the trust or the property transfer to the trust avoided. Utah Code Ann. § 25-6-14(8).

2. If a trust or a property transfer to a trust is avoided and a court concludes that the trustee did not act in bad faith in accepting or administering the property that is the subject of the trust, such trustee will be given a first lien against the property that is the subject of the trust equal to the amount of the costs (including attorney's fees) properly incurred in defending the action or proceedings to avoid the trust or the property transfer. Additionally, the trust or property transfer will be avoided subject to the proper fees, costs, pre-existing rights, claims and interests of the trustee (and any predecessor trustee that did not act in bad faith). Utah Code Ann. § 25-6-14(9).

3. If a trust or a property transfer to a trust is avoided and a court concludes that a beneficiary of a trust did not act in bad faith, the beneficiary will be permitted to retain any distribution received by the beneficiary as a result of the exercise of discretion granted to the trustee provided such power or discretion was properly exercised before the creditor commenced an action to avoid the trust or property transfer. *Id.*

J. For a discussion of this statute and Utah law, see Robert S. Tippett, "Utah Asset Protection Trusts," LISI Asset Protection Planning Newsletter #305 (September 2, 2015) at http://www.leimbergservices.com.

XIV. RHODE ISLAND LAW.

A. Rhode Island law permits residents and non-residents to create asset protection trusts. See § 18-9.2-1 of the General Laws of Rhode Island, *et. seq*.

B. 1. According to § 18-9.2-2 of the General Laws of Rhode Island, a "**trust instrument**" means an instrument appointing a "**qualified trustee**" for "**property**" that is the subject of a "**disposition**," which the instrument:

a. expressly incorporates the general or public laws of Rhode Island to govern the validity, construction and administration of the trust;

b. is "**irrevocable**;" and

c. provides that the interest of the transferor or other beneficiary in the trust property or the income may not be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily, before the qualified trustee actually distributes the property or income to the beneficiary. According to the act, the foregoing rule shall be deemed a restriction on the transfer of the transferor's beneficial interest that is enforceable under applicable nonbankruptcy law within the meaning of section 541(c)(2) of the Bankruptcy Code. R.I. Gen. Laws § 18-9.2-2(10).

2. A trust instrument will not be "**revocable**" because the transferor retains any one or more of the following:

a. a power to veto a distribution from the trust;

b. a power of appointment (other than a power to appoint to the transferor, the transferor's creditors, the transferor's estate or the creditors of the transferor's estate) exercisable by will or other written instrument of the transferor effective only upon the transferor's death;

c. the potential or actual receipt of income, including rights to such income retained in the trust instrument;

d. the potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust (within the meaning of section 664 of the Code) and the transferor's right, at any time, by written instrument delivered

to the trustee, to release the transferor's retained interest in the trust in favor of a charitable organization that has a succeeding beneficial interest in the trust;

e. the receipt each year of a percentage (not exceeding five percent (5%)) specified in the trust instrument of the initial value of the trust assets or of a fixed amount on an annual basis not exceeding five percent (5%) of the initial value of the trust assets;

f. the potential or actual receipt or use of principal if such potential or actual receipt or use of principal would be the result of a qualified trustee's or an "**advisor**" acting:

i. in the qualified trustee's discretion;

ii. pursuant to a standard governing the distribution of principal that does not confer upon the transferor a substantially unfettered right to the receipt or use of principal;

g. the right to remove a trustee or advisor and to appoint a trustee or advisor (other than a person who is a related or subordinate party with respect to the transferor (within the meaning of section 672(c) of the Code));

h. the potential or actual use of real property held under a qualified personal residence trust (within the meaning of such term as described in section 2702(c) of the Code) and the possession and enjoyment of a qualified annuity interest (within the meaning of such term as described in Treasury Regulation section 25.2702-5(c)(8)); and

i. the potential or actual receipt of income or principal to pay, in whole or in part, income taxes due on income of the trust if pursuant to a provision in the trust instrument expressly providing for the payment of such taxes and such potential or actual receipt of income or principal is the result of a qualified trustee's acting;

i. in his, her or its discretion; or

ii. at the direction of an advisor who is acting in the advisor's discretion. R.I. Gen. Laws § 18-9.2-2(10)(ii).

C. 1. The term "**transferor**" means a natural person who, or entity which, as an owner of property or as a holder of a general power of appointment, directly or indirectly, makes a disposition or causes a disposition to occur. R.I. Gen. Laws § 18-9.2-2(8).

2. a. The term "**qualified trustee**" means a person who:

i. in the case of a natural person, is a resident of Rhode Island, other than the transferor; or

ii. in all other cases, is authorized by general or public laws of Rhode Island to act as trustee and whose activities are subject to the supervision by the

Rhode Island Department of Business Regulation, the Federal Deposit Insurance Corporation, the Comptroller of the Currency or the Office of Thrift Supervision; and

b. maintains or arranges for custody in Rhode Island of some or all of the property that is the subject of the qualified disposition, maintains records for the trust on an exclusive or nonexclusive basis, prepares or arranges for the preparation of fiduciary income tax returns for the trust, or otherwise materially participates in the administration of the trust. R.I. Gen. Laws § 18-9.2-2(9).

c. The transferor or any other natural person who is not a resident of Rhode Island or an entity authorized by Rhode Island law to act as trustee shall not be considered a qualified trustee. However, a transferor may appoint one or more advisors, including, but not limited to:

i. advisors who have authority under the terms of the trust instrument to remove and appoint qualified trustees or trust advisors;

ii. advisors who have authority under terms of the trust instrument to direct, consent to or disapprove distributions from the trust. R.I. Gen. Laws § 18-9.2-2(9)(iii).

d. The transferor of a qualified disposition may serve as an advisor of a trust that is a qualified disposition only with respect to the retention of a right to veto distributions from such trust. *Id.*

3. The term "**property**" includes real property, personal property and interests in real or personal property. R.I. Gen. Laws § 18-9.2-2(5).

4. a. The term "**disposition**" means a transfer, conveyance or assignment of property (including a change in the legal ownership of property occurring upon the substitution of one trustee for another or the addition of one or more new trustees), or the exercise of a power that causes a transfer of property to a trustee. However, this term does not include the release or relinquishment of an interest that was the subject of a qualified disposition. R.I. Gen. Laws § 18-9.2-2(4).

b. A "**qualified disposition**" means a disposition by or from a transferor to a trustee, with of without, consideration by means of a trust instrument. R.I. Gen. Laws § 18-9.2-2(6).

D. 1. No type of action, including an action to enforce a judgment entered by a court or other adjudicative authority, may be filed at law or in equity for attachment or any other remedy against any property that is the subject of a qualified disposition or for the avoidance of a qualified disposition unless the action is filed pursuant to Rhode Island Uniform Fraudulent Transfer Act.

2. Notwithstanding the Rhode Island Uniform Fraudulent Transfer Act, a creditor may not bring an action to avoid a qualified disposition if:

a. the creditor's claim against the transferor originated before the qualified disposition was made, unless such action is filed within four (4) years after the qualified disposition is made or, if later, within one (1) year after the qualified disposition was or could reasonably have been discovered; or

b. the creditor's claim against the transferor originated subsequent to the qualified disposition, unless the action is brought within four (4) years after the qualified disposition is made.

3. In any action in which a creditor challenges a transferor's qualified disposition, the creditor has the burden to prove the matter by clear and convincing evidence.

E. Notwithstanding the foregoing, the following persons may bring an action to avoid a qualified disposition:

1. to the extent of a debt owed to any person on or before the date of a qualified disposition on account of an agreement or order of a court for the payment of support or alimony in favor of the transferor's spouse, former spouse or children, or for a division or distribution of property in favor of the transferor's spouse or former spouse;

2. to the extent of a claim against the transferor or other person for whom the transferor is or was vicariously liable by a person who suffers death, personal injury or property damage on or before the qualified disposition by a transferor, which death, personal injury or property damage is determined to have been caused by the tortious act or omission of the transferor or any other person that the transfer is or was vicariously liable. R.I. Gen. Laws § 18-9.2-5.

F. 1. A creditor of a transferor whose claim originated before or after a qualified disposition has only such rights with respect to a qualified disposition as are provided in §§ 18-9.2-5 and 18-9.6-6 of the Rhode Island General Laws, inclusive. Additionally, a creditor or assignee may not have a claim against any of the following:

a. a trustee; or

b. advisor (including a trust protector); or

c. any person involved in counseling, drafting, administering, preparing, executing or funding of the trust. R.I. Gen. Laws § 18-9.2-4(d).

2. Additionally, all actions involving a qualified disposition are barred unless filed against a trustee, trust protector, trust advisor or other fiduciary involved in the counseling, drafting, preparation, administration, execution or funding of a trust if, as of the date such action is brought, an action by a creditor with respect to such qualified disposition would be barred. R.I. Gen. Laws § 18-9.2-4(e).

G. 1. A qualified disposition will be avoided only to the extent necessary to satisfy a transferor's debt to a creditor (including any costs if authorized by a court) who

successfully filed an action to have the qualified disposition avoided. R.I. Gen. Laws § 18-9.2-6(a).

2. If a qualified disposition is avoided and a court concludes that the trustee did not act in bad faith in accepting or administering property that is the subject of the qualified disposition, such trustee will be given a first lien against the property that is the subject of the qualified disposition equal to the amount of the costs (including attorney's fees) properly incurred in defending the action or proceedings to avoid the qualified disposition. Additionally, the qualified disposition will be avoided subject to the proper fees, costs, pre-existing rights, claims and interests of the qualified trustee (and any predecessor qualified trustee that did not act in bad faith). It is presumed that a qualified trustee did not act in bad faith by merely accepting property that is subject of a qualified disposition. R.I. Gen. Laws § 18-9.2-6(b)(1).

3. If a qualified transfer is avoided and a court concludes that a beneficiary of a trust did not act in bad faith, the beneficiary will be permitted to retain any distribution received by the beneficiary as a result of the exercise of discretion granted to the qualified trustee provided such power or discretion was properly exercised before the creditor commenced an action to avoid the qualified disposition. It is presumed that a beneficiary (including the transferor) did not act in bad faith in settling the trust or accepting a distribution permitted by the trust. R.I. Gen. Laws § 18-9.2-6(b)(2).

4. A creditor has the burden of proving by clear and convincing evidence that a trustee or beneficiary acted in bad faith except in the case of a transferor-beneficiary in which case the creditor's burden is to prove bad faith is a preponderance of the evidence. R.I. Gen. Laws § 18-9.2-6(b)(2)(c).

XV. NEVADA LAW.

A. Nevada law permits both residents and non-residents to create asset protection trusts. See the Spendthrift Trust Act of Nevada set forth in § 166.010 of the Nevada Revised Statutes, *et. seq*. Nevada also boasts the shortest applicable period for a creditor to challenge a transfer to an asset protection as a fraudulent conveyance among states with domestic asset protection trust statutes.

B. 1. In Nevada, a "**spendthrift trust**" is defined as a trust that by its terms contains a valid restraint on the voluntary and involuntary transfer of the interest of the beneficiary. Nev. Rev. Stat. § 166.020.

2. No specific language is required for the creation of a spendthrift trust and it is sufficient if by the terms of the writing the creator manifests an intention to create such a trust. Nev. Rev. Stat. § 166.050.

C. 1. Any person competent to execute a will or deed may, by a writing, duly executed, by will, conveyance or other writing, create a spendthrift trust in real, personal or mixed property for the benefit of the settlor or the settlor and another person if the writing is:

a. "**irrevocable**;"

b. does not "**require**" that any part of the income or principal of the trust be distributed to the settlor; and

c. was not intended to hinder, delay or defraud known creditors.

2. A writing is considered "**irrevocable**" notwithstanding that the settlor may veto a distribution of income and/or principal from the spendthrift trust or although the settlor possesses a special *inter vivos* or testamentary special power of appointment or similar power; and

3. A writing does not "**require**" a distribution to the settlor if the settlor may receive such distribution only in the discretion of another person. Nev. Rev. Stat. § 166.040.

D. Unless the trust instrument expresses a contrary intention, the Spendthrift Trust Act of Nevada governs the construction, operation and enforcement in Nevada of all spendthrift trusts created in or outside of Nevada if:

1. all or part of the land, rents, issues or profits are in Nevada;

2. all or part of the property, interest on money, dividends upon stock and other produce thereof, affected, are in Nevada;

3. the declared domicile of the settlor of a spendthrift trust affecting personal property is in Nevada; or

4. at least one (1) trustee that is qualified (as provided under E) below has the powers that include maintaining records and preparing income tax returns for the trust and all or part of the administration of the trust is performed in Nevada. Nev. Rev. Stat. § 166.015(1).

E. If the settlor is a beneficiary of the trust, at least one (1) trustee of the spendthrift trust must be:

1. a natural person who resides and has his domicile in Nevada;

2. A trust company that:

a. is organized under federal law or under the laws of Nevada or another state; and

b. maintains an office in Nevada for the transaction of business; or

3. A bank that:

a. is organized under federal law or under the laws of Nevada or another state;

b. maintains an office in Nevada for the transaction of business; and

c. possesses and exercises trust powers.

Nev. Rev. Stat. § 166.015(2).

F. Unless the trust instrument declares otherwise, the Spendthrift Trust Act of Nevada also governs the construction, operation and enforcement, outside of Nevada, of all spendthrift trusts created in Nevada, except so far as prohibited by valid laws of other states. Nev. Rev. Stat. § 166.015(3).

G. A creditor may not bring an action with respect to a transfer of property to a spendthrift trust:

1. If the creditor is a creditor when the transfer is made, unless such action is brought within:

a. Two (2) years after the transfer is made; or

b. Six (6) months after the creditor discovers or reasonably should have discovered the transfer, whichever is later; or

2. If the creditor becomes a creditor subsequent to the transfer to the spendthrift trust, unless the action is brought within two (2) years after the transfer is made to the spendthrift trust. Nev. Rev. Stat. § 166.170.

H. In *Dahl v. Dahl*, Utah County Civil No. 090402989 (Utah.Distr.4th, Nov. 11, 2011), a Utah trial court in Provo, Utah denied a spouse's request to consider the assets of a domestic asset protection trust (the "**Trust**"), established in Nevada and created by her husband, in the division of marital assets. Note that Utah is a DAPT state. See Article X, above.

Dr. Charles F. Dahl ("**Charles**") and Kim Dahl ("**Kim**") married in 1992 and were living in Utah during their marriage. In 2002, Charles created the Trust, naming his brother, C. Robert Dahl, as investment trustee (the "**Trustee**"). The discretionary beneficiaries of the Trust were Charles, Kim, their issue and organizations to be designated by Charles. Shortly after the Trust was created, Charles transferred 97% of a Utah LLC to the Trust, retaining a 1% interest for himself and 1% for each of his two children. The LLC owned brokerage accounts valued at just under $1 million. In 2003, Charles and Kim transferred their primary residence to the Trust.

Beginning in 2006, Charles and Kim became embroiled in a highly-contested divorce. While the divorce was still pending, Kim brought an action in the Fourth Judicial District Court, Appellate Court in Utah County (the "**Court**") seeking to attack the Trust on a number of grounds. In her petition, Kim sought the following relief from the Court with regard to the Trust: (i) a determination that the Trust should be null and void, (ii) a determination that Kim had an immediate interest in the Trust and (iii) a determination that the Trust was revocable. The Court granted a Motion for Summary Judgment by Charles on all three issues.

On the first claim, the Court ruled that "null and void" is not a formal cause of action. The Court noted that under the law set forth in *Ockey v. Lehmer*, 189 P.3d 51 (Utah 2008), contracts that offend an individual, such as those arising from fraud, misrepresentation, or mistake, are voidable, and only contracts that offend public policy or harm the public are void *ab initio*. Kim failed to accuse Charles of anything actionable under Ockey. Therefore, the Court found no basis on which to find the Trust "null and void."

With regard to the second claim, the Court noted that Trust distributions could only be made in the absolute discretion of the Trustee and, additionally, were subject to Charles' veto power. Kim was merely a discretionary beneficiary. Therefore, the Court found that Kim had no immediate interest in the corpus of the Trust.

Regarding the third claim, the Court ruled that the language used in the Trust reserved a statutory right to amend with the consent of all beneficiaries and did not, as Kim argued, create a general right to amend or alter the terms of the Trust. On the contrary, the Court noted that the Trust clearly reflected Charles' intention that it be irrevocable. The Court pointed out that the "most compelling" counter-argument was based on the relevant Nevada statute, NRS 163.560, which provided that a trust explicitly declared to be irrevocable is irrevocable for all purposes. The Court noted that under *Innerlight, Inc. v. Matrix Group, LLC*, 2009 UT 31, choice of law and choice of forum provisions in contracts and legal document are enforceable. The Court upheld Charles' choice of Nevada law and found that it was irrevocable under NRS 163.560.

Kim appealed ruling on August 7, 2012, making the following arguments:

1. The Trust was revocable under Utah law;

2. The Court erred in resorting to Nevada law as an alternative basis to find the Trust irrevocable because the application of Nevada law leads to a result that violates Utah's public policy;

3. The Court abused its discretion in entering summary judgment on Kim's alter ego theory without allowing her to conduct discovery; and

4. The Court erred in issuing a hypothetical ruling that a cause of action not before him would have been barred by the state of limitations.

Upon Kim's appeal to the Supreme Court of Utah, the court held that Utah law applies, that the Trust was revocable as a matter of law, and that Kim was entitled to withdraw her share of the marital property she contributed to the Trust as a settlor.

Kim asserted that the district court erred when it declared that she had no enforceable interest in Trust assets, the Court reversed the district court, determining that Utah law applied because of its strong public policy interest in the equitable division of marital assets, and that Utah state law should apply to the trust even though the stated choice of law in the trust was Nevada. The Court's opinion cited to *Waddoups v. Amalgamated Sugar Co.*, 2002 UT 69, ¶ 14, 54 P.3d 1054, for the authority that Utah choice-of-law rules apply whereby although Utah will generally enforce a choice-of-law provision contained in a trust document, it would not do so if

such a reading would undermine a strong public policy of the State of Utah, see UTAH CODE § 75-7-107 & cmt. ("This section does not attempt to specify the strong public policies sufficient to invalidate a settlor's choice of governing law."); see also Jacobsen Constr. Co. v. Teton Builders, 2005 UT 4, ¶ 19, 106 P.3d 719 (refusing to allow parties to "employ choice of law provisions to force forum states to enforce contractual terms wholly repugnant to local public policy"). Thus, the court refused to enforce a settlor's choice-of-law since doing so undermined Utah's strong public policy goals.

Kim argued that the Trust was revocable under Utah law, despite the Trust stating "Trust Irrevocable," because Charles reserved in the Trust an unrestricted power to amend the Trust as the Trust stated "Settlor reserves *any power whatsoever* to alter or amend *any* of the terms or provisions hereof. Emphasis added)." Charles argued that the stated Trust lanaguge did not give him a right to unilaterally amend, alter or terminate the trust without consent from all beneficiaries. Charles did not argue that there may have been a typographical error (i.e., using the term "any" instead of the term "no"); this may have been the better argument of the two. The Supreme Court of Utah was unpersuaded, analyzing secondary sources (Restatement (Second) of Trusts and The Law of Trusts and Trustees) and citing to Utah law (Utah Code Ann. § 75-7-605) for the proposition that an unrestricted power to amend any and all provisions of a trust renders a trust revocable under Utah Law.

After holding that the Trust was revocable under Utah law, the Supreme Court of Utah dismissed Charles' argument that Kim had no enforceable interest in the trust because Utah law prohibited her from withdrawing her assets from an irrevocable trust under Utah Code Ann. § 75-7-605(2). Charles argued that Kim could not revoke the Trust with regards to the portion of Trust property attributable to her sepearate property or any marital property. The Supreme Court of Utah concluded that Kim was a settlor of the Trust, despite having nothing to do with the preparation of the Trust and not signing the Trust or related documents. A trust under Utah law is created by the transfer of property by the owner to another person acting as trustee. Utah Code Ann. § 75-7-401(1)(a). It was indisputable that Kim contributed property to the Trust. Kim neither knowingly nor intentionally forfeited her status as a settlor. As a settlor of the Trust, Kim could revoke that portion of the Trust funded with either her marital or separate property. See Utah Code Ann. § 75-7-605(2).

For an excellent discussion of *Dahl*, see the commentary by Steve Oshins and Jeremy Spackman in LISI Asset Protection Planning Newsletter #227 (July 3, 2013) at http://www.leimbergservices.com and in Asset Protection Planning Newsletter #283, February 12, 2015, at http://www.leimbergservices.com. For additional background and commentary on the case, see the commentary by Steve Oshins and Jeremy Spackman in LISI Asset Protection Planning Newsletter #227 (July 3, 2013) at http://www.leimbergservices.com and the commentary by Jay Adkisson in LISI Asset Protection Planning Newsletter #291 (Apr. 16, 2015) at http://www.leimbergservices.com. For a discussion of the Nevada Act, see Elizabeth Brickfield, Var Lordahl and Matthew Policastro, "The Myths and Realities of Nevada Self-Settled Asset Protection Trusts," 23 Nevada Lawyer 10 (Jan. 2015); and Kriston Simmons, "Trusts under Nevada Law," in LISI Asset Protection Planning Newsletter #290 (Apr. 13, 2015) at http://www.leimbergservices.com.

I. Nevada permits decanting under Nev. Rev. Stat. § 163.556. Following an amendment in 2015 to the statute, a trustee is permitted to decant a Nevada trust into a new trust that removes a fixed income interest, so long as the first trust from which the trustee is decanting did not qualify for a marital deduction, charitable deduction, or was not one that paid a qualified interest pursuant to § 2702. If the trust being decanted did qualify for a marital deduction, charitable deduction or is one that pays a qualified interest under § 2702, the trust may be decanted, so long as the new trust does not reduce the income interest of an income beneficiary under the first trust. For commentary on updates to Nevada's decanting statute, as well as other estate and trust laws, see Kriston Simmons, "SB484: Nevada Legislature Allows for Greater Flexibility with Irrevocable Trusts," in LISI Estate Planning Newsletter #2313 (June 16, 2015) at http://www.leimbergservices.com.

XVI. MISSOURI LAW.

A. Missouri law permits residents and non-residents to create asset protection trusts. See 456.5-505 of the Missouri Revised Statutes.

B. 1. According to Missouri Revised Statutes § 456.5-505, an irrevocable trust with a spendthrift provision will prevent the settlor's creditors from satisfying claims from the trust assets except:

a. where the conveyance of the assets to the trust was fraudulent as to creditors pursuant to Chapter 428 of the Missouri Revised Statutes; or

b. to the extent of the settlor's beneficial interest in the assets of the trust, if at the time the trust became irrevocable:

i. the settlor was the sole beneficiary of either income or principal of the trust or retained the power to amend the trust; or

ii. the settlor was one of a class of beneficiaries and retained a right to receive a specific portion of the income or principal of the trust that was determinable solely from the provisions of the trust instrument.

C. 1. A spendthrift provision is valid if it restrains either the voluntary or involuntary or both the voluntary and involuntary transfer of a beneficiary's interest.

2. Use of terms in a trust that provide the interest of a beneficiary is held subject to a "**spendthrift provision**" or words of similar import is sufficient to restrain both the voluntary and involuntary transfers of the beneficiary's interests. Mo. Rev. Stat. § 456.5-502.

D. 1. Pursuant to the Missouri Fraudulent Transfer Act, a creditor's claim is extinguished as follows:

a. if the debtor made the transfer or incurred the obligation with actual intent to hinder, delay or defraud any creditor the action must be brought within four (4) years after the transfer was made or the obligation was incurred or, if later, within one (1) year after the transfer or obligation was or could reasonably have been discovered by the claimant;

b. if the debtor made the transfer or incurred the obligation, without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor 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 would incur, debts beyond his ability to pay as such debts became due, an action must be brought within four (4) years after the transfer was made or the obligation was incurred; or

c. if a debtor made a transfer which is fraudulent as to a creditor whose claim originated before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time and the insider had reasonable cause to believe that the debtor was insolvent, an action must be brought within one (1) year after the transfer was made or the obligation was incurred. Mo. Rev. Stat. §§ 428.049; 428.024.

2. In determining whether there was actual intent to make a fraudulent conveyance under the Missouri Fraudulent Transfer Act, consideration is given, but not limited to, the following factors:

a. transfer or obligation was to an insider;

b. debtor retained possession or control of the transferred property after the transfer;

c. transfer or obligation was disclosed or concealed;

d. before the transfer was made or obligation incurred, the debtor had been sued or threatened with suit;

e. transfer was of substantially all the debtor's assets;

f. debtor absconded;

g. debtor removed or concealed assets;

h. value of consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

i. debtor was insolvent or became insolvent shortly after the transfer was made or the obligation incurred;

j. transfer occurred before or shortly after a substantial debt was incurred; and

k. debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

E. For a recent Missouri case addressing issues related to its trust code see *In re Reuter*, 499 B.R. 655 (W.D. Mo. 2013). See also Pennel, "Pennel on In re Reuter," LISI Asset Protection Planning Newsletter #234 (January 8, 2014) at http://www.leimbergservices.com.

XVII. COLORADO LAW.

A. Colorado law does not contain extensive statutory provisions permitting wealth protection trusts, however, §38-10-111 of the Colorado Revised Statutes provides:

> All deeds of gift, all conveyances, and all transfers or assignments, verbal or written, of goods, chattels, or things in action, or real property, made in trust for the use of the person making the same shall be void as against the creditors existing of such person.

It is possible that this provision condones the creation of self-settled wealth protection trusts under certain circumstances in Colorado. See *e.g.*, *In re: Baum*, 22 F.3d 1014 (1994). See, however, Sitkoff, "State Competition for Trust Funds," Ch. 12 University of Miami Heckerling Institute on Estate Planning 40, fn. #69 (2008) providing, "Some commentators have read an older statute in Colorado as authorizing APTs as to future creditors, see Colo. Rev.Stat. Ann. § 38-10-111, but in *dicta* the Colorado Supreme Court has rejected that interpretation. *In re Cohen*, 8 P.3d 429, 432-34 (Colo. 1999)."

B. To access this provision on the web go to: http://198.187.128.12/colorado/lpext.dll/Infobase4/58f06/59614/59797/59892?fn=document-frame.htm&f=templates&2.0.

XVIII. SOUTH DAKOTA LAW.

A. South Dakota law enables residents and non-residents to create asset protection trusts under § 55-16-1, *et. seq* of the South Dakota Codified Laws ("**SDCL**").

B. A "**trust instrument**" is defined as an instrument appointing a "**qualified trustee**" for the "**property**" that is the subject of a "**disposition**" and such instrument:

1. expressly incorporates the law of South Dakota to govern the validity, construction and administration of the trust;

2. is irrevocable; and

3. provides that the interest of the transferor or other beneficiary in the trust property or the income therefrom may not be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily, before the qualified trustee actually distributes the property or income therefrom to the beneficiary, and that such provision shall be deemed to be a restriction on the transfer of the transferor's beneficial interest in the trust that is enforceable under applicable nonbankruptcy law within the meaning of 11 U.S.C. § 541(c)(2). SDCL § 55-16-2.

C. A trust instrument is not considered revocable because the transferor retains one or more of the following powers:

1. the power to veto a distribution from the trust;

2. a power of appointment, other than a power to appoint to the transferor, the transferor's creditors, the transferor's estate or the creditor's of the transferor's estate, exercisable by will or other written instrument effective only upon the transferor's death;

3. the potential or actual receipt of income, including rights to such income retained in the trust instrument;

4. the potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust (as such terms are defined in § 664 of the Code);

5. the receipt each year of a percentage specified in the trust instrument (not to exceed five percent (5%)) of the initial value of the trust or its value determined from time to time pursuant to the trust instrument;

6. the potential or actual receipt or use of principal if such potential or actual receipt or use of principal would be the result of a qualified trustee, including a qualified trustee acting at a trust advisor's direction, acting either in such qualified trustee's sole discretion or pursuant to an ascertainable standard in the trust instrument;

7. the potential or actual use of real property held under a qualified personal residence trust (within the meaning of such term as described in § 2702(c) of the Code); and

8. a pour back provision that pours back to the transferor's will or revocable trust all or part of the trust assets. *Id.*

D. 1. Under § 55-16-1(8) of the SDCL, the term "**transferor**" means any "**person**" who is:

a. an owner of property;

b. a holder of a power of appointment which authorizes the holder to appoint in favor of the holder, the holder's creditors, the holder's estate or the creditor's of the holder's estate; or

c. a trustee, who directly or indirectly, makes a disposition or causes a disposition to be made.

2. The term "**person**" means an individual, a corporation, a partnership, an association, a joint stock company, a business trust, a trust, an unincorporated organization, or two or more persons having a joint or common interest. SDCL § 55-4-1.

E. 1. According to § 55-16-3 of the SDCL, the term "**qualified trustee**" means:

a. a natural person who is a resident of South Dakota, other than the transferor; or

b. a person authorized by South Dakota to act as a trustee or a regulated financial institution which:

i. maintains or arranges for custody in South Dakota of some or all of the property that is subject of the qualified disposition;

ii. maintains records for the trust on an exclusive or nonexclusive basis;

iii. prepares or arranges for the preparation of fiduciary income tax returns for the trust; or

iv. otherwise materially participates in the administration of the trust.

2. a. According to § 55-16-4 of the SDCL, the following persons cannot be a qualified trustee:

i. a transferor;

ii. a natural person who is not a resident of South Dakota;

iii. an entity not authorized by the laws of South Dakota to act as a trustee.

b. Notwithstanding the foregoing, a transferor may appoint one or more co-trustees, trust advisors, trust protectors or other fiduciaries, including:

i. a fiduciary who has authority to remove and appoint qualified trustees or trust advisors;

ii. a fiduciary who has authority under the terms of the trust instrument to direct, consent to, or disapprove a distribution from the trust; and

iii. any fiduciary whether or not such fiduciary is a qualified trustee. SDCL § 55-16-4.

3. A transferor may only serve as a fiduciary in the limited capacity to veto distributions as described under § 55-16-2(2). SDCL § 55-16-5.

F. If a trustee ceases to qualify as a qualified trustee, such trustee is deemed to have resigned at that time and is replaced with a successor trustee appointed in the trust instrument or by court order. SDCL § 55-16-6.

G. The term "**property**" means real property, personal property and interests in real or personal property. SDCL § 55-16-1(5).

H. 1. A "**disposition**" is a transfer, conveyance or assignment of property, including a change of the legal ownership of property occurring upon the substitution of one trustee for another or the addition of one or more new trustees and includes the exercise of a power so as to cause a transfer of property to a trustee. SDCL § 55-16-1(4).

2. The term "**qualified disposition**" means a disposition by or from a transferor to a qualified trustee, with or without consideration, by means of a trust instrument. SDCL § 55-16-1(6).

I. 1. No type of action, including an action to enforce a judgment entered by a court or other adjudicative authority, may be filed at law or in equity for attachment or any other remedy against any property that is the subject of a qualified disposition or for the avoidance of a qualified disposition unless the action is filed pursuant the Uniform Fraudulent Transfer Act of chapter 54-8A. SDCL § 55-16-9.

2. Notwithstanding §§ 55-16-9 to 55-16-14, the following persons may bring an action against a trust subject to a qualified disposition:

a. a person who is owed alimony or child support payments to the extent of such debt; and

b. any person who suffers death, personal injury or property damage on or before the date of a qualified disposition by a transferor and such death, personal injury or property damage is determined to be caused by the transferor's act or omission or the transferor is vicariously liable. SDCL § 55-16-15.

3. A claim for relief with respect to a fraudulent transfer of a settlor's assets under § 55-16-9 is extinguished unless the action is brought by a creditor of the settler meeting one of the following requirements:

a. two years after the transfer is made; or

b. six months after the transfer is or reasonably could have been discovered by the creditor if the creditor:

i. demonstrates that the creditor asserted a specific claim against the settler before the transfer; or

ii. files another action, other than an action under § 55-16-9, against the settler that asserts a claim based on an act or omission of the settlor that occurred before the transfer, and the action is filed within two years after the transfer; or

c. becomes a creditor subsequent to the transfer into the trust, and the action under § 55-16-9 is brought within two years after the transfer is made.

4. In any action against property that is the subject of a qualified disposition or for the avoidance of a qualified disposition, the creditor has the burden to prove the matter by clear and convincing evidence. *Id.*

5. A creditor or assignee of a transferor whose claim arose before or after a qualified disposition has only such rights with respect to a qualified disposition as are provided in §§ 55-16-9 to 55-16-16 of the SDCL, inclusive. Additionally, a creditor or assignee may not have a claim against:

a. a trustee or trust protector; or

b. advisor (including a trust protector); or

c. any person involved in counseling, drafting, administering, preparing, executing or funding of the trust. SDCL § 55-16-12.

6. Moreover, all actions involving a qualified disposition are barred unless filed against a trustee, trust protector, trust advisor or other fiduciary involved in the counseling, drafting, preparation, administration, execution or funding of a trust that is the subject of a qualified disposition within the period provided by the Uniform Fraudulent Transfer Act. SDCL § 55-16-13.

J. 1. A qualified disposition will be avoided only to the extent necessary to satisfy a transferor's debt to a creditor (including any costs if authorized by a court) who successfully filed an action to have the qualified disposition avoided. SDCL § 55-16-16.

2. If a qualified disposition is avoided and a court concludes that a qualified trustee did not act in bad faith in accepting or administering property that is the subject of the qualified disposition, such trustee will be given a first lien against the property that is the subject of the qualified disposition equal to the amount of the costs (including attorney's fees) properly incurred in defending the action or proceedings to avoid the qualified disposition. Additionally, the qualified disposition will be avoided subject to the proper fees, costs, pre-existing rights, claims and interests of the qualified trustee (and any predecessor qualified trustee that did not act in bad faith). It is presumed that a qualified trustee did not act in bad faith by merely accepting property that is subject of a qualified disposition. *Id*.

3. If a qualified transfer is avoided and a court concludes that a beneficiary of a trust did not act in bad faith, the beneficiary will be permitted to retain any distribution received by the beneficiary as a result of the exercise of discretion granted to the qualified trustee provided such power or discretion was properly exercised before the creditor commenced an action to avoid the qualified disposition. It is presumed that a beneficiary (including the transferor) did not act in bad faith in settling the trust or accepting a distribution permitted by the trust. *Id.*

K. Notwithstanding any other provision of law, no action of any kind, including an action to enforce a judgment entered by a court or other body having adjudicative authority, may be brought at law or in equity against the trustee, or advisor described in § 55-16-4, of a trust that is the subject of a qualified disposition, or against any person involved in the

counseling, drafting, preparation, execution, or funding of a trust that is the subject of a qualified disposition, if, as of the date such action is brought, an action by a creditor with respect to such qualified disposition would be barred under §§ 55-16-9 to 55-16-12. A South Dakota court has exclusive jurisdiction over an action brought under a claim for relief that is based on a transfer of property to a trust that is the subject of qualified disposition. A South Dakota court may award attorneys' fees and costs to the prevailing party in such an action. SDCL § 55-16-13.

L. Effective July 1, 2016, South Dakota law authorizes the creation of a community property trust by married resident and nonresidents of South Dakota. Property transferred to the trust, which may be revocable or irrevocable, will be considered community property under South Dakota law. This enables settlors to achieve a 100 percent income tax basis step-up at the death of the first to die spouse. Bill Lipkind & Terry Prendergast: New South Dakota Special Spousal Trust, **LISI** Estate Planning Newsletter #2433, (July 7, 2016) at http://www.LeimbergServices.com.

XIX. TENNESSEE LAW.

A. Tennessee has asset protection trust legislation. Tennessee permits a resident and non-resident to create an "**Investment Services Trust**" under the Tennessee Investment Services Act of 2007 ("**TISA**"). § 35-15-505(a)(2) of the Tennessee Code.

B. According to § 35-16-102(7) of the Tennessee Code, an Investment Services Trust is an instrument appointing a "**qualified trustee**" for the property that is the subject of a "**disposition**," and such instrument:

1. expressly incorporates the law of Tennessee to govern the validity, construction and administration of the trust;

2. is irrevocable; and

3. provides that the interest of the transferor or other beneficiary in the trust property or the income may not be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily, before the qualified trustee actually distributes the property or income to the beneficiary.

C. The term "**transferor**" means a person who is the owner of property, a holder of a power of appointment which authorizes the holder to appoint in favor of the holder, the holder's creditors, the holder's estate or the creditors of the holder's estate or a trustee and who, directly or indirectly makes a disposition or causes a disposition to be made. § 35-16-102(15) of the Tennessee Code.

D. A trust agreement will not be considered revocable because a transferor retains any one or more of the following powers:

1. the power to veto a distribution;

2. a power of appointment (other than a power to appoint to the transferor, the transferor's creditors, the transferor's estate or the creditor's of the transferor's estate) exercisable by will or other written instrument of the transferor effective only upon the transferor's death;

3. the potential or actual receipt of income, including rights to such income retained in the trust;

4. the potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust (as such terms are defined in § 664 of the Code);

5. the receipt each year of an amount specified in the trust, and such amount is not to exceed five percent (5%) of the initial value of the trust or its value determined from time to time pursuant to the trust;

6. the potential or actual receipt or use of principal if such potential or actual receipt or use of principal would be the result of a qualified trustee's acting:

a. in the qualified trustee's discretion;

b. pursuant to a standard that governs the distribution of principal and does not confer upon the transferor a power to consume, invade or appropriate property for the benefit of the transferor unless the transferor's power is limited by an ascertainable standard relating to the health, education, support or maintenance (within the meaning of §§ 2041(b)(1)(A) or 2514(c)(1) of the Code); or

c. at the direction of an advisor who is acting:

i. in such advisor's discretion; or

ii. pursuant to a standard that governs the distribution of principal and does not confer upon the transferor a power to consume, invade or appropriate property for the benefit of the transferor unless the transferor's power is limited by an ascertainable standard relating to the health, education, support or maintenance (within the meaning of §§ 2041(b)(1)(A) or 2514(c)(1) of the Code);

7. the right to remove a trustee or advisor and to appoint a new trustee or advisor; provided, however, that such right shall not include the appointment of a person who is a related or subordinate party with respect to the transferor (within the meaning of § 672(c) of the Code); and

a. the potential or actual use of real property held under a qualified personal residence trust (within the meaning of such term as described in § 2702(c) of the Code). § 35-16-111 of the Tennessee Code.

E. 1. Under § 35-16-102(4) of the Tennessee Code, the term "**disposition**" means a transfer, conveyance or assignment of property including a change in the legal

ownership of property occurring upon the substitution of one (1) trustee for another or the addition of one (1) or more new trustees. The term also encompasses the exercise of a power that causes a transfer to a trustee or trustees; however, the term does not include the release or relinquishment of an interest in property that until the release or relinquishment was the subject of a qualified disposition.

2. A "**qualified disposition**" is a disposition by or from a transferor with or without consideration, to an Investment Services Trust after the transferor executes a "**qualified affidavit**" in accordance with § 35-16-102(10). § 35-16-102(11) of the Tennessee Code.

3. Under § 35-16-102(10) the term qualified affidavit means a sworn affidavit signed by the transferor prior to a disposition of assets to an Investment Services Trust that states the:

a. transferor has full right, title and authority to transfer the assets to the trust;

b. transfer of the assets to the trust will not render the transferor insolvent;

c. transferor does not intend to defraud a creditor by transferring the assets to the trust;

d. transferor does not have any pending or threatened court actions against the transferor, except those court actions identified by the transferor on an attachment to the affidavit;

e. transferor is not involved in any administrative proceedings except for those administrative proceedings identified on an attachment to the affidavit;

f. transferor does not contemplate filing for relief under the provisions of the federal bankruptcy code; and

g. assets being transferred to the trust were not derived from unlawful activities.

i. For a discussion of the purpose of providing an affidavit of solvency, see "Gassman & Daniels, The Affability of Affidavits in Domestic Asset Protection Trust Planning," Steve Leimberg's Asset Protection Planning Newsletter #293 (Apr. 28, 2015).

F. Under § 35-16-102(12) of the Tennessee Code, the term "**qualified trustee**" means:

1. in the case of a natural person, an individual who is a resident of Tennessee, and in all other cases, a person authorized by Tennessee law to act as a trustee and whose activities are subject to supervision by the Tennessee department of financial

institutions, the federal deposit insurance corporation, the comptroller of the currency or the office of thrift supervision and such person:

a. maintains or arranges for custody in Tennessee of some or all of the property that is the subject of the qualified disposition, maintains records for the Investment Services Trust on an exclusive or nonexclusive basis, prepares or arranges for the preparation of required income tax returns for the Investment Services Trust, or otherwise materially participates in the administration of the Investment Services Trust; and

b. is not the transferor of the Investment Services Trust.

G. 1. No type of action, including an action to enforce a judgment entered by a court or other adjudicative authority, may be filed at law or in equity for attachment or any other remedy against property that is subject to a qualified disposition to an Investment Services Trust property or for the avoidance of a qualified disposition to an Investment Services Trust unless the action is brought pursuant to the provisions of the Uniform Fraudulent Transfer Act, compiled in title 66, chapter 3, part 3. § 35-16-104(a) of the Tennessee Code.

2. Pursuant to § 35-16-104(b) of the Tennessee Code, a creditor's claim is extinguished unless it accrued:

a. before the qualified disposition to an Investment Services Trust was made, and the action is brought within the period set forth in § 66-3-310, that is, within two (2) years after the transfer or obligation was incurred or six (6) months after the person discovers or reasonably should have discovered the qualified disposition; or

b subsequently to the qualified disposition and the action is brought within two (2) years after the qualified disposition is made.

H. No person may bring an action with respect to a transfer of property to a spendthrift trust:

1. if the person is a creditor when the transfer is made, unless the action is commenced within the later of two years after the transfer is made or six months after the person discovers or reasonably should have discovered the transfer; or

2. if the person becomes a creditor after the transfer is made, unless the action is commenced within two years after the transfer is made; and

I. No creditor may bring such an action unless that creditor proves by clear and convincing evidence that the settlor's transfer to the trust was made with the intent to defraud that specific creditor.**]

1. A creditor shall have only such rights against a qualified disposition as are provided in § 35-16-104(d) of the Tennessee Code. Additionally, a creditor may not have a claim against:

a. a trustee;

b. an advisor (including a trust protector) of an Investment Services Trust; or

c. any person involved in the counseling, drafting, preparation, execution and funding of an Investment Services Trust.

2. Furthermore, all actions involving a qualified disposition to an Investment Services Trust are barred unless the action is brought against a trustee, advisor or against any person involved in the counseling, drafting, preparation, administration, execution or funding of the trust within the periods provided under § 35-16-104 of the Tennessee Code.

3. A qualified disposition to an Investment Services Trust will be avoided only to the extent necessary to satisfy the transferor's debt to the creditor (including any costs if authorized by a court) who successfully avoided a qualified disposition to an Investment Services Trust. § 35-16-106(a) of the Tennessee Code.

4. If a qualified disposition to an Investment Services Trust is avoided pursuant to § 35-16-104 of the Tennessee Code and a court concludes that the qualified trustee did not act in bad faith in accepting or administering the property that is the subject of the qualified disposition, such trustee will be given a first lien against the property that is the subject of the qualified disposition equal to the entire cost (including attorney's fees) properly incurred in defending the action or proceedings to avoid the qualified transfer. The qualified disposition will be avoided subject to the proper fees, costs, preexisting rights, claims and interests of the qualified trustee (and any predecessor qualified trustee that did not act in bad faith). It is presumed that a qualified trustee did not act in bad faith by merely accepting property that is subject of a qualified disposition. § 35-16-106(b) of the Tennessee Code.

5. If a qualified disposition to an Investment Services Trust is avoided pursuant to § 35-16-104 of the Tennessee Code and a court concludes that a beneficiary of an Investment Services Trust did not act in bad faith, the beneficiary will be permitted to retain any distribution received by him, her or it as a result of the exercise of discretion granted to the qualified trustee provided such power or discretion was properly exercised before the creditor commenced an action to avoid the qualified disposition. It is presumed that a beneficiary (including the transferor) did not act in bad faith in by transferring property to the trust or accepting a distribution permitted by the trust. *Id*.

J. For an excellent discussion of the Tennessee asset protection law, see Rick Travis & Wick Ruehling: Creating a Self-Settled Asset Protection Trust in Tennessee, **LISI** Asset Protection Planning Newsletter #276, (December 9, 2014) at http://www.LeimbergServices.com.

K. Tenn. Code Ann § 35-15-505(d) provides:

> With respect to an irrevocable trust for which the settlor made a qualified election pursuant to 26 U.S.C. § 2523(f), the power of a trustee, and any benefit resulting to the settlor from any exercise of such power, whether arising under the trust

agreement or any other provision of the law, to make a distribution to or for the benefit of a settlor or to otherwise permit the settlor to use or benefit from trust property following the death of the settlor's spouse, shall not be considered an amount that may be distributed to or for the settlor's benefit for purposes of subdivision (a)(2). This subsection (d) shall not limit a creditor's remedies under the Uniform Fraudulent Transfer Act, compiled in title 66, chapter 3, part 3, regarding the settlor's transfers to such trust.

XX. WYOMING LAW.

A. Wyoming permits residents and non-residents to create "**qualified spendthrift trusts**." See W.S. 4-1-510.

B. According to Wyoming law, a "**settlor**" may create a qualified spendthrift trust by a trust instrument that appoints a "**qualified trustee**" for "**qualified trust property**," and the trust instrument:

1. states it is a qualified spendthrift trust under W.S. 4-10-510;

2. expressly incorporates the law of Wyoming to govern the validity, construction and administration of the trust;

3. provides the settlor's interest in the trust income and principal, or both, is held subject to a spendthrift provision under W.S. 4-10-501 and such provision in the trust will be deemed a restriction on the transfer of the settlor's beneficial interest in the trust that is enforceable under applicable nonbankruptcy law within the meaning of §541(c)(2) of the Bankruptcy Code; and

4. is irrevocable. *Id.*

C. However, for purposes of W.S. 4-10-510, a trust agreement is considered irrevocable despite retention by the settlor of the following powers by the settlor:

1. the power to veto a distribution from the trust;

2. an *inter vivos* or testamentary general or limited power of appointment;

3. the potential or actual receipt of income;

4. the potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust;

5. the receipt each year of a percentage specified in the trust instrument (not to exceed five percent (5%)) of the initial value of the trust or its value determined from time to time pursuant to the trust instrument;

6. the potential or actual receipt or use of principal when a qualified trustee, including a trustee acting at the direction of a trust advisor, other than the settlor,

makes such distribution or grants such use in the trustee's sole discretion or pursuant to an ascertainable standard contained in the trust instrument;

7. the right to add or remove a trustee, trust protector or trust advisor and to appoint a new trustee, trust protector or trust advisor, other than the settlor;

8. the potential or actual use of real property held under a qualified personal residence trust; and

9. the right to serve as an investment advisor to the trust, with the powers provided in W.S. 4-10-712(a)(iii) and (iv). *Id.*

D. 1. Under W.S. 4-10-103(a)(xviii), the term "**settlor**" means a person, including a testator, grantor or trust maker, who creates, transfers or contributes property to, a trust. W.S. 4-10-103(a)(xviii).

2. A "**person**" is defined as an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, government, governmental subdivision, agency or instrumentality, public corporation or any other legal or commercial entity under W.S. 4-10-103(a)(xii).

E. The term "**qualified trustee**" means:

1. a natural person who is a resident of Wyoming;

2. a person authorized by Wyoming to act as a trustee or a regulated financial institution which:

a. maintains or arranges for custody in Wyoming of some or all of the qualified trust property;

b. maintains records for the qualified spendthrift trust on an exclusive or nonexclusive basis;

c. prepares or arranges for the preparation of fiduciary income tax returns for the qualified spendthrift trust; or

d. otherwise materially participates in the administration of the qualified spendthrift trust. W.S. 4-10-103(a)(xxxv).

3. The settlor and any other natural person who is not a resident of Wyoming or an entity that is not authorized by Wyoming to act as a trustee or is not a regulated financial institution may not serve as a qualified trustee. *Id.*

F. The term "**qualified trust property**" means the property of a qualified spendthrift trust including real property, personal property and interests in real or personal property and all gains, appreciation and income thereon which:

1. are the subject of a "**qualified transfer**"; and

2. are acquired with the proceeds of property of a qualified transfer. W.S. 4-10-511.

G. 1. The term "**qualified transfer**" means a transfer, conveyance or assignment of property, by or from a settlor, with or without consideration, to a qualified trustee, under a trust instrument which is a qualified spendthrift trust. W.S. 4-10-512.

2. Qualified transfer also includes a change in the legal ownership of property occurring upon the substitution of a qualified trustee for another or the addition of one (1) or more qualified trustees, or the exercise of a power that causes a transfer of property to a qualified trustee. *Id.*

3. A qualified transfer requires an affidavit from the settlor to the trustee of the qualified spendthrift trust in the form provided in W.S. 4-10-523. *Id.* However, Wyoming is unique among states that presently have domestic asset protection legislation in that it requires the settlor to swear in the affidavit that the settlor has and will maintain personal liability insurance in the amount of one million dollars ($1,000,000) or an amount equal to the value of the property transferred to the qualified spendthrift trust. Although the statute does not expressly state that the trust will lose its qualified spendthrift trust status if the settlor does not maintain the requisite personal liability insurance, the loss of status as a qualified spendthrift trust is implied in such circumstances. This requirement may potentially hinder a Wyoming qualified spendthrift trust from being designed as a completed gift trust for Federal estate and gift tax purposes because of the settlor's ability to subject the trust assets to the claims of his or her creditors by failing to maintain or continue to maintain the requisite personal liability insurance. The statute requiring such liability insurance does not specify the type of liability insurance that is required making this requirement extraordinarily vague.

a. For a discussion of the purpose of providing an affidavit of solvency, see "Gassman & Daniels, The Affability of Affidavits in Domestic Asset Protection Trust Planning," Steve Leimberg's Asset Protection Planning Newsletter #293 (Apr. 28, 2015).

H. 1. No type of action, including an action to enforce a judgment entered by a court or other adjudicative authority, may be filed at law or in equity for attachment or any other remedy against any qualified trust property or to set aside a qualified transfer unless the action is filed pursuant to Wyoming's Fraudulent Transfers Act set forth in W.S. 34-14-201, *et seq*. W.S. 4-10-514.

2. However, the provisions of W.S. 4-10-510 through W.S. 4-10-523 shall not apply in the following instances:

a. debts on account of an agreement or order of court for the payment of support in favor of the settlor's children;

b. qualified trust property that is listed on an application or financial statement used to obtain or maintain credit other than for the benefit of the qualified spendthrift trust; or

c. property of a qualified spendthrift trust transferred to the trust by a settlor who received the property by a fraudulent transfer as defined by the Wyoming Fraudulent Transfers Act. W.S. 4-10-520.

3. Pursuant to the Wyoming Fraudulent Transfers Act, a creditor's claim is extinguished as follows:

a. if the debtor made the transfer or incurred the obligation with actual intent to hinder, delay or defraud any creditor the action must be brought within four (4) years after the transfer was made or the obligation was incurred or, if later, within one (1) year after the transfer or obligation was or could reasonably have been discovered by the claimant;

b. i. if the debtor made the transfer or incurred the obligation, without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor 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 would incur, debts beyond his ability to pay as such debts became due, an action must be brought within four (4) years after the transfer was made or the obligation was incurred; or

ii. if the debtor made the transfer or incurred the obligation after a claim arose and the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of that transfer or obligation, an action must be brought within (4) years after the transfer was made or the obligation was incurred; and

c. if a debtor made a transfer which is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time and the insider had reasonable cause to believe that the debtor was insolvent, an action must be brought within one (1) year after the transfer was made or the obligation was incurred. W.S. 34-14-210.

4. A creditor or assignee of a settlor of a qualified spendthrift trust has only such rights with respect to the qualified trust property as provided in W.S. 4-10-514 through 4-10-523. Additionally, a creditor or assignee may not have a claim against:

a. a trustee or trust protector; or

b. trustee advisor or other fiduciary of the trust; or

c. any person involved in the counseling, drafting, administration, preparation, execution or funding of the trust. W.S. 4-10-517.

5. Moreover, all actions involving a qualified transfer are barred unless filed against a trustee, trust protector, trust advisor or other fiduciary of a qualified spendthrift trust, or against any person involved in the counseling, drafting, preparation, administration,

execution or funding of the trust within the period provided by Wyoming's Fraudulent Transfers Act. W.S. 4-10-518.

6. a. If there is an existing irrevocable trust and the settlor, trustee or trust protector of such trust elects in writing to treat such trust as a qualified spendthrift trust, for purposes of Wyoming's Fraudulent Transfers Act, the transfer shall relate back to the date of such election, if:

i. the trust is modified nonjudicially under W.S. 4-1-111 to conform to the requirements of W.S. 4-10-510 within one year after the election; or

ii. a petition is filed under W.S. 4-10-412 to conform to the provisions of W.S. 4-10-510 within thirty (30) days of the election. W.S. 4-10-516.

b. If the situs of a wealth protection trust in another jurisdiction is moved to Wyoming, for purposes of Wyoming's Fraudulent Transfers Act, the transfer will relate back and be considered made from the date of the original transfer to such trust. W.S. 4-10-515(b).

I. 1. A qualified transfer to a qualified spendthrift trust will be avoided only to the extent necessary to satisfy a settlor's debt to a creditor (including any costs if authorized by a court) who successfully filed an action to have the qualified transfer to a qualified spendthrift trust avoided. W.S. 4-10-521(a).

2. If a qualified transfer to a qualified spendthrift trust is avoided pursuant to Wyoming's Fraudulent Transfers Act and a court concludes that a qualified trustee did not act in bad faith in accepting or administering property that is the subject of the qualified transfer, such trustee will be given a first lien against the property that is the subject of the qualified disposition equal to the amount of the costs (including attorney's fees) properly incurred in defending the action or proceedings to avoid the qualified transfer. Additionally, the qualified transfer will be avoided subject to the proper fees, costs, pre-existing rights, claims and interests of the qualified trustee (and any predecessor qualified trustee that did not act in bad faith). It is presumed that a qualified trustee did not act in bad faith by merely accepting property that is subject of a qualified transfer. *Id*.

3. If a qualified transfer is avoided pursuant to Wyoming's Fraudulent Transfers Act and a court concludes that a beneficiary of a trust did not act in bad faith, the beneficiary will be permitted to retain any distribution received by the beneficiary as a result of the exercise of discretion granted to the qualified trustee provided such power or discretion was properly exercised before the creditor commenced an action to avoid the qualified transfer. It is presumed that a beneficiary (including the settlor) did not act in bad faith in settling the trust or accepting a distribution permitted by the trust. *Id.*

4. A creditor has the burden of proving by clear and convincing evidence that a trustee or beneficiary of a qualified spendthrift trust acted in bad faith, provided, however, the burden of proving that a beneficiary who is also the settlor of the qualified spendthrift trust acted in bad faith shall be a preponderance of the evidence. *Id*.

J. In House Bill 159 (2011 Wyoming Laws Ch. 126), the Wyoming Legislature is considering amending § 4-10-506 of the Wyoming Laws by adding the following provision:

> (e) For purposes of this section, a person who created a trust for his or her spouse under section 2523(e) of the Internal Revenue Code, or for which the election in section 2523(f) of the Internal Revenue Code was made, shall not be treated as a settlor of the trust, as of and after the death of his or her spouse.

For an excellent summary of Wyoming asset protection trust law see, Leonard, "Wyoming Self-Settled Asset Protection Trusts," LISI Asset Protection Planning Newsletter #281, (February 9, 2015) at http://www.LeimbergServices.com.

XXI. NEW HAMPSHIRE LAW.

A. Effective January 1, 2009, New Hampshire law permits residents and non-residents to create asset protection trusts. See § 564-D:1, *et. seq*., of the New Hampshire Qualified Dispositions in Trust Act ("**NHQDTA**").

B. 1. According to § 564-D:2 of NHQDTA, a "**trust instrument**" means a trust instrument appointing a "**qualified trustee**" for "**property**" that is the subject of a "**disposition**," which trust instrument satisfies the following requirements:

a. it expressly incorporates the laws of New Hampshire to govern the validity, construction and administration of the trust;

b. it is "**irrevocable**;" and

c. it provides that the interest of the transferor or other beneficiary in the trust property or the income may not be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily, before the qualified trustee actually distributes the property or income to the beneficiary. This type of provision is deemed a restriction on the transfer of the transferor's beneficial interest that is enforceable under applicable nonbankruptcy law within the meaning of § 541(c)(2) of the Bankruptcy Code.

2. A trust instrument will be considered "**irrevocable**" even though the trust instrument includes any one or more of the following rights, powers and interests:

a. a transferor's power to veto a distribution;

b. a power of appointment (other than a power to appoint to the transferor, the transferor's creditors, the transferor's estate, or the creditor's of the transferor's estate) exercisable by will or other written instrument of the transferor effective only upon the transferor's death;

c. a transferor's potential or actual receipt of income, including rights to such income retained in the trust instrument;

d. a transferor's potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust (each within the meaning of § 664(d) of the Internal Revenue Code) and the transferor's right, at any time, to release in a writing delivered to the qualified trustee, all or any part of the transferor's retained interest in such trust in favor or one or more charitable organizations that have a remainder interest in such trust at the time of the release;

e. the transferor's receipt each year of a percentage (not exceeding five percent (5%)) specified in the trust instrument of the initial value of the trust assets or their value determined from time to time pursuant to the trust instrument;

f. the transferor's potential or actual receipt or use of principal if such potential or actual receipt or use of principal would be the result of a qualified trustee or qualified trustees, including a qualified trustee or qualified trustees acting at the direction of a trust advisor, acting either in such qualified trustee's or qualified trustees' sole discretion or pursuant to an ascertainable standard contained in the trust instrument;

g. the transferor's right to remove a trustee or a trust advisor and to appoint a new trustee or trust advisor, other than a person who is a related or subordinate party with respect to the transferor (within the meaning of § 672(c) of the Code);

h. the transferor's potential or actual use of real property held under a personal residence trust (within the meaning of § 2702(c) of the Code);

i. the transferor's potential or actual receipt or use of a qualified annuity interest (within the meaning of § 2702 of the Code);

j. the ability, whether pursuant to discretion or direction, of a qualified trustee to pay, after the transferor's death, all or any part of the transferor's debts outstanding at the transferor's death, the expenses of administering the transferor's estate, or any estate or inheritance tax imposed on or with respect to the transferor's estate.

Additionally, a trust instrument will not be deemed to be revocable because of the transferor's potential or actual receipt of income or principal to pay, in whole or in part, income taxes due on trust income if such receipt of income or principal is pursuant to a provision contained in the trust instrument expressly providing for the payment of such taxes and such receipt of income or principal results from either the qualified trustee's acting in the qualified trustee's discretion or the qualified trustee acting at the direction of a trust advisor who is acting in such advisor's discretion. § 564-D:2 of NHQDTA.

C. 1. The term "**transferor**" means any person as an owner of "**property**," a holder of a power of appointment which authorizes the holder to appoint in favor or the holder, holder's creditors or creditors of either or as trustee who makes a disposition or causes a disposition to be made. § 564-D:1.IX of NHQDTA.

2. The term "**qualified trustee**" means:

a. in the case of a natural person, a person who is a resident of New Hampshire other than the transferor; and

b. in all other cases, is a state or federally chartered bank or trust company having a place of business in New Hampshire and is authorized to engage in trust business in New Hampshire and maintains or arranges for custody in New Hampshire of some or all of the property that is subject of the qualified disposition, maintains records in New Hampshire for the trust on an exclusive or nonexclusive basis, prepares or arranges for the preparation in New Hampshire of fiduciary income tax returns for the trust, or otherwise materially participates in New Hampshire in the administration of the trust. § 564-D:3 of NHQDTA.

3. The transferor or any other natural person who is not a resident of New Hampshire or an entity authorized by New Hampshire to act as trustee shall not be considered a qualified trustee. However, a transferor may appoint one or more trust advisors, including, but not limited to:

i. trust advisors who have authority under the terms of the trust instrument to remove and appoint qualified trustees or trust advisors; and

ii. trust advisors who have authority under the terms of the trust instrument to direct, consent to, or disapprove distributions from the trust.

Any individual (including the transferor of the qualified disposition) may serve as a trust advisor. However, if the transferor serves as the trust advisor, his or her rights and powers as a trust advisor must be limited to the right to disapprove distributions from the trust and the right to consent to a trustee's action or inaction relating to the investment of trust assets. § 564-D:4 of NHQDTA.

4. The term "**property**" includes real property, personal property and interests in real or personal property. § 564-D:1.VI of NHQDTA.

5. a. The term "**disposition**" means a conveyance, assignment or any other transfer of property (including a change in the legal ownership of property occurring upon the substitution of one trustee for another or the addition of one or more new trustees), or the exercise of a power that causes a transfer of property to a trustee. However, this term does not include the release or relinquishment of an interest that was the subject of a qualified disposition. § 564-D:1.IV of NHQDTA.

b. A "**qualified disposition**" means a disposition by or from a transferor to a qualified trustee, with or without consideration by means of a trust instrument. § 564-D:1.VII of NHQDTA.

D. 1. No action of any kind, including an action to enforce a judgment entered by a court or other adjudicative authority, may be brought at law or in equity for attachment or other provisional remedy against property that is the subject of a qualified disposition or for the

avoidance of a qualified disposition unless the action is filed pursuant to New Hampshire Uniform Fraudulent Transfer Act.

2. A creditor's claim against a qualified disposition is extinguished unless:

a. the creditor's claim against the transferor originated on or after the qualified disposition and the action is brought within four (4) years after the qualified disposition is made; or

b. the creditor's claim originated before the qualified disposition was made and the action is brought within the following limitations periods provided for in the New Hampshire Uniform Fraudulent Transfer Act:

i. within four (4) years after, or if later, within 1 year after a debtor makes a transfer or incurs an obligation that is fraudulent as to a creditor, whether the creditor's claim originated before or after the transfer was made or obligation incurred, if the debtor made the transfer or incurred the obligation with actual intent to hinder, delay or defraud any creditor of the debtor;

ii. within four (4) years after a debtor makes a transfer or incurs an obligation that is fraudulent as to a creditor, whether the creditor's claim originated before or after the transfer was made or obligation incurred, if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for 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 believed or should have reasonably believed that the debtor would incur debts beyond his or her ability to pay;

iii. within four (4) years after a debtor makes a transfer or incurs an obligation that is fraudulent as to a creditor whose claim originated before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor was rendered insolvent because of such transfer or obligation; or

iv. within one (1) year after a transfer made by a debtor is fraudulent as to a creditor whose claim originated before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time and the insider had reasonable cause to believe that the debtor was insolvent. N.H. Rev. Stat. Ann. §§ 545-A:4; 545-A:5 and 545-A:9.

E. Notwithstanding the foregoing fraudulent transfer rules, the following persons may bring an action to avoid a qualified disposition:

1. any person to whom the transferor is indebted on account of a marital agreement or an agreement or order of court for the payment of support or alimony in favor of such transferor's spouse, former spouse or children, or for a division or distribution of property

in favor of such transferor's spouse or former spouse; however, only to the extent of such debt; and

2. any person who suffers death, personal injury or property damage on or before the date of a qualified disposition by a transferor, which death, personal injury or property damage is at any time determined to have been caused in whole or in part by the act or omission of the transferor or any person the transferor is or was vicariously liable. § 564-D:15 of NHQDTA.

F. 1. A creditor of a transferor whose claim arose before, or at the time of or after a qualified disposition has only such rights with respect to a qualified disposition as are provided in §§ 564-D:9 to 564-D:16 of NHQDTA, inclusive. Additionally, a creditor or assignee does not have a claim against any of the following:

a. a trustee;

b. advisor; or

c. any person involved in counseling, drafting, preparing, preparing, executing or funding of the trust. § 564-D:12 of NHQDTA.

2. Additionally, all actions involving a qualified disposition are barred unless filed against a trustee, trust protector, trust advisor or other fiduciary involved in the counseling, drafting, preparation, administration, execution or funding of a trust if, as of the date such action is brought, an action by a creditor with respect to such qualified disposition would be barred. §§ 564-D:12 and 564-D:13 of NHQDTA.

G. 1. A qualified disposition will be avoided only to the extent necessary to satisfy the transferor's debt to a creditor (including any costs if authorized by a court) who successfully filed an action to have the qualified disposition avoided. § 564-D:16 of NHQDTA.

2. If a qualified disposition is avoided and a court concludes that the trustee did not act in bad faith in accepting or administering property that is the subject of the qualified disposition, such trustee will be given a first lien against the property that is the subject of the qualified disposition equal to the amount of the costs (including attorney's fees) properly incurred in defending the action or proceedings to avoid the qualified disposition. Additionally, the qualified disposition will be avoided subject to the proper fees, costs, pre-existing rights, claims and interests of the qualified trustee (and any predecessor qualified trustee that did not act in bad faith). It is presumed that a qualified trustee did not act in bad faith by merely accepting property that is subject of a qualified disposition. § 564-D:16 of NHQDTA.

3. If a qualified transfer is avoided and a court concludes that a beneficiary of a trust did not act in bad faith, the beneficiary will be permitted to retain any distribution received by the beneficiary as a result of the exercise of discretion granted to the qualified trustee provided such power or discretion was properly exercised before the creditor commenced an action to avoid the qualified disposition. It is presumed that a beneficiary

(including the transferor) did not act in bad faith in settling the trust or accepting a distribution permitted by the trust. § 564-D:16 of NHQDTA.

H. Section 564-D:2 of NHQDTA was recently revised to clarify the powers a transferor may retain if the transferor serves as a trust advisor of an asset protection trust. If the transferor is acting as an advisor the transferor is permitted to direct, consent or veto the investment decisions of a fiduciary, and can retain added authority in regards to trust assets except for a power that permits a transferor in the transferor's capacity as an advisor to participate in any choice to distribute trust assets to or for the benefit of the transferor, the transferor's creditors, the transferor's estate, or creditors of the transferor's estate.

I. For an excellent analysis of the NHQDTA, see "Mayo: Self-Settled Spendthrift Trusts under New Hampshire Law," Steve Leimberg's Asset Protection Newsletter #296 (May 19, 2015).

J. New Hampshire Revenue Statute Section 564-B:5-505(a)(2)(C)-(D) states:

> (a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:
> (1) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.
> (2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be
> distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular
> settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution. This
> subparagraph shall not apply to: . . .
> (C) a trust described in section 2523(e) of the Internal Revenue Code;
> (D) a trust described in section 2523(f) of the Internal Revenue Code; . . .

XXII. HAWAII LAW.

A. Effective July 1, 2010, Hawaii law permits residents and non-residents to create asset protection trusts. See § 554G-1, *et. seq*., of the Permitted Transfers in Trust Act ("**PTTA**").

B. 1. According to § 554G-2 of PTTA, a "**trust instrument**" means an irrevocable instrument appointing a "**permitted trustee**" for the "**permitted property**" that is the subject of a disposition.

2. A trust instrument must be irrevocable and expressly incorporate Hawaii law governing the validity, construction and administration of the trust. § 554G-5 of PTTA.

3. A trust instrument is not considered revocable on the account of the following:

a. a transferor's power to veto a distribution from the trust;

b. a power of appointment, other than a general power of appointment, that may be exercised by will or other written instrument of the transferor effective only upon the transferor's death;

c. a transferor's potential or actual receipt of income, including rights to income retained in the trust instrument;

d. a transferor's annual receipt of a percentage (not exceeding 5%) of the initial value of the trust assets or its value determined from time to time pursuant to the trust instrument or of a fixed amount that on an annual basis does not exceed 5% of the initial value of the trust assets;

e. a transferor's potential or actual receipt or use of trust's principal due to the discretionary action of a permitted trustee or to a provision in the trust instrument that governs the distribution of principal, provided that any included provision does not confer upon the transferor a substantially unfettered right to the receipt or use of the principal;

f. a transferor's right to remove a permitted trustee or advisor and to appoint a new permitted trustee or advisor;

g. a transferor's potential or actual receipt of income or principal to pay income taxes due on income of the trust if the trust instrument includes a provision allowing or directing the use of trust funds to pay income taxes due, or if the permitted trustee acts in the trustee's discretion to allow payment of income taxes on the trust income; or

h. a permitted trustee's authority pursuant to discretion, direction or a transferor's exercise of a testamentary power of appointment to pay all or any part of the transferor's debts outstanding at the transferor's death, the expenses of administering the transferor's estate or any estate or inheritance tax imposed on or with respect to the transferor's estate. § 554G-5(c)(8) of PTTA.

4. Additionally, a trust instrument may provide that the interest of a beneficiary of the trust, including the transferor, may not be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily, before the permitted trustee actually distributes the property or income to the beneficiary. Any provision of this type in the trust instrument will be deemed to be a restriction on the transfer of the transferor's beneficial interest in the trust that is enforceable under applicable nonbankruptcy law within the meaning of 11 United States Code Section 541(c)(2) of the Bankruptcy Code or any successor provision. § 554G-5(d) of PTTA.

C. 1. The term "**transferor**" means an owner of permitted property; a holder of a power of appointment that authorizes the holder to appoint in favor of the holder, the holder's creditors, the holder's estate or the creditors of the holder or the holder's estate; or a trustee who directly or indirectly makes a disposition of permitted property. § 554G-2 of PTTA.

2. a. The term "**permitted trustee**" means:

i. in the case of a natural person, a person who is a resident of Hawaii (other than the transferor); or

ii. a bank or trust company authorized to do business in Hawaii that possesses and exercises trust powers and has its principal place of business in Hawaii. § 554G-2 of PTTA.

b. If a permitted trustee ceases to meet the aforementioned requirements and no other trustee remains that meets such requirements, the permitted trustee shall be deemed to have resigned when that trustee no longer meets the requirements. At that time, the successor permitted trustee provided for in the trust instrument shall become the permitted trustee. In the absence of any successor permitted trustee provided in the trust agreement, a trust advisor or protector provided for in the trust instrument shall appoint a successor permitted trustee. In the absence of an appointed trust advisor or protector, a Hawaii court of competent jurisdiction shall, upon application of any interested party, appoint a successor permitted trustee. § 554G-4(b) of PTTA.

3. The term "**permitted transfer**" means a transfer of permitted property by or from a transferor to a permitted trustee by means of a trust instrument, regardless of whether consideration is exchanged. § 554G-2 of PTTA.

4. The term "**permitted property**" means cash, marketable securities, life insurance contracts and non-private annuities. § 554G-2 of PTTA.

a. The term "**cash**" means United States currency. § 554G-2 of PTTA.

b. The term "**marketable securities**" means securities that are:

i. exchanged on a recognized exchange within the United States including, common stock, bonds, mutual funds or exchanged traded funds; and

ii. permitted to be held by a fiduciary under Hawaii law. § 554G-2 of PTTA.

The term "**marketable securities**" does not include real estate or any interests in corporations, partnerships and limited liability companies that are not publicly traded. § 554G-2 of PTTA.

D. A transferor may appoint, through the trust instrument, one or more advisors or protectors, including the following:

1. advisors who have authority under the terms of the trust to remove and appoint permitted trustees, advisors or protectors;

2. advisors who have authority under the terms of the trust to direct, consent to or disapprove of distributions from the trust; and

3. advisors, including the transferor, who serve as investment advisors to the trust. § 554G-5(e) of PTTA.

E. A permitted trustee is not prohibited from diversifying trust assets; however, the permitted trustee is only allowed to invest in permitted property. § 554G-6 of PTTA.

F. The transferor has only the powers and rights specifically conferred by the trust instrument. Except as permitted in 554G-5(c) and 554G-4.5(a)(3) of the PTTA, a transferor shall have no rights or authority with respect to the property that is the subject of a permitted transfer or to the income from property that is the subject of a permitted transfer. Any agreement or understanding purporting to grant or permit the retention of any greater rights or authority is void. § 554G-7(b) of PTTA.

G. 1. No claim, including an action to enforce a judgment enter by a court or other body having adjudicative authority, by a creditor against property that is subject to a permitted transfer that arises after a permitted transfer and no claim by a creditor to avoid a permitted transfer shall be brought in law or in equity for attachment or other provisional remedy unless the permitted transfer was made with actual intent to defraud, hinder or delay the creditor. § 554G-8 of PTTA.

2. An allowable claim shall be extinguished unless:

a. the creditor's claim arose before the permitted transfer was made and the action is brought on the later of the date of the permitted transfer or the date of the enactment of the PTTA; or

b. the creditor's claim arose concurrent with or subsequent to the permitted transfer and the action is brought within two (2) years after the permitted transfer is made. § 554G-8(b) of PTTA.

3. In any action against a permitted transfer, the burden to prove intent to defraud, hinder or delay by ***clear and convincing evidence*** shall be upon the creditor. § 554G-8(c) of PTTA.

4. Notwithstanding the foregoing, the following persons may avoid permitted transfers:

a. any person to whom the transferor is indebted on account of a family court supervised agreement or family court order for the payment of support or alimony to the transferor's spouse, former spouse or children or for a division or distribution of property to the transferor's spouse or former spouse, but only to the extent of the debt and not to any claim for forced heirship, legitimate or elective share;

b. any person who suffers death, personal injury or property damage on or before the date of a permitted transfer; provided that the death, personal injury of property damage is determined to have been caused in whole or in part by the tortuous act or omission of either the transferor or another person the transferor is or was vicariously liable to the extent of the transferor's liability or vicarious liability;

c. any lender who extends a secured or collateralized loan to the transferor based on the transferor's or the transferor's agent's express or implied representation that the assets of a trust established under the PTTA would be available as security against the loan if the transferor defaults; or

d. any outstanding Hawaii tax obligations but only to the extent necessary to extinguish the outstanding tax liabilities. § 554G-9 of PTTA.

H. 1. A permitted transfer will only be avoided to the extent necessary to satisfy the transferor's debt to the creditor at whose instance the transfer has been avoided, together with costs, including attorney's fees, as allowed by a court. § 554G-10 of PTTA.

2. If a permitted transfer is avoided and a court concludes that the trustee did not act with intent to defraud, hinder or delay the creditor in accepting or administering the property that is the subject of the permitted transfer, such trustee will be given a first lien against the property that is the subject of the permitted transfer equal to the amount of the costs (including attorney's fees) properly incurred in defending the action or proceedings to avoid the permitted transfer. § 554G-10(b)(1)(A) of PTTA.

3. If a permitted transfer is avoided and a court concludes that a beneficiary of a trust did not act in bad faith, the beneficiary will be permitted to retain any distribution made prior to the creditor's commencement of an action to avoid the permitted transfer. It shall be presumed that a beneficiary did not act with intent to defraud, hinder or delay the creditor merely by creating the trust or by accepting a distribution made in accordance with the terms of the trust. § 554G-10(b)(2) of PTTA.

4. A creditor shall have no right against the interest of a beneficiary to a trust based solely on the beneficiary's right to authorize or direct the trustee to use all or part of the trust property to pay:

a. estate or inheritance taxes imposed upon or due to the beneficiary's estate;

b. debts of the beneficiary's estate; or

c. expenses of administering the beneficiary's estate unless the beneficiary actually directs the payment of taxes, debts or expenses and then only to the extent of that direction. § 554G-10(d) of PTTA.

I. No creditor or any other person shall have any claim or cause of action, including an action to enforce a judgment entered by a court or other body having adjudicative authority, against a trustee or advisor or against any person involved in drafting, preparing, executing or funding a trust or in counseling the parties to a trust that is the subject of a permitted transfer if, as of the date of the action, the action would be barred under the PTTA. § 554G-8(f) of PTTA.

J. Hawaii has eliminated the rule against perpetuities as it applies to a trust created pursuant to the PTTA. § 525-4. Hawaii Revised Statutes.

For an excellent analysis of the Hawaiian asset protection trust act see Bove & Langa: The Hawaiian Asset Protection Trust Law, Steve Leimberg's Asset Protection Newsletter #165 (October 26, 2010); Curtis K. Saiki and Jared N. Kawashima: Hawai`i's Permitted Transfers in Trust, Steve Leimberg's Asset Protection Planning Newsletter #303 (August 6, 2015) at http://www.LeimbergServices.com.

XXIII. ARIZONA LAW.

A. Arizona Revised Statutes Article 14-10505A.2. provides in relevant part:

> Subject to the requirements of this section, with respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution. This paragraph does not apply to any trust from which any distribution to the settlor can be made pursuant to the exercise of a power of appointment held by a third party or abrogate otherwise applicable laws relating to community property. A creditor of a settlor:
>
> (a) Shall not reach any trust property based on a trustee's, trust protector's or third party's power, whether or not discretionary, to pay or reimburse the settlor for any income tax on trust income or trust principal that is payable by the settlor under the law imposing the tax or to pay the tax directly to any taxing authority.
>
> (b) Is not entitled to any payment or reimbursement that is to be made directly to any taxing authority.

B. Arizona Revised Statutes Article 14-10505E provides in relevant part:

> For the purposes of this section, amounts and property contributed to the following trusts are not deemed to have been contributed by the settlor, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts shall not be treated as a settlor:
>
> 1. An irrevocable inter vivos marital trust that is treated as qualified terminable interest property under section 2523(f) of the internal revenue code if the settlor is a beneficiary of the trust after the death of the settlor's spouse.
>
> 2. An irrevocable inter vivos marital trust that is treated as a general power of appointment trust under section 2523(e) of the internal revenue code if the settlor is a beneficiary of the trust after the death of the settlor's spouse.
>
> 3. An irrevocable inter vivos trust for the settlor's spouse that does not qualify for the gift tax marital deduction if the settlor is a beneficiary of the trust after the death of the settlor's spouse.

4. An irrevocable inter vivos trust created by the settlor's spouse for the benefit of the settlor, regardless of whether or when the settlor also created an irrevocable inter vivos trust with respect to which such spouse is a beneficiary.

C. Arizona Revised Statutes Article 14-10505F provides in relevant part:

For the purposes of subsection E, a person is a beneficiary whether so named under the initial trust instrument or through the exercise by that person's spouse or by another person of a limited or general power of appoi

D. For an analysis of trusts under Arizona law, see "Rupprecht: Trusts Under Arizona Law," Steve Leimberg's Asset Protection Newsletter #298 (May 28, 2015).

XXIV. FLORIDA LAW. Florida. Florida Statutes § 736.0505(3) provides:

Subject to the provisions of s. 726.105, for purposes of this section, the assets in:

(a) A trust described in s. 2523(e) of the Internal Revenue Code of 1986, as amended, or a trust for which the election described in s. 2523(f) of the Internal Revenue Code of 1986, as amended, has been made; and (b) Another trust, to the extent that the assets in the other trust are attributable to a trust described in paragraph (a), **shall, *after* the death of the settlor's spouse, be deemed to have been contributed by the settlor's spouse and not by the settlor**.

XXV. VIRGINIA LAW.

A. Effective July 1, 2012, Virginia law permits residents and non-residents to create asset protection trusts. *See* §§ 64.2-745.1 and 64.2-745.2 of the Virginia Code. Only trusts that comply with §§ 64.2-745.1 and 64.2-745.2 are eligible to receive protection from the settlor's creditors.

B. Under § 64.2-745.1.A, a "**settlor**" may "**transfer**" assets to a "**qualified self-settled spendthrift trust**" ("**QSSST**") and retain a "**qualified interest**."

C. A transfer to a QSSST shall not be deemed to have been made with intent to delay, hinder, or defraud creditors for purposes of Virginia law merely because the settlor retained a qualified interest in the trust and the transfer was made without consideration. Therefore, a transfer to a QSSST is not *per se* a transfer with the intent to delay, hinder, or defraud creditors. A creditor may still bring an action to set aside transfers with the intent to delay, hinder, or defraud creditors, whether or not involving a QSSST, transfers of insolvent transferors or transfers that render the transferor insolvent. § 64.2-745.1.C.

D. A QSSST is:

1. an irrevocable trust;

2. created during the settlor's lifetime;

3. of which there is at least one beneficiary other than the settlor to whom:

a. income may be distributed, if the settlor's qualified interest pertains to income; or

b. principal may be distributed, if the settlor's qualified interest pertains to principal; or

c. both income and principal may be distribtued, if the settlor's qualified interest pertains to income and principal; and

4. the trust at all times has a "**qualified trustee**." § 64.2-745.1.2.A.

E. A qualified trustee is:

1. any person who is a Virginia resident; or

2. an entity authorized to engage in trust business within Virginia and who:

a. maintains or arranges for custody within Virginia of some or all of the trust property; or

b. maintains trust records in Virginia on an exclusive or nonexclusive basis; or

c. prepares or arranges for the preparation in Virginia of fiduciary income tax returns; or

d. otherwise materially participates in the administration of the trust in Virginia. § 64.2-745.2.A.

F. However, a trustee is not a qualified trustee if the trustee's authority to make distributions of income or principal or both are subject to the direction of someone who, were that person a trustee, would not meet the requirements of a qualified trustee. § 64.2-745.2.A.

G. A qualified interest is:

1. a settlor's interest in a QSSST,

2. to the extent that such interest entitles the settlor to receive distributions of income, principal, or both, in the sole discretion of an "**independent qualified trustee**." § 64.2-745.2.A.

H. Only qualified interests are protected under the statute. § 64.2-745.1.C.

I. An independent qualified trustee is a person who is not, and whose actions are not, subject to direction by:

1. the settlor;

2. any natural person who is not a Virginia resident;

3. any entity that is not authorized under Virginia law to engage in trust business in Virginia;

4. the settlor's spouse;

5. a parent or issue of the settlor;

6. a sibling of the settlor;

7. an employee of the settlor;

8. a business entity of which the settlor possesses at least thirty percent (30%) of the voting interests of the entity;

9. a subordinate employee of the settlor or an entity in which the settlor is an executive. § 64.2-745.2.A.

J. If either the office of qualified trustee or independent qualified trustee becomes vacant, the office is filled,

1. by a person or entity designated in the trust; or, if none,

2. by a person or entity designated by unanimous agreement of qualified beneficiaries; or, if none,

3. by court order. §§ 64.2-745.2.B and C.

K. A QSSST need not have an independent qualified trustee to be valid, however, only an independent qualified trustee may make distributions to the settlor pursuant to the settlor's qualified interest. *See* § 64.2-745.2.A.

L. Under § 64.2-745.1.D, a settlor's creditor has five (5) years from the date of the transfer to challenge it as a fraudulent transfer, which in effect creates a five (5) year statute of limitations to challenge any transfer to the trust. After five (5) years all claims related to property in the trust are time barred.

M. Under § 64.2-745.1,

1. if a trust qualifies as a QSSST, a creditor only has those rights provided in § 64.2-745.1; and

2. no creditor has a claim or cause of action against "any trustee, trust adviser, trust director, or any person involved in the counseling, drafting, preparation, or execution of, or transfers to a qualified self-settled spendthrift trust."

N. If the administration of a trust migrates from another situs to Virginia, the statute of limitations for purposes of the five (5)-year lookback period begins to run as of the date the trust meets all of the requirements for a QSSST under Virginia Law. § 64.2-745.1.G.

O. The settlor is permitted to make an initial and subsequent transfers to a QSSST. A subsequent transfer to a QSSST does not recommence the statute of limitations as to the initial transfer or any other prior transfer. Therefore, multiple transfers to a QSSST may have multiple statute of limitation periods running simultaneously. Any distribution from the trust to a beneficiary is deemed to come from the most recent property transferred to the trust first. § 64.2-745.1.F.

P. A subsequent transfer is disregarded in determining whether a creditor's claim with respect to a prior transfer is valid. § 64.2-745.1.F.1.

Q. As to revocable trusts:

1. during the lifetime of the settlor, the assets of a revocable trust are subject to the claims of creditors;

2. upon the death of the settlor, subject to the settlor's right to direct the source of payment of liabilities, the assets of a revocable trust are subject to the claims of creditors. § 64.2-747.A.

R. As to irrevocable trusts, only QSSSTs are protected from creditors during the settlor's life or at the settlor's death. If a trust does not satisfy the QSSST rules, a creditor of the settlor may reach the maximum amount distributable to or for the settlor's benefit. *See* § 64.2-747.A.2.

S. A trust is not deemed revocable based on the inclusion of any of the following:

1. a power of appointment, other than a power to appoint to the settlor's estate or the creditors of the settlor's estate;

2. the settlor's qualified interest in the trust;

3. the settlor's right to receive income or principal pursuant to an ascertainable standard;

4. the settlor's potential or actual receipt of income or principal from a charitable remainder unitrust or annuity trust and the settlor's right to release any part of the settlor's retained interest;

5. the settlor's receipt each year of a unitrust amount up to five percent (5%);

6. the settlor's right to remove a trustee and to appoint a new trustee;

7. the settlor's use of real property held under a qualified personal residence trust, or of a qualified annuity interest under § 2702 of the Code;

8. the ability of a qualified trustee to pay estate debts, expenses, or taxes; and

9. a settlor's receipt of income or principal to pay income taxes due on trust income, or the trustee's direct payment of such taxes, pursuant to a provision that expressly provides for the direct payment of such taxes or reimbursement to the settlor for such tax payments. § 64.2-745.2.D.

T. The holder of a power of withdrawal is treated as the settlor to the extent of the withdrawal right. Also, when a power of withdrawal has lapsed, been released, or otherwise expired, the holder of the power of withdrawal is treated as the settlor to the extent of the withdrawal right (ignoring §§ 2041(b)(2), 2514(e) or 2503(b) of the Internal Revenue Code). § § 64.2-745.2.E.

U. Section 64.2-747.B.3 of the Virginia Statutes provides in relevant part:

1. The assets in a trust that are attributable to a contribution to an inter vivos marital deduction trust described in either § 2523 (e) or (f) of the Internal Revenue Code of 1986, after the death of the spouse of the settlor of the inter vivos marital deduction trust shall be deemed to have been contributed by the settlor's spouse and not by the settlor.

Note that in some respects it may be more flexible for a settlor forming a trust in Virginia to utlize the SQIT statute under Section 64.2-747.B.3 rather than forming and funding a QSSST. Using this statute as an alternative to a QSSST should be thoroughly considered.

XXVI. MICHIGAN LAW.

Section 700.7506(4) of the Michigan Compiled Laws provides in relevant part:

> (4) An individual who creates a trust shall not be considered a settlor with regard to the individual's retained beneficial interest in the trust that follows the termination of the individual's spouse's prior beneficial interest in the trust if all of the following apply: (a) The individual creates, or has created, the trust for the benefit of the individual's spouse. (b) The trust is treated as qualified terminable interest property under section 2523(f) of the internal revenue code, 26 USC 2523. (c) The individual retains a beneficial interest in the trust income, trust principal, or both, which beneficial interest follows the termination of the individual's spouse's prior beneficial interest in the trust.

XXVII. NORTH CAROLINA LAW.

On June 27, 2011, a new subsection (c) was added to N.C.G.S. § 36C-5-505 to provide:

> (c) Subject to Article 3A of Chapter 39 of the General Statutes, for purposes of this section, if the settlor is a beneficiary of the following trusts after the death

of the settlor's spouse, the property of the trusts shall, after the death of the settlor's spouse, be deemed to have been contributed by the settlor's spouse and not by the settlor:

(1) An irrevocable inter vivos marital trust that is treated as a general power of appointment trust described in section 2523(e) of the Internal Revenue Code.

(2) An irrevocable inter vivos marital trust that is treated as qualified terminable interest property under section 2523(f) of the Internal Revenue Code.

(3) **An irrevocable inter vivos trust of which the settlor's spouse is the sole beneficiary during the lifetime of the settlor's spouse but which does not qualify for the federal gift tax marital deduction.** [Emphasis added.] (Note that the North Carolina self-settled trust statute, similar to the statute in Arizona, does not require the initial trust to qualify for the Federal gift tax marital deduction. It would also seem possible under this statute to design the lead trust without a mandatory income distribution provision so all distributions to the spouse could be solely within the trustee's discretion. Perhaps the lead trust could also be designed such that gifts to the trust would not constitute completed gifts for Federal gift tax purposes.)

(4) Another trust, to the extent that the property of the other trust is attributable to property passing from a trust described in subdivision (1), (2), or (3) of this subsection.

For purposes of this subsection, the settlor is a beneficiary whether so named under the initial trust instrument or through the exercise of a limited or general power of appointment.

For an excellent discussion of this statute and North Carolina law, see Beadle, Sneeringer, Gopman & King, "Tar Heel (or Is It Blue Devil) Trusts under North Carolina Law," LISI Asset Protection Planning Newsletter #271 (November 24, 2014) at http://www.leimbergservices.com.

XXVIII. OHIO LAW.

Ohio law now permits an individual to establish an asset protection trust. See Ohio Stat. Sec. 5816.01. The law is referred to as the "**Ohio Legacy Trust Act**" (the "**Ohio Act**").

Section 5816.02 of the Ohio Revised Code contains various definitions that are relevant to understanding the Ohio Act. As used in the Ohio Act (unless otherwise modified):

The term "**advisor**" means a person that satisfies the eligibility criteria specified in division (A) of section 5816.11 of the Ohio Act and who is granted the power by the terms of a Bearcat Trust to remove or appoint one or more trustees of the trust or direct, consent to, or veto a trustee's actual or proposed investment, distribution or other decisions. A person will be considered an advisor even though that person may be referred by another title, such as protector.

The term "**asset**" means the Property of a transferor, however, does not include Property to the extent it is encumbered by a valid lien; Property to the extent it is exempt at the time of a qualified disposition under any applicable nonbankruptcy law, including, but not limited to, section 2329.66 of Ohio law; Property held in the form of a tenancy by the entireties to the extent that, under the law governing the entireties estate at the time of a qualified disposition, it is not subject to process by a creditor holding a claim against only one tenant; or any property transferred from a nonlegacy trust to a legacy trust to the extent that the property would not be subject to attachment under the applicable nonbankruptcy law governing that nonlegacy trust.

The term "**Bankruptcy Code**" means the United States Bankruptcy Code set forth in 11 U.S.C. Chapter 11, as the same may be amended from time to time.

The term "**beneficiary**" has the meaning set forth in section 5801.01 of Ohio law.

The term "**claim**" means a right to payment, whether or not the right is reduced to judgment or is liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

The term "**creditor**" means a person who possess claim against a transferor and any transferee or assignee of, or successor to, that claim.

The term "**debt**" is a liability on a claim.

The term "**disposition**" is a transfer, conveyance, or assignment of property, including, but not limited to, a partial, contingent, undivided, or co-ownership interest in property. A "**disposition**" includes the exercise of a general power of appointment in a manner that directs a transfer of property to a trustee or trustees, however, it does not include:

(1) The release or relinquishment of an interest in property that, until the release or relinquishment, was the subject of a qualified disposition;

(2) The exercise of a limited power of appointment in a manner that directs a transfer of property to a trustee or trustees;

(3) A disclaimer of an interest in a trust, bequest, devise, or inheritance.

The term "**Internal Revenue Code**" means the United States Internal Revenue Code of 1986, as set forth in 100 Stat. 2085, 26 U.S.C. 1 *et seq.*, as the same may be amended from time to time.

The term "**investment decision**" means any decision regarding retaining, purchasing, selling, exchanging or tendering property or any other decision regarding a transaction that affects the ownership of or rights in investments.

The term "**Legacy Trust**" means a trust that is documented by a written agreement to which each of the following are applicable:

(1) The trust agreement designates at least one "**qualified trustee**" regarding the property that is the subject of a qualified disposition.

(2) The trust agreement provides that Ohio law wholly or partially governs its validity, construction and administration.

(3) The trust agreement provides that it is irrevocable.

(4) The trust agreement contains a spendthrift provision that applies to the interests of any beneficiary in the trust property, including any interests of a transferor in the trust property.

A trust agreement that otherwise meets all of the requirments necessary to qualify as a Legacy Trust will still be considered to qualify as a Legacy Trust even though the trust agreement permits one or more nonqualified trustees to serve and regardless of the language used to satisfy such requirements.

The term "**lien**" has the same meaning as in section 1336.01 of Ohio law.

The term "**nonlegacy Trust**" means any trust that is not a Legacy Trust.

The term "**nonqualified Trustee**" means any trustee that is not a a qualified trustee.

The term "**person**" has the same meaning as set forth in section 5801.01 of Ohio law.

The term "**Property**" has the same meaning as set forth in section 5801.01 of Ohio law.

The term "**qualified affidavit**" means an affidavit containing all of the provisions required by section 5816.06 of the Ohio Act.

The term "**qualified disposition**" refers to a disposition made by a transferor to any trustee of a trust that is, was, or becomes a Legacy Trust.

The term "**qualified trustee**" refers to a person who is not a transferor and who is either:

(1) if a natural person, a resident of this Ohio.

(2) if not a natural person, is authorized by the law of Ohio or by a court of competent jurisdiction in Ohio to act as a trustee and whose activities are subject to supervision by the Ohio superintendent of banks, the federal deposit insurance corporation, the comptroller of the currency, or the office of thrift supervision or a successor of any of them.

In addition to the foregoing, the person must maintain or arrange for custody in Ohio of some or all of the property that is the subject of the qualified disposition, must maintain records for the Legacy Trust on an exclusive or nonexclusive basis, must prepare or arrange for the preparation of required income tax returns for the Legacy Trust, or otherwise materially participate in the administration of the Legacy Trust.

The term "**Spendthrift provision**" has the identical meaning as is set forth in section 5801.01 of Ohio law.

The terms "**spouse**" and "**former spouse**" refer only the person to whom a transferor was married on or prior to making a qualified disposition to a Legacy Trust.

The term "**transferor**" refers to a person who directly or indirectly makes a disposition.

The term "**valid lien**" has the identical meaning as set forth in section 1336.01 of Ohio law.

Section 5816.03 of the Ohio Act provides that in addition to any other method permitted by law, a spendthrift provision in a Legacy Trust may be stated as provided in division (B) of Section 5805.01 of the Ohio Revised Code. Unless provided otherwise in the Ohio Act, the spendthrift provisions included in a Legacy Trust must restrain both the voluntary and involuntary transfer of a transferor's interest in the Legacy Trust. Furthermore, a spendthrift provision included in a Legacy Trust is enforceable under applicable nonbankruptcy law within the meaning of Section 541(c)(2) of the Bankruptcy Code. This is the case regardless of whether the agreement creating the Legacy Trust provides any reference to such enforceability. Moreover, a Legacy Trust and the spendthrift provisions included in such trust may provide for any other restraints on alienation permitted by any law in Ohio in addition to the restraints required by Section 5816.03.

Notwithstanding the foregoing, a transferor's interest in property that is the subject of a qualified disposition can be attached or otherwise involuntarily alienated in in regards to any debt that the transferor owes pursuant to an agreement or court order for any of the following:

(1) Payment of child or spousal support or alimony to or for the settlor's spouse, former spouse, child, or children, or to any government agency designated by statute, rule, or regulation to be the payee of such child or spousal support or alimony;

(2) Division or distribution of property in favor of the transferor's spouse or former spouse.

A settlor's interest in property transferred pursuant to a qualified disposition and the settlor's beneficial interest in a Legacy Trust shall not be subject to any claim for forced heirship or legitime. Additionally, a settlor's interest in property transferred that is the subject of a qualified disposition and the settlor's beneficial interest in a Legacy Trust shall not be subject to a distributive award under Section 3105.171 of the Ohio Revised Code or to any similar award under the law of any other jurisdiction, to any person other than the settlor's spouse or former spouse. A court must liberally construe and apply this rule when holding that such similarity is present. Finally, nothing in the Ohio Act shall be construed to deprive a beneficiary of any exemption that the beneficiary may be entitled to claim under any applicable law after the trust property is distributed to the beneficiary.

Section 5816.04 of the Ohio Act provides that if conferred in the agreement establishing the Legacy Trust, a settlor can have all of the rights, powers, and interests described in Section 5816.05 of the Ohio Act. Additionally, a settlor cannot have any rights,

powers or interests in, over, to, or regarding the assets of a Legacy Trust unless such rights, powers or interests are granted, permitted, or set forth in Section 5816.05 of the Ohio Act and the agreement establishing the Legacy Trust. Similar to the law of Alaska, Delaware and Nevada, the Ohio Act provides:

> any written, verbal, tacit, express, or implied agreement or understanding or any other agreement or understanding purporting to grant, permit, or recognize any greater rights, powers, or interests than are provided in this section or the governing legacy trust instrument is void. Any portion of a legacy trust instrument that is not voided under this section shall remain valid and effective.

Section 5816.05 of the Ohio Act provides that a legacy trust may allow or provide for any or all of the following rights, powers, interests, or provisions, none of which grants, or is considered to be, either alone or in any combination, a right or power to revoke a trust or to voluntarily or involuntarily transfer an interest in that trust:

A provision that, upon the happening of a defined event, results in the termination of a transferor's right to mandatory income or principal;

The power of a transferor to veto a distribution from the trust;

A power of appointment, other than a power to appoint to a transferor, a creditor of the transferor, the estate of the transferor, or a creditor of the transferor's estate, that is exercisable by will or by other written instrument of a transferor effective upon the death of the transferor or during the lifetime of the transferor;

The right of a transferor to receive trust income as set forth in the trust instrument.

A transferor's potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust as those terms are defined in Section 664 of the Internal Revenue Code, and the transferor's right, at any time and from time to time by written instrument delivered to the trustee, to release the transferor's retained interest in that unitrust or annuity trust, in whole or in part, in favor of one or more charitable organizations that have a succeeding beneficial interest in that unitrust or annuity trust;

The power of a transferor to consume, invade, or appropriate property of the trust, but only if limited in each calendar year to five percent (5%) of the value of the trust principal at the time of the exercise of the power;

A transferor's potential or actual receipt or use of principal or income of the trust if the potential or actual receipt or use is or would be the result of any of the following that applies with respect to one or more of the qualified trustees:

(1) A qualified trustee's acting in the trustee's discretion. For purposes of division (G)(1) of Section 5816.05 of the Ohio Act, a qualified trustee shall have discretion with respect to the distribution or use of principal or income unless the discretion is expressly denied to the trustee by the terms of the trust instrument.

(2) A qualified trustee's acting pursuant to a standard in the trust instrument that governs the distribution or use of principal or income; and

(3) A qualified trustee's acting at the direction of an advisor who is acting in the advisor's discretion or pursuant to a standard in the trust instrument that governs the distribution or use of principal or income. If an advisor is authorized to direct that distribution or use, the advisor's authority shall be discretionary unless otherwise expressly stated in the trust instrument.

The right of a transferor to remove any advisor and appoint a new advisor who satisfies the eligibility criteria set forth in division (A) of Section 5816.11 of the Ohio Act;

The right of a transferor to remove any trustee and appoint a new trustee;

A transferor's potential or actual use of real property or tangible personal property, including, but not limited to, property held under a qualified personal residence trust as described in Section 2702(c) of the Internal Revenue Code and regulations promulgated under that section, or a transferor's possession and enjoyment of a qualified interest as defined in Section 2702(b) of the Internal Revenue Code;

Any provision requiring or permitting the potential or actual use of trust income or principal to pay, in whole or in part, income taxes due on the income of the trust, including, but not limited to, any provision permitting that use in the discretion of any one or more of the qualified trustees acting in the qualified trustee's discretion or at the direction of an advisor who is acting in the advisor's discretion;

The ability of a qualified trustee, whether pursuant to the qualified trustee's discretion or the terms of the legacy trust instrument or at the direction of an advisor, to pay after the death of a transferor all or any part of the debts of the transferor outstanding on or before the transferor's death, the expenses of administering the transferor's estate, or any estate, gift, generation skipping transfer, or inheritance tax;

Any provision that pours back after the death of a transferor all or part of the trust property to the transferor's estate or any trust;

Any other rights, powers, interests, or provisions permitted or allowed by any other section of the Ohio Act.

Section 5816.06 of the Ohio Act provides that except as otherwise provided in Section 5816.06 of the Ohio Act, a transferor shall sign a "**qualified affidavit**" before or substantially contemporaneously with making a qualified disposition.

A qualified affidavit shall be notarized and shall contain all of the following statements under oath:

(1) The property being transferred to the trust was not derived from unlawful activities.

(2) The transferor has full right, title, and authority to transfer the property to the legacy trust.

(3) The transferor will not be rendered insolvent immediately after the transfer of the property to the legacy trust.

(4) The transferor does not intend to defraud any creditor by transferring the property to the legacy trust.

(5) There are no pending or threatened court actions against the transferor, except for any court action identified by the affidavit or an attachment to the affidavit.

(6) The transferor is not involved in any administrative proceeding, except for any proceeding identified by the affidavit or an attachment to the affidavit.

(7) The transferor does not contemplate at the time of the transfer the filing for relief under the Bankruptcy Code.

A qualified affidavit is considered defective if it materially fails to meet the requirements set forth in division (B) of Section 5816.06 of the Ohio Act, but a qualified affidavit is not considered defective due to any one or more of the following:

(1) Any nonsubstantive variances from the language set forth in division (B) of Section 5816.06 of the Ohio Act;

(2) Any statements or representations in addition to those set forth in division (B) of Section 5816.06 of the Ohio Act if the statements or representations do not materially contradict the statements or representations required by that division; and

(3) Any technical errors in the form, substance, or method of administering an oath if those errors were not the fault of the affiant, and the affiant reasonably relied upon another person to prepare or administer the oath.

A qualified affidavit is not required from a transferor who is not a beneficiary of the legacy trust that receives the disposition. Also, a subsequent qualified affidavit is not required in connection with any qualified disposition made after the execution of an earlier qualified affidavit if that disposition is a part of, is required by, or is the direct result of, a prior qualified disposition that was made in connection with that earlier qualified affidavit.

If a qualified affidavit is required by Section 5816.06 of the Ohio Act and a transferor fails to timely sign a qualified affidavit or signs a defective qualified affidavit, subject to the normal rules of evidence, that failure or defect may be considered as evidence in any proceeding commenced pursuant to Section 5816.07 of the Ohio Act, but the legacy trust or the validity of any attempted qualified disposition shall not be affected in any other way due to that failure or defect. For a discussion of the purpose of providing an affidavit of solvency, see "Gassman & Daniels, The Affability of Affidavits in Domestic Asset Protection Trust Planning," Steve Leimberg's Asset Protection Planning Newsletter #293 (Apr. 28, 2015).

Section 5816.07 of the Ohio Act provides that, notwithstanding any provision of law to the contrary but subject to division (G) of section 5816.10 of the Ohio Act, no creditor may bring an action of any kind, including, but not limited to, an action to enforce a judgment entered by a court or other body having adjudicative authority, an action at law or in equity, or an action for an attachment or other final or provisional remedy, against any person who made or received a qualified disposition, against or involving any property that is the subject of a qualified disposition or is otherwise held by or for any trustee as part of a legacy trust, or against any trustee of a legacy trust, except that a creditor, subject to Section 5816.07 of the Ohio Act and Section 5816.08 of the Ohio Act, may bring an action to avoid any qualified disposition of an asset on the ground that a transferor made the qualified disposition with the specific intent to defraud the specific creditor bringing the action.

A creditor's cause of action or claim for relief under division (A) of Section 5816.07 of the Ohio Act to avoid any qualified disposition of an asset is extinguished unless that action is brought by a creditor of a transferor who meets one of the following requirements:

(1) The creditor is a creditor of the transferor before the relevant qualified disposition, and the action is brought within the later of the following periods:

(a) Eighteen months after the qualified disposition; and

(b) Six months after the qualified disposition is or reasonably could have been discovered by the creditor if the creditor files a suit against the transferor, other than an action under division (A) of Section 5816.07 of the Ohio Act to avoid the qualified disposition, or makes a written demand for payment on the transferor that in either case asserts a claim based on an act or omission of the transferor that occurred before the qualified disposition, and that suit is filed, or the written demand is delivered to the transferor, within three years after the qualified disposition.

(2) The creditor becomes a creditor after the qualified disposition, and the action under division (A) of Section 5816.07 of the Ohio Act to avoid the qualified disposition is brought within eighteen months after the qualified disposition.

In any action to avoid the qualified disposition under Section 5816.07 of the Ohio Act, the burden is upon the creditor to prove the matter by clear and convincing evidence. This division is construed as providing a substantive rather than a procedural rule or right under the law of this state.

Notwithstanding any provision of law to the contrary but subject to division (G) of Section 5816.10 of the Ohio Act, a creditor or any other person shall have only the rights and remedies with respect to a qualified disposition that are provided in Section 5816.07 of the Ohio Act and Section 5816.08 of the Ohio Act, and the creditor or other person shall have no claim or cause of action against any trustee or advisor of a legacy trust or against any person involved in the counseling in connection with, or the drafting, preparation, execution, administration, or funding of, a legacy trust.

Notwithstanding any provision of law to the contrary but subject to division (G) of Section 5816.10 of the Ohio Act, and in addition to any other limitations, restrictions, or bars imposed by Section 5816.07 of the Ohio Act, no action of any kind, including, but not limited to, an action to enforce a judgment entered by a court or other body having adjudicative authority, shall be brought at law or in equity against a trustee or an advisor of a legacy trust or against any person involved in the counseling in connection with, or the drafting, preparation, execution, administration, or funding of, a legacy trust if and to the extent that, in connection with the qualified disposition that forms the basis of that action, the time in which a creditor could sue to avoid that qualified disposition would have expired under Section 5816.07 of the Ohio Act.

If more than one qualified disposition is made in connection with the same legacy trust, all of the following apply:

(1) Each qualified disposition will be separately evaluated, without regard to any subsequent qualified disposition, to determine whether a creditor's claim regarding that particular qualified disposition is extinguished as provided in division (B) of Section 5816.07 of the Ohio Act.

(2) The following apply when determining the order in which property is paid, applied, or distributed from a legacy trust:

(a) Any payment, application, or distribution of money is considered to have been made from or with the money most recently received or acquired by any trustee of a legacy trust except to the extent that it is proven otherwise beyond a reasonable doubt. As used in division (F)(2)(a) of Section 5816.07 of the Ohio Act:

(i) The term "**money**" means cash or cash equivalents.

(ii) The term "**cash**" means the coins or currency of the United States or any other nation.

(iii) The term "**cash equivalent**" includes certified or uncertified checks; money orders; bank drafts; any electronic transfer of funds; negotiable instruments; instruments indorsed in blank or in bearer form; securities issued or guaranteed by the United States, any state of the United States, or any state or federal agency; funds on deposit in any savings or checking account or any similar account; funds on deposit in any money market account or similar account; any demand deposit account, time deposit account, or savings deposit account at any bank, savings and loan association, brokerage house, or similar institution; or any other monetary instrument or device that is commonly or routinely accepted as a cash equivalent. Division (F)(2)(a)(iii) of Section 5816.07 of the Ohio Act shall be liberally construed and applied.

(b) Any payment, application, or distribution of fungible assets other than money is considered to have been made from or with the fungible assets most recently received or acquired by any trustee of a legacy trust except to the extent that it is proven otherwise by clear and convincing evidence. For purposes of division (F)(2)(b) of Section 5816.07 of the Ohio Act:

(i) Any asset that can be classified as either money or a fungible asset shall be classified as money.

(ii) The term "**fungible assets**" means any assets, other than money, that are interchangeable for commercial purposes and the properties of which are essentially identical. Division (F)(2)(b)(ii) of Section 5816.07 of the Ohio Act shall be liberally construed and applied.

(c) Division (F)(2) of Section 5816.07 of the Ohio Act is construed as providing a substantive rather than a procedural rule or right under the law of this state.

For purposes of Section 5816.07 of the Ohio Act, the counseling in connection with, or the drafting, preparation, execution, administration, or funding of, a legacy trust includes the counseling in connection with, or the drafting, preparation, execution, administration, or funding of, any limited partnership, limited liability company, corporation, or similar or comparable entity if the limited partnership interests, limited liability company interests, stock, or other similar or comparable ownership interests in the relevant entity are subsequently transferred to any trustee of any trust that is, was, or becomes a legacy trust.

Section 5816.08 of the Ohio Act provides that all of the following apply in connection with any action brought pursuant to Section 5816.08 of the Ohio Act or division (A) of Section 5816.07 of the Ohio Act:

If a qualified disposition is wholly or partially avoided, all of the following apply:

(1) That specific qualified disposition shall be avoided only to the extent necessary to satisfy a transferor's debt to the creditor who brought the action pursuant to division (A) of Section 5816.07 of the Ohio Act, and any part of the qualified disposition that is not used to satisfy that debt shall remain subject to the legacy trust in question.

(2) All other qualified dispositions to any trustee of the legacy trust in question, including, but not limited to, any qualified disposition of a partial, co-ownership, or undivided interest in property by a transferor other than the transferor whose qualified disposition is avoided, together with the legacy trust itself, shall remain valid and effective.

(3) If the court is satisfied that a trustee has not acted in bad faith in accepting or administering the property that is the subject of the avoided qualified disposition, all of the following apply:

(a) The trustee shall have a first and paramount lien against the property that is the subject of the qualified disposition in an amount equal to the entire cost, including attorney's fees, properly incurred by the trustee in the defense of the action or proceedings to avoid the qualified disposition.

(b) The qualified disposition shall be avoided subject to the proper fees, costs, and pre-existing rights, claims, and interests of the trustee and of any predecessor trustee that has not acted in bad faith.

(c) For purposes of division (A)(3) of Section 5816.08 of the Ohio Act, no trustee shall be considered to have acted in bad faith merely because the trustee accepted the property that is the subject of the qualified disposition.

(4) If the court is satisfied that a beneficiary of a legacy trust has not acted in bad faith in receiving a distribution from that trust, the avoidance of the qualified disposition shall be subject to the right of the beneficiary to retain that distribution if the distribution was made upon the exercise of a trust power or discretion vested in a trustee or advisor and that power or discretion was exercised prior to the creditor's commencement of the action to avoid the qualified disposition. For purposes of division (A)(4) of Section 5816.08 of the Ohio Act, no beneficiary, including a beneficiary who is also a transferor of the trust, shall be considered to have acted in bad faith merely because the beneficiary accepted a distribution made in accordance with the terms of the trust instrument.

(5) A creditor has the burden of proving by clear and convincing evidence that a trustee or a beneficiary acted in bad faith under division (A)(3) or (4) of Section 5816.08 of the Ohio Act. Division (A)(5) of Section 5816.08 of the Ohio Act is construed as providing a substantive rather than a procedural rule or right under the law of this state.

The court shall award reasonable attorney's fees and costs to any prevailing party in any final judgment rendered in any action wholly or partially brought under Section 5816.08 of the Ohio Act or division (A) of Section 5816.07 of the Ohio Act.

Section 5816.09 of the Ohio Act provides that any successor or replacement trustees of a legacy trust shall be determined or selected in the following manners:

If in any action involving a legacy trust or any trustee of the legacy trust a court takes an action in which the court declines to apply the law of Ohio in determining the validity, construction, or administration of the trust, the effect of any term or condition of the trust, including, but not limited to, a spendthrift provision, or the rights and remedies of any creditor or other suitor in connection with a qualified disposition, then immediately upon such action and without the need for any order of any court, any qualified trustee who is a party to that action shall cease in all respects to be a trustee of the legacy trust, and the position of trustee shall be occupied in accordance with the terms of the trust instrument that governed the legacy trust immediately before that cessation, or, if the terms of the trust instrument do not provide for another trustee and the trust would otherwise be without a trustee, any court of this state, upon the application of any beneficiary of the legacy trust, shall appoint a successor qualified trustee upon the terms and conditions that it determines to be consistent with the purposes of the trust and the Ohio Act. Upon a qualified trustee ceasing to be a trustee pursuant to division (A)(2) of Section 5816.09 of the Ohio Act, that qualified trustee shall have no power or authority other than to convey trust property to any other trustee that is appointed, installed, or serving in accordance with division (A)(2) of Section 5816.09 of the Ohio Act. For purposes of division (A) of Section 5816.09 of the Ohio Act, the term "**court**" includes a judicial tribunal, an administrative tribunal, or other adjudicative body or panel.

In all cases other than the situation described in division (A) of Section 5816.09 of the Ohio Act, if a legacy trust ceases to have at least one qualified trustee, the vacancy in the

qualified trusteeship shall be filled pursuant to Section 5807.04 of the Ohio law except to the extent that the legacy trust expressly provides otherwise; and if a legacy trust ceases to have at least one trustee, the vacancy in the trusteeship shall be filled pursuant to Section 5807.04 of the Ohio law, and the successor trustee shall be a qualified trustee unless the legacy trust instrument expressly provides otherwise.

Section 5816.10 of the Ohio Act provides that in the event of any conflict between any provision of the Ohio Act and any provision of Chapter 1336 of the Ohio law or any other provision of law similar to any provision of Chapter 1336 of the Ohio law, the provision of the Ohio Act shall control and prevail.

A statement in a trust instrument stating that it "**shall be governed by the laws of Ohio**" or other statement to similar effect or of similar import is considered to expressly incorporate the laws of this state to govern the validity, construction, and administration of that trust instrument and to satisfy division (K)(1)(b) of Section 5816.02 of the Ohio Act.

A disposition by a nonqualified trustee to a qualified trustee shall not be treated as other than a qualified disposition solely because the nonqualified trustee is a trustee of a nonlegacy trust.

A disposition to any nonqualified trustee of a legacy trust shall be treated as a qualified disposition if at the time of the disposition any of the following applies:

(1) There is at least one qualified trustee serving pursuant to the terms of that legacy trust.

(2) There is no qualified trustee serving but the circumstances require the appointment or installation of a qualified trustee pursuant to division (A)(2) of Section 5816.09 of the Ohio act.

(3) There is no qualified trustee serving but within one hundred eighty days after the date of disposition a qualified trustee fills the vacancy in the qualified trusteeship or an application to appoint a qualified trustee is filed pursuant to division (B) of Section 5816.09 of the Ohio Act.

If a disposition is made by a trustee of a nonlegacy trust to a trustee of a legacy trust, both of the following apply:

(1) Except to the extent expressly stated otherwise by the terms of that disposition, the disposition shall be considered a qualified disposition for the benefit of all of the persons who are the beneficiaries of both the nonlegacy trust and the legacy trust.

(2) The date of the disposition to the legacy trust shall be considered to be the date on which the property that was part of the nonlegacy trust was first continuously subject to any law of a jurisdiction other than this state that is similar to this chapter. A court shall liberally construe and apply division (E)(2) of Section 5816.10 of the Ohio Act in finding that such continuity and similarity exist.

A legacy trust may contain any terms or conditions that provide for changes in or to the place of administration, situs, governing law, trustees or advisors, or the terms or conditions of the legacy trust or for other changes permitted by law.

Any valid lien attaching to property before a disposition of that property to a trustee of a legacy trust shall survive the disposition, and the trustee shall take title to the property subject to the valid lien and subject to any agreements that created or perfected the valid lien. Nothing in this chapter shall be construed to authorize any disposition that is prohibited by the terms of any agreements, notes, guaranties, mortgages, indentures, instruments, undertakings, or other documents. In the event of any conflict between division (G) of Section 5816.10 of the Ohio Act, and any other provision of this chapter, division (G) of Section 5816.10 of the Ohio Act shall control.

To the maximum extent permitted by the Ohio Constitution and the United States Constitution, the courts of this state shall exercise jurisdiction over any legacy trust or any qualified disposition and shall adjudicate any case or controversy brought before them regarding, arising out of, or related to, any legacy trust or any qualified disposition if that case or controversy is otherwise within the subject matter jurisdiction of the court. Subject to the Ohio Constitution and the United States Constitution, no court of this state shall dismiss or otherwise decline to adjudicate any case or controversy described in division (H) of Section 5816.10 of the Ohio Act on the ground that a court of another jurisdiction has acquired or may acquire proper jurisdiction over, or may provide proper venue for, that case or controversy or the parties to the case or controversy. Nothing in division (H) of Section 5816.10 of the Ohio Act shall be construed to do either of the following:

(1) Prohibit a transfer or other reassignment of any case or controversy from one court of this state to another court of this state; or

(2) Expand or limit the subject matter jurisdiction of any court of this state.

Section 5816.11 of the Ohio Act provides that any person may serve as an advisor of a legacy trust except that a transferor may act as an advisor only in connection with investment decisions. Also, an advisor shall be considered a fiduciary unless the terms of a legacy trust instrument expressly provide otherwise.

Section 5816.12 of the Ohio Act provides that except to the extent expressly provided otherwise by the terms of a legacy trust instrument, each trustee and each advisor of a legacy trust shall have the greatest discretion permitted by law in connection with all matters of trust administration, all trust distributions, and all other trustee or advisor decisions.

Section 5816.13 of the Ohio Act provides that no beneficiary or other person shall be considered to have a property interest in any property of a legacy trust to the extent that the distribution of that property is subject to the discretion of one or more qualified trustees or advisors, either acting alone or in conjunction with any other person, including any person authorized to veto any distributions from the legacy trust.

Section 5816.14 of the Ohio Act provides that the Ohio Act applies to qualified dispositions made on or after the effective date of Section 5816.14 of the Ohio Act.

Practice Note: For a comparison of the current domestic asset protection trust acts see Shaftel, "A comparison of the Various State Domestic Asset Protection Trust Statutes," 35 EP 3 (March 2008).

XXIX. SOUTH CAROLINA LAW.

Section 62-7-505 of the South Carolina Trust Code provides in relevant part:

(a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

(2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

(b) For purposes of this section:

(2) the assets in a trust that are attributable to a contribution to an inter vivos marital deduction trust described in either Section 2523(e) or (f) of the Internal Revenue Code of 1986, after the death of the spouse of the settlor of the inter vivos marital deduction trust are deemed to have been contributed by the settlor's spouse and not by the settlor.

For an excllent discussion of South Carolina on this topic, see Collins, "Asset Protection Trusts in South Carolina," LISI Asset Protection Planning Newsletter #284, (February 25, 2015) at http://www.LeimbergServices.com.

XXX. MARYLAND LAW.

Section 14-116 of the Maryland Estates and Trust Code provides in relevant part:

Interests in grantor and qualified terminable interest property trusts.

(a) In general. -- An individual who creates a trust may not be considered the settlor of that trust with regard to the individual's interest in the trust if:

(1) That interest is the authority of the trustee under the trust instrument or any other provision of law to pay or reimburse the individual for any tax on trust income or trust principal that is payable by the individual under the law imposing that tax; or

(2) All of the following apply:
(i) The individual creates or has created the trust for the benefit of the individual's spouse;
(ii) The trust is treated as qualified terminable interest property under § 2523(f) of the Internal Revenue Code of 1986; and
(iii) The individual's interest in the trust income, trust principal, or both follows the termination of the spouse's prior interest in the trust.

(b) Rights of creditors. -- A creditor of an individual described in subsection (a) of this section may not attach, exercise, reach, or otherwise compel distribution of:
(1) Any principal or income of the trust;
(2) Any principal or income of any other trust to the extent that the property held in the other trust is attributable to a trust described in subsection (a)(2) of this section;
(3) The individual's interest in the trust; or
(4) The individual's interest in any other trust to the extent that the property held in the other trust is attributable to a trust described in subsection (a)(2) of this section.

(c) Construction of section. -- This section may not be construed to affect any State law with respect to a fraudulent transfer by an individual to a trustee.

For an excellent discussion of Maryland asset protection trust law, see Franke & Sessions, "Self-Settled Asset Protection Trusts for Married Couples in Maryland," LISI Asset Protection Planning Newsletter #292, (April 23, 2015) at http://www.LeimbergServices.com.

XXXI. OREGON LAW.

Section 130.315 of the Oregon Uniform Trust Code provides in relevant part:

> (4) The assets of an irrevocable trust that are attributable to a contribution to an inter vivos marital deduction trust described in section 2523(e) or (f) of the Internal Revenue Code, as in effect on December 31, 2012, after the death of the spouse of the settlor of the inter vivos marital deduction trust shall be deemed to have been contributed by the settlor's spouse and not by the settlor.
>
> (5) The assets of an irrevocable trust for the benefit of a person, including the settlor, are not subject to claims of creditors of the settlor to the extent that the property of the trust is subject to a presently exercisable general power of appointment held by a person other than the settlor.
>
> (6) Subsections (2) and (3) of this section do not apply to a person other than a settlor who is a beneficiary of a revocable or irrevocable trust and who is also a trustee of the trust, if the power to withdraw for the person's own benefit is limited by an ascertainable standard.

XXXII. KENTUCKY LAW.

Section 381.180 of the Kentucky Unorm Statutory Trust Act provides in relevant part:

> (8) (a) For the purposes of this section, amounts and property contributed to the following trusts are not deemed to have been contributed by the settlor of the trust, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts shall not be treated as a settlor:

1. An irrevocable inter vivos marital trust that is treated as qualified terminable interest property under Section 2523(f) of the Internal Revenue Code of 1986, as amended, if the settlor is a beneficiary of the trust after the death of the settlor's spouse;
2. An irrevocable inter vivos marital trust that is treated as a general power of appointment trust under Section 2523(e) of the Internal Revenue Code if the settlor is a beneficiary of the trust after the death of the settlor's spouse;

3. An irrevocable inter vivos trust for the spouse of the settlor that does not qualify for the gift tax marital deduction if the settlor is a beneficiary of the trust only after the death of the settlor's spouse.

(b) For the purposes of this subsection, a person is a beneficiary whether so named under the initial trust instrument or through the exercise by that person's spouse or by another person of a limited or general power of appointment.

(c) For purposes of this section, the settlor shall be any person who:

1. Created the trust;
2. Contributed property to the trust; or
3. Is deemed to have contributed property to the trust.

For an excellent discussion of Kentucky asset protection trust law, see Morris & Anderson, "Kentucky Asset Protection Trusts," LISI Asset Protection Planning Newsletter #299, (June 8, 2015) at http://www.LeimbergServices.com.

XXXIII. TEXAS LAW.

Section § 112.035 of the Texas Property Code provides in relevant part:

(g) For the purposes of this section, property contributed to the following trusts is not considered to have been contributed by the settlor, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts may not be treated as a settlor:

(1) an irrevocable inter vivos marital trust if:

(A) the settlor is a beneficiary of the trust after the death of the settlor's spouse; and

(B) the trust is treated as:

(i) qualified terminable interest property under Section 2523(f), Internal Revenue Code of 1986; or
(ii) a general power of appointment trust under Section 2523(e), Internal Revenue Code of 1986;

(2) an irrevocable inter vivos trust for the settlor's spouse if the settlor is a beneficiary of the trust after the death of the settlor's spouse; or

(3) an irrevocable trust for the benefit of a person:

(A) if the settlor is the person's spouse, regardless of whether or when the person was the settlor of an irrevocable trust for the benefit of that spouse; or

(B) to the extent that the property of the trust was subject to a general power of appointment in another person.

(h) For the purposes of Subsection (g), a person is a beneficiary whether named a beneficiary:

(1) under the initial trust instrument; or

(2) through the exercise of a limited or general power of appointment by:

(A) that person's spouse; or

(B) another person.

For a good detailed discussion of the Texas asset protection trust statute, see Ripp & Jetel: Asset Protection Trusts...in Texas? **LISI** Asset Protection Planning Newsletter #280 (February 5, 2015).

XXXIV. MISSISSIPPI LAW

A. Effective July 1, 2014, Mississippi has asset protection trust legislation. Mississippi permits residents and non-residents to create a "**qualified disposition trust**" under the Mississippi Qualified Disposition in Trust Act (the "**MQDTA**"), Title 91, Chapter 9, Article 15. Miss. Code Ann. §§ 91-9-701–91-9-723.

B. Under the MQDTA:

1. "**Claim**" means a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

2. "**Creditor**" means, with respect to a transferor, a person who has a claim.

3. "**Debt**" means liability on a claim.

4. "**Disposition**" means a transfer, conveyance or assignment of property, including a change in the legal ownership of property occurring upon the substitution of one (1) trustee for another or the addition of one or more new trustees. "Disposition" also includes the exercise of a power so as to cause a transfer of property to a trustee or trustees, but shall not

include the release or relinquishment of an interest in property that, until the release or relinquishment, was the subject of a qualified disposition.

5. "**Investment advisor**" means a person given authority by the terms of a qualified disposition trust to direct, consent to or disapprove a transferor's actual or proposed investment decisions, distribution decisions or other decisions of the transferor.

6. "**Investment decision**" means the retention, purchase, sale, exchange, tender, or other transaction affecting the ownership of or rights in investments.

7. "**Person**" means an individual, a corporation, an organization, or other legal entity.

8. "**Property**" includes real property, personal property, and interests in real or personal property.

9. "**Qualified affidavit**" means a sworn affidavit signed by the transferor before making a qualified disposition. In the event of a disposition by a transferor who is a trustee, the affidavit shall be signed by the transferor who made the original disposition to the trustee, or a predecessor trustee, in a form that meets the requirements of subsections (n)(ii) and (iii) of this section and shall state facts as of the time of the original disposition.

10. "**Qualified disposition**" means a disposition by or from a transferor to a qualified trustee or qualified trustees, with or without consideration, by means of a qualified disposition trust, after the transferor executes a qualified affidavit.

11. "**Qualified trustee**" means a person who:

a. In the case of a natural person, is a resident of this state, or, in all other cases, is authorized by the law of this state to act as a trustee and whose activities are subject to supervision by the Mississippi Department of Banking and Consumer Finance, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision or any successor to them;

b. Maintains or arranges for custody in this state of some or all of the property that is the subject of the qualified disposition, maintains records for the trust on an exclusive or nonexclusive basis, prepares or arranges for the preparation of required income tax returns for the trust, or otherwise materially participates in the administration of the trust; and

c. Is not the transferor;

12. "**Spouse**" or "**former spouse**" means only persons to whom the transferor was legally married at, or before, the time the qualified disposition is made.

13. "**Transferor**" means a person who, directly or indirectly, makes a disposition or causes a disposition to be made in such person's capacity:

a. As an owner of property;

b. As a holder of a power of appointment that authorizes the holder to appoint in favor of the holder, the holder's creditors, the holder's estate or the creditors of the holder's estate; or

c. As a trustee.

14. "**Qualified disposition trust**" means a trust instrument appointing a qualified trustee or qualified trustees for the property that is the subject of a disposition, which instrument:

a. Expressly incorporates the law of this state to govern the validity, construction and administration of the trust;

b. Is irrevocable; and

c. Provides that the interest of the transferor or other beneficiary in the trust property or the income from the trust property may not be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily, before the qualified trustee or qualified trustees actually distribute the property or income from the property to the beneficiary.

C. Under the MQDTA, a qualified affidavit shall state that:

1. The transferor has full right, title, and authority to transfer the assets to the trust;

2. The transfer of the assets to the trust will not render the transferor insolvent;

3. The transferor does not intend to defraud a creditor by transferring the assets to the trust;

4. The transferor does not have any pending or threatened court actions against the transferor, except for those court actions identified by the transferor on an attachment to the affidavit;

5. The transferor is not involved in any administrative proceedings, except for those administrative proceedings identified on an attachment to the affidavit;

6. The transferor does not contemplate filing for relief under the provisions of the federal bankruptcy code;

7. The assets being transferred to the trust were not derived from unlawful activities; and

8. The transferor is a named insured of a general liability insurance policy and, if applicable, a professional liability insurance policy, with policy limits of at least One Million Dollars ($1,000,000.00) for each respective policy.

9. For a discussion of the purpose of providing an affidavit of solvency, see "Gassman & Daniels, The Affability of Affidavits in Domestic Asset Protection Trust Planning," Steve Leimberg's Asset Protection Planning Newsletter #293 (Apr. 28, 2015).

D. The MQDTA provides that:

1. Notwithstanding any law to the contrary, no action of any kind, including, but not limited to, an action to enforce a judgment entered by a court or other body having adjudicative authority, shall be brought at law or in equity for an attachment or other provisional remedy against property that is the subject of a qualified disposition or for the avoidance of a qualified disposition, unless the action is brought pursuant to the provisions of the Uniform Fraudulent Transfer Act, Section 15-3-101 et seq., and in the case of a creditor whose claim arose after a qualified disposition, unless the qualified disposition was also made with actual intent to defraud such creditor.

2. Notwithstanding Section 15-3-115 of the Mississippi Code, a creditor's claim under subsection (a) shall be extinguished (a) if the person is a creditor when the qualified disposition to a qualified disposition trust is made, unless the action is commenced within the later of two (2) years after the qualified disposition is made or six (6) months after the person discovers or reasonably should have discovered the qualified disposition; or (b) if the person becomes a creditor after the qualified disposition to a qualified disposition trust is made, unless the action is commenced within two (2) years after the qualified disposition is made;

3. If subsection (b)(1) applies, a person shall be deemed to have discovered the existence of a qualified disposition to a qualified disposition trust at the time any public record is made of any transfer of property relative to the qualified disposition, including, but not limited to, the conveyance of real property that is recorded in the office of the chancery clerk of the county in which the property is located or the filing of a financing statement under Title 75, Chapter 9 of the Mississippi Code, or the equivalent recording or filing of either with the appropriate person or official under the laws of a jurisdiction other than this state; and no creditor shall bring an action with respect to property that is the subject of a qualified disposition unless that creditor proves by clear and convincing evidence that the settlor's transfer of the property was made with the intent to defraud that specific creditor.

4. A qualified disposition that is made by means of a disposition by a transferor who is a trustee shall be deemed to have been made as of the time, whether before, on or after July 1, 2014, the property that is the subject of the qualified disposition was originally transferred to the transferor acting in the capacity of trustee, or any predecessor trustee, in a form that meets the requirements of Section 91-9-703(n)(2) and (3).

E. Notwithstanding any law to the contrary, a creditor, including a creditor whose claim arose before or after a qualified disposition, or any other person shall have only the rights

with respect to a qualified disposition as are provided in this section and Section 91-9-711, and neither a creditor nor any other person shall have any claim or cause of action against the trustee, an advisor of a trust that is the subject of a qualified disposition, or against any person involved in the counseling, drafting, preparation, execution, or funding of a trust that is the subject of a qualified disposition. For purposes of this section, counseling, drafting, preparation, execution or funding of a trust that is the subject of a qualified disposition includes the counseling, drafting, preparation, execution and funding of a limited partnership or a limited liability company if interests in the limited partnership or limited liability company are subsequently transferred to the trust that is the subject of a qualified disposition.

F. Notwithstanding any law to the contrary, no action of any kind, including, but not limited to, an action to enforce a judgment entered by a court or other body having adjudicative authority, shall be brought at law or in equity against a trustee or an advisor of a trust that is the subject of a qualified disposition, or against any person involved in the counseling, drafting, preparation, execution or funding of a trust that is the subject of a qualified disposition, if, as of the date the action is brought, an action by a creditor with respect to the qualified disposition would be barred under this section.

G. In circumstances where more than one (1) qualified disposition is made by means of the same qualified disposition trust, then (a) the making of a subsequent qualified disposition shall be disregarded in determining whether a creditor's claim with respect to a prior qualified disposition is extinguished as provided in 91-9-707(b); and (b) any distribution to a beneficiary shall be deemed to have been made from the latest qualified disposition.

H. If, in any action brought against a trustee of a trust that is the result of a qualified disposition, a court takes any action whereby the court declines to apply the law of this state in determining the effect of a spendthrift provision of the trust, the trustee of the trust shall immediately upon the court's action and without the further order of any court, cease in all respects to be trustee of the trust and a successor trustee shall succeed as trustee in accordance with the terms of the trust or, if the trust does not provide for a successor trustee and the trust would otherwise be without a trustee, a court of this state, upon the application of any beneficiary of the trust, shall appoint a successor trustee upon the terms and conditions it determines to be consistent with the purposes of the trust and this article. Upon the trustee's ceasing to be trustee, the trustee shall have no power or authority other than to convey the trust property to the successor trustee named in the trust in accordance with this section.

I. A trust that is the subject of a qualified disposition shall be subject to this section whether or not the transferor retains any or all of the powers and rights described in Section 91-9-709 or serves as an investment advisor pursuant to Section 91-9-717.

J. Notwithstanding any provision of subsection (a) or (b) to the contrary, the limitations on actions by creditors in law or equity shall not apply and the creditors' claims shall not be extinguished if the transferor is indebted on account of an agreement, judgment, or order of a court for the payment of one or more of the following:

1. To any person to whom the transferor is indebted on account of an agreement or order of court for the payment of support or alimony in favor of the transferor's

spouse, former spouse or children, or for a division or distribution of property in favor of the transferor's spouse or former spouse, but only to the extent of such debt;

2. To any person who suffers death, personal injury, or property damage on or before the date of a qualified disposition by a transferor, which death, personal injury, or property damage is at any time determined to have been caused, in whole or in part, by the tortious act or omission of either such transferor or by another person for whom such transferor is or was vicariously liable, but only to the extent of such claim against such transferor or other person for whom such transferor is or was vicariously liable;

3. To the State of Mississippi or any political subdivision thereof, including, but not limited to, court-ordered restitution in a criminal matter; or

4. To any creditor in an amount not to exceed One Million Five Hundred Thousand Dollars ($1,500,000.00) if the transferor failed to maintain a One Million Dollar ($1,000,000.00) umbrella policy as required under the MQDTA.

5. A claim provided under this subsection shall be asserted against a trustee only upon a final nonappealable determination of a Mississippi court or a fully domesticated, final nonappealable order of a court of another state that the debt is past due; and after the court has determined that the claimant has made reasonable attempts to collect the debt from any other sources of the transferor or that any attempt would be futile.

6. This subsection shall not apply to any claim for forced heirship, legitime or elective share.

K. The transferor shall obtain a general liability policy and, if applicable, a professional liability policy, and each policy must have a policy limit of at least One Million Dollars ($1,000,000.00). Policy premiums must be paid by the transferor.

L. Under the MQDTA, a transferor shall have only the powers and rights conferred by the qualified disposition trust. The powers and rights conferred by the qualified disposition trust upon the transferor are personal powers and rights that may not be exercised by a creditor or any other person, except as expressly permitted by the trust. Except as permitted by Sections 91-9-717 and 91-9-721, the transferor shall have no rights or authority with respect to the corpus of the trust or the income from the trust, and any agreement or understanding purporting to grant or permit the retention of any greater rights or authority shall be void.

M. Under the MQDTA, a qualified disposition shall be avoided only to the extent necessary to satisfy the transferor's debt to the creditor at whose instance the disposition had been avoided, together with costs, including attorneys' fees, that the court may allow.

N. If any qualified disposition shall be avoided, then if the court is satisfied that a qualified trustee has not acted in bad faith in accepting or administering the property that is the subject of the qualified disposition, the qualified trustee shall have a first and paramount lien against the property that is the subject of the qualified disposition in an amount equal to the entire cost, including attorneys' fees, properly incurred by the qualified trustee in the defense of the action or proceedings to avoid the qualified disposition; the qualified disposition shall be

avoided subject to the proper fees, costs, preexisting rights, claims and interests of the qualified trustee and of any predecessor qualified trustee that has not acted in bad faith; and for purposes of this subsection, it shall be presumed that the qualified trustee did not act in bad faith merely by accepting the property; and if the court is satisfied that a beneficiary of a trust has not acted in bad faith, the avoidance of the qualified disposition shall be subject to the right of the beneficiary to retain any distribution made upon the exercise of a trust power or discretion vested in the qualified trustee or qualified trustees, which power or discretion was properly exercised prior to the creditor's commencement of an action to avoid the qualified disposition. It shall be presumed that the beneficiary, including a beneficiary who is also a transferor of the trust, did not act in bad faith merely by creating the trust or by accepting a distribution made in accordance with the terms of the trust.

O. Under the MQDTA, a spendthrift provision as described in Section 91-9-703(n)(3) shall be deemed to be a restriction on the transfer of the transferor's beneficial interest in the trust that is enforceable under applicable nonbankruptcy law within the meaning of Section 541(c)(2) of the Bankruptcy Code, codified in 11 USCS, Section 541(c)(2), or any successor provision.

P. For purposes of the MQDTA, neither the transferor nor any other natural person who is a nonresident of this state nor an entity that is not authorized by the law of this state to act as a trustee or whose activities are not subject to supervision as provided in Section 91-9-703(k)(1) shall be considered a qualified trustee; however, nothing in this article shall preclude a transferor from appointing one (1) or more advisors, including, but not limited to: advisors who have authority under the terms of the trust instrument to remove and appoint qualified trustees or trust advisors; advisors who have authority under the terms of the trust instrument to direct, consent to or disapprove distributions from the trust; and investment advisors, whether or not the advisors would meet the requirements imposed by Section 91-9-703(k). "**Advisor**" includes a trust "**protector**" or any other person who, in addition to a qualified trustee, holds one or more trust powers.

Q. Under the MQDTA, a person may serve as an investment advisor notwithstanding that the person is the transferor of the qualified disposition, but the person may not otherwise serve as advisor to a trust that is a qualified disposition trust except with respect to the retention of the veto right permitted by Section 91-9-721(a).

R. Under the MQDTA, if a qualified trustee of a qualified disposition trust ceases to meet the requirements of Section 91-9-703(k)(1), and there remains no trustee that meets the requirements, the qualified trustee shall be deemed to have resigned as of the time of that cessation, and thereupon the successor qualified trustee provided for in the qualified disposition trust shall become a qualified trustee of the qualified disposition trust, or in the absence of any successor qualified trustee provided for in the qualified disposition trust, then a court of this state shall, upon application of any interested party, appoint a successor qualified trustee.

S. A qualified disposition trust shall not be deemed revocable on account of its inclusion of one (1) or more of the following:

1. A transferor's power to veto a distribution from the trust;

2. A power of appointment, other than a power to appoint to the transferor, the transferor's creditors, the transferor's estate or the creditors of the transferor's estate, exercisable by will or other written instrument of the transferor effective only upon the transferor's death;

3. The transferor's potential or actual receipt of income, including rights to the income retained in the trust;

4. The transferor's potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust as those terms are defined in Section 664 of the Internal Revenue Code of 1986, codified in 26 USCS Section 664, and any successor provision;

5. The transferor's receipt each year of an amount specified in the trust instrument, the amount not to exceed five percent (5%) of the initial value of the trust or its value determined, from time to time, pursuant to the trust;

6. The transferor's potential or actual receipt or use of principal if the potential or actual receipt or use of principal would be the result of a qualified trustee's or qualified trustees' acting:

a. In the qualified trustee's or qualified trustees' discretion. For purposes of this section, a qualified trustee is presumed to have discretion with respect to the distribution of principal unless the discretion is expressly denied to the trustee by the terms of the trust;

b. Pursuant to a standard that governs the distribution of principal and does not confer upon the transferor a power to consume, invade, or appropriate property for the benefit of the transferor, unless the power of the transferor is limited by an ascertainable standard relating to the health, education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or Section 2514(c)(1) of the Internal Revenue Code of 1986, codified in 26 USCS Section 2041(b)(1)(A) or 26 USCS Section 2514(c)(1), as in effect on July 1, 2014, or as later amended; or

c. At the direction of an advisor described in Section 91-9-715 who is acting in the advisor's discretion or pursuant to a standard that governs the distribution of principal and does not confer upon the transferor a power to consume, invade, or appropriate property for the benefit of the transferor, unless the power of the transferor is limited by an ascertainable standard relating to the health, education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or Section 2514(c)(1) of the Internal Revenue Code of 1986, 26 USCS Section 2041(b)(1)(A) or 26 USCS Section 2514(c)(1), as in effect on July 1, 2010, or as later amended;

7. The transferor's right to remove a trustee or advisor and to appoint a new trustee or advisor; provided, however, that the right shall not include the appointment of a person who is a related or subordinate party with respect to the transferor within the meaning

of Section 672(c) of the Internal Revenue Code of 1986, 26 USCS Section 672(c), and any successor provision;

8. The transferor's potential or actual use of real property held under a qualified personal residence trust within the meaning of the term as described in Section 2702(c) of the Internal Revenue Code of 1986, codified in 26 USCS Section 2702(c), and any successor provision;

9. The transferor's potential or actual receipt of income or principal to pay, in whole or in part, income taxes due on income of the trust if the potential or actual receipt of income or principal is pursuant to a provision in the qualified disposition trust that expressly permits a distribution to the transferor as reimbursement for the taxes and if the distribution would be the result of a qualified trustee's or qualified trustees' acting:

a. In the qualified trustee's or qualified trustees' discretion or pursuant to a mandatory direction in the qualified disposition trust; or

b. At the direction of an advisor described in Section 91-9-717, who is acting in the advisor's discretion;

10. The ability, whether pursuant to direction in the qualified disposition trust or discretion of a qualified trustee to pay, after the death of the transferor, all or any part of the debts of the transferor outstanding at the time of the transferor's death, the expenses of administering the transferor's estate, or any estate or inheritance tax imposed on or with respect to the transferor's estate; and

11. A qualified trustee's or qualified trustees' authority to make distributions to pay taxes in lieu of or in addition to the power to make a distribution for taxes pursuant to subsection (c), (f), (i), or (j) by direct payment to the taxing authorities.

T. Section 91-9-503 of the Mississippi Code provides that if the trust instrument provides that a beneficiary's interest in income or principal or both of a trust is not subject to voluntary or involuntary transfer, the beneficiary's interest in income or principal or both under the trust may not be transferred and is not subject to the enforcement of a money judgment until paid to the beneficiary.

U. Section 91-9-505 of the Mississippi Code provides that if the trust instrument provides that the trustee shall pay income or principal or both of a trust for the education or support of a beneficiary, the beneficiary's interest in income or principal or both under the trust, to the extent the income or principal or both is necessary for the education or support of the beneficiary, may not be transferred and is not subject to the enforcement of a money judgment until paid to the beneficiary. This section shall not be applied or construed to limit or otherwise diminish a restraint on transfer that is valid under Section 91-9-503.

V. Section 91-9-507 of the Mississippi Code provides:

1. If the trust instrument provides that the trustee shall pay to or for the benefit of a beneficiary so much of the income or principal or both of a trust as the trustee in

the trustee's discretion sees fit to pay, a transferee or creditor of the beneficiary may not compel the trustee to pay any amount from the trust that may be paid only in the exercise of the trustee's discretion. This subsection shall not be applied or construed to limit or otherwise diminish a restraint on transfer that is valid under Section 91-9-503.

2. If the trustee has knowledge of a transfer of a beneficiary's interest in a trust or has been served with process in a proceeding for garnishment or attachment or the like by a judgment creditor seeking to reach a beneficiary's interest in a trust, and the trustee pays to or for the benefit of the beneficiary any part of the income or principal of the trust that may be paid only in the exercise of the trustee's discretion, the trustee is liable to the transferee or creditor to the extent that the payment to or for the benefit of the beneficiary impairs the right of the transferee or creditor. This subsection does not apply if the beneficiary's interest in the trust is subject to a restraint on transfer that is valid under Section 91-9-503.

3. This section applies regardless of whether the trust instrument provides a standard for the exercise of the trustee's discretion.

4. Nothing in this section limits any right the beneficiary may have to compel the trustee to pay to or for the benefit of the beneficiary all or part of the income or principal of a trust.

W. Section 91-9-509, Mississippi Code of 1972, which provided for the situation when a settlor is beneficiary of a settlor-created trust, was repealed.

XXXV. FEDERAL TAX ISSUES WITH ASSET PROTECTION TRUSTS.

A. Incomplete Gift Trusts.

1. Generally, gratuitous transfers to wealth protection trusts are structured to qualify as incomplete gifts for Federal gift tax purposes because most individuals who establish and fund such trusts plan to transfer assets to the trust in excess of the $5,000,0000 (as indexed from the base amount) lifetime gift tax exemption amount under §2505 of the Code. A number of techniques can be used to design a trust to cause gifts to the trust to be deemed as incomplete gifts for gift tax purposes, however, not incomplete for property law purposes.

2. Section 2501 imposes a tax "on the transfer of property by gift." The gift tax imposed under § 2501 applies whether the transfer is in trust or otherwise, whether the transfer is direct or indirect, and regardless of the property transferred. § 2511(a). Nonetheless, the gift tax under § 2501 is imposed only if a donor parts with such dominion and control over the property to render the gift complete. Reg. § 25.2511-2. If upon a transfer of property the donor reserves any power over its disposition, the gift may be wholly incomplete, or it may be partially complete and partially incomplete depending upon all the facts in the particular case. Reg. § 25.2511-2(b). Accordingly, in every case of a transfer of property subject to a retained power, the terms of the power must be examined and its scope determined. Reg. § 25.2511-2(b). Regulation § 25.2511-2(b) provides in part:

> if a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among his descendants, no portion of the transfer is a completed gift.

a. A gift is incomplete if and to the extent that a donor reserves the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. Reg. § 25.2511-2(c). See also *e.g.*, PLR 201507008. A gift is not considered incomplete, however, merely because the donor reserves the power to change the manner or time of enjoyment of the gift, *i.e.*, change the timing of a beneficiary's enjoyment. Reg. § 25.2511(d).

b. In *Sanford's Estate v. Com'r.*, 308 U.S. 39 (1939), a donor transferred property to a trust reserving the power to modify and revoke the trust and revest the title to all of the trust assets in himself. Five years later the donor released the power to revoke the trust, however, he reserved the power to continue to modify it. In the grantor's written release and reservation of his power to revoke and modify, he specifically provided that his continuing power to modify the trust should not include the power to withdraw principal or income. The issue under consideration was whether an *inter vivos* transfer of property to the trust by the donor reserving to himself the power to designate new beneficiaries (other than himself) constituted a completed gift. The court noted that:

> 'taxation is not so much concerned with the refinements of title as it is with the actual command over the property taxed' [citations omitted] *and that the retention of control over the disposition of the trust property, whether for the benefit of the donor or others, renders the gift incomplete until the power is relinquished whether in life or at death*. The rule was thus established, and has ever since been consistently followed by the Court, that a transfer of property upon trust, with power reserved to the donor either to revoke it and recapture the trust property *or to modify its terms so as to designate new beneficiaries other than himself is incomplete*, and becomes complete so as to subject the transfer to death taxes only on relinquishment of the power at death. (Emphasis supplied.) *Id*. at 43.

See also Reg. § 25.2511-2(f).

Where a donor retains the power to change or modify the beneficial interests in a trust such a power will cause the gratuitous transfer of property by the donor to the trust to be incomplete for gift tax purposes, even if the exercise of such power can be defeated by the actions of other parties. See *Goldstein v. Com'r.*, 37 T.C. 897 (1962) and *Estate of Goelet v. Com'r*., 51 T.C. 352 (1968).

c. i. Under the foregoing rules, if the donor-settlor is the sole current beneficiary of a trust and retains a testamentary special power of appointment over trust property, any gratuitous transfers by the donor to the trust will constitute incomplete gifts for Federal gift tax purposes.

ii. It should also be possible for a donor-settlor to retain a testamentary special power of appointment over the trust to avoid a taxable gift even though the settlor may be one of a class of permissible beneficiaries to whom an independent trustee may at any time make distributions of income and principal in such trustee's sole, absolute and uncontrolled discretion (that is, a "**pot trust**"). See *e.g.*, Reg. § 25.2511-2(b); PLRs 9030005, 200148028, 200247013, 200502014, 200612002, 200647001, 200715005, 200729025, 200731019 and 200731019. See also Wells, "Domestic Asset Protection Trusts-A Viable Estate and Wealth Preservation Alternative," LXXVVII The Florida Bar Journal 44 (May 2003); and Fox & Huft, "Asset Protection and Dynasty Trusts," Vol. 37 No. 2 Real Property Probate and Trust Journal 287 (Summer 2002). The foregoing concept is similar to the gift tax rule set forth in Regs. § 25.2511-1(h)(4) which provides:

> ***If A creates a joint bank account for himself and B (or a similar type of ownership by which A can regain the entire fund without B's consent) there is a gift to B when B draws upon the account for his own benefit, to the extent of the amount drawn without any obligation to account for a part of the proceeds to A.*** Similarly, if A purchases a United States savings bond, registered as payable to "A or B," there is a gift to B when B surrenders the bond for cash without any obligation to account for a part of the proceeds to A. (Emphasis added.)

See also PLRs 201410001, 201410002, 201410003, 201410004, 201410005, 201410006, 201410007, 201410008, 201410009 and 201410010 all providing:

> Further, Grantor retained Grantor's Testamentary Power to appoint the property in Trust to any person or persons or entity or entities, other than Grantor's estate, Grantor's creditors, or the creditors of Grantor's estate. Under §25.2511-2(b) the retention of a testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder. Accordingly, the retention of this power causes the transfer of property to Trust to be incomplete with respect to the remainder in Trust for federal gift tax purposes.

Nevertheless, use of a testamentary special power of appointment as the sole mechanism to cause a gift to be incomplete for Federal gift tax purposes has been called into question after the release of Chief Counsel Memorandum 201208026. In IRM 201208026, two settlors created an irrevocable trust and gratuitously transferred property to it. The trustee of the trust was a child of the settlors who was also a current beneficiary (that is, an adverse party for tax purposes), and the beneficiaries during the lifetime of the settlors were the settlors' children, other descendants, and their spouses. The only power the settlors retained was a testamentary limited power of appointment. The trust was to terminate when both settlors died. The ruling held that transfers to the trust were completed gifts because during the term of the trust the settlors retained no dominion or control over trust assets. The fact that the settlors retained a limited testamentary power of appointment was insufficient to treat the transfers as incomplete gifts. Perhaps a critical difference between the terms of the trust in IRM 201208026 to the terms of the trust in all of the other authority discussed above is that neither settlor was a current beneficiary of the trust, that is, the trustee could not make any distribution of trust property to either settlor. For an additional discussion of some of the practical issues created

by this memorandum and some revisions to the trust agreement which may have allowed the settlors to achieve their goals in establishing the trust, see "Gift Taxes: Chief Counsel Memorandum Switches IRS Position on Completed Gifts," 54 DTR G-6 (March 20, 2012) and LISI Estate Planning Newsletter #1936 (March 6, 2012) at http://www.leimbergservices.com. See also Rubin, LISI Estate Planning Newsletter #1959 (May 8, 2012), at http://www.leimbergservices.com; Aucutt, "Ron Aucutt's Top Ten Estate Planning and Estate Tax Developments of 2012," LISI Estate Planning Newsletter #2043 (December 31, 2012) at http://www.leimbergservices.com; and Gassman, *et. al*, "Planning After IRS Memo 201208026: How Foreign Can Creditor Protection Trust Laws Get?," LISI Asset Protection Planning Newsletter #207 (September 11, 2012) at http://www.leimbergservices.com.

d. Under Regulation § 25.2511-2(e) a donor is considered as possessing a power if the power is exercisable by the donor in conjunction with any person who does not have a substantial adverse interest in the disposition of the transferred property or the income from such property. A person who serves as a trustee is not considered as possessing an adverse interest in the disposition of such property or its income merely by reason of such person's position as a trustee. Reg. § 25.2511-2(e). (See *e.g.*, PLR 201507008 providing, "Trustor also retained a Lifetime Limited Power of Appointment to appoint income and principal to the issue of Trustor's father or Foundation. Trustor's Lifetime Limited Power of Appointment can only be exercised in conjunction with the Trust Protector. Under §§ 25.2511-2(e) and 25.2514-3(b)(2), Trustor is considered to solely possess the power to exercise Trustor's Lifetime Limited Power of Appointment because the Trust Protector (who is merely a coholder of Trustor's Lifetime Limited Power of Appointment) has no substantial adverse interest in the disposition of the assets transferred by the Trustor to Trust because (i) the Trust Protector may not have any beneficial interest in any trust (whether before or after the Trustor's death), (ii) the Trust Protector is not a permissible appointee of the Trustor's Lifetime Limited Power of Appointment, and (iii) the Trust Protector is not a taker in default of the exercise of the Trustor's Lifetime Limited Power of Appointment.") See also PLR 201525002 and PLR 201525003 both providing:

> because the CDA, either Spouse or the LLC, or in default, the Trust Protector, does not have a substantial adverse interest to Grantor's Consent Veto Power, under § 25.2511-2(e), Grantor is considered as having himself the power to veto any Charitable Quarterly Distribution to Grantor's Charities for any reason and for no reason. Accordingly, based upon the facts submitted and representations made, we conclude that the Proposed Transfer of property to Trust will be an incomplete gift, assuming Grantor retains Grantor's Consent Veto Power, Grantor's Sole Discretionary Veto Power, and Grantor's Testamentary Power.

See also, *Camp v. Com'r.*, 195 F.2d 999, 1004 (1st Cir. 1952). In *Camp*, the grantor reserved a power to revoke a trust in conjunction with half-brother ("**B**") or mother ("**M**"). The terms of the trust provided for income to be paid to the grantor's spouse during her life and at her death, principal would be paid to M for her life, and at M's death, to B. The court held that M and B had no interest in the life estate given to the grantor's spouse. Therefore, neither the interests of M nor B were adverse to the termination of the life estate for grantor's spouse. The court held that the Treasury Regulation (a predecessor to Regs. § 25.2511-2(e)) provides that where a grantor reserves the power to terminate a beneficiary's interests even with the concurrence of a

third party who has no interest in the trust adverse to such termination, it is in reality the same as if the grantor retained such power himself. See also *Paxton v. Com'r.*, 57 T.C. 627 (1972); and *Joseloff v. Com'r.*, 8 T.C. 213 (1947).

e. In PLR 201525002, the grantor (the "Grantor") of an irrevocable trust (the "Trust") requested rulings concerning the gift tax consequences of (1) transfers to the Trust by the Grantor, and (2) the release of certain powers retained by the Grantor.

The Trust provided that the trustee could make discretionary distributions of income and/or principal to any one or more of the Grantor and certain charitable organizations. The Grantor retained a testamentary power to appoint the remainder interest in the Trust to the Grantor's spouse and to certain charitable organizations named in the Trust. The Grantor also retained certain veto powers over distributions from the Trust. The Grantor's veto powers were exercisable with the consent of parties whose interests were not adverse to the Grantor for purposes of Regs. § 25.2511-2(e). Furthermore, the Grantor planned to execute a springing durable power of attorney that would become effective upon the Grantor's incapacity and would allow the Grantor's attorney-in-fact to exercise the Grantor's veto powers over distributions from the Trust.

1. *The Grantor's Gifts to the Trust were Incomplete Gifts.*

A. The Grantor retained a testamentary power to appoint the property in the Trust to Grantor's spouse and to several named charitable organizations. Under Regs. § 25.2511-2(b), the retention of a testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder of the trust. Accordingly, the Service concluded that the Grantor's retention of a testamentary power of appointment over the remainder of the Trust caused any transfers to the Trust to be incomplete with respect to the remainder interest in the Trust. However, if at any time the Grantor released his testamentary power of appointment, such release would result in a completed gift of the remainder interest in the Trust.

B. In *Estate of Sanford v. Comm'r,* 308 U.S. 39 (1939), the taxpayer created a trust for the benefit of named beneficiaries and reserved the power to revoke the trust in whole or in part, and to designate new beneficiaries other than himself. Six years later, the taxpayer relinquished the power to revoke the trust, however, retained the right to change the beneficiaries. Five years later, the taxpayer relinquished the right to change the beneficiaries. The court stated that a donor's gift is not complete, for purposes of the gift tax, when the donor has reserved the power to determine those other people who would ultimately receive the property. Accordingly, the court held that the taxpayer's gift was complete when he relinquished his right to change the beneficiaries of the trust.

In PLR 201525002, the Grantor's veto powers effectively gave the Grantor the power to change the interests of the beneficiaries during his lifetime. Accordingly, the Service concluded that the retention of such veto powers caused the Grantor's transfers to the Trust to be incomplete gifts. A grantor's retention of a power to change the beneficial interests in a trust causes the transfer to the trust to be incomplete for gift tax purposes even though the power

may be defeated by the actions of third parties. See *Goldstein v. Comm'r*, 37 T.C. 897 (1962); see also *Estate of Goelet v. Comm'r,* 51 T.C. 352 (1968). Under Regs. § 25.2511-2(c), a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries.

The parties whose consent would be required for the exercise of the Grantor's distribution veto powers did not have interests that were "substantially adverse" to the interests of the Grantor for purposes of Regs. § 25.2511-2(e). Thus, the Grantor himself was considered as having the power to veto distributions from the Trust. Accordingly, the Service concluded that a proposed transfer of property by the Grantor to the Trust would be an incomplete gift assuming that after such transfer the Grantor retained any powers to veto distributions that would be exercisable with the consent of a non-adverse party. See also Rev. Rul. 79-63,1979-1 C.B. 102; *Paxton v. Comm'r,* 57 T.C. 627 (1972); *Camp v. Comm'r,* 195 F.2d 999, 1004 (1st Cir. 1952); *Joseloff v. Comm'r,* 8 T.C. 213 (1947).

2. *The Grantor's Capacity was Immaterial for Gift Tax Purposes.*

A. The Service concluded that if the Grantor became incapacitated and was unable to exercise either (i) the Grantor's veto powers over distributions from the Trust, or (ii) the Grantor's testamentary power of appointment over the remainder interest in the Trust, a declaration of the Grantor's incapacity would not result in a completed gift of property to the Trust on the date when the Grantor was declared incapacitated (provided that the Grantor had not released the aforementioned powers prior to being declared incapacitated). A declaration of the Grantor's incapacity would not constitute a release or termination of the Grantor's veto powers for purposes of Regs. § 25.2511-2(f). The practical inability of the Grantor to exercise his veto powers or his testamentary power of appointment due to incapacity would not affect the existence of such powers.

B. Finally, the Service concluded that the Grantor's execution of a springing durable power of attorney authorizing the Grantor's attorney-in-fact the to exercise the Grantor's veto powers over distributions from the Trust would not result in a completed gift of any transfers to the Trust by the Grantor. An attorney-in-fact acting on the Grantor's behalf would not cause the Grantor to release or terminate the Grantor's veto powers and, therefore, the Grantor's execution of a springing durable power of attorney would not be deemed a release or termination of the Grantor's veto powers under Regs. § 25.2511-2(f).

B. Completed Gift Trusts.

1. In Revenue Ruling 76-103, 1976-1 C.B. 293, a settlor established an *inter vivos* trust. The terms of the trust provided that the trustee could distribute income or principal to the settlor in the trustee's "absolute discretion." Upon the death of the settlor any remaining principal was payable to the descendants of the settlor. The circumstances surrounding the creation of the trust indicated that it had not been created primarily for the settlor's benefit. The trustee was given the absolute discretion to change the situs of the trust to another state. The trust was considered a "**discretionary trust**" in the state where it was established and administered. Furthermore, under the law of the state where the trust was

created and administered all of the property in a discretionary trust "**may be subjected to the claims of the grantor's creditors, whenever such claims may arise**."

The issue addressed in the ruling was whether the transfer to the trust was an incomplete gift for federal gift tax purposes because all of the assets transferred to the trust were subject to the claims of the grantor's creditors. The ruling held that the gift was incomplete because both "prior and subsequent creditors" of the settlor could reach the maximum amount of trust property the trustees could in their discretion distribute to the settlor. Thus, the ruling noted that the settlor could enjoy all trust property "by relegating [his] creditors to the trust for settlement of their claims." Case law supports the holding in Revenue Ruling 76-103. See *e.g.*, *Outwin v. Com'r*, 76 T.C. 153 (1981); *Paolozzi v. Com'r*, 23 T.C. 182 (1954). See also *Estate of Paxton v. Com'r*, 86 T.C. 785 (1986) (Estate tax inclusion based on creditor's rights doctrine).

2. The opposite result was reached in Revenue Ruling 77-378, 1977-2 C.B. 347, where the settlor's creditors could not compel distributions under state law. In this ruling a settlor contributed one-half of his "income-producing property" to a trust with a corporate trustee. The trustee was given the power to distribute trust income and principal to the settlor in its "absolute and uncontrolled discretion." Upon the settlor's death, the trust was directed to terminate and the assets distributed to the settlor's spouse and children. Unlike the facts in Revenue Ruling 76-103, "under applicable state law the trustee's decision whether to distribute trust assets to the grantor [was] entirely voluntary." The settlor could not require any trust property be distributed to him. Additionally, the settlor's creditors could not reach any of the assets in the trust. The ruling stated:

> Even though a trustee may have an unrestricted power to return all of the trust's assets to the grantor, if the grantor's interest in the trust is not enforceable either by the grantor or on the grantor's behalf, then the grantor has parted with dominion and control over the property transferred into the trust. See section 25.2511-2(b) of the regulations. Furthermore, if the grantor retains such a mere expectancy that the trustee will distribute trust assets to the grantor rather than an enforceable interest in the trust, the expectancy does not prevent the completion or reduce the value of the gift. *Herzog v. Commissioner*, 41 B.T.A. 509 (1940), *aff'd*, 116 F.2d 591 (2nd Cir. 1941).

The holding in Revenue Ruling 77-378 is also supported by case law. See *e.g.*, *Wells v. Com'r*, T.C. Memo 1981-574 (no estate tax inclusion because transfer constituted complete *inter vivos* gift); *Estate of Uhl*, 241 F.2d 867 (7th Cir. 1957); *Estate of German v. United States*, 85-1 U.S.T.C. 13,610 (Ct. Cl. 1985) (same). The IRS continues to adhere to this result in its publicly released but nonbinding documents. See *e.g.*, PLR 200944002; PLR 9837007; PLR 9332006; PLR 8829030; PLR 8037116; PLR 7833062; TAM 8213004.

Taxpayers and Internal Revenue Service personnel are permitted to rely on revenue rulings to determine the tax effect of a transaction. See Rev. Proc. 89-14, 1989-1 CB 814, §§ 7.01(4), 7.01(5). According to §§ 7.01(5) and 7.01(6) Revenue Procedure 89-14:

> Taxpayers generally may rely upon revenue rulings, and revenue procedures published in the Bulletin in determining the tax treatment of their own transactions and need not request specific rulings applying the principles of a published revenue ruling or revenue procedure to the facts of their particular cases. However, taxpayers, Service personnel and others concerned are also cautioned to determine whether a revenue ruling or revenue procedure on which they seek to rely has been revoked, modified, declared obsolete, distinguished, clarified or otherwise affected by subsequent legislation, treaties, regulations, revenue rulings, revenue procedures or court decisions.

Thus, taxpayers are entitled to rely on the holding in Revenue Ruling 77-378 in structuring gifts to a trust settled in a jurisdiction that does not apply the self-settled trust doctrine to certain types of irrevocable trusts. Unless presented with substantially different facts, it is unlikely that the Internal Revenue Service would take a litigation position inconsistent with its position set forth in a published revenue ruling.

3. **PLR 200944002**. In PLR 200944002, the grantor wanted to establish an irrevocable trust for the benefit himself and his wife and descendents. Initially, he proposed to fund the trust with a cash gift and have an independent trust company serve as the sole trustee. Under the terms of the trust the trustee would be granted the authority to distribute the income and principal in such amounts and proportions as it determines in its sole and absolute discretion for the benefit of one or more members of the class consisting of the grantor, his wife and his descendants. Any income not so distributed would be accumulated and added to principal.

Also to be included under the terms of the trust, upon its termination no part of the income or principal could be distributed to the grantor, his estate, his creditors or the creditors of his estate. Upon the death of the survivor of the grantor and his wife, the remaining principal and accrued income of the trust would be directed to be allocated to any descendant of the grantor then living to be held in separate trusts. If no such descendant was then living, the remaining principal and accrued income would be distributed to one or more charitable organizations.

The trust agreement would also provide that neither the grantor, his wife, a former wife of the grantor; any beneficiary of a trust under the agreement, the spouse or former spouse of any beneficiary of any trust under the agreement nor any person related or subordinate to the grantor within the meaning of § 672(c) of the Code, could serve as a trustee.

The grantor would also retain the right, exercisable in a nonfiduciary capacity, without the approval or consent of any person in a fiduciary capacity, to acquire trust property by substituting other property of equivalent value. According to the terms of the proposed trust agreement the grantor could exercise this authority by certifying in writing that the property that was transferred in exchange for the trust property is the same value. The trustee would also have a fiduciary duty to ensure the grantor's compliance with the terms of this substitution power. Before the substitution of property is completed, the trustee would need to be satisfied that the properties acquired and substituted are of equal value. Additionally, the substitution

power cannot be exercised in a way that could change the beneficial interests of the beneficiaries of the trust.

The trust would also provide that the grantor could not serve as a trustee or remove any trustee of the trust. The trust agreement will also prohibit the trustee from paying the grantor (or his executor) any income or principal to discharge the grantor's income tax liability.

The grantor in this ruling was a resident of Alaska and it was proposed that the trust would also have a situs in Alaska. Under its trust code Alaska permits a settlor to create a self-settled trust.

Finally, the terms of trust agreement prohibited the trustee from paying the grantor or the grantor's executors any income or principal of the Trust to discharge of the grantor's income tax liability.

The taxpayer requested the Service rule on the following issues:

(1) Whether the taxpayer would make a completed taxable gift when making a gratuitous transfer to trust.

(2) Whether any portion of assets in the trust would be includible in the taxpayer's estate at his death.

Completed Gift Issue:

Section 2501 provides that the gift tax applies to the transfer of property by gift during any calendar year by any individual, resident or nonresident.

Section 2511(a) provides that the gift tax applies regardless of whether the gift is made in trust or in another manner, whether the gift is direct or indirect, and whether the property gifted is real or personal or tangible or intangible property.

Section 25.2511-2(b) provides that as to any property or portion of such property where the donor has relinquished such *dominion and control* as to leave the donor with no authority to change its disposition, whether for the donor's benefit or for the benefit of another, the gift is complete.

Section 25.2511-2(c) provides that a gift is not complete in every case where the donor reserves the authority to revest the beneficial title to the property. Additionally, a gift is not complete when a reserved power gives the donor the right to designate new beneficiaries or alter the interests of the beneficiaries between themselves.

In this ruling the Service recognized that the grantor retained no authority to revest beneficial title and he did not reserve any right to designate new beneficiaries or alter the interests of the beneficiaries. As a result, the ruling held that the grantor's gifts to this trust would be treated as completed gifts.

Estate Tax Issue:

The gross estate of a decedent ("**D**") includes the value of all property to the extent of any interest therein in which D made a transfer (except in the case of a *bona fide* sale for adequate and full consideration in money or money's worth), in trust or otherwise, where D retained for life or a period which cannot be ascertained without reference to D's death or does not end prior to D's death, the possession or enjoyment of, or the right to the income from, the property. § 2036(a)(1).

The use, possession, right to income, or other enjoyment of property that is transferred is treated as being retained to the extent that it is to be applied to the discharge of a legal obligation of D. Regs. § 20.2036-1(b)(2).

The ruling held that the substitution power on its own would not cause the trust to be includible in grantor's gross estate. See Rev. Rul. 2008-16, 2008 I.R.B. 796.

The ruling noted that the trustee was prohibited from reimbursing grantor for income taxes paid by the grantor attributable to income from the trust. Thus, it held that the grantor did not retain a reimbursement right that could cause the Trust to be includible in grantor's gross estate under § 2036. See Rev. Rul. 2004-64, 2004-2 C.B. 7.

Finally, in the most important part of the ruling, the Service held that the trustee's discretionary authority to distribute income and principal to grantor would not by itself be sufficient to cause the assets of the Trust to be includible in grantor's gross estate under § 2036. Prior to this ruling and the advent of the state asset protection trust acts that have been enacted since 1997 the Service was unwilling to rule on the estate tax inclusion issue in cases involving completed gift self-settled trusts. See *e.g.*, 9837007 (holding, "We are expressly not ruling on whether the assets held under the Trust agreement at the time of Donor's death will be includible in Donor's gross estate for federal estate tax purposes"). It should also be noted that the Service was willing to rule on this same issue in regards to a discretionary tax reimbursement provision in PLR 200822008 (discussed *infra*). Thus, the Service was backing off its prior position even before it released PLR 200944002.

PLR 200944002 closed with a warning that it was not ruling in regards to whether the Trustee's authority to make distributions to the grantor combined with other facts (such as a pre-existing arrangement or understanding between the grantor and the trustee regarding such distributions) would cause inclusion of the assets of the Trust in the grantor's estate under § 2036.

The blackletter law appears to be that a gift is incomplete when a trustee has an unrestricted power to distribute income or principal to a settlor, if the settlor's creditors can reach the trust assets under the self-settled trust doctrine. *Com'r. v. Vander Weele*, 254 F.2d 895 (6th Cir. 1958); *Outwin v. Com'r*, 76 T.C. 153 (1981), *acq*., 1981-1 C.B. 2; *Hambleton v. Com'r.*, 60 T.C. 558 (1973), *acq*. in result, 1974-1 C.B. 1; *Paolozzi v. Com'r.*, 23 T.C. 182 (1954), *acq*. 1962-1 C.B. 4. However, if the settlor's creditors cannot reach the trust assets because the self-settled trust doctrine is not applicable, a gratuitous transfer to such a trust should be a completed gift for purposes of the Federal gift tax. See *e.g.*, PLR 200944002; PLR 9837007;

PLR 9332006. Thus, it is important to determine the settlor's retained rights. If it is not possible to ensure that anything of value would pass to the other beneficiaries of the trust, the settlor's transfers to the trust will constitute incomplete gifts. In a string of private letter rulings, it is apparent that the IRS will respect the situs issues related to the settlement of self-settled trusts for tax planning purposes. See *e.g.*, PLR 201636027; PLR 201636028; 201636029; 201636030; 201636031; PLR 201636032; PLR 201628010 (Service deferred ruling on income tax status of trust); PLR 201614008; PLR 201614007; PLR 201614006; PLR 201613009; PLR 201550005; PLR 201550006; PLR 201550007; PLR 201550008; PLR 201550009; PLR 201550010; PLR 201550011; PLR 201550012; PLR 201510008; PLR 201510007; PLR 201510006; PLR 201510005; PLR 201510004; PLR 201510003; PLR 201510002; PLR 201510001; PLR 201440012; PLR 201440011; PLR 201440010; PLR 201440009; PLR 201440008; PLR 201436032; PLR 201436031; PLR 201436030; PLR 201436029; PLR 201436028; PLR 201436027; PLR 201436026; PLR 201436025; PLR 201436024; PLR 201436023; PLR 201436022; PLR 201436021; PLR 201436020; PLR 201436019; PLR 201436018; PLR 201436017; PLR 201436016; PLR 201436015; PLR 201436014; PLR 201436013; PLR 201436012; PLR 201436011; PLR 201436010; PLR 201436009; PLR 201436008; PLR 201430007; PLR 201430006; PLR 201430005; PLR 201430004; PLR 201430003; PLR 201426014; PLR 201410001, PLR 201410002, PLR 201410003, PLR 201410004, PLR 201410005, PLR 201410006, PLR 201410007, PLR 201410008, PLR 201410009, PLR 201410010, PLR 200148028, PLR 200247013, PLR 200502014, PLR 200612002, PLR 200647001, PLR 200715005, PLR 200729025, PLR 200731019, PLR 200731019, PLR 201310002, PLR 201310003, PLR 201310004, PLR 201310005 and PLR 201310006.

The taxpayer in PLR 201510001 requested rulings under §§ 671, 2041, 2501, and 2514 of the Code in designing the taxpayer's NING. (For purposes of this portion of the outline, we are only concerned with the issues regarding § 671.) In the ruling, the grantor (the "**Grantor**") created an irrevocable trust (the "**Trust**"), for the benefit of the Grantor, his issue, his spouse ("**Spouse**"), Individual 1, Individual 2, and Individual 3 (collectively, the "**Beneficiaries**"). The Trust provides that, during the Grantor's lifetime, the trustees shall distribute such amounts of net income and principal as directed by a Power of Appointment Committee (the "**Committee**") and/or the Grantor as follows:

> (1) At any time, the Co-Trustees, pursuant to the direction of the majority of the Committee members, with the written consent of the Grantor, shall distribute to the Grantor or the Beneficiaries such amounts of the net income or principal as directed by the Committee (the "**Grantor's Consent Power**");
>
> (2) At any time, the Co-Trustees, at the direction of all of the Committee members other than the Grantor, shall distribute to the Grantor or the Beneficiaries such amounts of the net income or principal as directed by the Committee (the "**Unanimous Consent Power**"); and
>
> (3) The Grantor shall have the power in a nonfiduciary capacity, at any time, to appoint to any one or more of the Beneficiaries such amounts of the principal as

the Grantor deems advisable to provide for such Beneficiary's health maintenance, support and education (the "**Grantor's Sole Power**").

Upon the Grantor's death, the balance of the Trust may be distributed to such persons or entities (other than Grantor, his estate, his creditors, or the creditors of his estate) as the Grantor appoints by his will. In default of the exercise of the Grantor's limited power of appointment, the balance of Trust will be divided into shares and distributed to the Grantor's issue, to Individual 1, to Individual 2, and to Individual 3.

The Trust provides that the Committee may direct distributions from the Trust to or for the benefit of any one or more of Beneficiaries equally, or unequally, and to the exclusion of others. The members of the Committee serve in a non-fiduciary capacity. The Committee is composed of the Grantor, Child 1, Child 2, Individual 1, Individual 2, Guardian 1, and Guardian 2. If the Committee at any time consists of at least three or more members other than Grantor, all the members of the Committee, including the Grantor, may by unanimous vote add one or more members to the Committee provided that such members are beneficiaries of the Trust. If at any time Committee does not include at least one member other than Grantor, the Committee will cease to exist. In any event, the Committee will cease to exist upon Grantor's death.

The taxpayer requested the following rulings:

1. That so long as the Power of Appointment Committee is serving, no portion of the items of income, deductions, and credits against tax of the Trust would be included in computing the taxable income, deductions, and credits of the Grantor or any members of the Power of Appointment Committee under § 671 of the Code;

2. That the contribution of property to the Trust by Grantor would not be a completed gift for federal gift tax purposes;

3. That any distribution of property from the Trust by the Committee to the Grantor would not be a completed gift, by any member of Committee;

4. That any distribution from the Trust by the Committee to any Beneficiary (other than the Grantor) would not be a completed gift by any member of Committee (other than Grantor); and

5. The Committee members do not possess a general power of appointment within the meaning of § 2041 of the Code and, accordingly, the Trust would not be includible in any Committee member's estate under § 2041.

Ruling 1.

The IRS concluded that no provisions of the Trust would cause the Grantor or any other person to be treated as the owner of any portion of Trust under §§ 673, 674, 676, 677, or 678 of the Code. Further, an examination of the Trust revealed no provisions that would cause

administrative controls to be considered exercisable primarily for the benefit of the Grantor or any other person under § 675 of the Code. Thus, the circumstances attendant on the operation of the Trust would determine whether Grantor or any other person would be treated as the owner of any portion of the Trust under § 675. The IRS ruled that this was a question of fact, the determination of which must be deferred until the federal income tax returns of the parties involved were examined.

Rulings 2 & 3.

Under § 25.2511-2(e) of the Code, a donor is considered as having a power if it is exercisable by the donor in conjunction with any person not having a substantial adverse interest in the disposition of the transferred property or the income therefrom. The Committee members were not deemed to be takers in default for purposes of § 25.2514-3(b)(2) of the Code; they were found to be merely co-holders of the power. Under § 25.2514-3(b)(2), a co-holder of a power is only considered as having an adverse interest where he may possess the power after the possessor's death and may exercise it at that time in favor of himself, his estate, his creditors, or the creditors of his estate. In this case, the Committee ceased to exist upon Grantor's death. Accordingly, the Committee members did not have interests adverse to Grantor under § 25.2514-3(b)(2) or for purposes of § 25.2511-2(e). Therefore, the Grantor possessed the power to distribute income and principal to any beneficiary of the Trust because he retained the Grantor's Consent Power. The retention of the Grantor's Consent Power caused the Grantor's transfer of property to the Trust to be wholly incomplete for federal gift tax purposes.

The Grantor also retained the Grantor's Sole Power over the principal of the Trust. Under § 25.2511-2(c), a gift is incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries or to change the interests of the beneficiaries. In this case, the Grantor's Sole Power gave the Grantor the power to change the interests of the beneficiaries. Accordingly, the retention of the Grantor's Sole Power caused the transfer of property by the Grantor to the Trust to be considered wholly incomplete for federal gift tax purposes.

The Grantor retained a testamentary limited power of appointment over the property in the Trust. Under § 25.2511-2(b)(2), the retention of a testamentary power to appoint the remainder of a trust is considered a retention of dominion and control over the remainder. Accordingly, the retention of this power caused the Grantor's transfer of property to the Trust to be incomplete with respect to the remainder of the Trust.

The Committee possessed the Unanimous Consent Power over income and principal. This power was not a condition precedent to the Grantor's powers. The Grantor's powers over the income and principal were presently exercisable and were not subject to a condition precedent. The Grantor retained dominion and control over the income and principal of the Trust until the Committee members exercised their Unanimous Consent Power. Accordingly, this power did not cause the transfer of property to the Trust to be complete for federal gift tax purposes. *See Goldstein v. Commissioner*, 37 T.C. 897 (1962); *Estate of Goelet v. Commissioner*, 51 T,C. 352 (1968).

Accordingly, the Service concluded that the contribution of property by the Grantor to the Trust was not a completed gift subject to federal gift tax. Any distribution from the Trust to the Grantor would be considered a return of the Grantor's property; therefore, any distribution of property from the Trust by the Committee to the Grantor would not be a completed gift by any member of the Committee. Additionally, the Service concluded that upon the Grantor's death, the fair market value of the property in the Trust would be includible in Grantor's gross estate for federal estate tax purposes.

Rulings 4 & 5.

The powers held by the Committee members under the Grantor's Consent Power were powers exercisable only in conjunction with the Grantor. Accordingly, under §§ 2514(b) and 2041(a)(2), of the Code, the Committee members did not possess general powers of appointment by virtue of possessing such powers. Further, the powers held by the Committee members under the Unanimous Consent Powers were not considered general powers of appointment for purposes of §§ 2514(b) and 2041(a)(2). As in the examples in Treas. Reg. §§ 25.2514-3(b)(2) and 20.2041-3(c)(2), the Committee members had substantial adverse interests in the property subject to these powers. Accordingly, any distribution made from the Trust to a beneficiary (other than the Grantor) pursuant to the exercise of the Grantor's Consent Power and the Unanimous Consent Powers would not be gifts by the Committee members. Instead, such distributions would be gifts by the Grantor.

The Service concluded that any distribution of property by the Committee to any beneficiary (other than the Grantor) would not be a completed gift by any member of the Committee. Further, the Service concluded that any distribution of property from the Trust to a beneficiary (other than the Grantor) would be a completed gift by the Grantor. Finally, the Service concluded that the powers held by the Committee members were not general powers of appointment for purposes of § 2041(a)(2) and, accordingly, the possession of these powers by the Committee members would not cause the Trust property to be includible in any Committee member's gross estate under § 2041(a)(2).

Importantly, the trust in PLR 201510001 was probably established in Nevada in accordance with the Spendthrift Trust Act of Nevada set forth in § 166.010, *et. seq.* of the Nevada Revised Statutes. This is because that act permits a settlor to retain an *inter vivos* special power of appointment that was included in the trust agreement in the facts of this private letter ruling. See N.R.S. 166.040.2(b). This type of trust (commonly referred to as a "**NING Trust**" or a "**Nevada Income Non-Grantor Trust**") is established by a resident of a state that imposes a state income tax to shift certain income from the settlor's state of residence to Nevada which does not impose an income tax. The only possible way for the Service to conclude that the trust in this ruling qualified as a non-grantor trust for federal income tax purposes was for the Service to respect the situs issue, that is, that a non-resident of Nevada could establish a trust in Nevada and obtain the benefits of its asset protection legislation that applies to self-settled asset protection trusts.

The DING was not without controversy on the estate and gift tax side. In calendar year 2007, the Service took a particular interest in issues related to general powers of appointment in DING type trusts and to the methods that could be used to cause transfers to the trust to constitute incomplete gifts for Federal gift tax purposes. The Service said it was studying such issues closely and requested comments. See IR-2007-127. The Estate and Gift Tax Committee of the Trust and Estate Division of the ABA's Section of Real Property Trust and Estate Law Section submitted comments in response to IR-2007-127 on September 26, 2007. See ABA Section of Real Property, Trust and Estate Law, Letter to Internal Revenue Service dated September 26, 2007. Between PLR 200715005 and PLRs 201310002-201310006, no DING Trust rulings were issued. CCA 201208026 concluded that testamentary powers of appointment retained by grantors over a trust under which the grantors were not beneficiaries caused the remainder interest to be an incomplete gift, however, the testamentary powers of appointment relate only to the remainder interest. This had the effect of raising concerns that merely reserving a testamentary limited power of appointment in the grantor could have been insufficient by itself to cause the transfer to a DING trust to be an incomplete gift by the grantor. See Akers, "Private Letter Rulings 201310002-201310006 (March 8, 2013): Favorable 'DING Trust' Letter Rulings; Confirmation of IRS's Position That Settlor's Retention of Testamentary Power of Appointment Does Not Necessarily Cause Full Transfer to Trust to be Incomplete Gift," Bessemer Trust (Mar. 2013).

Some see the use of DING and NINGs as a mechanism to avoid taxes, "[t]he only purpose of setting up these trusts, near as far as we can tell, is avoiding state tax. . ." Rubin, "Wealthy N.Y. Residents Escape Tax With Trusts in Nevada," Bloomberg (December 18, 2013) (quoting James Wetzler, former New York state tax commissioner). One commentator went as far as to analogize the use of DING trusts by residents from high tax states such as New York as "another example of how those who steal with a pen get richer, while those who steal at the point of a gun get jail." See David Cay Johnston, "Getting Dinged by the DING," 2010 TNT 59-8, 1655 (March 29, 2010).

On March 31, 2014, Governor Andrew Cuomo signed into law the 2014-2015 Executive Budget for the state of New York. See N.Y. Laws 2014, ch. 59. Under the legislation, income non-grantor trusts (such as NINGs and DINGs) created by New York residents are deemed to be "grantor trusts" for New York income tax purposes, which results in the income being included in the New York grantor's income whether or not the income is distributed to the grantor. N.Y. Tax Law § 612(b)(41). This provision is effective for income earned on or after January 1, 2014, however, not for trusts that were liquidated before June 1, 2014. Additionally, the legislation provides that distributions from Exempt New York Resident Trusts (trusts established by New York residents that have no New York trustees, no New York tangible property or real estate, and no New York source income) to a New York resident beneficiary after 2014 are subject to New York income taxes with respect to certain accumulations of trust income. This "throwback" tax, similar to the tax imposed by the state of California, will not apply to income that was accumulated in the trust either (A) before 2014, or (B) before the beneficiary first became a New York resident. There is no interest charge on the throwback tax. Capital gains are not typically considered income for these purposes (if the capital gains are not included in distributable net income). See Montesano, "New York Enacts

Significant Changes to Its Estate, Gift, GST and Trust Income Tax Laws," 39 Estates, Gifts and Trusts Journal 165 (July 10, 2014).

4. Section 2036 of the Code provides:

> The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer...by trust or otherwise, under which he has retained for his life or for any period which does not in fact end before his death--(1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

5. Section 2038 of the Code provides in pertinent part that:

> The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer...by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person...to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

6. If the settlor is a discretionary beneficiary and his creditors, either existing or future, may under applicable state law reach the trust assets in satisfaction of claims, the trust property will be includible in the settlor's gross estate under §2038 of the Code because of the settlor's power to "terminate the trust by relegating his or her creditors to the entire property of the trust." Rev. Rul. 76-103, 1976-1 C.B. 293; See also, *Outwin v. Com'r*, 76 T.C. 153 (1981), *acq.*, 1981-1 C.B. 2.

7. **Herzog v. Commissioner**. *Herzog v. Commissioner*, 116 F.2d 591 (1941). On August 23, 1935, Edward Rayne McComb Herzog ("**Herzog**"), transferred securities with a value of $214,137.38 to a trust with Bank of New York ("**BNY**"), as the corporate trustee, and Douglas S. Gibbs ("**Gibbs**"), as the individual trustee. The trust provided that:

> [T]he trustee should hold, invest and reinvest the securities and any additions thereto, and should pay the net income therefrom to [Herzog] and his wife, so long as they should be living together, at such times and in such proportions as [Gibbs], or his successors, should in his or their discretion deem proper, with power on the part of Gibbs or his successors to allocate the entire net income either to Herzog or his wife so long as they are living together as husband and wife. The trust instrument further provided that the trustees upon the death of the wife, or in the event she should cease to live with the grantor, should pay the net income to him and to his children then living at such times and in such proportions as Gibbs, or his successors, should deem proper, with power to allocate the entire net income to the grantor, or among his said children.

Upon Herzog's death if his wife survived him, the trustees were to divide the trust fund into equal shares for his wife and children. Upon the death of Herzog's wife, the principal of her share was to be paid to Herzog's issue, *per stirpes*. Herzog retained no right to alter, amend or revoke the trust, or to change the beneficial interests as fixed by its terms. On the date of the execution of the trust, Gibbs directed BNY to pay all of the income to Herzog until further notice.

Herzog filed a gift tax return reporting the transfer of the remainder interest. The Service argued that the transfer of all of the securities was subject to gift tax. The Board of Tax Appeals ruled for the Service. Herzog appealed.

The issue on appeal was whether Herzog owed gift tax on the entire property transferred in trust or only the remainder distributable at or after his death.

On appeal, the Tax Court (the "**court**") held for the Service. The court noted that Herzog retained no right to receive income, only a chance to receive it by reason of the exercise of a power in his favor by Gibbs.

Herzog argued that his creditors could reach the income through a lawsuit directing Gibbs to exercise the power in their favor. The court noted that under New York law, where a trust has been created by a third person, the income of which may be applied to the use of some person in the discretion of a trustee, the trustee could not be compelled to exercise discretion in favor of such third person or the creditors of the latter.

Herzog argued that there was no gift of anything except the remainder because no beneficiary could be identified who was entitled to any intervening estate. *See Porter v. Commissioner*, 288 U.S. 436 (1933). In *Porter*, the grantor of a trust reserved a power to revoke the appointments and to substitute other beneficiaries expressly excepting himself and his estate. The court in *Porter* held that the corpus of such a trust should be included in the grantor's estate and subject to an estate tax because the grantor had not parted with control over it relying on the fact that the grantor controlled the disposition while he lived. The court disagreed with Herzog, noting that he parted with every actual right in the corpus and only retained an expectancy.

Herzog then argued that a gift tax should not be imposed on the intermediate interests in the trust because the corpus could be included in his estate at the time of his death. *See Estate of Sanford v. Commissioner*, 308 U.S. 39 (1939). The court disagreed with Herzog. The court noted that the Revenue Act (as then promulgated) provided "for the credit of gift taxes on estate taxes subsequently levied on property included in the gift and that the possibility of overlapping [did] not necessarily preclude the imposition of gift tax" to Herzog's transfer. The court reasoned that Herzog had not retained a right to the income, nor retained in conjunction with any person the right to designate the recipients of it. The court explained that if the transfer was complete, very likely a gift tax might be imposed regardless of any possible future estate tax.

8. **Estate of Gramm v. Commissioner**. *Estate of Gramm v. Commissioner*, 17 T.C. 1063 (1951). Christianna K. Gramm ("**Christianna**") created a trust with the Provident Trust Company ("**Provident**"), Ida G. Betelle and Theodore K. Gramm (Ida and Theodore are collectively Christianna's "**children**") as co-trustees. The trust was funded with all of Christianna's securities. Christianna was to receive net income for life and the trustees were to pay her:

> [W]ith the written consent of her children and part or all of the corpus which she might request in writing; but if her children were incapable of giving her approval or written consent, request by decedent herself for any part of the principal would be sufficient if the corporate trustee, the sole judge, determined they were incapable of giving such written approval or consent.

Provident was also given the power to: "expend out of the share of principal from which any beneficiary under this Deed may be receiving income such sums as Trustees may consider to be proper for the comfort, education, maintenance or support of such beneficiary." The trust also allowed Christianna to revoke or amend the trust with the consent of her children, or, if Provident determined the children could not give consent, Provident's consent.

The Service determined a deficiency in gift tax, arguing that the transfer in trust was a taxable gift. The court held for Christianna, finding no completed gift since the corpus might have been totally depleted by the time of her death without the consent of any adverse party.

The court focused the issue on whether the trust gave a remaindermen an interest which resulted in a taxable gift. Testimony by an assistant trust officer of Provident noted the fact that the trust was to be revocable without consent as first drafted, however, Provident was reluctant to act as corporate trustee under those circumstances. That testimony was important in helping the court determine whether there was a complete taxable gift as the court pointed out that there was no restriction in the trust limiting the extent to which the principal might be used for Christianna's the "comfort, education, maintenance or support." Provident acted under a power of attorney when dealing with Christiann's property prior to the creation of the trust. As Christianna got older, a trust was created in lieu of the power of attorney. Thus, money Christianna might have required for her 'comfort,' was incapable of determination or calculation at the time of the trust's creation.

The court noted that the power granted to Provident to invade the principal for Christianna's benefit was not a completely unfettered power. Under those circumstances, the court could not characterize the transaction as a complete taxable transfer for gift tax purposes.

9. **Paolozzi v. Commissioner**. *Paolozzi v. Commissioner*, 23 T.C. 182 (1954). On December 21, 1949, Alice Spaulding Paolozzi ("**Alice**"), filed a gift tax return for the taxable year 1938. Alice owned cash and securities which became distributable to her on her 21st birthday, May 12, 1938. It was suggested by Alice's legal advisers that Alice place these assets in a trust. On June 21, 1938, Alice created a trust (the "**Trust**") and funded the Trust with the aforementioned cash and securities. The fair market value on June 21, 1938 of the property transferred to the Trust was $276,821.66.

The Trust provided for entirely discretionary distributions of income to Alice during her lifetime with the remainder to be held in further trust for Alice's descendants. At the time of creating the trust Alice was assured by the trustees that they would give her the income of the trust if she wanted it, unless the trustees had reason to believe that Alice was acting under compulsion. At the same time, it was explained to Alice that under the provisions of the trust she had no absolute right, as a matter of law, to demand and receive the income, and that the trustees must take all beneficiaries into consideration.

Concerning the transfer to the Trust, Alice reported total gifts of $71,021.37, which was the value on June 21, 1938 of a remainder of $276,821.66 after a life estate of an individual who was then of Alice's age.

The only question presented was whether Alice was taxable on the entire value of property transferred by her to the Trust on June 21, 1938, or whether Alice retained a life interest in the trust susceptible of valuation which would allow a gift tax deduction.

The Tax Court held that Alice retained an interest in the Trust sufficient to allow Alice a deduction for gift tax purposes because Alice's creditors could look to the trust for settlement of their claims under the law of Massachusetts (the governing law of the Trust).

Alice established the Trust of which trust she was, during her lifetime, the sole beneficiary, at a time when she was contemplating marriage to an Italian citizen. By virtue of such marriage, Alice would, under Italian law, become an Italian national. The Italian government was, at that time, subjecting foreign securities held by its nationals to stringent restrictions. To avoid such restrictions and to thwart possible confiscation of the considerable property which was distributed to her on her 21st birthday, Alice, on the advice of counsel, created the Trust and effected the transfer in question. The trustees were empowered by the terms of the trust instrument to hold, manage, invest, and reinvest the property as a trust fund until Alice's death and to pay to her, during her lifetime, so much of the net income as they in their absolute discretion should deem to be to her best interest. Provisions were made for remainders over to Alice's issue, or in failure thereof, to Alice's sister or brother, or to their issue. Subsequent to the transfer, Alice filed a gift tax return in which she reported as a taxable gift only the value of the remainder after a life estate of one then of her age.

The Service argued that Alice's transfer was a complete gift of the entire amount of the property transferred to the Trust because Alice reserved no interest in and control over any beneficial interest in the Trust susceptible of valuation by actuarial methods. The Service argued at most, Alice had an expectancy which was not the equivalent of a life estate; and that, therefore, no amount of the value of the gift should be deducted from the value of the property transferred for purposes of computing the gift tax pursuant to § 501 of the Revenue Act of 1932.

On the other hand, Alice argued that under the law of Massachusetts (which governed the Trust), Alice's creditors could reach the maximum amount that the trustees could, in the exercise of the trustees' discretion, pay to her or apply for Alice's benefit. Alice reasoned that she could at any time realize all of the economic benefit of the income accruing to the Trust

during her lifetime by borrowing money or otherwise becoming indebted, and then relegating the creditor to the Trust income for reimbursement.

In *Ware* v. *Gulda,* 117 N. E. 2d. 137 (1954), the Supreme Judicial Court of Massachusetts held that a creditor of a settlor-beneficiary of a discretionary trust could reach for satisfaction of a claim the maximum amount which the trustee could pay to the beneficiary or apply for the benefit thereof. The fact that the trustee had not exercised the discretionary power would not preclude such creditor from looking to the trust and obtaining payment out of the trust property to which the debtor, however, for such failure, was entitled. In so ruling, the court said, *inter alia:*

> The established policy of this Commonwealth long has been that a settlor cannot place property in trust for his own benefit and keep it beyond the reach of creditors. *Pacific National Bank v. Windram*, 133 Mass. 175; *Jackson v. Von Zedlitz*, 136 Mass. 342; *Taylor v. Buttrick*, 165 Mass. 547, 551, 43 N. E. 507; *Forbes v. Snow,* 245 Mass. 85, 89, 140 N. E. 418.
>
> The rule applied by the Tax Court was found in Restatement: Trusts § 156 (2):
>
> Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.

In view of the clear exposition of Massachusetts law set out in *Ware* v. *Gulda, supra,* the Tax Court held that Alice's creditors could at any time look to the Trust of which she was settlor and beneficiary for settlement of their claims to the full extent of the income thereof. Alice could therefore at any time obtain the enjoyment and economic benefit of the full amount of the trust income. The Tax Court held that Alice correctly reported the transfer for gift tax purposes.

10. **Vander Weele v. Commissioner**. *Vander Weele v. Commissioner*, 27 T.C. 340 (1956). On March 25, 1950, Sarah Gilkey Vander Weele ("**Sarah**") created a trust, of which she was the sole life beneficiary, consisting of stocks, securities, and the remainder interest in a testamentary trust created by her grandfather. The trust was expressly irrevocable. The trust required payment to Sarah of the trust income for life or until the receipt of the remainder interest in her grandfather's testamentary trust upon the death of her mother. Thereafter, the trustees were directed to pay Sarah "such reasonable and substantial portion of the entire net annual income of the entire trust estate as to the Trustees in their sole judgment and discretion shall deem desirable and ample for the comfortable well-being and enjoyment."

At the time of the trust's creation, Sarah was assured by the trustees that they would construe the terms of the trust liberally and pay her the entire income of the trust before and after the remainder interest was received. In the event the income of the trust was insufficient for that purpose, the trustees were authorized to invade the trust principal.

Sarah and her husband, Frederick Vander Weele ("**Frederick**"), each filed a gift tax return which treated the transfer of the entire trust assets as having been made one-half (1/2) by

each, and each reported one-half (1/2) of the value of the trust created by Sarah. Subsequent to the filing, they each took the position that no taxable gift had been made by them and each filed claims for refund of the gift tax reported and paid. The Service issued notices of deficiency to Sarah and Frederick.

The issue was whether the transfer in trust of securities and a remainder interest in trust property constituted a taxable gift.

The tax court ruled that no gifts were made, holding that Sarah retained the dominion, control, and beneficial use and enjoyment of the trust income and corpus.

The Service took the position that the transfer of property in trust constituted a taxable gift of the entire trust, unreduced by an amount equal to the actuarial value of a life estate in the property so transferred. In support of Sarah's argument that the transfer did not constitute a completed gift, she relied on the decisions in *Paolozzi v. Commissioner*, 23 T.C. 182 (1954) and *Estate of Gramm v. Commissioner*, 17 T.C. 1063 (1951).

In its review of *Paolozzi*, the court noted that it upheld the taxpayer's contention in that case where:

> [The petitioner's] creditors could reach the maximum amount which the trustees could pay to [the petitioner in *Paolozzi*] or apply for her benefit, [the petitioner] could realize the economic benefit of the income accruing to the trust during [the petitioner's] life simply by borrowing money and then relegating the creditor to the trust income for reimbursement.

The court analogized that Sarah's situation was similar to the petitioner in *Paolozzi* where Sarah was entitled to receive the entire net income from the stocks and securities for life or until the vesting in the remainder interest. Upon receipt of the remainder interest in the trust established by her grandfather, the trustees had the power to pay Sarah for life "such reasonable and substantial portion of the entire net annual income" as "to the trustees in their sole judgment and discretion shall seem desirable and ample for the comfortable well-being and enjoyment of the Donor." The trust was governed by Michigan law, and it noted that Michigan law does not protect the interest of a trust created for the benefit of the settlor. Therefore, Sarah's creditors could reach the income of the trust to the extent that it was distributable to her, and this fact, according to the court, meant Sarah retained sufficient dominion and control over the trust income as to prevent the imposition of gift tax.

The court cited to *Gramm* for the proposition that there was no taxable gift. In *Gramm*, the taxpayer created a trust designating a corporate fiduciary and her children as trustees. The decedent was to receive net income for life, and a provision was made for distribution upon her death. The trust gave the corporate trustee the power to invade the principal for any amount considered proper for the comfort, education, maintenance, or support of the settlor. The court in *Gramm* pointed out that "comfort" was indeterminable, and as such, since there was no restriction in the trust limiting the extent to which principal might be used for "comfort, education, maintenance or support," there was an unlimited possibility of withdrawal of the

trust fund and no completed gift.

In *Vander Weele*, the court analogized to *Gramm* since the trustees had an unrestricted power to invade the trust for the benefit of Sarah. It also noted that Sarah's trust provided for her personal financial security due to her understanding with the trustees that funds should be used to pay expenses.

11. **In re Estate of Uhl**. *In re Estate of Uhl*, 241 F.2d 867 (7th Cir. 1957). In 1938, Edgar M. Uhl ("**Edgar**"), transferred property to an irrevocable trust (the "**Trust**") governed by Indiana law. Under the trust instrument, Edgar reserved the right to be paid $100.00 monthly from the Trust, however, Edgar retained no control over the balance of the trust property. At Edgar's death, the remaining trust property was to be divided equally between Edgar's nephew and nieces. Edgar died testate on March 7, 1951.

National City Bank of Evansville, as administrator of Edgar's estate, argued that only the part of the estate which was necessary to produce income of $100 a month was properly included in Edgar's gross estate (it was stipulated that the amount necessary to produce $100 a month was $50,218.85, or 59.63% of the corpus). The Tax Court held that the entire corpus should be included in Edgar's estate, and assessed a deficiency of $9,265.99. In its decision, the Tax Court relied upon a provision of the trust agreement stating that: "[t]he trustee may in his discretion pay a greater sum than $100.00 a month if it shall deem advisable."

The Tax Court did not find that Edgar had retained a right to more than $100.00 a month from the trust income. However, because at the time the trust agreement was executed, Indiana law was such that Edgar's creditors might have successfully brought suit to reach all the income from the Trust, the Tax Court held that "the decedent could have obtained the enjoyment and economic benefit of such income by the simple expedient of borrowing money or otherwise becoming indebted, and then relegating the creditor to the trust income for reimbursement." Therefore, the Tax Court held that Edgar retained sufficient rights to all the income of the trust to make the entire corpus includable in Edgar's gross estate.

The issue presented was whether the value of the entire trust estate was subject to a federal estate tax as a part of Edgar's gross estate where Edgar had irrevocably transferred property to a trust and had also retained an income interest in the trust of $100 per month.

The court held that the Service properly levied an estate tax deficiency for that part of the corpus necessary to produce the $100.00 a month. However, the remainder of the corpus, over which Edgar had no control and was subject only to the uncontrolled discretion of the trustee, did not remain Edgar's property at Edgar's death and should not have been included in Edgar's gross estate.

The pertinent sections of the Revenue Act, § 811(c) (1) (B), 26 U.S.C. 1952 Ed., Sec. 811, provided that the value of a decedent's gross estate included any interest of which the decedent had made a transfer, under which the decedent retained for his life or for any period not ascertainable with reference to the decedent's death, or for any period which did not in fact end before the decedent's death, "the possession or enjoyment of or the right to income from

the property." The appellate court found that under this section, by the retention of an income interest of $100.00 a month, Edgar reserved a right to the income from the trust property to that extent; however, the balance of the trust estate was removed from Edgar's dominion or control, such that the only part of the trust estate which should have been included in Edgar's gross estate at his death was that part which represented the income to which Edgar had retained the right of receipt. The remaining amount of the estate irrevocably conveyed to the trustee was a completed gift which was not includible in Edgar's estate.

No cases under the federal estate tax law had previously dealt with this precise issue, so the appellate court looked to precedents under the gift tax law. In *Herzog v. Commissioner*, 116 F.2d 591, a settlor executed an irrevocable trust which gave the trustee the discretion to pay the income either to the settlor or the settlor's wife. The question presented was whether this discretionary power of the trustee amounted to a reversion in the settlor of the right to enjoyment of the income or whether the title had vested in the trustee exclusive of any such right. The court said:

> It was only by virtue of the trustee's direction, which on this record must be regarded as entirely voluntary, that the [settlor] received any of the income; and this direction might be terminated whenever the trustee deemed it proper that the wife should receive the income. Such a hope or passive expectancy is not a right. It is not enough to lessen the value of the property transferred.

In *Rheinstrom v. Commissioner*, 105 F.2d 642 (1939), a settlor had executed a trust irrevocably transferring property for the benefit of the taxpayer and the taxpayer's four children. The taxpayer retained a life interest in 40% of the net income. 50% was to be paid to the beneficiaries, and the remaining 10% was to be held by the trustees with discretion to pay to taxpayer such part thereof as to the trustees might seem best. The court held that the taxpayer had retained no legal interest in the 10%, saying:

> Whether she would ever receive any of this reserve fund depended entirely upon the trustees, over whose acts she retained no control. The fact that the record shows that they have paid it to her or used it for her benefit, we do not consider of importance. By the terms of the trust instrument, they might distribute all or part of the reserve fund to her during her lifetime, or they might withhold all of it.

The court added that no one could compute the value of the settlor's mere expectation that her trustees would ever pay her an amount in addition to the enjoyment which she reserved.

The appellate court in *Uhl* therefore concluded that only that part of the trust estate from which income was reserved to Edgar should have been included in Edgar's gross estate, because Edgar could not compel the trustee to pay Edgar any sums other than $100.00 a month, and the trustee was under no duty to pay Edgar more than that.

The Tax Court had based its decision upon the theory that Edgar's creditors might have reached all of the corpus of the estate including that over which the taxpayer had retained no control, saying: "While the decedent may not have been able to force the trustee to distribute the income to him, nevertheless he could have reached the full amount of the trust income through his creditors." The appellate court found that even though part of the estate which produced $100.00 a month might have been reached by Edgar's creditors, the Indiana statute itself did not apply to property or the income therefrom over which Edgar retained no dominion and no control. That part of the corpus of the estate was, after the creation of the trust, the property of the trust beneficiaries, subject only to an uncontrolled discretion in the trustee to divert to Edgar something that Edgar could not have compelled the trustee to give him.

12. **Estate of Holtz v. Commissioner**. In *Estate of Leon Holtz v. Commissioner*, 38 T.C. 37 (1962), Leon Holtz ("**Leon**"), pursuant to a deed of trust signed on June 12, 1953 (the "**Trust**"), transferred property having a value of over $384,117 that consisted of over 200 mortgages, most of which had a value of less than $2,000. Land Title Bank and Trust Company, which later became Provident Tradesmens Bank and Trust Company ("**Provident**"), served as trustee. The Trust provided, in part, as follows:

> **FIRST**
>
> Trustee shall keep the principal of this trust invested and shall distribute the net income therefrom and the principal thereof as follows: A. During the lifetime of Settlor: 1. The income shall be paid to him or to his order, or upon his direction, shall be accumulated and added to the principal. 2. As much of the principal as Trustee may from time to time think desirable for the welfare, comfort and support of Settlor, or for his hospitalization or other emergency needs, shall be either paid to him or applied directly for his benefit by Trustee . . .
>
> **SEVENTH**
>
> A. Settlor or any other person, upon approval and acceptance by Trustee, may add to the principal of this trust by deed or will or otherwise. B. It is hereby expressly declared by Settlor that he has been fully advised as to the legal affect of the execution of this Deed of Trust and informed as to the character and amount of the property hereby transferred and conveyed; **and further that he has given consideration to the question whether the transfer herein contained shall be revocable or irrevocable and he hereby declares the same to be irrevocable and that it shall without any power in Settlor at any time to revoke, change or annul any of the provisions herein contained; except that Settlor and others may hereafter bring other properties within the operation of this Deed of Trust**. [*emphasis added*]

Upon Leon's death, if his wife survived him, the income of the Trust was to be paid to her during her lifetime, and a similar provision was made for invasion of principal for her benefit during her lifetime. The Trust was to terminate at the death of the survivor of Leon and his wife and the remaining principal was payable to the estate of the survivor.

The facts surrounding the signing of the Trust were stipulated as follows: prior to affixing his signature to the Trust, Leon asked the drafting attorney and the trust officer serving as trustee whether he would have "enough money" following the transfers to the Trust, and the trust officer replied that the Trust provided for the payment of all income to Leon and also he could have money out of the principal. The trust officer assured Leon that the bank would be liberal in giving him money out of the corpus.

Leon transferred an additional $50,000 in cash to the Trust on January 18, 1955. In 1954, trust principal was paid on behalf of Leon for his hospital bills; these were the only amounts paid out of the Trust principal to Leon or for his benefit.

Leon died in 1958 (his wife predeceased him in 1955). Provident, the surviving executor under Leon's Will), filed gift tax returns for the calendar years 1953-1955 on behalf of Leon. The Service determined deficiencies in gift tax against Leon, and argued that as a result of the transfers, Leon made taxable gifts in 1953 in the amount of $263,277.63, and in 1955 in the amount of $35,570, computing the value of the taxable gifts by reducing the value of the property transferred in each instance by the actuarial value of Leon's life estate and reversionary interest in each transfer. Provident, the petitionr in the Tax Court case, argued that the transfers were not completed gifts and that no part of the value thereof was subject to gift tax.

The issue for decision was whether the transfers in trust made by Leon in 1953 and 1955 were completed gifts for purposes of Federal gift tax (the deficiency for 1954 was a result of a technical adjustment dependent on the decision of the issue for 1953). Provident argued that the transfers were not completed gifts and that no part of the value thereof was subject to gift tax. The court held for Provident; no part of or interest in the property transferred to the Trust constituted a completed gift for gift tax purposes when transferred to the trust.

The issue turned on whether the settlor abandoned sufficient dominion and control over the property transferred to put it beyond recall. The court noted that Leon neither reserved the power in himself alone to modify, alter, or revoke the trust and thus revest the trust property in himself, as in *Burnet v. Guggenheim*, 288 U.S. 280 (1933), nor reserved the power to alter the disposition of the property or income therefrom in some way not beneficial to himself, as in *Estate of Sanford v. Commissioner*, 308 U.S. 39 (1939), nor reserved the power in conjunction with someone else to modify, alter, or revoke the trust, as in *Camp v. Commissioner*, 195 F.2d 999 (C.A. 1, 1952), rev'g. in part 15 T.C. 412 (1950).

The court analyzed whether the discretionary power placed in the trustee by the Trust made the gifts of the remainder interests incomplete for gift tax purposes. The court cited to cases that held that if the trustee is free to exercise his unfettered discretion and there is nothing to impel or compel him to invade corpus, the settlor retains a mere expectancy which does not make the gift of corpus incomplete. *Herzog v. Commissioner*, 116 F.2d 591 (C.A. 2, 1941), affd. 41 B.T.A. 509 (1940). However, if the exercise of the trustee's discretion is governed by some external standard which a court may apply in compelling compliance with the conditions of the trust agreement, and the trustee's power to invade is unlimited, the gift of corpus is incomplete (*Commissioner v. Irving Trust Co.*, 147 F.2d 946 (C.A. 2, 1945), affd. 2 T.C. 1052

(1943)), and this is true even though such words as "absolute" and "uncontrolled" are used in connection with the trustee's discretion, provided the external standards are clearly for the guidance of the trustee in exercising his discretion. *Estate of John J. Toeller*, 6 T.C. 832 (1946), affd. 165 F.2d 665 (C.A. 7, 1948); *Estate of Lelia E. Coulter*, 7 T.C. 1280 (1946). The court noted that the theory behind the rule was that by placing such standards for guidance of the trustee's discretion in a trust agreement itself, a settlor had not actually lost all dominion and control of the trust corpus or put it completely beyond recall.

> The rule of thumb appears to be a reasonable application of the general rule established in the Guggenheim, Sanford, and Shaughnessy cases because where there is a reasonable possibility that the entire corpus might be repaid to the settlor there can be no assurance that anyone else will receive anything in the form of a gift, and if the corpus should happen to be kept intact until the settlor's death, even though the transfer in trust was not subjected to a gift tax, the corpus of the trust will in all likelihood be subjected to the estate tax in the settlor's estate. [*citations omitted*]

The court looked to the Trust and Leon's behavior with regards to the Trust's creation in making its decision. Under the terms of the Trust, it was entirely possible that the entire corpus might be distributed during Leon's lifetime and no one other than him would receive any portion of the Trust. As long as that possibility was present, Leon had not abandoned sufficient dominion and control over the property transferred to make a gift. The facts stipulated to indicated that: (a) there was an understanding of the parties that the trustee would distribute principal at any time Leon's needs reasonably justified it; and (b) since the trust consisted of approximately 200 small mortgages, the records to which were inaccurate and inadequate, the management of the Trust's property appeared to be a motivating factor for Leon to establish the Trust.

While the language used in the trusts and the surrounding circumstances involved in *Sarah Gilkey Vander Weele*, 27 T.C. 340 (1956), affd. 254 F.2d 895 (C.A. 6, 1958) and *Estate of Christianna K. Gramm*, 17 T.C. 1063 (1951) were different than the language used in the Trust and the circumstances in the instant case, the court thought that they were close enough to hold that the transfers were not completed gifts and that no part of the value thereof was subject to gift tax.

13. **PLR 7833062**. PLR 7833062, May 18, 1978, concerns the federal gift tax consequences of making a revocable trust irrevocable.

On February 11, 1966, a settlor transferred corporate stock to a revocable trust executed by the settlor on that date. The trust provided that the net income from the trust would be distributed quarterly or monthly to the settlor or used for the benefit of the settlor and the settlor's wife during the settlor's life. The trust further provided that the trustee shall distribute to the settlor as much of the principal of the trust as the settlor requested. If the settlor was unable to request a distribution of principal, the trustee was authorized to distribute such amounts from the principal as the trustee deemed "advisable for the (settlor's) comfortable maintenance, support and welfare or for that of his wife."

On the death of the settlor the trust principal was to be distributed to the settlor's wife and children.

The trust agreement was modified by the settlor on October 19, 1977 to release the settlor's power to alter, amend or revoke the trust. The settlor further released his power to invade the principal or demand distribution of principal to himself. The modification did not, however, affect the authority of the trustee, in the trustee's discretion, to invade principal for the settlor's benefit.

Generally, if a trustee is given a broad discretionary power to invade the trust corpus on behalf of the settlor, however, the power is not limited by a definite standard, the settlor has parted with dominion and control over the property, and the entire transfer is complete and subject to the gift tax. *Herzog v. Commissioner*, 41 B.T.A. 509 (1940), aff'd 116 F.2d 591 (2d Cir. 1941); *Higgins v. Commissioner*, 129 F.2d 237 (1st Cir. 1942); Rev. Rul. 77-378, 1977-42 IRB 10. If the power of the trustee to invade in behalf of the settlor is subject to a fixed and ascertainable standard which makes it possible to value the maximum amount to which the settlor might be entitled, the transfer is incomplete to that extent. Regs. § 25.2511-2(b); Rev. Rul. 62-13, 1962-1 C.B. 181. If the trustee's power, although governed by some ascertainable standard, permits the settlor to demand the return of the entire trust corpus, the gift may be wholly incomplete, or partially incomplete and partially complete, depending upon all the facts in the particular case. Regs. § 25.2511-2(b). The gift is normally wholly incomplete, however, only where, under the facts and circumstances of the case, substantial invasion is probable and there is no assurance that anything of value will pass to anyone other than the settlor. *Gramm v. Commissioner*, 17 T.C. 1063 (1951); *Estate of Holtz v. Commissioner*, 38 T.C. 37 (1962).

Treasury Regulation § 25.2511-1(g)(2) provides that an ascertainable standard is a clearly measurable standard under which the holder of a power is legally accountable. Thus, if under the standard provided in the trust agreement and applicable state law, the settlor can compel the trustee to return trust property to the settlor, the standard is ascertainable.

Additionally, the gift may be incomplete, irrespective of whether the trustee's discretion is subject to an ascertainable standard, if the settlor can indirectly recapture the trust property under applicable state law by borrowing money and relegating his creditors to the trustee for satisfaction of their debts. *Paolozzi v. Commissioner*, 23 T.C. 182 (1954); *Commissioner v. Vander Weele,* 254 F.2d 895 (6th Cir. 1958); Rev. Rul. 62-13, 1962-1 C.B. 181, Rev. Rul. 76-103, 1976-1 C.B. 292.

The taxpayer in PLR 7833062 stated that the trustee's discretionary power to invade principal for the settlor's "comfortable maintenance, support and welfare" was not an ascertainable standard within the meaning of Treasury Regulation § 25.2511-2(b). Assuming this was a correct statement of the law in New York, the settlor could not compel the trustee to make payments of corpus to the settlor. Thus, the settlor retained no right to principal and no dominion or control over the corpus. Rather, the settlor possessed a mere expectancy. Therefore, the Service ruled the sixth modification of the trust caused the gift of the remainder interest to be complete in its entirety and as such the gift was subject to the gift tax. The gift

nevertheless would be incomplete under Revenue Ruling 76-103 if the trust assets were subject to the claims of the settlor's creditors under applicable state law.

Unlike 'State X' in Revenue Ruling 76-103, the Service noted that creditors in New York apparently had no right to the trust corpus in a discretionary trust. Citing *Hamilton v. Drogo,* 241 N.Y. 401, 150 N.E. 496 (1926) and *Sand v. Beach*, 270 N.Y. 281, 200 N.E. 821 (1936), the Court of Appeals in *Herzog v. Commissioner*, *supra*, concluded that, in New York, a trustee of a discretionary trust cannot be compelled to exercise his discretion in favor of the settlor or the settlor's creditors.

Accordingly, the Service held that the settlor's modification of the trust which made the trust irrevocable caused the gift of the remainder to be complete for federal gift tax purposes and subject to the gift tax under § 2501 of the Code.

However, if on further consideration of New York law, it was determined that the trustee's powers of invasion for the benefit of the settlor were subject to an ascertainable standard, enforceable by the settlor, the Service noted that the gift might be deemed wholly incomplete or partially incomplete and partially complete, depending upon the facts and circumstances surrounding the execution of the trust and the modification.

14. **PLR 8037116**. In PLR 8037116, June 23, 1980, a trustee requested a ruling regarding whether trust property was includible in the settlor's gross estate, pursuant to §§ 2036 and 2037 of the Code.

The settlor was a nonresident alien. The settlor created a trust which he funded with various marketable securities. The trust provided that the trustees, in their sole discretion, could pay or apply so much of the principal of the trust estate and so much of the net or accumulated income to or for the support and benefit of any descendants of the settlor's mother, including the settlor during the settlor's lifetime. Upon the death of the settlor, the trust provided for the outright distribution of the trust estate in specified percentages to the settlor's two brothers and the children of one of the settlor's brothers. If, at the time of the settlor's death there was no such issue, the trustees were directed to distribute the trust estate for such charitable purposes as the trustees may decide in their sole discretion. The trustee made distributions of income over the years to beneficiaries other than the settlor. For federal income tax purposes, the trust had been treated as a grantor trust under § 677 of the Code. There had been no distributions of principal from the trust.

The settlor did not retain the right to alter, amend, or revoke the trust, or to change the beneficial interests under the terms of the agreement.

The settlor did not retain outright control over the disposition of trust principal and income, since the trustee could make distributions as he considered appropriate in the trustee's sole discretion. However, the settlor did place himself within the class of beneficiaries eligible to receive any amount of principal and income during the settlor's lifetime. The only distributions made from the creation of the trust until the settlor's death were payments of income to beneficiaries other than the settlor.

Where a settlor has not expressly reserved the power to modify the trust either as to dispositive or administrative provisions in the trust agreement, no such power will be implied. Bogert, *Trusts & Trustees*, second ed. (1962) section 992; *Comm. v. Guitar*, 72 F.2d 544 (5th Cir. 1934).

Section 2036(a)(1) of the Code provides for inclusion in the gross estate of property over which the decedent had retained possession or enjoyment, or the right to income. In this case, the decedent did not retain the right to possess, enjoy, or receive income from the property, however, he did retain the ***opportunity*** to enjoy it. However, in the same jurisdiction, the Circuit Court of Appeals has characterized such a retained interest a passive expectancy rather than a right to enjoyment of the property, with the result that the property was not includible in the gross estate. *Herzog v. Comm'r*. 116 F.2d 591, 593 (2d Cir. 1941).

Section 2036(a)(2) of the Code requires inclusion where the decedent retains the right to designate beneficiaries of property transferred.

Section 2037 of the Code provides for the inclusion in the gross estate of all property transferred by the decedent for less than adequate and full consideration if (1) possession or enjoyment of the property can be obtained through ownership only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property where immediately before his death the value of the reversionary interest exceeded five percent (5%) of the value of the property. Section 2037(b) of the Code defines reversionary interest as the possibility that property transferred by the decedent may return to him or his estate or may be subject to a power of disposition by the decedent.

In *In re Uhl's Estate*, 241 F.2d 867 (7th Cir. 1957), the court held that where the trustee had the sole discretion to pay a certain amount of income to the settlor of a trust, the corpus generating that income did not remain the settlor's property until his death, however, passed instead to the trustee at the time the trust was created, so that the value of the corpus was not includible in the settlor's gross estate. Likewise, in *Herzog v. Comm'r*., 116 F.2d 591, 593 (2d Cir. 1941), the court held that the possibility that the settlor-beneficiary might receive trust income at the voluntary discretion of the trustee constitutes a hope or passive expectancy rather than a right, and such expectancy is not sufficient to lessen the value of the property transferred.

The Service determined that the trust in question was irrevocable.

The Service concluded that the ability of the settlor to receive income and principal under the terms of the trust he created was not sufficient to require inclusion of the property under § 2036(a)(1) of the Code.

The settlor gave the trustee sole discretion to distribute principal and income to the beneficiaries designated in the trust. The trust also gave the settlor the right to release the trustees from all liability, responsibility, or accountability for their acts or omissions as trustees, thereby binding all income beneficiaries, remaindermen, and other interested parties. The Service determined that giving the settlor such authority was not the equivalent of

giving the settlor the right to designate beneficiaries, however, was a more limited power retained by the settlor for purposes of administrative convenience. Thus, the Service concluded that the trust property was not includible under § 2036(a)(2) of the Code.

With respect to § 2037 of the Code, all beneficiaries (including the settlor) were eligible to possess or enjoy principal and income from the trust during the settlor's lifetime, at the trustee's discretion. This provision was determined to be outside the scope of § 2037(a)(1) of the Code where a beneficiary could assume ownership of trust property only by surviving the settlor.

Furthermore, the Service concluded that the settlor did not retain a reversionary interest subject to the settlor's power of disposition, or to benefit himself or his estate, since the trust agreement provided an irrevocable distribution of property to the trustee during the settlor's life, then upon the settlor's death to others, and any benefits that the settlor could have received would have been at the sole discretion of the trustee. Consequently, the value of the trust property was not includible in the gross estate under section 2037(a) or (b) of the Code.

15. **Outwin v. Commissioner**. In *Outwin v. Commissioner*, 76 T.C. 153 (1981), petitioners Edson S. Outwin ("**Edson**") and Mary M. Outwin ("**Mary**"), a married couple, each created and funded irrevocable trusts (each trust hereafter referred to as a "**Trust**" and collectively referred to as the "**Trusts**") in 1969 governed by Massachusetts law. Under the terms of each Trust: (1) the trustee had discretion to pay income and principal to grantor during his or her life, however, such distributions were permitted only upon te prior written consent of such grantor's spouse; (2) at the death of each grantor, the surviving spouse (if any) was entitled to mandatory distributions of income, discretionary distributions of principal and was given a testamentary power of appointment over the assets; and (3) two financial advisors to Edson and Mary were named as trustees of the Trusts.

Prior to creating the Trusts, the trustees assured Edson and Mary that (1) any assets conveyed to the Trusts would be transferred back to each respective grantor upon request; and (2) if Edson and Mary became unhappy with the Trusts, the trustees would make discretionary distributions of all of the assets.

The Service subsequently issued a notice of deficiency for unpaid gift tax to each of the petitioners for $167,895.09 (that is, one-half (1/2) of the combined value of the assets the petitioners contributed to all of the Trusts).

The sole question presented was whether the transfers in trust made by Edson and Mary constituted taxable gifts for purposes of § 2501 of the Code.

The Tax Court held that because creditors of the grantor of each Trust could reach the trust assets for satisfaction of claims under Massachusetts law (notwithstanding the veto power given to each such grantor's spouse), Edson's and Mary's transfers to the Trusts were incomplete gifts for gift tax purposes as the grantor of each trust failed to relinquish sufficient dominion and control over of the property.

The gift tax provisions of the Code do not define the term "completed gift," however, it is well settled that a conveyance in trust will not be subject to gift tax where the donor retains dominion and control over the property transferred. *Estate of Sanford v. Commissioner*, 308 U.S. 39 (1939); *Burnet v. Guggenheim*, 288 U.S. 280 (1933); *Estate of Mandels v. Commissione*r, 64 T.C. 61 (1975); *Hambleton v. Commissioner*, 60 T.C. 558 (1973); *Estate of Holtz v. Commissioner*, 38 T.C. 37 (1962).

Edson and Mary contended that no completed gifts resulted from the creation of their respective Trusts because the trustees had orally agreed prior to the execution of the written agreements to (1) distribute the Trust income or corpus whenever the grantors requested such funds, and (2) terminate the Trusts upon their request by making liquidating distributions of all the remaining corpus. Consequently, Edson and Mary maintained that they never relinquished dominion and control over the property transferred to the trusts.

Edson and Mary alternatively argued that under Massachusetts law, the creditors of a grantor-beneficiary of a discretionary trust could reach the assets of the trust for satisfaction of their claims, notwithstanding the veto power over discretionary trust distributions vested in the grantor's spouse. Accordingly, Edson and Mary contended that the transfers to the Trusts were incomplete under the principle established in *Paolozzi v. Commissioner*, 23 T.C. 182 (1954).

The Tax Court noted that where a trust agreement specifies that distributions to the settlor are to be made in the absolute discretion of the trustees, with no enforceable standard provided, the transfer is generally held to be complete for gift tax purposes. *Herzog v. Commissione*r, 116 F.2d 591 (2d Cir. 1941); *Rheinstrom v. Commissioner,* 105 F.2d 642 (8th Cir. 1939); *Estate of Holtz v. Commissioner*, 38 T.C. 37, 42 (1962); *Commissioner* v. *Irving Trust Co*., 147 F.2d 946 (2d Cir. 1945); *Estate of Toeller v. Commissione*r, 6 T.C. 832 (1946), affd. 165 F.2d 665 (7th Cir. 1948). However, the Tax Court noted that there is a different result where applicable state law permits creditors of the settlor-beneficiary to pierce the trusts for satisfaction of claims.

In *Paolozzi v. Commissioner*, 23 (*supra*), the taxpayer ("**Paolozzi**") created a trust under the terms of which the trustees were authorized to pay to Paolozzi so much of the trust income as the trustees, in their absolute discretion, determined to be in Paolozzi's best interest. Upon Paolozzi's death, the trust assets were to be distributed to Paolozzi's issue. Paolozzi reported a taxable gift when the trust was established in an amount equal to the value of the assets transferred reduced by the value of a life estate for an individual Paolozzi's age. Under Massachusetts law, the creditors of a settlor-beneficiary of a discretionary trust could reach for satisfaction of claims the maximum amount which the trustee could pay to the settlor or apply for her benefit. The Tax Court concluded that Paolozzi could at any time obtain the economic benefit of the trust income simply by borrowing and then forcing her creditors to look to her interest in the trust income for a source of repayment. On that basis, the *Paolozzi* court held that the gift was incomplete to the extent of the value of Paolozzi's retained life estate. Accord, *Vander Weele v. Commissioner*, 27 T.C. 340, 343-344 (1956), affd. 254 F.2d 895 (6th Cir. 1958) (involving Michigan law). See also *Estate of Holtz v. Commissioner*, 38 T.C. 37, 42 n. 3 (1962); *Herzog v. Commissioner*, 116 F.2d 591 (2d Cir. 1941) (reaching a contrary result under New York law); Rev. Rul. 76-103, 1976-1 C.B. 293. Cf. *Hambleton v. Commissioner*, 60 T.C. 558, 565-566 (1973).

Under the rule of *Paolozzi*, the Tax Court analyzed whether the assets of each of Edson's and Marys' Trusts could be subjected to the claims of the respective grantor's creditors under Massachusetts law. The Tax Court cited the following general rule regarding the rights of creditors of a settlor-beneficiary of a discretionary trust as expressed in 1 Restatement, Trusts 2d, sec. 156(2) (1959):

> Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.

The Tax Court noted that the Supreme Judicial Court of Massachusetts formally adopted this general rule in *Ware v. Gulda*, 331 Mass. 68, 117 N.E.2d 137 (1954).

The Tax Court found that a veto power over discretionary trust distributions bestowed upon Edson and Mary was insufficient to render the *Gulda* rule inapplicable. Additionally, the Tax Court found that (1) absent unforeseen circumstances, such as divorce, the possibility that Edson or Mary would veto a disbursement by the trustee was remote, and (2) the fact that Edson or Mary might reciprocate by veto of disbursements to the other would tend to further discourage use of the veto. The *Gulda* opinion and the cases cited therein evidence a strong public policy in Massachusetts against persons placing property in trust for their own benefit while at the same time insulating such property from the claims of creditors. That policy would be easily frustrated if creditors were prevented from reaching the trust assets merely because the settlor's spouse was given an interest in the trust and the right to veto discretionary distributions which might deplete that interest.

The Tax Court saw no basis for assuming that the *Gulda* decision was predicated on the existence of an enforceable right of the settlor to discretionary distributions, regardless of whatever judicial restrictions Massachusetts courts might place on the exercise of trustees' discretion. The rule adopted by the Massachusetts Supreme Court and set forth in 1 Restatement, Trusts 2d, sec. 156(2) (1959), refers only to amounts which the trustee *could* pay to the settlor. It makes no mention of amounts which the trustee could be *required* to pay if the settlor seeks judicial review of the trustee's actions. None of the authorities the Tax Court consulted cite the existence of an enforceable right to discretionary distributions as the rationale for the Restatement rule. See generally 2 A. Scott, Trusts, sec. 156.2 (3d ed. 1967).

The Tax Court therefore held that creditors of Edson or Mary could reach the assets of their respective discretionary Trusts for reimbursement under Massachusetts law, and under the holding of *Paolozzi*, Edson and Mary failed to surrender dominion and control over the Trusts' assets.

In reaching its decision, the Tax Court expressly disavowed any reliance on the oral understandings between Edson and Mary and the trustees to the effect that the trustees would be totally responsive to any requests from Edson and Mary for discretionary distributions. On occasion, the Tax Court has considered extrinsic evidence (such as the settlor's financial condition, his or her purpose in establishing the trust, and oral assurances by the trustees that

the funds would be made available upon request) to help determine whether a right to discretionary distributions rendered a transfer in trust incomplete for gift tax purposes. See *Estate of Holtz v. Commissione*r, 38 T.C. 37, 43-44 (1962); *Vander Weele v. Commissioner*, 27 T.C. 340, 345-346 (1956), *affd.* 254 F.2d 895 (6th Cir. 1958); *Gramm v. Commissioner*, 17 T.C. 1063, 1066 (1951). In each of these foregoing cases, a standard limiting the trustee's discretion was provided in the trust instrument and the extrinsic evidence served primarily to indicate the probability that the trust funds would be used to satisfy that standard. However, there were no ascertainable standards in the Trusts. Yet, the provisions vesting absolute discretion in the trustees were flatly contradicted by the oral understandings to which Edson, Mary, and the trustees testified. The Tax Court gave little weight to the testimony regarding the oral understandings for several reasons: (1) Edson's and Mary's testimony was self-serving; (2) the trustees were close personal friends of Edson and Mary; and (3) Edson and Mary had yet to receive any distributions from their respective discretionary trusts. Furthermore, the court found that, while the testimony indicated Edson and Mary received the specified assurances from the trustees, there was insufficient evidence to prove that either Edson or Mary agreed in advance to consent to any proposed distributions from the other's trusts. Accordingly, the Tax Court decided the case solely on the creditor's rights theory set forth in *Paolozzi*.

16. **Estate of Wells v. Commissioner**. *Estate of Wells v. Commissioner*, 42 T.C.M. 1305 (1981). On December 23, 1969, Gizella Wells ("**Gizella**") created an irrevocable *inter vivos* trust (the "**Trust**"), designating her son, David I. Wells ("**David**") as trustee. Under the terms of the Trust, the trustee had the sole discretion to distribute to distribute income or principal to Gizella during her life. Additionally, the Trust would terminate upon Gizella's death and the remaining principal would be distributed in equal shares to David's daughters.

Prior to creating the Trust, Gizella indicated to her accountant, Arthur Steinthal ("**Arthur**"), that Gizella wished to make a gift to her grandchildren. Gizella, concerned with the effect of the gift on her cash flow and standard of living, was advised by Arthur that if Gizella sold certain stocks, made a $30,000 gift to the Trust, and also sold a certain rental property on the installment method, Gizella could receive more annual income than she had previously been receiving. On Arthur's advice, Gizella sold her stocks and rental property and funded the Trust with $30,000 in cash. Gizella filed a gift tax return for 1969 reporting the $30,000 gift to the Trust.

Gizella did not request any funds from the Trust during her life, however, the trustee distributed all of the Trust income to Gizella to allow Gizella travel for recreation. Gizella died in 1975 and the petitioner was appointed as the executor of Gizella's estate. The Service asserted that Gizella retained an interest in the trust within the meaning of § 2036 of the Code and determined an estate tax deficiency of $8,901.80.

The sole question presented in the case was whether Gizella retained any interest in the Trust within the meaning of § 2036 (a)(1) of the Code.

The Tax Court held that as Gizella transferred the property to the trust absolutely, unequivocally, irrevocably, and without possible reservations, the trust corpus was not includible in Gizella's gross estate under § 2036 of the Code.

The Service argued that Gizella retained for life "possession or enjoyment" of the $30,000 initially transferred to the trust, and therefore, the Trust corpus was includible in her estate under § 2036 of the Code. Additionally, the Service argued that the trustee, in paying the income to Gizella, was acting pursuant to a prearrangement in which it was understood that Gizella would "enjoy" the income from the property that she transferred to the Trust.

David contended that Gizella unconditionally, absolutely, and irrevocably transferred the property to the Trust and that no income was received by Gizella pursuant to an arrangement entered into contemporaneously with the transfer to the Trust. Therefore, David, contended, § 2036(a)(1) of the Code was inapplicable.

Section 2036(a) of the Code provides:

> (a) General Rule. — The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death — (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

The Tax Court noted that § 2036(a) of the Code reflects a "legislative policy of subjecting to tax all property which has been the subject of an incomplete *inter vivos* transfer." *United States v. O'Malley*, 383 U.S. 627, 631 (1966). Section 2036(a)(1) applies if the decedent retained the "right to income" from or "possession or enjoyment" of the transferred property. Thus, although a decedent may not have reserved or retained the "right" to the income, the transfer may still come within § 2036(a)(1) if the decedent retained "possession or enjoyment" of the transferred property. *Skinner's Estate v. United States*, 316 F. 2d 517 (3rd Cir. 1963); *McNichol's Estate v. Commissioner*, 265 F. 2d 667, 670-671 (3rd Cir. 1959), affg. 29 T.C. 1179 (1958), cert. denied 361 U.S. 829 (1959); but see Stephens, Maxfield & Lind, Federal Estate and Gift Taxation, par. 4.08(4)(c), p. 4-139, ft. 35 (4th Ed. 1978).

However, the mere receipt of all the income from the transferred property does not of itself trigger inclusion in the gross estate under § 2036(a)(1) of the Code. Such enjoyment must have been "retained." *Estate of Green v. Commissioner*, 64 T.C. 1049, 1061 (1975); *Estate of Nicol v. Commissioner*, 56 T.C. 179, 182 (1971); *Estate of Barlow v. Commissioner*, 55 T.C. 666, 670 (1971). See also *Uhl's Estate v. Commissioner*, 241 F. 2d 867 (7th Cir. 1957), revg. and remanding 25 T.C. 22 (1955). Thus, § 2036(a)(1) of the Code applied only if Gizella "retained" enjoyment pursuant to an agreement or understanding reached contemporaneously with the transfer. *McNichol's Estate v. Commissioner, supra; Estate of Hendry v. Commissioner*, 62 T.C. 861, 872 (1974); *Estate of Kerdolff v. Commissioner*, 57 T.C. 643, 648 (1972); *Estate of Barlow v. Commissioner, supra* at 670; *Estate of Beckwith v. Commissioner*, 55 T.C. 242, 247 (1970), cf. *Estate of Wyly v. Commissioner*, 610 F. 2d 1282 (5th Cir. 1980).

The Tax Court noted that retention or reservation need not be expressed in the instrument of transfer, nor need it be legally enforceable, for § 2036(a)(1) of the Code to apply. *Estate of McCabe v. United States,* 475 F. 2d 1142, 1146 (1973); *Skinner's Estate v. United States, supra; McNichol's Estate v. Commissioner, supra; Atkinson v. United States*, 231 F. Supp. 933 (E.D.S.C. 1964). The existence of such an agreement or prearrangement can be inferred from the facts and circumstances surrounding the transfer, and the subsequent use, of the property. *Skinner's Estate v. United States, supra; McNichol's Estate v. Commissioner, supra; Estate of McCabe v. United States, supra; Estate of Kerdolff v. Commissioner, supra* at 648; *Estate of Hendry v. Commissioner, supra* at 872. Additionally, the Tax Court noted that the burden was upon David to show that no implied understanding or arrangement existed. *Estate of Hendry v. Commissioner, supra* at 872, and cases cited therein. *Estate of Kerdolff v. Commissioner, supra* at 648; *Estate of Linderme v. Commissioner*, 52 T.C. 305, 309 (1969), also see *Skinner's Estate v. United States, supra* at 520.

The Tax Court found that Gizella's intent in transferring property to the Trust was to provide a gift for her grandchildren. Gizella placed the property in an irrevocable trust and filed a gift tax return for the *entire value* of the property, $30,000. Compare *Skinner's Estate v. United States, supra* at 520 and *Estate of Green v. Commissioner, supra* at 1062-1063 (where the taxpayers filed gift tax returns reporting only the value of the property less a retained life estate). Concerned with the effect of the gift on her cash flow, Gizella specifically asked her accountant how such a gift would affect her standard of living. Only after being informed that she could afford to complete such a gift did Gizella transfer the property to the Trust. **The Tax Court was swayed by the testimony of David and Arthur that Gizella intended to make an absolute, unequivocal, irrevocable transfer.**

Additionally, the Tax Court noted that the Trust provisions granting the trustee discretionary power to distribute income or corpus to Gizella in and of themselves did not alter its finding that Gizella's motive in transferring the property to the Trust was to make a completed gift to her grandchildren. Nor did the provisions render the trust corpus includible under § 2036(a)(1) of the Code. See *Uhl's Estate v. Commissioner, supra.* Arthur informed Gizella that such a provision would not affect the taxability of the gift and would *allow* the trustee to distribute funds to her in case of a medical emergency without violating the terms of the Trust. The triggering event of § 2036(a)(1) of the Code is not the mere receipt of income. Rather, some arrangement or understanding, and certainly not the mere inclusion of a provision allowing the trustee to distribute and Gizella to receive such income or corpus, is necessary for § 2036(a) of the Code to apply. See *Estate of Green v. Commissioner*, *supra*; *Uhl's Estate v. Commissioner*, *supra.*

Furthermore, the cash flow analysis which Arthur presented to Gizella further supported the Tax Court's finding that Gizella transferred the property to the trust without an agreement, express or implied, that Gizella would receive the income. The Tax Court noted that in the years immediately following the transfer, Gizella, as projected, did not need the income from the Trust for her yearly support or ordinary living expenses. She used that income to take trips all over the world. Thus, the Tax Court found that Gizella never counted on, relied upon, or expected the income from the Trust.

Faced periodically with the choice of accumulating the income for his children or distributing the income to Gizella that she could travel, David chose the latter, however, was never obligated to distribute the money to Gizella, and with each period he could have changed his mind. Decedent never asked for any of the income, was reluctant at first to take it. David never felt he was required to make any distributions. It was his decision alone, exercised in his absolute discretion. Additionally, David testified that he never at any time prior to the creation of the Trust discussed with his mother his discretionary power to distribute trust income or principal to her.

After careful consideration of the entire record, the Tax Court found that David sustained his heavy burden of showing that no income was received by Gizella from the Trust pursuant to an agreement, express or implied, entered into contemporaneously with the transfer of the property to the Trust. Thus, Gizella did not reserve or retain any "enjoyment or possession" of the property in the Trust within the meaning of § 2036 (a)(1) of the Code when she transferred such property to the Trust. The Tax Court held that the corpus of the trust was therefore not includible in Gizella's gross estate under § 2036 of the Code.

17. **TAM 8213004**. In TAM 8213004, December 7, 1981, the two issues were: 1) Whether a settlor made a completed gift when he transferred property to an irrevocable trust where the independent trustee had discretion to pay income to the settlor during the settlor's life; and 2) Whether the settlor's transfer to an irrevocable trust was a transfer to a "trust for the use of the creator" under Section 7.31 of the New York Estates Powers, and Trust Law, so that it was void as to the creditors of the settlor's estate and therefore includible in the settlor's estate under Section 2038 of the Internal Revenue Code.

The settlor executed an irrevocable trust agreement in 1973, and transferred property to the trust in 1974 having a fair market value of approximately $630,000 to A as the sole trustee. The trust was governed by New York law.

Pursuant to the trust instrument, A had discretion to pay all or some of the net income of the trust to the settlor during the settlor's life. Additionally, A had the power to pay such amounts of principal to the settlor's wife during the settlor's life. After the settlor's death, the trustee had the power to pay such amounts of income and principal to the settlor's spouse as A determined in its sole discretion. After the death of both the settlor and his spouse, the trustee was authorized to pay such amounts of income and principal to the settlor's son as the trustee determined.

The settlor filed a gift tax return for the year 1974, but did not include the transfer to the irrevocable trust in the return, citing Revenue Ruling 62-13, 1962-1 C.B. 181, for the proposition that the transfer to the irrevocable trust was an incomplete gift.

The settlor died testate on February 16, 1979. The executor of the settlor's estate did not include the assets of the irrevocable trust in the settlor's gross estate.

The estate tax examiner contended that the settlor made a completed gift to his spouse and son at his death rather than in 1974 when the property was transferred to the trust.

Additionally, the examiner contended that the trust assets were includible in the settlor's estate under Section 2038 of the Internal Revenue Code. The examiner's Section 2038 argument was based upon his reading of Section 7-3.1 of the New York Estates, Powers and Trust Law which provides that a transfer in trust wholly for the benefit of the settlor is void as against existing or subsequent creditors. The examiner contended that the trust the settlor created violated Section 7-3.1 of the New York Estates, Powers and Trust Law and therefore, the assets transferred were available for the purpose of satisfying the claims of creditors of the settlor's estate.

Law & Analysis – Issue 1: In Revenue Ruling 62-13, 1962-1 C.B. 181, the Service stated that where property was transferred to a trust under the terms of which the trustee was given broad discretionary powers over the distribution of income and corpus to the settlor such transfer constitutes an incomplete gift for federal gift tax purposes.

Revenue Ruling 62-13 was later clarified by Revenue Ruling 77-378, 1977-2 C.B. 347, which provides that a transfer of property to a trust under the terms of which the trustee has the discretionary power, entirely voluntary under applicable state law, to distribute income and corpus to the settlor constitutes a completed gift of the entire value of the property transferred. Revenue Ruling 62-13 was clarified and distinguished because under the state law in the prior ruling, the settlor retained the economic benefit of the trust income and corpus by virtue of assigning, selling, or transferring his interest in the trust to his creditors. Since under the facts of Revenue Ruling 62-13 the settlor retained the ability to relegate his creditors to the trust fund for payment, there was no assurance that anything of value would pass to anyone other than the settlor and, thus, the gift was incomplete.

In the instant case, the settlor transferred property to an irrevocable trust and relinquished all control over the trust income and principal to A as trustee. Under New York law at the time, the settlor did not have the power to relegate his creditors to the trust fund for payment nor did he have any power to compel the trustee to make distributions to him. See *Herzog v. Commissioner*, 41 B.T.A. 509 (1940); aff'd, 116 F. 2d 591 (2nd Cir. 1941). Accordingly, the Service ruled that the transfer of property to the irrevocable trust in 1974 constituted a completed gift for federal gift tax purposes, and pursuant to § 6019 of the Code, the settlor should have included the transfer in the total taxable gifts for that quarter.

Section 6501(e)(2) of the Code extends the general three (3) year limitation for assessing the tax to six (6) years after the date a gift tax return is filed if the taxpayer omits from the total amount of gifts made during the period an amount which exceeds twenty-five percent (25%) of the total amount of gifts stated on such return. Since the settlor failed to report the transfer of approximately $630,000 on his return for the period ending March 30, 1974, and the amount omitted exceeded twenty-five percent (25%) of the total gifts reported ($102,000), the Service ruled the tax due on the settlor's transfer should have been assessed on or before June 25, 1980. Barring fraud, no tax on that transfer could be assessed after such date.

Law & Analysis – Issue 2: Section 7-3.1 of the New York Estates, Powers and Trusts Law (the "**E.P.T.L.**") provides that "a disposition in trust for the use of the creator is void as against the existing or subsequent creditors of the creator."

There have been several New York cases interpreting Section 7-3.1 of the E.P.T.L. The cases are in agreement that the statute is applicable only to those transfers in trust which are *solely* for the use of the settlor. See, *Curtis v. Leavitt*, 15 N.Y. 2 (1857); *Newton v. Jay*, 107 Div. 457, 95 N.Y.S. 413 (1905); *Liberty Storage & Warehouse Co. v. Van Wyck*, 256 App. Div. 641 (1939); and *In re Bourne's Will*, 158 N.Y.S. 2d 1009 (1957).

Since several individuals other than the settlor had interests in the income and corpus of the trust, the trust was not deemed to be a "trust for the use of the creator" within the meaning of Section 7-3.1 of the E.P.T.L. Accordingly, because the trust created by the settlor in 1973 was not void under New York law as to the creditors of the settlor's estate. The Service ruled there was no reason to address the includability of the trust assets in the settlor's estate under § 2038 of the Code.

Thus, the TAM held (1) the settlor made a completed gift for federal gift tax purposes in 1974, and (2) the trust created by the settlor was not a "trust for the use of the creator" within the meaning of Section 7-3.1 of the E.P.T.L., and there was no basis for including the trust in the settlor's estate under § 2038 of the Code.

18. **Estate of German v. U.S.** *Estate of German v. U.S.*, 7 Cl.Ct. 641 (1985). On July 31, 1969, Estelle E. German ("**Estelle**") made transfers of property to six separate trusts (the "**Trusts**") for her sons, Frederick A. German ("**Frederick**") and Arthur W. German ("**Arthur**"), as trustees, jointly. Each trust agreement provided that the trustees should accumulate the net income of the trust, and that at the end of each year should add the accumulated net income to the principal of the trust. Three of the trusts were for the benefit of Frederick, and three were for the benefit of Arthur. Each trust provided that after Estelle's death the trustees, in their sole and absolute discretion, were to accumulate for, pay to or apply for the benefit of the respective trust beneficiary all or part of the net income and principal of the trust, and, upon the death of the beneficiary, to such members of Frederick's or Arthur's family, as the case may be, as each should appoint.

Notwithstanding the foregoing, during Estelle's life, the trustees had the power at any time in their absolute and uncontrolled discretion to pay to or apply for the benefit of Estelle all or part of the net income and principal as the trustees should determine, in their absolute and uncontrolled discretion, for any reason whatsoever, subject only to the condition that the trustees receive the written consent of the respective beneficiary of the particular trust, Frederick or Arthur, individually, as the case may be.

Estelle filed a gift tax return for 1969 which reflected that she had made no taxable gift during that year. Estelle died on November 21, 1970. Her estate tax return, filed August 11, 1972, did not include in her estate the value of the assets transferred to the Trusts in 1969. Subsequently, a federal estate tax deficiency of $355,959 was assessed against Estelle's estate, which amounts were paid on various dates in 1973 and 1974. A timely claim for refund was filed on December 17, 1975, which was denied on December 28, 1979.

The question presented was whether Estelle divested herself of her interest in property in 1969 when she transferred such property to the Trusts with a proviso that the trustees might,

in their absolute discretion, pay any or all of the income or principal to Estelle at any time during her lifetime, if they received the written consent of the person who was entitled to receive the principal and accumulated income of the Trusts after her death, or, whether Estelle continued to enjoy the right to the income or principal of the Trusts up to the date of her death, because under Maryland law if Estelle chose to incur any debts, Estelle's creditors could attach or levy upon the Trusts' assets to collect on such debts.

On the government's motion for summary judgment, the Claims Court held that the government could not assess an estate tax deficiency on the grounds that the value of six trusts established by Estelle during her lifetime should have been included in the Estelle's gross estate, where the government did not establish that under Maryland law that Estelle's creditors could have reached the income or principal of the trusts up to time of her death. Estelle's estate was not equitably estopped from recovering estate tax overpayment.

Section 2036 of the Code includes in the gross estate the value of any interest in property of which a decedent has at any time made a transfer under which he has retained for his life the possession or enjoyment of, or the right to income from, the property, or the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom. Section 2038 of the Code includes in the gross estate the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power by the decedent alone or by the decedent in conjunction with any other person, to alter, amend, revoke, or terminate.

The government's theory that the value of the Trusts established by Estelle during her lifetime should have been included in her gross estate was based upon the rationale of *Outwin v. Commissioner*, 76 T.C. 153 (1981) (acq., 1981-2 C.B. 2), a gift tax case. In *Outwin*, a settlor had created four irrevocable trusts, which were to accumulate the income during the settlor's lifetime. After the settlor's death, if the settlor's wife survived him, the settlor's wife was entitled to mandatory distributions of the trust income annually, and to distribution of the corpus to her only in the absolute and uncontrolled discretion of the trustee. Additionally, the settlor's wife was given a special testamentary power of appointment over the corpus. Notwithstanding the foregoing, the trustees were given the power at any time during the life of the settlor to pay to or apply for the benefit of the settlor such part or parts of the income and principal as the trustees should determine in their absolute and uncontrolled discretion, for any reason; however, such distributions by the trustees required the prior written consent of the settlor's wife. The Service determined that in transferring property to such trusts that the taxpayer had made a completed taxable gift, while the taxpayer contended to the contrary. The Tax Court overruled the Commissioner on the ground that the gift was not completed because the taxpayer retained dominion and control over the property transferred. The Tax Court stated that "[w]here the trust agreement specifies that distributions to the settlor are to be made in the absolute discretion of the trustees, with no enforceable standard provided, the transfer is generally held to be complete for tax purposes." *Id*. at 162. However, "[a] different result obtains where state law permits creditors of the settlor-beneficiary to pierce the trusts for satisfaction of claims." *Id*. This result follows, the court said, from the fact that if under state law the creditors of a settlor-beneficiary of a discretionary trust may reach for satisfaction of

claims the maximum amount which the trustee may pay to the settlor or apply for her benefit, the taxpayer could at any time "obtain the economic benefit of the trust income simply by borrowing and then forcing [his] creditors to look to [his] interest in the trust income for a source of repayment." *Id*. The Tax Court held that the gift was incomplete to the extent of the value of the taxpayer's life estate because it found that the taxpayer's creditors did have such a right under Massachusetts law (which applied to the *Outwin* trust). *Accord, Commissioner v. Vander Weele*, 254 F.2d 895 (6th Cir.1958) (applying Michigan law); *Paolozzi v. Commissioner*, 23 T.C. 182 (1954) (also applying Massachusetts law); and Rev. Rul. 76-103, 1976-1 C.B. 293. But see *Herzog v. Commissioner*, 116 F.2d 591 (2d Cir.1941), and *In Re Uhl's Estate*, 241 F.2d 867 (7th Cir.1957), reaching contrary results under New York and Indiana law, respectively.

The government in *German* claimed that under Maryland law (which governed the Trusts), Estelle's creditors could have reached the principal and interest of the Trusts until the time of her death. Accordingly, the government claimed that Estelle had not disposed of her right to possession and enjoyment of the property, and the transfer took effect upon her death. Estelle's estate maintained that Maryland law did not give Estelle's creditors such right, and, accordingly, her gifts were completed at the time she transferred the assets in trust and they were no longer subject to estate tax. Thus, the narrow issue to be decided by the Court of Claims was the extent of the rights of Estelle's creditors with respect to the trust income and assets under Maryland law.

The government relied primarily on the Maryland case of *Warner v. Rice*, 66 Md. 436, 8 A. 84 (1887). In *Warner*, the court held that the income of property placed in trust by a debtor was subject to attachment by such debtor's creditors where the trust provided that (A) the trustees had discretion to pay income to the debtor and his family, (B) the debtor retained the right to appoint the remaining principal at his death by will (in default of appointment, the remaining principal would be distributed under Maryland law) and (C) the deed specified that it was to be "free from liability for any of [the debtor's] debts, contracts or engagements." *Warner* at 85. The court held that the debtor's creditors could reach the income of such trust because "a beneficial legal estate, in fee or for life, cannot be conveyed or devised to a person with a provision that it shall not be alienated, or that it shall not be subject to the debts of the legal owner." The court further noted:

> "[t]he object of the deed of trust was not to destroy or divest himself of his right of property, but simply to place a legal estate therein in a trustee, as, perhaps, a guard against improvident management. But the equitable estate remains in [the debtor] during his life, with full power of disposition by will, and, in default of will, the property devolves on his heirs and representatives at his death, when the trust will terminate . . . As we have seen, there is no limitation over or cesser of [the debtor's] equitable life-estate, or his interest in the rents and profits of the property, upon seizure of the same by his creditors." *Warner* at 86.

The Court of Claims distinguished the instant case from *Warner* in several respects. First, if the trustee, in the exercise of his discretion, did not distribute the income or principal to Estelle, it would go to the specified remaindermen; whereas in *Warner,* the undistributed trust

income would be accumulated for the settlor's benefit and the corpus distributed pursuant to his will. Second, before Estelle could receive any distribution from the trustees, the consent of a beneficiary having an adverse interest had to be obtained. Third, the Trusts in the instant case, however, not in *Warner*, made dispositions of the property upon Estelle's death and were not intended solely to shield Estelle's assets from her creditors.

In *Mercantile Trust Co. v. Bergdorf Goodman & Co*., 173 A. 31 (1934), the Maryland Court of Appeals confirmed that where there is no proof of fraud, the rights of attaching creditors to property in a trust created by a debtor depend upon whether the property which is not distributed to the settlor-beneficiary or according to his direction goes back to the settlor or to a third-party at his death. In *Mercantile Trust,* the settlor had created an *inter vivos* trust, retaining a life estate in the trust assets and a power of appointment by will, which, if not exercised, would result in the property passing to her then living issue or next of kin. The Maryland court held that although the creditors could attach the settlor's income from the life estate, in the absence of a fraudulent conveyance they could not reach the corpus of the trust, because, "there was an immediate vesting of the remainder in the next of kin of the settlor," and "[w]ith the ownership of the corpus in the remaindermen, even though the possession may be delayed or defeated by the will of the donor, the corpus cannot be attached to satisfy the creditors of the settlor." (*Id*. at 34-35.) *Accord*, *United States v. Baldwin*, 283 Md. 586, 391 A.2d 844 (1978).

The Court of Claims reasoned that if the unexercised right of the settlor in *Mercantile Trust Co.* and *Baldwin* to dispose of the corpus by will was not sufficient to render the trust property subject to execution by creditors because of the interests of the remaindermen in such property in default of appointment, the unexercised discretion of the trustees of the Trusts with respect to both principal and income would not render either vulnerable to Estelle's creditors under Maryland law.

The Court of Claims noted that apart from *Warner* the government did not cite any Maryland decision in which creditors were able to reach income or corpus which could be distributed to the settlor of a trust, not as a matter of right, however, in the uncontrolled discretion of the trustee. Additionally, the Court of Claims noted that the government cited no decision, either in the Maryland courts or elsewhere, where the creditor was held to be entitled to attach trust property where the trustee's discretion could only be exercised with the prior consent of those who would receive the property in default of such exercise.

In *Outwin*, the Tax Court admitted that it had been unable to find any authorities in any state which addressed the precise issue. *Outwin*, 76 T.C. at 165. However, the Tax Court resolved that problem by reasoning that in view of the strong public policy of the Massachusetts courts against persons placing property in trust for their own benefit while at the same time insulating such property from the claims of creditors, the veto power of a spouse would not be a barrier to such creditors under Massachusetts law, because it assumed (1) that (in the absence of divorce) the possibility that the spouse would veto a disbursement by the trustee to her husband was remote, and (2) the fact that the husband might reciprocate by veto of disbursements to the wife under her similar trust would tend to further discourage her veto. *Id.* at 166-67. The Court of Claims found no such strong public policy in the Maryland courts

where there is a remainder interest, and found no assumption by the Maryland courts that a settlor's spouse may be deemed merely the settlor's alter ego for purposes of insulating property from the settlor's creditors in a non-fraudulent conveyance transaction.

The Court of Claims held that the government failed to establish that under Maryland law, Estelle's creditors could have reached the income or principal of her the Trusts up to the time of her death, and thus, the government could not assess an estate tax deficiency on grounds that the value of the Trusts established by Estelle during her lifetime should have been included in Estelle's gross estate.

19. **Estate of Paxton et al. v. Commissioner**. In *Estate of Paxton et al. v. Commissioner*, 86 T.C. 785 (1986), Floyd G. Paxton ("**Floyd**") organized a corporation, Kwik Lok Corporation of Yakima ("**Kwik Lok**") and in 1965 Floyd owned all of Kwik Lok's outstanding stock. Floyd also participated in the organization of Kwik Lok Corporation of Indiana ("**Kwik Lok Indiana**") in 1960 and Paxton Industries, Inc., ("**Paxton Industries**") in 1962. Kwik Lok held nearly all of the stock of Kwik Lok Indiana except three shares which were held by Floyd prior to August 1967. Floyd held all of the stock in Paxton Industries up to that date.

Floyd created the F.G. Paxton Family Organization Trust (the "**PFO Trust**") Trust in 1967. Additionally, Floyd and his wife, Grace Paxton, ("**Grace**") created the International Development Trust (the "**IDT Trust**") in 1968. Floyd, his family members and several of his close associates contributed assets to the PFO Trust. Floyd and Grace contributed assets to the IDT Trust. Under the terms of the PFO Trust and the IDT Trust (collectively, the "**Trusts**"), both of which were amended on several occasions:

(A) certificates of interest (the "**Certificates**") were issued as consideration for the contributions to the trusts;

(B) the only right possessed by the holder of the Certificates was the receipt of trust distributions, which were determined in the absolute discretion of the trustees; and

(C) the Certificates were negotiable only with the express prior consent of the trustees.

PFO Trust and IDT Trust Certificates were issued to Floyd, to his family, and to company employees. Floyd and Grace initially held, collectively, 86.38% of the PFO Trust Certificates and, after conveying Certificates in 1971, 50.02% of the Certificates. Floyd and his Wife held, collectively, 50% of the IDT Trust Certificates. Floyd's son, Jerre Paxton ("**Jerre**"), was appointed as First Trustee for both Trusts. As First Trustee, Jerre had sole discretion to make trust distributions.

Floyd died on December 10, 1975 and Jerre was appointed as the personal representative of Floyd's estate. A family attorney advised Jerre that no estate tax return was required as the value of the assets in Floyd's community estate did not exceed $60,000. No

estate tax return was filed for Floyd's estate. Floyd's Certificates were distributed to his children and other family members.

The issue presented to the court in this case was whether Floyd's gross estate included, under §§ 2033, 2036, 2037, or 2038 of the Code, certain property which Floyd had transferred to Trusts during his life.

The Tax Court held that Floyd's transfers to the Trusts were includable in his estate under § 2036(a) of the Code because:

1. Floyd made the transfers subject to an understanding, express or implied, that he would receive the trust income or corpus or both when requested; and

2. Floyd retained an interest in the trust income and corpus that his creditors could reach.

The Tax Court saw the Trusts as an attempt on the part of Floyd to convey wealth to his children without transfer tax. Floyd established two trusts during his life to which he and his wife transferred nearly all of their property. Neither Floyd nor Grace filed a gift tax return in connection with such transfers. The Tax Court found it incomprehensible that Floyd, a wealthy man, would transfer nearly all of his property to irrevocable trusts making no provisions for (A) his own support after a stream of licensing agreement royalties expired in 1982, when Floyd would have been just 64; and (B) Grace's support. The Court noted that Floyd's son, Jerre, was given absolute discretion to make trust distributions. The Court determined that there was an understanding between Floyd and Jerre that Floyd would receive distributions when needed, and for that reason held that the transfer to the Trusts were includable in his estate under § 2036(a) of the Code.

Additionally, the Tax Court noted that in a self-settled trust, the grantor's creditors can reach the maximum amount which the trustee can pay to the grantor. The Tax Court found that under Washington law, Floyd's creditors could reach the entire trust corpus because the trustees had the authority to distribute the entire trust corpus to Floyd. The Tax Court held that because Floyd's creditors could reach the maximum amount which, under the terms of the Trusts, could be distributed to him, Floyd's transfer to the Trusts were includable in his estate under § 2036(a)(1) of the Code.

20. **PLR 8829030**. In PLR 8829030, April 20, 1988, the taxpayer requested a determination of whether certain interests in trusts were includible in the gross estates of such taxpayer's child and grandchild.

In January 1944, A transferred stock to B, his spouse, and to C, and D, his children. Within a short period, B, C, and D transferred the stock to trust X. A subsequently transferred stock to B, C, and D several more times before his death. This stock was invariably transferred by the recipient to trust X or to trust Y, as described below.

B, C, and D were named as grantors of trust X, and C was the trustee of trust X. Trust X provided that the trustee shall, in its absolute discretion, pay all of the income of the trust to B during her life, and upon the death of B the trustee shall, within its absolute discretion pay all

of the income to A for his life. Upon the death of the survivor of A and B, the trustee was directed to divide the trust assets into three equal parts and distribute one share each to C, D, and E respectively. E was D's child and A's adopted child.

B died on November 15, 1948. On January 18, 1950, A, C, and D executed trust Y, which amended and revoked trust X. C and D were the named grantors of trust Y, and C was the trustee. Under the terms of trust Y, the trustee was to pay the net income, in the trustee's absolute discretion, to A, C, D, and E. The trust was to terminate upon the death of the survivor of A and D or on December 31, 1964, whichever occurred later. If A or D or both died before December 31, 1964, the trustee was to, in the trustee's absolute discretion, pay the income to the surviving income beneficiaries until the termination of trust Y. If C or E died before Y terminated, the trustee was to, in the trustee's absolute discretion, pay the income to the surviving income beneficiaries and the issue of C and E until the termination of trust Y. Upon the termination of trust Y, the trustee was to divide the remaining trust property, into two equal parts, and distribute one part to C and one part to E, or their respective issue if C or E was not then living. A died in April 1954, C died in January 1977, E died in August 1986, and D died in April 1987. D was a resident of State Z when she died and E was a resident of State W when he died. The trust is administered in State W.

The trustee distributed the income of trust X and trust Y as required by the governing instruments. From 1944 to 1948 the trustee distributed all of the income of trust X to B. In 1949 the trustee distributed all of the income of trust X to A. After trust X was revoked and from January 23, 1950 until C's death, the trustee distributed the income of trust Y in equal shares to C, D, and E. After C's death, the trustee distributed C's share of the income from trust Y to C's issue, *per stirpes*. The trustee continued to distribute the respective shares of income to D, E, and C's issue from trust Y until D's death in 1987.

Where state law deems that the assets of a discretionary trust are subject to claims of the grantor's creditors, the transfer of property to such a discretionary trust does not constitute a completed gift for federal gift tax purposes. Additionally, if the grantor dies before the gift becomes complete, the date of death value of the trust corpus will be includible in the grantor's gross estate under § 2038 of the Code because of the grantor's retained power to, in effect, terminate the trust by relegating the grantor's creditors to the entire property of the trust.

Under the law of State W, if the trustee had absolute discretion to withhold from the beneficiary all payments or beneficial use, such that the beneficiary could force the trustee to distribute anything to him, a creditor of a beneficiary cannot reach the assets of the trust in satisfaction of the beneficiary's debts. See *Huffman v. Chasteen*, 209 S.W.2d 705 (1948); *Department of Public Welfare v. Meek*, 95 S.W.2d 599 (1936).

State Z's courts have generally applied the law where the trust is administered in resolving legal issues involving the administration of the trust. In *Farmers and Merchants Bank v. Woolf*, 523 P.2d 1346 (1974), the State Z Supreme Court held that where a settlor creates a trust to be administered in a state other than that of his domicile, the law of the state where the trust is administered is the proper choice of law rather than the testator's domicile or some other jurisdiction. *See also*, 5 *Scott, Law of Trusts*, sections 625-628 (3d ed. 1967).

Accordingly, in determining whether a creditor could attach D's interest in trust Y, the law in State W governed.

In the instant case, the trustee possessed, pursuant to the terms of the governing instrument, absolute discretion to distribute income to D and E. The law under the applicable state would not allow a creditor of a beneficiary to reach the interest of a beneficiary of a discretionary trust. Since D and E are beneficiaries of the discretionary trust in question, their creditors could not reach their interests in the trust in satisfaction of debts. As such, assuming arguendo that D and E were grantors, D and E did not possess any interests in the trust at death that would require inclusion of any trust corpus in their respective gross estates under § 2038 of the Code.

Trust Y had two levels of grantors. On one level, D and E were grantors of trust Y to the extent that each of their one-third (1/3) remainder interests in trust X passed to Y when X was amended and revoked. For the exchange of their respective remainder interests in X, D received a discretionary income interest in trust Y, and E received a discretionary income interest and a possible remainder interest in one-half (1/2) of trust Y. On another level, D may also have been a grantor of trust Y. As noted above, D was one of the named grantors of trust Y. Each time A transferred stock to B, C, and D, they, in turn, transferred the stock to either trust X or trust Y, whichever was in effect when the stock was transferred. The taxpayer represents that B, C, and D were mere conduits and that the real grantor of both trusts was A. The taxpayer represented that the parties had agreed that when A transferred stock to B, C, and D, they would in turn transfer the stock to the respective trust (either X or Y). However, the taxpayer was unable to submit any written agreement between the parties. In the absence of the written agreement, the existence of an implied or oral agreement between the parties is a question of fact on which the Service declined to rule.

Similarly, the Service declined to rule whether D and E, with respect to property which they transferred to trust Y, retained interests therein which would necessitate the inclusion of the values in their respective gross estates pursuant to § 2036 of the Code. Under trust Y, D received the right, at the discretion of the trustee, to receive trust income for life and E received a similar discretionary income interest. However, during the term of Y, D and E were each consistently paid one-third (1/3) of the trust income. The taxpayer maintained that there was an implied agreement between the parties regarding the transfer of stock into trust X and trust Y. Whether D and E retained any income interests under trust Y would depend upon whether there existed an implied agreement between the beneficiaries and the trustee of trust Y to distribute income. The Service ruled that the existence of an implied agreement required a factual determination which is appropriately made by a District Director.

Additionally, the Service noted that § 2037 of the Code would be applicable in the case of E's transfer to trust Y. As noted above, the Service concluded that E was the grantor of trust Y to the extent of the value of the one-third (1/3) remainder interest in trust X that E possessed and transferred. Under the terms of trust Y, E possessed the right to receive one-half (1/2) of the trust corpus if he survived termination of the trust. If E failed to survive termination, his share of the trust corpus would pass to his issue. Thus, for purposes of § 2037 of the Code, E made a transfer to trust Y pursuant to which: (1) possession or enjoyment of the property

transferred could be obtained by E's issue only if they survived E; and (2) E retained a reversionary interest in the property transferred. See Regs. § 20.2037-1(e), example 3. The Service determined that § 2037 of the Code was applicable to the transfer provided the factor for valuing E's reversionary interest, determined in immediately before E's death, exceeded five percent (5%). Additionally, the Service determined that the appropriate factor to be utilized would be dependent on E's age and D's age immediately before the death of E. If this factor exceeded five percent (5%), a proportionate part of the value of the trust corpus on the date of E's death would be includible in E's gross estate.

21. **PLR 9332006**. In PLR 9332006, August 20, 1992, rulings regarding the income, excise, gift, and estate tax consequences, the taxpayer sought the establishment and funding of a trust organized under the laws of Country X.

Settlor A and Settlor B (hereinafter referred to individually as a "**Settlor**" and collectively as the "**Settlors**") were siblings. Both Settlors were United States citizens. Each Settlor owned a Percentage A interest in Corporation A, a domestic corporation. Corporation A owned all of the voting common stock of Corporation B, also a domestic corporation. That voting common stock represented Percentage B of the value of Corporation B. The balance of Corporation B's stock, represented by non-voting common shares, was owned by the Partnership, a domestic limited partnership. The Partnership conducted no active business. Each Settlor directly owned Percentage C of the interests in the Partnership. Together, those interests comprised all of the Partnership's limited partnership interests. Corporation A, which owned a Percentage B general partnership interest in the Partnership, was the sole general partner of the Partnership.

The Settlors created an irrevocable trust (the "**Trust**") under the laws of Country X and contributed nominal consideration to fund it. The beneficiaries of the trust included the Settlors, Beneficiary A (a living parent of the Settlors and a United States citizen), and the Settlors' living and future heirs. Either (1) the Trustee (an independent Country X corporation) with the consent of the Protector, or (2) Beneficiary A, could direct trust income or principal be appointed to or for the benefit of any beneficiary, provided, however, that only the Protector may make any such appointment for the benefit of Beneficiary A or of either Settlor. The term of the trust was 100 years, unless it was terminated earlier in the sole discretion of the Trustee. Upon termination, the Trustee could, in its discretion, appoint assets of the Trust to any or all of the then beneficiaries, or, if there were no then living beneficiaries, for charitable purposes. Each Settlor was precluded from becoming a successor trustee.

Under the laws of Country X, a trust may include provisions pertaining to the rights and obligations of a Protector. The Trust named a United States citizen as Protector and made provision for the appointment of successor Protectors. The Trust further provided that the Protector may appoint new or additional trustees (however, not, as noted above, a Settlor), and that neither a Protector nor the estate of a Protector was a permissible beneficiary of the Trust.

It was represented that: (1) the Protector could not be a person or entity related to or under the control of either Settlor; (2) under the laws of Country X neither a beneficiary nor any creditor of any beneficiary, including the Settlors, could compel the trustee to distribute the Trust's assets to or for their benefit at any time during the trust term; (3) that transfers by the

Settlors of interests in the Partnership to the Trust were not in any way liable to be set aside under any applicable fraudulent conveyance or other law, domestic or foreign; (4) neither the Trustee nor the Settlors planned to hold Trust assets anywhere other than Country X; and that the Trust was a "**foreign trust**" within the meaning of § 7701(a)(31) of the Code.

The Settlors proposed to transfer each of their interests in the Partnership to the Trust.

Rulings were requested regarding the following issues:

(1) Were the transfers of interests in the Partnership to the Trust by the Settlors completed gifts for purposes of § 2511 of the Code at the time of the transfers to the Trust?

(2) Would any portion of the Trust be includible in the estates of either Settlors A or B under §§ 2033, 2036, 2037, or 2038 of the Code?

Issue 1: *Were interests in the Partnership transferred to the Trust by the Settlors completed gifts subject to federal gift tax under § 2511 of the Code?*

The Sixth Circuit Court and Tax Court have held that a grantor of an irrevocable *inter vivos* trust has not completely parted with dominion and control over trust assets where the grantor could in actuality retain the economic benefit and enjoyment of the entire trust income and corpus by borrowing money or by selling, assigning, or transferring the grantor's interest in the trust fund and relegating the grantor's creditors to the trust fund for payment. *Commissioner v. Vander Weele*, 254 F.2d 895 (6th Cir. 1958); *Outwin v. Commissioner*, 76 T.C. 153 (1981); *Estate of Paxton v. Commissioner*, 86 T.C. 785 (1986). In view of the Settlors' retained rights in these cases, there was no assurance that anything of value had passed to the remaindermen and the gifts were held to be entirely incomplete. See also Rev. Rul. 76-103, 1976-1 C.B. 374 (concluding that such an incomplete gift would be includible in the gross estate for estate tax purposes under § 2038 of the Code).

In the instant case, the Settlors, however, could part with dominion and control over the property being transferred into the Trust. Although the Trustee had an unrestricted power to pay over trust assets to the Settlors, the Settlors could not individually or together require that any of the assets of the Trust be distributed to themselves. Further, assuming taxpayers' representation regarding the law of Country X was correct, neither of the Settlors could utilize assets transferred to the Trust by incurring debt and relegating Settlor's creditors to the trust.

Accordingly, based on the taxpayers' representations regarding Country X law, the Service ruled that transfers of interests in the Partnership to the Trust were completed gifts and the entire value of the interests in the Partnership transferred to the Trust by the Settlors was subject to the federal gift tax.

Issue 2: *Would interests in the Partnership transferred to the Trust by the Settlors be includible in their gross estates under §§ 2033, 2036, 2037, or 2038 of the Code?*

In *United States v. Byrum*, 408 U.S. 125 (1972), 1972-1 C.B. 518, the decedent was a controlling shareholder and a member of the board of directors of a closely-held corporation. The Supreme Court held that stock in the corporation transferred by the decedent to an irrevocable trust was not included in his gross estate under § 2036 of the Code even though the decedent expressly retained the right to vote the transferred stock and to veto the sale or disposition of the stock by the trustee. The Court held that the decedent, as a controlling shareholder and a member of the board of directors, had a fiduciary duty to promote the interests of the corporation and not to exercise his voting power to promote his personal interests at the expense of the minority shareholders. Accordingly, the decedent's retained power to vote the stock did not constitute the retained enjoyment of the transferred stock or the right to designate the income from the transferred stack for purposes of § 2036 of the Code.

In the instant case the Settlors were the sole shareholders of Corporation A, which was the general partner in the Partnership. Accordingly, the grantors had management authority over the Partnership, which would include the authority to control partnership distributions. However, similar to the decedent in *Byrum*, each Settlor in the instant case occupied a fiduciary position with respect to the limited partners of the partnership, and could not distribute or withhold distributions or otherwise manage the Partnership for purposes unrelated to the conduct of the partnership business.

Furthermore, based on the taxpayer representations regarding the law of Country X, the property transferred to the Trust would not be included in the gross estate of either Settlor under § 2033 of the Code, since the gift to the Trust would be complete and neither Settlor would have the right to compel a distribution from the trust. Similarly, interests in the Partnership transferred to the Trust by either Settlor would not be included in that Settlor's gross estate under §§ 2036, 2037, or 2038 of the Code, since under the facts presented, the Trustee's discretion to make distributions to a Settlor was not a retained interest or power for purposes of those sections. See Rev. Rul. 76-103, 1976-1 C.B. 374.

Accordingly, the Service ruled that the value of the interests in the Partnership transferred by a Settlor to the Trust would not be includible in the gross estate of that Settlor under §§ 2033, 2036, 2037, or 2038 of the Code.

22. **PLR 200822008**. In PLR 200822008, a grantor established an irrevocable trust on a date after September 25, 1985. The grantor's spouse was designated as the initial trustee of the trust and at the time of the ruling was currently serving as the trustee. Immediately upon execution of the trust agreement and in accordance with its terms, the trust was divided into two separate shares, the "Exempt Trust" and the "Non-Exempt Trust." The Non-Exempt Trust was funded with the first $5,000 transferred to the trust as the initial gift. Thereafter, the Exempt Trust was directed to be funded with a pecuniary amount equal to the lesser of the balance of the initial gift allocated to the Non-Exempt Trust or the grantor's remaining GST exemption and the remaining GST exemption of the grantor's spouse under Section 2631 of the Code.

Until the "Triggering Event," the trust agreement gave the trustee of the Exempt Trust the authority to distribute all, part or none of the trust income and principal, in the trustee's discretion to any of the grantor's descendants for any such descendant's health, education,

maintenance, or support. The Triggering Event is defined in the trust agreement as the earlier to occur of (a) the date that the Exempt Trust is no longer considered a grantor trust under Section 671, *et*. *seq*. of the Code (the "**grantor trust rules**") or (b) the date the Trustee elects.

After the Triggering Event, until the first to die of the grantor or the grantor's spouse, the trustee is authorized to distribute to the grantor's spouse as much or all of the income and/or principal of the Exempt Trust as the trustee determines in its sole discretion. Notwithstanding the foregoing, any such distribution can only be made with the consent of an adverse party (as such term is defined in Section 672 of the Code). Upon the first to occur of the death of the grantor or the grantor's spouse, the trustee is directed to distribute the remaining trust corpus to any one or more of the grantor's descendants as the grantor's spouse may appoint by will. The balance of the trust assets that are not appointed are directed to be divided into equal shares for the grantor's then living children with any then living child of a deceased child being treated as a child of the grantor. Any such shares established by this division are directed to be held in further trust for the benefit of the beneficiaries.

Until the "Triggering Event," the trust agreement gave the trustee of the Non-Exempt Trust the authority to distribute all, part or none of the trust income and principal, in the trustee's discretion to any of grantor's children for their health, education, maintenance, or support. The term Triggering Event is defined in the same manner as it is for purposes of the Exempt Trust. Upon the Triggering Event the trustee is directed to divide the remaining assets of the Non-Exempt trust into as many equal shares as are necessary to provide one share for each of the grantor's children who are then living and one share for each of the grantor's children who are deceased but have descendants then living. Each share for a deceased child is directed to be further divided into shares, *per stirpes*, for such child's then living descendants. These shares are to be administered under Article VI of the Trust instrument. Each separate share is directed to be distributed outright to the beneficiary for whom the share was established.

Although the facts of the ruling do not disclose the terms of the provision causing grantor trust status, the ruling acknowledges that the grantor is the owner of the Exempt Trust and the Non-Exempt Trust under the grantor trust rules. Therefore, the grantor is required to include the income, gains, losses, credits, etc. of the trust in determining his personal income tax liability. The trust agreement also provided that the trustee may not reimburse the grantor for any such income tax that he is required to pay as a result of the trust constituting a grantor trust. Furthermore, the trust agreement provides that the grantor waives any right he may have to be reimbursed for such tax liability.

The trustee proposed to petition an appropriate court to modify the terms of the trust to allow the trustee, in its discretion, to pay to the grantor or his legal representative such amounts as are sufficient to satisfy the grantor's federal, state, or local income tax liability incurred by the grantor by reason of the grantor trust status of the trust. Furthermore, this reimbursement power would only be exercisable by the trustee with the consent of a "Reimbursement Committee" and at least one child of the grantor who is also a beneficiary of the trust and who is an adult (provided such child qualifies as an adverse party Section 672(c) of the Code).

E, an independent attorney, will be appointed as the initial member of the Reimbursement Committee. E is not an employee of grantor or an employee of a corporation whose stock is owned by the grantor (or any trust under the trust agreement) or whose executives include the grantor, or a relative of the grantor listed in Section 672(c) of the Code. The grantor's spouse, if she is then living, and if not, the grantor's children who are then living by majority vote, or if there are no such children then living, the grantor's then living descendants (also by majority vote), may remove any person serving on the Reimbursement Committee for any reason. These same individuals (in the same circumstances) may also appoint additional persons to serve on the Reimbursement Committee at any time with or without cause. Notwithstanding the foregoing, no one who is related or subordinate to the grantor (within the meaning of Section 672(c) of the Code) is permitted to be appointed as a member of the Reimbursement Committee.

As is typically the case, the facts of the ruling do not disclose the state where the settlor is a resident, the jurisdiction where the trust is being administered or governing law of the trust. Since Florida, New York and Texas all have "tax reimbursement statutes" it may be a good assumption that the trust is administered in one of those states, and the law of one of those states is the governing law of the trust.

In regards to estate tax and GST tax issues, the taxpayer requested the Service rule that:

(a) Any income taxes that the grantor is reimbursed will not cause the value of the assets in the trust to be included in the grantor's gross estate.

(b) The reformation will not result in the trust assets being included in the grantor's gross estate.

(c) The modification of the trust agreement proposed in the ruling will not affect the inclusion ratio of the Exempt Trust for GST tax purposes.

The ruling examined the application of § 2036 of the Code. According to Regulation § 20.2036-1(b)(2), the use, possession, right to income, or other enjoyment of transferred property is treated as having been retained by the decedent to the extent that the transferred property is to be applied towards the discharge of a legal obligation of the decedent. See also *Estate of Prudowsky v. Com'r*, 55 T.C. 890 (1971), *aff'd*, 465 F.2d 62 (7th Cir. 1972) (property held under the state Uniform Gifts to Minors Act was included in the decedent's gross estate under § 2036(a)(1) of the Code because the decedent, as custodian, retained the authority to use the property to satisfy his legal obligation to support a minor for whose benefit the custodianship was created); *Richards v. Com'r*, T.C.M. 1965-263, *aff'd*, 375 F.2d 997 (10th Cir. 1967) (trust corpus includible in decedent's gross estate under Section 2036(a)(1) because mandatory distributions of trust income to his spouse satisfied his spousal support obligation). Nevertheless, Section 2036 generally will not apply where trust assets may be used to satisfy a decedent-settlor's legal obligations only in the discretion of the trustee, whether or not such discretion is exercised by the trustee. *Com'r v. Estate of Douglas*, 143 F.2d 961 (3d Cir. 1944), *acq.* 1944 C.B. 7; *Estate of Mitchell v. Com'r*, 55 T.C. 576 (1970), *acq.* 1971-2 C.B. 3.

The ruling neglects to discuss the potential application of Section 2038 of the Code to the trust, however, this section would most likely be the proper section to be applied to include any portion of the trust assets in the grantor's estate attributable to gifts made by the grantor prior to the reformation. Technically, Section 2036 of the Code is only applicable where a grantor retains an interest in a trust or a power over trust assets or the income from such assets. On the other hand Section 2038 merely requires the grantor to hold a proscribed power at death. Section 2036 could technically cause inclusion of the portion of the trust attributable to gifts made the grantor after the reformation is completed and Section 2038 could be applicable to cause inclusion of the trust assets before and after the reformation.

The Service issued Revenue Ruling 2004-64, 2004-27 I.R.B. 7 on July 6, 2004 which provides rules related to payment by the trustee of the grantor's income tax liability on income generated by assets held in a wholly-owned grantor trust. Important to this discussion, the ruling contains rules related to estate tax inclusion when a trust agreement or applicable law provides that the trustee may reimburse the grantor from the trust for the grantor's income tax liability incurred from income generated by the trust.

In the Revenue Ruling the taxpayer ("**T**"), a United States citizen, establishes and funds an irrevocable *inter vivos* trust for the benefit of his descendants. The trust agreement contains a provision requiring the trustee be a person who is not related or subordinate to the taxpayer within the meaning of Section 672(c) of the Code. Under the terms of the trust (except as discussed below) T retains no beneficial interest in or power over the trust income or corpus that would cause any gift to the trust to constitute an incomplete gift for federal gift tax purposes. Except as discussed below, T also retains no beneficial interest in or power over the trust income or corpus that would cause the trust assets to be included in his gross estate for federal estate tax purposes at his death. Nonetheless, the trust agreement contains certain provisions that cause T to be treated as the owner of the trust under the grantor trust rules. During the first year of the trust it generates taxable income of $10*x*. Pursuant to the grantor trust rules T must include the $10*x* in his taxable income. As a result T's personal income tax liability for the first year of the trust increases by $2.5*x*. T dies in the third year after he established the trust. On the date of his death the fair market value of trust's assets is $150*x*.

The Revenue Ruling contains three fact "situations." In the third fact situation the trust agreement contains a discretionary tax reimbursement provision. According to the Revenue Ruling, if T is treated as the owner of any portion of trust under the grantor trust rules for any taxable year, the trustee may, in the trustee's discretion, distribute to T for the taxable year, a sufficient amount of assets from the trust to satisfy T's personal income tax liability attributable to the inclusion of such income in T's taxable income. Accordingly, to reimburse T for his tax liability attributable to the income from the trust generated in its first year, the trustee exercises its discretionary power by distributing $2.5*x* to T. According to the ruling, provided there is no express or implied understanding between T and the trustee regarding the trustee's exercise of the trustee's discretion, the discretionary authority granted to the trustee to satisfy T's obligation to pay his tax liability would not alone cause the inclusion of the trust assets in T's gross estate for federal estate tax purposes. The ruling provides that this will be the case regardless of whether the trustee actually reimburses T from trust assets for the income tax he pays that is attributable to the trust's income. Further, the ruling states that the same

result will occur if the trustee's discretion to reimburse T for this income tax is granted under applicable state law rather than under the trust agreement. Nevertheless, the ruling cautions:

> such discretion combined with other facts (including but not limited to: an understanding or pre-existing arrangement between [T] and the trustee regarding the trustee's exercise of this discretion; a power retained by [T] to remove the trustee and name [T] as successor trustee; *or applicable local law subjecting the trust assets to the claims of [T]'s creditors*) may cause inclusion of Trust's assets in [T]'s gross estate for federal estate tax purposes. (Emphasis added.)

Similar to Revenue Ruling 2004-64, PLR 200822008 neglected to provide an extensive discussion of the concept of a self-settled trust, that is, a trust in which the settlor, *i.e.,* the donor, remains eligible to receive distributions of income and/or principal from the trust. Nonetheless, the treatment of this type of trust under the law governing to the trust is important to the result the taxpayer seeks to achieve in the ruling, that is, avoiding any portion of the trust becoming subject to inclusion in the grantor's estate for estate tax purposes.

In PLR 200822008, after the proposed reformation, the trustee will have the discretion to reimburse the grantor for his income tax liability actually incurred by the grantor because of items of income and gain in the trust. Accordingly, if there is no express or implied understanding between the grantor, the members of the Reimbursement Committee and the trustee with respect to the trustee's exercise of discretion to reimburse the grantor, the trustee's discretion to satisfy grantor's tax liability would not by itself cause inclusion of the trust in the grantor's estate for estate tax purposes. Nonetheless, this authority in conjunction with other factors (such as an understanding or pre-existing arrangement between grantor and the trustee, or member(s) of the Reimbursement Committee regarding the trustee's use of this authority; or applicable law subjecting the trust assets to the claims of the grantor's creditors) could cause inclusion of trust assets in grantor's estate for estate tax purposes.

Interestingly, the law of Delaware and Alaska each contain statutes that render any express (that is, not contained in the trust agreement) or implied agreement or understanding between a grantor and a trustee void. See 12 Del. Code Ann. § 3571; A.S. §§34.40.110(i). States that have or will enact discretionary tax reimbursement provisions should strongly consider enacting this type of prophylactic statutory rule. Such a rule might prove to be beneficial in combating an argument by the Service that there is an understanding or pre-existing arrangement between a grantor and a trustee as to the trustee exercising its reimbursement authority.

PLR 200822008 examined the potential application of the GST tax to the proposed modification. The ruling noted that the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. Nonetheless, the GST tax does not apply to any generation-skipping transfer under a trust that was irrevocable on September 25, 1985. A trust that became irrevocable on or before September 25, 1985, is referred to as a "grandfathered trust" or a trust that is not subject to GST tax. An "exempt trust" is a trust executed and funded after September 25, 1985, to which a grantor has allocated all or a portion of his GST exemption to exempt the trust from the GST tax.

The ruling noted that Regulation Section 26.2601-1(b)(4)(i) set forth rules for determining whether a modification, judicial construction, settlement agreement, or action taken by a trustee in regards to a grandfathered trust that is not subject to the GST tax will cause the trust to forfeit its exempt status. In this regard, Regulation Section 26.2601-1(b)(4)(i)(D) provides that a modification of a governing instrument of an exempt trust by judicial reformation, or non-judicial reformation that is valid under applicable law, will not cause a grandfathered trust to be subject to the GST tax provided the modification does not shift a beneficial interest in the trust to a beneficiary who is in a lower generation (as defined in Section 2651 of the Code) than the individual or individuals who held the beneficial interest prior to the modification. Additionally, the modification cannot extend the time for vesting of any beneficial interest in the trust beyond the period set forth in the original trust. The Regulation cautions that a modification of a trust will result in a shift in beneficial interest to a lower generation beneficiary where the modification results in an increase in the amount of a GST transfer or the creation of a new GST transfer.

The ruling noted that guidance has never been provided regarding the GST tax consequences of the modification of a trust established after September 25, 1985. According to the ruling, "At a minimum, a modification that does not affect the exempt status of a trust that is not subject to the GST tax because it was irrevocable on to September 25, 1985 should similarly not affect the inclusion ratio of a trust created after September 25, 1985." Thus, the ruling held that the same rules that apply under Regulation Section 26.2601-1(b)(4)(i) will be applied to trusts that are made exempt by allocation of a transferor's GST exemption which were established after the effective date of the GST tax.

The ruling held that the proposed modification would not shift a beneficial interest in the trust to a beneficiary that occupies a lower generation than the beneficiaries who have beneficial interests prior to the modification. It also noted that the modification does not extend the time for vesting of a beneficial interest in the trust beyond the perpetuities period provided in the original trust. Therefore, the ruling held that the proposed modification would not affect the inclusion ratio of the Exempt Trust for purposes of the GST tax.

The ruling expressed no opinion on the gift tax consequences of the proposed transaction. Nevertheless, if no estate tax inclusion would occur as a result of inclusion of the discretionary tax reimbursement provision in the trust agreement, that provision should not affect the grantor's ability to gift cash or other assets to the trust and have any such transfer treated as a completed gift for federal gift tax purposes. This result is consistent with the holdings in Revenue Ruling 76-103, 1976-1 C.B. 293, Revenue Ruling 77-378, 1977-2 C.B. 347, PLR 9837007 and PLR 9332006.

C. Income Tax Issues.

1. When "**violated**," the grantor trust rules attribute income earned by a trust and items of deduction and credits to the grantor. See I.R.C. § 671; Reg. § 1.671-2(b). In general, under § 679 of the Code a "**United States person**" (see discussion *infra*.) who directly or indirectly contributes property to a foreign trust will be treated as the owner of the portion of the foreign trust attributable to such contribution if there is a United States beneficiary of any portion of the trust. The grantor trust rules are set forth in §§ 671 through 679. For purposes

of this outline, references to a "**grantor trust**" refer to a trust that is treated as owned entirely by the grantor for income tax purposes under § 671, *et seq*. The definition of a foreign trust is set forth in § 7701(a)(30) and (31) and is discussed *infra*. Thus, in addition to the numerous ways a trust can violate the grantor trust rules under §§ 671-677, almost any foreign trust with a United States beneficiary that is established and funded by a citizen or resident of the United States will violate the grantor trust rules while the grantor is living.

2. Generally, the transfer of property to a foreign trust by a citizen or resident of the United States will be treated as a taxable sale for the fair market value of the property transferred. I.R.C. § 684(a). Nevertheless, this rule does not apply if the transfer is made to a foreign trust to the extent that the grantor-donor is treated as the owner of the trust under the grantor trust rules. I.R.C. § 684(b). In addition to the numerous ways a trust can violate the grantor trust rules, as previously mentioned, almost any foreign trust with a United States beneficiary that is established and funded by a citizen or resident of the United States will violate the grantor trust rules while the grantor is living.

The tax imposed under § 684 of the Code could also apply to a foreign trust upon cessation of grantor trust status. Grantor trust status can cease upon the death of the grantor of a trust. Nevertheless, the tax imposed under § 684 of the Code will not apply to assets in a grantor trust if such assets are includable in the estate of the grantor for estate tax purposes because "the basis of the property in the hands of the foreign trust is determined under" § 1014(a) of the Code. The assets in an incomplete gift trust should be includable in the grantor's estate for estate tax purposes at the grantor's death.

When a foreign grantor trust that is not included in the United States grantor's estate for Federal estate tax purposes ceases to be treated as a grantor trust as to its United States grantor, under § 684 the grantor-donor is "*treated as having transferred, immediately before (but on the same date that) the trust is no longer*" a grantor trust, the assets of the former grantor trust to a foreign trust. Regs. § 1.684-2(e)(1). Grantor trust status ceases at the grantor's death. Therefore, upon his death the grantor is treated as having transferred assets to a foreign trust immediately before, but on the same date that the trust ceases to be a grantor trust. Illustrating the application of this rule Example (2) of Regulation § 1.684-2(e)(2) provides in relevant part:

> On July 1, 2003, A dies, and as of that date no other person is treated as the owner of [Foreign Trust]. On that date, the fair market value of the property is 1200X, and its adjusted basis equals 350X…*A is treated as having transferred the property to* [Foreign Trust] *immediately before his death, and generally is required to recognize 850X of gain at that time*. (Emphasis supplied.)

Thus, the § 684 income tax liability generated because of a deemed transfer of assets to a foreign trust when a grantor dies is deemed to be incurred by the grantor while living and not following his death. This is important because in general § 2053 permits an estate tax deduction for the amount of claims against the estate if such claims are allowable under the laws of the jurisdiction where the estate is administered. Unpaid income taxes are deductible as a claim against an estate under § 2053 provided such taxes are attributable to income properly includible in an income tax return of a decedent for a period prior to the decedent's death. Regs. § 20.2053-6(f). Any income taxes on income received after a decedent's death

are not deductible on a decedent's estate tax return. See also Regulation § 2053-6(a) providing in relevant part "Taxes are deductible in computing a decedent's gross estate only as claims against the estate…and only to the extent not disallowed by section 2053(c)(1)(B)." Section 2053(c)(1)(B) provides in relevant part "Any income taxes on income received after the death of the decedent…shall not be deductible under this section." The legal obligation for payment of the § 684 tax is imposed on the grantor. Therefore, similar to the liability imposed on the grantor for the tax on the income of a grantor trust, payment of the § 684 tax by the grantor's estate should not constitute a taxable gift to the foreign trust even though an economic benefit is being passed to the trust and its beneficiaries.

D. Tax Compliance for a Foreign Trust.

1. Definition of Foreign Trust.

a. Section 7701(a)(31)(B) of the Code contains the definition of a "**foreign trust**" stating that it is "any trust other than a trust described in subparagraph (E) of paragraph (30)" of the same section. See also, CCA 201509035. Section 7701(a)(30) defines the term "**United States person**" and subsection (E) of such section includes in that definition any trust provided a court within the United States is able to exercise primary supervision over the administration of the trust (the "**court test**"), **and** one or more United States persons possess the authority to control **all substantial decisions** of the trust (the "**control test**"). In addition to a domestic trust, the term United States person includes a citizen or resident of the United States, a domestic partnership, a domestic corporation and any estate other than a foreign estate (as defined in § 7701(a)(31)(A) of the Code). See I.R.C. § 7701(a)(30).

b. A trust must meet both the court test and the control test to constitute a domestic trust. Reg. § 301.7701-7(a)(2). See also, CCA 201509035.

c. With limited exception a trust will fail the court test if it contains a migration provision. See Reg. § 301.7701-7(c)(4)(ii), providing:

> A court within the United States is not considered to have primary supervision over the administration of the trust if the trust instrument provides that a United States court's attempt to assert jurisdiction or otherwise supervise the administration of the trust directly or indirectly would cause the trust to migrate from the United States. However, this paragraph (c)(4)(ii) will not apply if the trust instrument provides that the trust will migrate from the United States only in the case of foreign invasion of the United States or widespread confiscation or nationalization of property in the United States.

See also, CCA 201509035.

d. Regulation § 301.7701-7(d)(ii) provides that "**substantial decisions**" are those decisions that persons are permitted or mandated to make under a trust instrument and applicable law and that are not ministerial.

i. Ministerial decisions include decisions regarding details related to bookkeeping, collection of rents, the execution of investment decisions and similar decisions. Reg. § 301.7701-7(d)(ii).

ii. According to Regulation §301.7701-7(d)(ii)(A)-(J), substantial decisions include, but are not limited to, decisions regarding:

(A) if and when to distribute income and principal and the amount of any such distribution;

(B) selecting a beneficiary;

(C) allocating receipts to income or principal;

(D) terminating a trust;

(E) compromising, arbitrating or abandoning claims for or against a trust;

(F) suing or defending suits for or against a trust;

(G) removing, adding or replacing a trustee;

(H) appointing a successor trustee to succeed a trustee who resigns, dies, or otherwise ceases to act as a trustee even though the authority to make such a decision is not accompanied by an unrestricted power to remove a trustee, unless such authority is restricted so that it cannot be exercised in a way that would alter the residency of the trust from a foreign jurisdiction to a domestic jurisdiction or from a domestic jurisdiction to a foreign jurisdiction; and

(I) making investment decisions. Nevertheless, if a United States person retains an investment advisor for a trust, investment decisions made by the advisor will be considered substantial decisions controlled by the United States person if such person can terminate the advisor's authority to make investment decisions at will.

2. Compliance Related to Foreign Trust.

a. See I.R.C. § 6048.

i. A donor-settlor of (or other transferor to) a foreign trust must report a "**reportable event**." I.R.C. § 6048(a)(1).

ii. Information required to be reported under § 6048(a) of the Code. See I.R.C. § 6048(a)(2).

iii. Under § 6048 of the Code a reportable event is:

(A) the establishment of any foreign trust by a United States person;

(B) the transfer of any funds or property to a foreign trust by a United States person;

(C) the death of a United States person who was treated as the owner of the foreign trust under the grantor trust rules (§§ 671-679 of the Code) or if any portion of the foreign trust is included in the estate of the United States person.

iv. Exceptions to reporting requirements:

(A) Transfers for fair market value.

(B) Transfers to deferred compensation arrangements under §§ 402(b), 404(a)(4) or 404A of the Code or transfers to charitable trusts described in § 501(c)(3) of the Code.

v. The "**responsible party**" must report the information required to be reported by § 6048 of the Code. Under § 6048(a)(4) of the Code the responsible party is the settlor who established an *inter vivos* foreign trust. In the case of a reportable event the responsible party is the transferor, except in the case of a transfer at death, in which case the personal representative of the transferor's estate is the responsible party.

vi. Annual reporting by the trustee of a foreign trust is also required when any United States person is treated as the owner of any portion of a foreign trust under the grantor trust rules (§§ 671-679 of the Code). I.R.C. § 6048(b)(1). The return must be filed by the trustee of the foreign trust, however, the requirement to ensure the return is filed is imposed on the settlor (or the person treated as the owner of any portion of the trust under the grantor trust rules). *Id*.

vii. Requirement that a foreign trust appoint a United States Agent. See I.R.C. § 6048(b)(2)(B). If the trust does not appoint a United States Agent, the Service may compute the tax liability of the owner of the trust under the grantor trust rules. I.R.C. § 6048(b)(2)(A).

viii. Reporting requirements of beneficiaries of a foreign trust. See I.R.C. § 6048(c).

b. A number of returns may be required to be filed by the settlor and the trustee to report transfers to a foreign trust, assets held by such a trust, distributions and/or transactions between the trust and the settlor or another beneficiary. These returns may include the following:

i. A settlor must report a transfer to his foreign asset protection trust on a Form 709 United States Gift (and Generation-Skipping Transfer) Tax Return (a "**Gift Tax Return**"). See I.R.C. § 6019. A gift tax return will need to be filed even though the gift is designed as an incomplete gift. See Reg. §§25.2511-2(j) and 25.6019-3.

ii. Form 3520. See I.R.C. § 6048.

iii. Form 3520A. I.R.C. §6048(b)(2)(B).

iv. Form 1041.

v. Form 1040*NR*. The Internal Revenue Service has intimated that it will issue a Form *1041NR* for use by foreign trusts filing United States tax returns. Nonetheless, as of the date of the last revision to this outline, the Internal Revenue Service has not published this form. When this form is published by the Internal Revenue Service it will probably be the most appropriate form for a foreign asset protection trust to file annually. As of the date of this manual, a joint project between the IRS and the AICPA Foreign Trust Task Force is currently underway to develop a Form *1041NR*. See McNamara, "New Foreign Trust Tax Form Project: 1041NR," 38 The Tax Adviser 516 (Sept. 2007). It should also be noted that the instructions to Form *1040NR* currently provide that it should be used to report the income of a foreign trust. The first page of Form *1040NR* also provides a box for the taxpayer to check indicating whether the taxpayer is an individual or an estate *or trust*.

vi. Authorization of Agent Agreement. An Authorization of Agent Agreement should be filed to notify the IRS regarding who is appointed to serve as the United States agent of the trust. The agent is appointed pursuant to this agreement, and the agreement should be filed with the IRS Service Center in Philadelphia, Pennsylvania, when the initial Form 3520 is due to be filed. The name, address, and taxpayer identification number of the United States agent must be included on Forms 3520 and 3520-A.

vii. Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts) may also be required to report certain information regarding foreign accounts held in a foreign asset protection trust. As the grantor of a foreign trust the grantor, or as discretionary beneficiaries of a foreign asset protection trust, the grantor and one or more of the other beneficiaries may be required to file this form. A United States grantor of a foreign trust that is a grantor trust under *IRC* §§671–679 and owns foreign financial accounts must file an annual Form TD F 90-22.1. A United States beneficiary of a foreign trust who has a beneficial interest in more than 50% of the assets or income of a trust that owns foreign financial accounts must file an annual Form TD F 90-22.1. Filing this form is currently required when the aggregate value of the foreign account exceeds $10,000. For this purpose, a financial account includes any bank, securities, derivatives, or other financial instruments account. This form must be filed with the Department of the Treasury by June 30 of the succeeding year in which the filer is required to report such an account. Taxpayers should also be aware that *IRC* §6038D imposes similar reporting requirements. See Weller & Gonzales, "Final Regulations on Specified Foreign Financial Asset Reporting By Domestic Entities," Steve Leimberg's International Tax Planning Newsletter #7 (Apr. 20, 2016). See also § 3 below for a further discussion of the FBAR. As discussed in § 3, the FBAR is only available electronically through the BSA E-Filing System, which allows the filer to enter the calendar year reported, including past years, on the online FinCEN Report 114.

viii. Form 8938, Statement of Specified Foreign Financial Assets, is generally required if an individual United States person (including residents, certain nonresident aliens, and residents of Puerto Rico or a United States possession) files a federal

income tax or information return with the IRS and had an interest in a foreign financial account or asset that exceeded $50,000 on the last day of the tax year or $75,000 at any point during the year. The reporting is done on Form 8938 and, commencing with returns filed in 2012, is attached to the annual return for tax years beginning after March 18, 2010. It is proposed, however, not yet required, that Form 8938 be filed by domestic corporations, partnerships, and trusts specified in regulations that have not yet been issued. The intent is to require reporting by entities that may be used by individuals to hide assets.

c. See I.R.C. § 643(h).

i. An amount paid to a U.S. person indirectly by a foreign trust through the use of an intermediary is deemed to have been paid directly by the foreign trust if the intermediary received the property from the foreign trust pursuant to a plan that had, as a principal purpose, the avoidance of U.S. tax.

ii. A principal purpose of tax avoidance is deemed to exist if the U.S. person is related to a grantor of the foreign trust, and the intermediary transfers to the U.S. person, within twenty-four (24) months before or after the transfer to the intermediary, property that the intermediary received from the trust, proceeds from the property, or other property in substitution for the property received from the trust.

iii. The Regulations state that a principal purpose of tax avoidance is deemed to exist, unless the U.S. person can demonstrate that:

1. The intermediary has a relationship with the U.S. person that establishes a reasonable basis for concluding that the intermediary would make a gratuitous transfer to the U.S. person (*i.e.*, a husband and wife);

2. The intermediary acted independently of the grantor and the trustee of the foreign trust;

3. The intermediary is not an agent of the U.S. person under generally applicable U.S. agency principles; and

4. The U.S. person timely complied with the reporting requirements of Section 6039F, if applicable, if the intermediary is a foreign person. See Reg § 1.643(h)-1(a)(2).

3. **Foreign Bank Account Reporting.**

Former Form TD F 90-22.1 has been superseded, effective September 30, 2013, by FinCEN Report 114, Report of Foreign Bank and Financial Accounts ("**FBAR**"), which requires the reporting of interests in foreign bank and financial accounts. The FBAR is only available electronically through the BSA E-Filing System, which allows the filer to enter the calendar year reported, including past years, on the online FinCEN Report 114. This electronic filing requirement was originally due to begin in July of 2012; however, it has been subject to several extensions to foster public awareness regarding the requirement to register with FinCEN, and to obtain a user ID and password from FinCEN in time to file their FBARs through the BSA E-

Filing System for the 2014 and 2015 reporting years by June 30, 2016. FinCEN Notice 2014-1 FBAR Filing Requirement–Extended Filing Date Related to Notice 2013-1 (available at www.fincen.gov/statutes_regs/guidance/pdf/FinCEN_Notice_2014-1_FBAR_Filing_Extension.pdf). If a United States person has a financial interest in or signature authority over a foreign financial account, including a bank account, brokerage account, mutual fund, trust, or other type of foreign financial account exceeding certain thresholds (discussed below), that person may be required to file an FBAR. For this purpose, a financial account includes any bank, securities, derivatives, or other financial instruments account. Before the e-filing mandate, United States persons could file an FBAR by mailing in the paper form to the Department of the Treasury in Detroit, Michigan. See Instructions to Form TD F 90-22.1.

Nevertheless, the Treasury Regulations and the instructions to the FBAR provide great detail with respect to specific situations. In accordance with Section 7701(a)(30) of the Internal Revenue Code a US person is:

1. a citizen or resident of the United States,
2. a domestic partnership,
3. a domestic corporation,
4. any estate (other than a foreign estate (the term "**foreign estate**" is defined in paragraph (31) of Section 7701(a) of the Internal Revenue Code.)), and
5. a trust if a court within the United States can exercise primary supervision over the administration of the trust (referred to as the "**court test**." See also Treasury Regulation § 301.7701-7(c)(4)(ii)), and one or more U.S. persons have the authority to control all substantial decisions of the trust. (The definition of "**substantial decisions**" is set forth in Treasury Regulation § 301.7701-7(d).)

For tax year 2015, the FBAR must be filed by June 30th of the succeeding year (that is, June 30, 2016) with the Department of the Treasury in Detroit, Michigan. However, beginning with tax year 2016, the due date of the FBAR will be April 15th with a maximum extension for a six (6)-month period ending on October 15th. H.R. 3236, Sec. 2006(b)(11). Public Law No.: 114-41 became public law on July 31, 2015, affecting taxable years after December 31, 2015. The new law allows for an extension under rules similar to the rules in Treas. Reg. § 1.6081-5. Also, for any taxpayer required to file the FBAR for the first time, any penalty for failure to timely request for, or file, an extension, may be waived by the Secretary. Therefore, for tax year 2016, the due date of the FBAR will be April 15th of the succeeding year (that is, April 15, 2017). At present, the IRS has not announced details related to any extension. The instructions state that forms filed in paper format will be returned unfiled and this change in policy may preclude the ability of taxpayers to do a quiet (or noisy) disclosure of his or her foreign accounts by filing past year returns. It will also require taxpayers to do the work for the government by registering with FINCEN and inputting their foreign financial information directly into the governmental database in electronic form, making it vastly easier to assimilate and utilize. (Instructions to Form TD F 90-22.1, p.6.) US persons are required to file an FBAR if (a) the U.S. person had a financial interest in or signature authority over at least one financial account located outside of the United States; and (b) the aggregate value of all foreign financial accounts exceeded $10,000 at *any time* during the calendar year to be reported. (31 CFR §§

1010.350(a) and 1010.306(c).) Filing exceptions exist for certain foreign financial accounts jointly owned by spouses, U.S. persons included in a consolidated FBAR, correspondent/*nostro* accounts (*i.e*, an account at a foreign bank in which a domestic bank keeps a reserve of foreign currency), foreign financial accounts owned by a governmental entity, foreign financial accounts owned by a international financial institution, Individual Retirement Account owners and beneficiaries, participants in and beneficiaries of tax-qualified retirement plans, certain individuals with signature authority over, however, no financial interest in a foreign financial account, trust beneficiaries (however only if a US person reports the account on an FBAR filed on behalf of the trust), and foreign financial accounts maintained on a US military banking facility. 31 CFR § 1010.350. Failure to properly file a complete and correct FBAR may subject you to a civil penalty of up to $10,000 per violation for violations that are not due to reasonable cause. 31 USC § 5321(a)(5)(B). (One has to wonder how many wealthy individuals who are valued taxpayers will choose to expatriate rather than become subject to such intrusive rules.) For an excellent discussion of the new FinCen Form 114 see Gopman, Morgan & Simmons, "Electronic Filing Requirement for FBAR," LISI Income Tax Planning Newsletter #52 (August 29, 2013) at http://www.leimbergservices.com. See also, Bowers, "U.S. Tax Reporting Obligations of Foreign Trusts," 39 Estates, Gifts and Trusts Journal 136 (May-June 2014).

The grantor of a foreign asset protection trust must file an FBAR annually to report any foreign financial accounts held in the trust. 31 CFR §§ 1010.350(a) and (e)(2)(iii). Furthermore, a US beneficiary of a foreign asset protection trust who has a beneficial interest in more than fifty percent (50%) of the assets or income of a trust that owns foreign financial accounts must file an annual FBAR. 31 CFR §§ 1010.350(a) and (e)(2)(iv). A US beneficiary of a foreign grantor trust is not required to file an FBAR if the trust, trustee of the trust, or agent of the trust is a US person that files an FBAR. 31 CFR 1010.350(g)(5).

Failure to properly file a complete and correct FBAR may subject a taxpayer to a civil penalty of up to $10,000 per violation for violations that are not due to reasonable cause. 31 USC § 5321(a)(5)(B). Where a person willfully violates or willfully causes any violation of 31 USC § 5314, the maximum penalty is increased to the greater of $100,000 or fifty percent (50%) of the amount determined under 31 USC § 5314(D). 31 USC § 5321(a)(5)(C). A person who willfully violates the FBAR reporting requirements may also be prosecuted criminally and upon conviction, fined up to $250,000, imprisoned for not more than five (5) years, or both. 31 USC § 5322(a). A civil monetary penalty may be imposed notwithstanding the fact that a criminal penalty is imposed for the same FBAR reporting violation. 31 USC § 5321(d).

For an excellent discussion of penalities related to failure to file FBARs see Rubin, "IRS Telegraphs What It Expects Will Be "Normal" FBAR Failure To File Penalties," LISI Asset Protection Planning Newsletter #300, (June 24, 2015).

4. **Foreign Account Tax Compliance Act.**

Enacted in 2010 as part of the Hiring Incentives to Restore Employment Act ("**HIRE**"), Pub.L.No. 111-147, 124 Stat. 71, the Foreign Account Tax Compliance Act ("**FATCA**") (see §§ 1471 and 1472 of Code of 1986) seeks to prevent US taxpayers from evading tax by hiding wealth in foreign financial accounts. FATCA requires foreign financial institutions ("**FFIs**") to report to the Service certain information about financial accounts owned by US taxpayers or by foreign entities in which US taxpayers have substantial ownership interests. See I.R.C. § 1471. Foreign entities that are not financial institutions are non-financial foreign entities ("**NFFEs**") and must identify United States persons substantial ownership interests, if any, to avoid FATCA withholding. See I.R.C. § 1472.

If an FFI fails to comply with the requirements imposed by FATCA, a thirty percent (30%) withholding tax is applied on any "**withholdable payment**" made to the FFI unless the United States withholding agent can reasonably rely on documentation that the payment is exempt from withholding. I.R.C. § 1471(a); Regs. § 1.1471-2T(a)(1). A withholdable payment means a payment of US source fixed or determinable annual or periodical income and gross proceeds from sale of property which can produce US source interest or dividends. I.R.C. § 1473(1). FATCA withholding applies regardless of whether the FFI receives a withholdable payment as a qualified intermediary or beneficial owner. Regs. § 1.1471-2T(a)(1).

A foreign entity will be an FFI if it comes within one or more of the categories of FFI contained in the Regulations under FATCA. Regs. § 1.1471-5(d). In the case of an entity that is resident in a jurisdiction that has in effect a Model 1 or Model 2 Intergovernmental Agreement ("**IGA**") with the US, that entity is treated as an FFI according to the Model 1 or Model 2 IGA and has reporting alternatives and modified withholding obligations. *Id.*

In the context of an offshore trust an FFI includes an investment entity that (1) "**primarily conducts as a business**" specified activities "**for or on behalf of a customer**" (see Regs. § 1.1471-5(e)(4)(i)(A)); (2) whose gross income is "**primarily attributable**" to specified investment activities and that is "**managed by**" an FFI (see Regs. § 1.1471-5(e)(4)(i)(B)); and (3) a collective investment vehicle or one of several different types of funds (see Regs. § 1.1471-5(e)(4)(i)(C)). Specified activities that can trigger FFI status include financial trading and portfolio management activities, and "**otherwise investing, administering, or managing funds, money, or financial assets on behalf of other persons**." Regs. § 1.1471-5(e)(4)(i)(A)(1)-(3).

Most corporate trustees will be classified as investment entity FFIs because trustees manage and administer the funds or money, or financial assets of a trust according to the mandates in such trusts. Regs. § 1.1471-5(e)(4)(i)(A). The Final Treasury Regulations provide examples that demonstrate the Service considers a trust with primarily investment income that is professionally managed by a corporate trustee to be an investment entity. Regs. § 1.1471-5(e)(4)(v), Ex. 6. A trust primarily has investment income if its gross income attributable to investing, reinvesting, or trading in financial assets equals or exceeds fifty percent (50%) of its gross income during the stated period. Regs. § 1.1471-5(e)(4)(iv). The definition of an investment entity in the Model IGA does not require the entity to primarily have investment income. See Article 1, Subparagraph (j) of the *Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA* (available at www.treasury.gov/press-center/press-releases/Documents/reciprocal.pdf).

A trust is "**professionally managed**" if the managing entity performs, directly or through a third party, any financial trading, portfolio management, or "**otherwise investing, administering, or managing funds, money, or financial assets on the trust's behalf**." Regs. § 1.1471-5(e)(4)(i)(B). This "**professionally managed**" test can be satisfied for either the trust itself or the trust's assets. Regs. § 1.1471-5(e)(4)(iv), Ex. 5 and Ex. 6. Trusts with individual trustees and individual asset managers are not FFIs. Regs. § 1.1471-5(e)(4)(iv), Ex. 5. Under an IGA, however, not under the Regulations, the "**professionally managed**" test can be satisfied although the trust's assets are managed by a US investment management firm because the managing entity need not be a non-US financial institution. See *Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA*, *supra*.

If an entity is classified as an FFI, it must meet the reporting requirements under FATCA to avoid withholding. I.R.C. § 1471(b). An FFI can meet the reporting requirements by entering into an agreement with the Service to become a participating FFI and provide the required information. *Id.* Generally, a participating FFI must:

- identify US accounts it maintains in accordance with certain verification and due diligence procedures;
- report certain information to the Service regarding the US accounts and accounts held by a US person who is unwilling to provide the required information (recalcitrant account holder); and
- deduct a withholding tax on any payment of US source income by the FFI to a recalcitrant account holder or nonparticipating FFI. I.R.C. § 1471(b); Regs. §§ 1.1471-4(a) and 1.1471-4T(a).

Additionally, an FFI can avoid withholding if it is treated as a deemed-compliant FFI. I.R.C. § 1471(b)(2); Regs. § 1471-5(f). A trust can become a registered deemed-compliant FFI if the trustee, which is also an FFI, agrees to sponsor the trust. Regs. § 1.1471-5(f)(1)(i)(F). As the trust's sponsoring FFI, the trustee handles the reporting obligations for the trust. *Id.* A trust that is not resident in a FATCA partner jurisdiction can also avoid withholding by becoming a certified deemed-compliant FFI. Regs. §§ 1.1471-5(f)(2)(iii) and 1.1471-5(f)(3). For example, an owner-documented trust must identify both US and non-US beneficiaries to the "**designated withholding agent**" that in turn reports the information about the US beneficiaries to the Service. Regs. § 1.1471-3(d)(6)(iv). To certify its status to the withholding agent, the trust can either provide an owner's report or obtain an auditor's letter from an auditor or US licensed attorney certifying the trust qualifies as an owner-documented FFI. Regs. § 1.1471-3(d)(6)(ii).

Trusts resident in a jurisdiction that has in effect a Model 1 or Model 2 IGA with the US are treated as FFIs pursuant to the Model IGAs. See *Model Intergovernmental Agreement to Improve Tax Compliance and to Implement FATCA*, *supra*. Under a Model 1 IGA FFIs are treated as registered deemed compliant FFIs and report to the tax authorities in the partner jurisdiction instead of the Service. See *e.g.*, Model 1 IGA, Article 4, para. 1. A Model 1 IGA also alters the reporting requirements and eliminates the withholding responsibilities of financial institutions resident in that jurisdiction. Model 1 IGA, Article 4, para. 1(e). Financial institutions resident in a Model 2 IGA jurisdiction must enter agreements with the Service to become participating FFIs as described above.

If the non-US trust does not fall within the definition of an FFI, it will be an NFFE. I.R.C. § 1472(d). If an NFFE is the beneficial owner of a withholdable payment, it must report certain information to the withholding agent. I.R.C. § 1472(b); Regs. §§ 1.1472-1; and 1.1472-1T. An NFFE meets this reporting requirement if the NFFE provides identifying information for each of its substantial US owners or certifies that it has no such owners. A substantial US owner is in the case of a trust, a US person treated as an owner of any portion of the trust under the grantor trust rules (see I.R.C. §§ 671-679) and any US person holding more than ten percent (10%) of the beneficial interests. I.R.C. § 1473(2); Regs. § 1.1473-1(b).

If the NFFE fails to meet the reporting requirement, the withholding agent must deduct and withhold thirty percent (30%) from the withholdable payment. I.R.C. § 1472(a). However, a withholding agent is not required to withhold on a payment treated as beneficially owned by an excepted NFFE. I.R.C. § 1472(c). An excepted NFFE includes an Active NFFE, meaning any NFFE if less than fifty percent (50%) of its gross income for the preceding tax year is passive income, and less than fifty percent (50%) of its assets produce or are held for the production of interest, dividends, rents or royalties (other than those derived in the active conduct of a trade or business), annuities, or other passive income. Regs. § 1.1472-1T(c)(1)(iv).

XXXVI. Third Party (Non-Self Settled) Trusts.

A. Spendthrift Trusts.

1. Florida Common Law

a. Notwithstanding the enactment of the new Florida Trust Code (the "FTC"), which became effective on July 1, 2007, like most other states, Florida common law already recognizes the validity of a spendthrift provision in a trust when the trust is created and funded by one individual for the benefit of one or more other individuals. See *Waterbury v. Munn*, 32 So. 2d 603 (Fla. 1947); *Preston v. City Nat'l Bank of Miami*, 294 So. 2d 11 (Fla. 3d DCA 1974); *Croom v. Ocala Plumbing and Electric Co.*, 57 So. 243 (Fla. 1911). In Florida, a spendthrift trust is defined as a trust created and funded by one individual for the benefit of another. See *Waterbury v. Munn*, 32 So. 2d 603 (Fla. 1947) ("A spendthrift trust is one that is created with the view of providing a fund for the maintenance of another."); *Preston v. City Nat'l Bank of Miami*, 294 So. 2d 11 (Fla. 3d DCA 1974); *Croom v. Ocala Plumbing and Electric Co.*, 57 So. 243 (Fla. 1911) ("…those trusts that are created with a view of providing a fund for the maintenance of another, and at the same time securing it against his own improvidence or incapacity for self-protection….").

b. The general rule in Florida is that the interest of a beneficiary under a trust, including the right to income from the corpus of the trust, is alienable by the beneficiary. *Goldman v. Mandell*, 403 So. 2d 511 (Fla. 5th D.C.A. 1981). Additionally, the interest of a beneficiary is liable to be taken in satisfaction of his or her debts and obligations. *Bradshaw v. American Advent Christian Home & Orphanage*, 199 So. 329 (Fla. 1970) (where trust provides income is to be applied for the use of the *cestui que* trust, equity may direct the application of the income to the payment of his debt); *Preston v. City National Bank of Miami*, 294 So. 2d 11 (Fla. 3d D.C.A. 1974); *Croom v. Ocala Plumbing and Electric Co.*, 57 So. 243 (Fla. 1911) (where one has an interest in property that he may alienate or assign, that interest,

whether legal or equitable, is liable for the payment of his debts). Failure to include a spendthrift provision in a trust in Florida could enable a beneficiary's creditor to attach the beneficiary's interest in the trust. *Bradshaw v. American Advent Christian Home & Orphanage*, 199 So. 329 (Fla. 1941); *Preston v. City Nat'l Bank of Miami*, 294 So.2d 11 (Fla. 3d D.C.A. 1974).

c. Although the import of a spendthrift trust is to restrain alienation by a beneficiary of his or her interest in such trust, at least one court has upheld a trust as a spendthrift trust even though it allowed transfers of interests among family members. *Mason v. Mason*, 798 So.2d 895, 897 (Fla. 5th DCA 2001).

d. A limited exception existed in Florida prior to the adoption of the FTC that permitted a creditor to reach the assets of spendthrift trust to satisfy alimony (and in *dicta*, child support) obligations. See *Bacardi v. White*, 463 So.2d 218 (Fla. 1985); *Southeast Bank of Sarasota v. Stone*, 500 So.2d 737 (Fla. 1st D.C.A. 1987).

2. New Florida Trust Code - Part V Creditors' Claims

a. In 2006, Florida adopted a modified version of the UTC that became effective on July 1, 2007. In preparing the text of the legislation, the Florida *Ad Hoc* Trust Code Revision Committee (the "**Committee**") used the UTC as the basis for trust law where trust law codification did not already exist. However, where Florida case law was contrary to a position in the UTC, where the Committee elected a different policy conclusion, or where the Committee wanted to avoid provisions that had proved controversial among the fifteen (15) states where the UTC had already been enacted, the Committee drafted its own provisions for the FTC.

b. The FTC maintains the basic rule regarding a creditor's right to attach a debtor-beneficiary's interest in a trust, that is, if a beneficiary's interest is not subject to a spendthrift provision, the court may authorize a creditor or assignee to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or by other means. F.S. § 736.0501 (2007).

c. The FTC specifically recognizes spendthrift trusts. F.S. § 736.0502(1) (2007). Pursuant to the FTC, a spendthrift provision is valid only if the provision restrains both voluntary and involuntary transfer of a beneficiary's interest. There is no required statutory language to create a spendthrift trust. A term of a trust that provides that the interest of a beneficiary is held subject to a spendthrift trust, or words of similar import will sufficiently restrain both voluntary and involuntary transfers of a beneficiary's interest. F.S. § 736.0502(2) (2007).

d. A beneficiary may not transfer an interest in a spendthrift trust, and, generally, a creditor or assignee of a beneficiary may not reach an interest or a distribution by a trustee before receipt of such interest by the beneficiary. F.S. § 736.0502(3) (2007). Unlike Florida common law, the FTC does not permit any exception to the restraint on alienation, including transfers among family members. See *e.g.*, *Mason v. Mason*, 798 So.2d at 897. The new spendthrift rule only applies to spendthrift trusts created after July 1, 2007, the

effective date of the FTC, because this complete restraint on alienation of an interest in a trust is mandatory and is a change from Florida common law. F.S. § 736.0502(1) (2007).

e. Florida Statutes § 736.0503(2) provides that a limited group of creditors ("**exception creditors**") may attach a beneficiary's interest in a spendthrift trust. These exception creditors were determined based on a review of existing case law in Florida and by the Committee. A spendthrift provision is unenforceable against the following creditors:

f. A beneficiary's child (that is, any person for whom an order or judgment for child support has been entered in Florida or any other state), spouse or former spouse who has a judgment or court order against the beneficiary for support or maintenance. This follows the holding of the *Bacardi* case, where the Florida Supreme Court concluded that an ex-wife of a beneficiary may garnish the beneficiary's interest in a spendthrift trust to pay alimony owed her under a divorce agreement. Note that the court limited the ex-wife's right of garnishment to any trust disbursements actually made from the trust or nondiscretionary trust disbursements due to the ex-husband as a beneficiary. *Bacardi v. White*, 463 So. 2d at 222. The ex-wife had no right to demand that the trustee make a distribution because the trust was a wholly-discretionary trust.

i. A judgment creditor who has provided services for the protection of a beneficiary's interest in the spendthrift trust (*e.g.*, an attorney who assisted a beneficiary in dealing with a matter related to the beneficiary's interest in the spendthrift trust).

ii. A claim of the state of Florida or the United States to the extent legally permissible. These two super creditors can immediately proceed against a spendthrift trust to settle claims.

g. The remedy available to the above exception creditors (other than the state of Florida or the United States) applies only as a last resort upon an initial showing that traditional methods of enforcing claims are insufficient. F.S. § 736.0503(3) (2007). Again, this limitation placed on these certain exception creditors comports with the ruling in *Bacardi*, although the *Bacardi* case only dealt with spousal (and, in *dicta*, child) support. More importantly, the *Bacardi* court only authorized this "enforcement alternative" against spendthrift trusts as a last resort when the traditional remedies were not effective. 463 So. 2d at 222. It may be that an "initial showing," as required by the FTC, that traditional methods are inadequate is a considerably easier burden for an exception creditor to overcome. This change is a compromise between public policy favoring spendthrift trusts and the administrative obstacles a creditor would otherwise have to face in proving the last resort element espoused in *Bacardi*.

h. An exception creditor stands in an analogous position to a spendthrift trust as a general creditor does to a non-spendthrift trust. Thus, an exception creditor may attach *present or future distributions to or for the benefit of* the debtor-beneficiary. Compare F.S. § 736.0503(3) (2007) with F.S. § 736.0501 (2007).

i. If a beneficiary has a right to mandatory distributions of income or principal, a creditor or assignee may attach such beneficial interest if the trustee has not made the required distribution in a reasonable time, regardless of whether a trust contains a spendthrift provision. F.S. § 736.0506(2) (2007). This provision of the FTC allows a creditor to overcome an uncooperative trustee who would choose to aid a likeminded beneficiary-debtor by refraining from making a required distribution.

j. **Practice Note**: If protecting trust assets from a beneficiary's creditors is the settlor's primary concern, a trust should not mandate any distributions, whether as a right to income (except when required for other reasons such as to allow a trust to qualify for a marital deduction for estate or gift tax purposes) or a right to principal. Frequently, trusts are drafted requiring distributions of all or a portion of trust corpus upon the beneficiary attaining a certain age (*e.g.*, age 30, 35 or 40). From a creditor protection perspective, such a provision is not advisable. See XXI.B., below. Further, trusts should be drafted to last for the longest period permitted under the applicable rule against perpetuities (in Florida, currently 360 years pursuant to F.S. § 689.225), since a distribution received upon termination of a trust is reachable by a creditor or assignee.

3. Florida Case Law

a. In *Miller v. Kresser*, 34 So. 3d 172 (4th Fla. Dist. Ct. App. 2010), the Florida 4th District Court of Appeals overturned a controversial trial court decision which allowed a creditor to pierce a third party spendthrift trust. In the case the plaintiff ("Plaintiff") obtained a judgment against the defendant ("Beneficiary") and Castles Construction and Development, LLC ("Castles Construction") on June 21, 2007 for slightly more than $1,000,000. The judgment related to a business deal involving Plaintiff, Beneficiary and Castles Construction. In April 2004, Beneficiary's mother ("Mother") established a trust (the "Spendthrift Trust") for the benefit of Beneficiary. Mother designated Beneficiary's brother ("Brother") sole trustee of the Spendthrift Trust. The Spendthrift Trust vested Trustee with absolute discretion to make distributions for Beneficiary and Beneficiary's "qualified spouse." (Subsequent to the execution of the Spendthrift Trust, Beneficiary divorced his wife and, thus, became the only current beneficiary of the Spendthrift Trust because his former wife no longer qualified as his qualified spouse under the terms of the Spendthrift Trust). The Spendthrift Trust included a spendthrift provision. It also granted the Trustee full discretion to terminate the trust and distribute the entire corpus to the beneficiaries for any reason whatsoever. The spendthrift provision in the Spendthrift Trust provided:

> The right of any person to receive any amount, whether of income or principal, pursuant to any of the provisions of this agreement, shall not, in any manner, be anticipated, alienated, assigned or encumbered, and shall not be subject to any legal process or bankruptcy or insolvency proceeding or to interference or control by creditors or others.

The termination provision in the Spendthrift Trust provides in pertinent part:

> In granting the trustee discretion over the payment of the income and principal of the trusts under this agreement, it is the settlor's intention

> that the independent trustee . . . shall have complete discretion to terminate any trust by distributing the entire principal to the beneficiary or beneficiaries eligible to receive distributions from such trust (and if more than one, in equal or unequal shares and to the exclusion of any one or more of them) without further accountability to anyone if the independent trustee determines that continuation of such trust is inadvisable in view of the size of the trust or for any other reason.

Mother transferred a one-third interest in a home located in the Florida Keys (the "**Keys Home**") to the Spendthrift Trust. Mother also transferred a one-third interest in the same residence to a trust for Brother and retained a one-third interest in the property in her own name. The Keys Home was valued at over $1,000,000 when Mother made these gifts. The Spendthrift Trust also held a one-half interest in an LLC which owns an office building and former funeral home, and a one-third interest in another LLC which owns five acres of unencumbered vacant property and another vacant lot.

Prior to establishing the Spendthrift Trust, Mother created her own revocable trust. This trust included provisions that provided for outright distributions to Brother and Beneficiary upon Mother's death. (The court mistakenly referred to this trust as a "testamentary trust," however, the record indicates it was Mother's *inter vivos* revocable trust agreement.) Shortly following entry of the final judgment by the trial court in favor of Plaintiff, Mother modified her revocable trust agreement by eliminating the outright gift to Beneficiary and replacing it with a pour-over gift directly to the Spendthrift Trust. Mother died less than three months later.

Plaintiff was unsuccessful in his attempts to collect any portion of his judgment from Beneficiary or Castles Construction. Thus, Plaintiff commenced proceedings supplementary against Beneficiary and Castles Construction and impleaded Brother as trustee of the Spendthrift Trust. Plaintiff argued that he was entitled to foreclose on the assets held in the Spendthrift Trust to satisfy his judgment because Beneficiary exercised significant authority and control over the trust assets and substantial influence over Brother. Plaintiff also recorded a *lis pendens* against the Keys Home.

While the post judgment proceedings were pending, the Keys Home was sold. The Spendthrift Trust received its one-third share of the sale proceeds. After the sale, $168,000 of the Spendthrift Trust's share of the proceeds were disbursed to various entities, including Beneficiary's law practice. Beneficiary testified that the distributions were loans and produced copies of promissory notes at trial although Brother testified that he was unaware they were loans, and Beneficiary held the original promissory notes.

The trial court conducted a non-jury trial during the post judgment proceedings to determine if the spendthrift provision could be invalidated. Although the trial court determined that the spendthrift provision in the Spendthrift Trust was valid when created, it ultimately held that the spendthrift provision and discretionary aspects of the Spendthrift Trust were invalid because of the degree of control Beneficiary exercised over the trust assets and over Brother as the trustee. Consequently, the trial court held that the Spendthrift Trust could be pierced by Plaintiff to satisfy his judgment.

The trial court determined that Brother had nearly relinquished all management of the day-to-day operations of the Spendthrift Trust to Beneficiary. It noted that Beneficiary seemed to exercise authority over all important decisions concerning the trust assets, including investment decisions, and Beneficiary possessed and kept control over the checkbook for the Spendthrift Trust. For example, when Beneficiary requested Brother as the trustee form an LLC and execute a note and mortgage for $1,400,000, Brother did so without any investigation or analysis. The trial court order found that Brother appeared to never conduct his own independent investigation of any major decisions involving the Spendthrift Trust, and made no independent determination if such decisions were in the best interest of the Spendthrift Trust.

The trial court summarized that Brother had limited knowledge of trust assets and was merely a puppet of Beneficiary and "rubber-stamped" Beneficiary's decisions. According to the trial court Brother "knows little about the Trust, has limited knowledge regarding what assets it own and …serves as the legal veneer to disguise [Beneficiary's] exclusive dominion and control of the Trust assets." As a result of the foregoing, the trial court held that while title to the assets may have been in the Spendthrift Trust, Trustee, "by giving [Beneficiary] complete access to, as well as dominion and control over the Trust's assets, has effectively turned over to Beneficiary all of the assets of the Trust . . . thereby subjecting the Trust's assets to execution."

Citing a number of Florida cases for authority as well as the Restatement (Second) of Trusts (Sec. 153(2)), the trial court held that a beneficiary who is entitled to have the principal of a trust conveyed to himself at his direction, essentially has dominion and control of the trust assets; as such, any purported restraint on his right to voluntarily or involuntarily transfer his interest in the principal should not be enforced.

The appellate court in *Miller* relied on a distinction between express powers in a trust and implied powers. The court recognized that Florida's common law recognizes the validity of spendthrift trusts. However, the court noted that other courts have invalidated spendthrift provisions where a trust provides a beneficiary with express control to demand distributions or to terminate the trust and to acquire the trust assets. According to the appellate court:

> If the trust allows the beneficiary to control all of the trust assets by terminating the trust or demanding distribution of the entire trust corpus, a court will allow the beneficiary's creditor to reach the entire trust corpus . . . . Likewise, if the trust allows for the beneficiary to demand a distribution of only a portion of the trust property, the courts have allowed a creditor to attach that portion over with the beneficiary has express control.

The court noted, however, that the Spendthrift Trust did not give Beneficiary any express control over the trust principal or distributions. While the appellate court agreed with the trial court that "the facts in this case are perhaps the most egregious example of a trustee abdicating his responsibilities to manage and distribute trust property, the law requires that the focus must be on the terms of the trust . . . . [and] The trust did not give [Beneficiary] any authority whatsoever to manage or distribute trust property."

Focusing exclusively on the terms of the Spendthrift Trust in *Miller* allowed the Florida appellate court to rule that although the trust beneficiaries may have a cause of action against Brother as the trustee, the Spendthrift Trust could not be pierced by the creditor. While it is nice to see that even in the most "egregious" case imaginable, the court found a spendthrift trust cannot be violated, as noted herein, it seems getting that close to the edge proved dangerous and expensive for this family.

For cases similar to *Miller* see also *Henkel v. The Bros. Mill Ltd. (In Re Eddy)*, 2015 WL 1585513 (Bankr. M.D. Fla. April 3, 2015); *United States v. Sullivan*, 2016 WL 1626622 (N.D. Ill., April 21,2016); *Bash v. Sydney Jackson Williams, Jr. Irrevocable Trust*, 2016 WL 1592445 (Bankr. N.D. Ohio, April 20, 2016); *Wilshire Credit Corp. v. Karlin*, 988 F.Supp. 570 (D. Md. 1997) and *S.E.C. v. Greenberg*, 105 F.Supp.3d 1342 (S.D. Fla. 2015). Nonetheless, the court in *Bash v. Sydney Jackson Williams, Jr. Irrevocable Trust* noted:

> On the other hand, nearly every court to have addressed the issue outside of Florida has concluded that alter ego liability should apply to trusts to the same it extent it applies to other legally created fictions. *See*, *Smith v. S.E.C.,* 432 Fed. Appx. 10 (2nd Cir. Aug. 8, 2011) ("we assumed that New York courts would allow the veil of a trust to be pierced in situations where the complete domination of a trust has been shown" and the moving party can show fraud or another wrong was committed); *In re Schwarzkopf,* 626 F.3d 1032 (9th Cir. 2010)("It is well-settled [under California law] that a trust created for the purpose of defrauding creditors or other persons is illegal and may be disregarded."); *Vaughn v. Sexton,* 975 F.2d 498 (8th Cir. 1992)("the concept of personal liability for the obligations of an entity considered to be an alter ego of an individual is frequently employed in relation to corporations...[and] we see no reason why the alter ego concept should not have the same effect in the case of a trust."); *Acheff v. Lazare*, 2014 WL 894491 (D. New Mex. Jan. 29, 2014)("Under New Mexico law, the Delos Trust is Mr. Edelman's alter ego and the trust veil should be disregarded..."); *Dexia Credit Local v. Rogan*, 2008 WL 4543013 (N.D. Ill. Oct. 9, 2008)("To pierce the veil of the trusts, Dexia must show that they and Rogan have such unity of interest that their separate personalities no longer exist, and that there are circumstances such that continuing to recognize their separateness would sanction a fraud or injustice."); *In re Gillespie,* 269 B.R. 383 (Bankr. E.D. Ark. 2001) (although alter ego doctrine is most often applied to corporations, "it also applies to trusts."); *Bracken v. Early*, 40 S.W.3d 499 (2000) (Ct. App. Tenn. 2000) ("The Trial Judge, in effect, found that defendant is the 'alter ego' of the trust, and we agree under all the circumstances the defendant is liable to the plaintiff for the monies received.") *William L. Comer Equity Trust v. United States*, 732 F.Supp. 755 (E.D. Mich. 1990)("[w]hile the Court uncovered no precedent analyzing the 'alter ego' theory of property ownership in the context of a trust, cases involving corporate entities provide appropriate guidance."). Tax law is in accord. *See, e.g. United States v. Lena,* 2008 WL 2774375 (S.D. Fla. June 11, 2008) ("Because the ultimate concern does not lie in the structure itself, but whether a person may hide behind a structure that is no more than the individual's alter ego, the Court finds there is no need to distinguish between a corporation and a trust."); *United States v. Dornbrock*, 2008 WL 769056 (S.D Fla. Jan. 17, 2008) ("the alter ego doctrine

> focuses on whether the taxpayer is similar to or controls another individual, trust, business, or corporation"); *United States v. Bahrs*, 2006 WL 2507574 (N.D. Fla. Aug. 29, 2006) ("there is an abundance of evidence to suggest that the trusts...were nothing more than shells set up to avoid both payment and collection of taxes").

4. Uniform Trust Code (the "UTC")

a. Section 501 of the UTC provides the same basic creditor right over trusts:

> To the extent a beneficiary's interest is not protected by a spendthrift provision, the court may authorize a creditor or assignee of the beneficiary to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means. The court may limit the award to such relief as is appropriate under the circumstances.

b. Recognizing the validity of a spendthrift trust, Section 502 of the UTC provides:

> (a) A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest. (b) A term of a trust providing that the interest of a beneficiary is held subject to a "spendthrift trust," or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest. (c) A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this [article], a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.

c. Limiting the protection given by a spendthrift provision under limited circumstances, Section 503 of the UTC provides:

> (a) In this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another State. (b) Even if a trust contains a spendthrift provision, a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance, or a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust, may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary. (c) A spendthrift provision is unenforceable against a claim of this State or the United States to the extent a statute of this State or federal law so provides.

5. Restatement of Trusts

a. Section 56 of the Restatement (Third) of Trusts provides in relevant part:

> creditors of a trust beneficiary, or of a deceased beneficiary's estate, can subject the interest of the beneficiary to the satisfaction of their claims, except insofar as a corresponding legal interest is exempt from creditors' claims.

b. Section 58 of the Restatement (Third) of Trusts provides in relevant part:

> (1) . . . if the terms of a trust provide that a beneficial interest may not be transferable by the beneficiary or subject to claims of the beneficiary's creditors, the restraint on voluntary and involuntary alienation of the interest is valid. (2) A restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid.

6. Other Case Law

a. In *Sligh v. First National Bank of Holmes County*, 704 So.2d 1020 (Miss 1997), the plaintiff ("P") was involved in an automobile accident with the defendant ("D"). D was driving his automobile while intoxicated. P sustained catastrophic injuries in the accident, including a broken spine, paralysis in both legs, loss of all sexual functions and his ability to control bowel and urinary functions. D was convicted in a criminal proceeding as a result of the accident and incarcerated. Following the accident P sued D for gross negligence resulting in personal injury, property damage and loss of consortium. D did not respond to P's complaint and a default judgment was entered against D in the amount of $5,000,000 ($2,000,000 in actual damages, $750,000 in punitive damages and $1,500,000 in actual damages and $750,000 in punitive damages for P's spouse.

D had no assets to satisfy the judgment. He was, however, the beneficiary of two spendthrift trusts established by his mother before her death. Each trust had an independent bank serving as its trustee, that is, First National Bank of Holmes County. Each trust contained the following provisions:

> 1. My said Trustee shall have full and complete authority to expend all or any part of the income or corpus of said trust property for the benefit of myself and my said son, Gene Lorance [that is, P], and shall have the right to make payments directly to me and to my said son or to anyone for myself or my said son.
>
> 2. The Trustee shall have the right to invest, re-invest, manage and care for said property in the same manner as though said property was the individual property of said Trustee, and my said Trustee shall not be required to give bond, or account to the Court, and shall have all the

> powers conferred by the Uniform Trustees' Powers Act as the same is now in force in the State of Mississippi and the power to sell, lease or encumber real property. My said Trustee shall exercise the powers herein granted for what may be, in the discretion of my said Trustee, in the best interest of myself and said Gene Lorance, and shall pay to me or the said Gene Lorance such sums and at such times as my said Trustee thinks in my or his best interest. No part of this trust, either principal or income, shall be liable for the debts of the said Gene Lorance, nor shall the same be subject to seizure by any creditor of his and he shall not have the right to sell, assign, transfer, encumber or in any manner anticipate or dispose of his interest in said property, or any part of same, or the income produced from said trust or any part thereof.

D was the life beneficiary of each trust. Each trust had two individuals (not D) who were the designated remainder beneficiaries.

P attempted to convince the court that it was appropriate to issue a writ of garnishment against the two spendthrift trusts by alleging:

> Lorance's mother, Edith Lorance, had actual knowledge of the following facts: her son was an habitual drunkard who had been unsuccessfully treated for alcoholism; he was mentally deficient and had been previously committed to mental institutions; he had impaired facilities due to his alcoholism and mental disorders; he regularly operated motor vehicles while intoxicated; he was a reckless driver who had been involved in numerous automobile accidents; and he had been arrested and convicted on numerous occasions for driving under the influence. The complaint alleged that despite her actual knowledge of these facts, Mrs. Lorance established the two trusts as part of her intentional plan and design to enable her son to continue to lead his intemperate, debauched, wanton and depraved lifestyle while at the same time shielding his beneficial interests in the trusts from the claims of his involuntary tort creditors. The Slighs alleged that it was a violation of public policy to enforce and give priority to spendthrift trust provisions over involuntary tort judgments against the beneficiary, and they urged the court to recognize and enforce a public policy exception to the spendthrift trust doctrine in favor of involuntary tort creditors by subjecting Lorance's beneficial interests to the payment of their tort judgment in one or more of several equitable ways…

The trial court dismissed P's complaint and P appealed to the Supreme Court of Mississippi. The Supreme Court of Mississippi reversed the holding of the trial court carving out a new exception to the spendthrift doctrine.

The court noted that spendthrift trusts and the spendthrift doctrine were recognized under Mississippi law. Citing *Leigh v. Harrison*, 11 So. 604 (Miss. 1892); *Calhoun v. Markow*, 151 So. 547 (Miss. 1933). The court also recognized that it created one exception to

the spendthrift trust rule if the trust was a self-settled trust. See *Deposit Guaranty Nat'l Bank v. Walter E. Heller & Co.*, 204 So.2d 856, 859 (Miss.1967). Nonetheless, after stating that the court "has had no opportunity to establish any other exceptions to the spendthrift doctrine" it began an analysis of the exceptions to the spendthrift rule. The court noted that there are four exceptions to the spendthrift trust rule that apply "in other jurisdictions" and are set forth in the Restatement (Second) of Trusts Section 157 (1959). These exceptions are stated in Section 157 as follows:

> Although a trust is a spendthrift trust or a trust for support, the interest of the beneficiary can be reached in satisfaction of an enforceable claim against the beneficiary,
>
> (a) by the wife or child of the beneficiary for support, or by the wife for alimony;
>
> (b) for necessary services rendered to the beneficiary or necessary supplies furnished to him;
>
> (c) for services rendered and materials furnished which preserve or benefit the interest of the beneficiary;
>
> (d) by the United States or a State to satisfy a claim against the beneficiary.

The court recognized that the foregoing rule did not provide an exception for involuntary tort creditors. In an attempt to justify such an exception the court cited Comment a of Section 157 which provides:

> The enumeration in this Section of situations in which the interest of the beneficiary of a spendthrift trust or of a trust for support can be reached *is not necessarily exclusive*. *The interest of a beneficiary of a spendthrift trust or a trust for support may be reached in cases other than those herein enumerated, if considerations of public policy so require*. *Thus it is possible that a person who has a claim in tort against the beneficiary of a spendthrift trust may be able to reach his interest under the trust*.

(Emphasis supplied.) Restatement (Second) of Trusts Section 157 cmt. (a) (1959).

The court also noted the public policy reasons supporting the spendthrift doctrine in Mississippi:

(i) The right of a donor to dispose of the donor's property as the donor wishes;

(ii) The interest of the public to protect an individual who is a spendthrift from poverty so such an individual does not become a burden on society; and

(iii) A creditor's responsibility to make itself aware of a debtor's interest in a spendthrift trust.

After considering the foregoing, the court stated that such considerations "do not weigh in favor of enforcing spendthrift trust provisions as against the claims of tort creditors or those found liable for gross negligence." First the court noted that the creditor in this case was not a voluntary creditor and therefore had no duty to ascertain the debtor's interest in a spendthrift trust prior to the accident. It also noted that society had a stronger interest in insuring the judgment creditor did not become a pauper. (Query whether this argument will justify carving out an exception to the spendthrift doctrine in every case.) Finally, the court noted that the right of a donor to put restrictions on the disposition of the donor's assets is not an absolute right, rather there are recognized exceptions to the spendthrift trust doctrine. The court stated:

> a donor may dispose of his property as he sees fit so long as such disposition does not violate the law or public policy. We find that it is indeed against public policy to dispose of property in such a way that the beneficiary may enjoy the income from such property without fear that his interest may be attached to satisfy the claims of his gross negligence or intentional torts.

The court also needed to address the interests of the remaindermen in each trust to justify its holding. It stated:

> The parties agree that the trusts' two remaindermen, Virginia Tate and William Bardin, have vested remainders. The trusts provide that First National Bank "shall have full and complete authority to expend *all or any part* of the income or corpus of said trust property for the benefit of myself and my said son." (emphasis added). Therefore, the interests of Ms. Tate and Mr. Bardin are vested remainders subject to complete defeasance in the event that all of the trust assets are expended to satisfy the interest of Lorance. Put another way, Lorance has a beneficial interest in *all* of the trust assets. Accordingly, we hold that all of the trust assets should be subject to the Slighs' claim, thereby defeating the interests of the two remaindermen.

Query whether the foregoing argument is valid. Certainly, one could reverse the argument in favor of the remaindermen in this or any other case with similar facts.

Query whether the due process rights of the remaindermen under the United States Constitution were violated by this holding.

In an immediate response to this case the Mississippi legislature reversed the holding of *Sligh* by passing the Family Trust Preservation Act of 1998. This legislation is discussed in detail in Section C.6.(b) *infra*.

Also important to note the court in *Sligh* found support for its holding in prominent national treatises on trusts. For instance, Scott on trusts provides:

> There is little authority on the question whether the interest of the beneficiary of a spendthrift trust can be reached by persons against whom he has committed a tort. In the absence of authority it was felt by those who were responsible for preparation of the Restatement of Trusts that no categorical statement could be made on the question. It is believed, however, that there is a tendency to recognize that the language of the earlier cases to the effect that no creditor can reach the interest of a spendthrift trust is too broad, and that in view of the cases that have been cited in the previous sections allowing various classes of claimants to reach the interest of the beneficiary, the courts may well come to hold that the settlor cannot put the interest of the beneficiary beyond the reach of those to whom he has incurred liabilities in tort.

Austin W. Scott, *The Law of Trusts* § 157.5 (4th ed. 1987). The same treatise also provides:

> In many of the cases in which it has been held that by the terms of the trust the interest of a beneficiary may be put beyond the reach of his creditors, the courts have laid some stress on the fact that the creditors had only themselves to blame for extending credit to a person whose interest under the trust had been put beyond their reach. The courts have said that before extending credit they could have ascertained the extent and character of the debtor's resources. Certainly, the situation of a tort creditor is quite different from that of a contract creditor. A man who is about to be knocked down by an automobile has no opportunity to investigate the credit of the driver of the automobile and has no opportunity to avoid being injured no matter what the resources of the driver may be.
>
> It may be argued that the settlor can properly impose such restrictions as he chooses on the property that he gives. But surely he cannot impose restrictions that are against public policy. It is true that the tortfeasor may have no other property than that which is given him under the trust, and that the victim of the tort is no worse off where the tortfeasor has property that cannot be reached than he would if the tortfeasor had no property at all. Nevertheless, there seems to be something rather shocking in the notion that a man should be allowed to continue in the enjoyment of property without satisfying the claims of persons whom he has injured. It may well be held that it is against public policy to permit the beneficiary of a spendthrift trust to enjoy an income under the trust without discharging his tort liabilities to others.

Additionally, the Bogart treatise provides:

> It is true that a tort creditor has had no chance to choose his debtor and cannot be said to have assumed the risk of the collectibility of his claim. The argument for the validity of spendthrift trusts based on notice to the business world of the limited interest of the beneficiary does not apply. It may be argued that the beneficiary should not be permitted to circumvent the case and statute law as to liability for wrongs by taking advantage of the spendthrift clause.

Bogert, *Trusts and Trustees* § 224 (2d ed. Rev. 1992).

b. In a case with arguably more egregious facts than those in *Sligh*, *Scheffel v. Krueger*, 782 A.2d 410 (N.H. 2001), the New Hampshire Supreme Court upheld the enforceability of a spendthrift provision in a trust. At the time of this decision New Hampshire law also contained a specific statute, that is, N.H. Rev. Stat. § 564.23, regarding the enforceability of a spendthrift provision in a trust. (Following the decision in *Scheffel*, N.H. Rev. Stat. § 564.23 was repealed in its entirety as New Hampshire adopted the UTC which contains its own spendthrift statute.) At the time of the *Sligh* decision, Mississippi did not have a statute on spendthrift provisions. In *Scheffel*, the defendant had sexually assaulted a minor child. Unlike the facts of *Sligh*, in *Scheffel*, the defendant had a mandatory right to receive all of the net income of the trust in quarterly installments. Furthermore, if he requested, the defendant could receive income payments in more frequent installments. Additionally, the trustee was permitted to distribute principal to the defendant in its sole discretion if necessary for the defendant's maintenance, support and education. Finally, the defendant could access the entire principal of the trust at age fifty-five (55).

7. Bankruptcy Proceedings

a. Spendthrift provisions will be respected in a bankruptcy proceeding when the trust is established by an individual other than the debtor. See *e.g.*, *In re Coumbe*, 304 B.R. 378 (2004); *Murphy v. Felice*, 494 B.R. 160 (Dist. Mass. 2013); and *In re Trawick*, 2013 WL 4574533 (Bkrtcy.C.D.Cal.), 497 B.R. 572, 2013 WL 4574533 (Bkrtcy.C.D.Cal. 2013)

b. In *In re Coumbe*, 304 B.R. 378 (2004), the principal of a spendthrift trust established and administered under Arizona law was held excludable from a debtor-beneficiary's bankruptcy estate even though the debtor was the sole trustee of the trust. In 1994, the debtor's mother created a testamentary trust for the primary benefit of her children (the debtor and his sister) and the secondary benefit of her grandchildren. The grandchildren were only entitled to receive distributions if the debtor and his sister predeceased them. The debtor was appointed as the sole initial trustee of the trust. The debtor's sister was named as the successor trustee if the debtor was unable or unwilling to serve as the trustee. Upon the death of the debtor's mother, the trust was divided into two equal shares. One share was set aside in further trust for the primary benefit of the debtor and the other share for the primary benefit of the debtor's sister. At that time, the debtor and his sister became the sole trustees of their respective separate shares of the trust. The trust agreement contained a spendthrift provision that provides:

> The interest of a beneficiary in the income or principal of the Trust hereunder shall be free from the control or interference of any creditor of the beneficiary or of the spouse of the beneficiary and shall not be subject to attachment, execution or other process of law or susceptible to anticipation, alienation or assignment, whether voluntarily or involuntarily encumbered, except in those cases where Trustee, in Trustee's sole discretion, approves the credit extended and the assignment of the beneficiary's interest hereunder as collateral therefor...

In 2002, the debtor and his wife filed for bankruptcy. It was estimated that there was $120,000 in the debtor's trust on the date the petition was filed. The debtor withdrew $20,000 from the trust within 180 days of filing his petition.

The bankruptcy trustee argued that the debtor's trust was not a valid spendthrift trust citing a rule under Arizona trust law related to a trust with a single beneficiary who is also the sole trustee. Thus, the trustee argued that the property in the trust should be property of the bankruptcy estate. The trustee also argued that the $20,000 withdrawn from the trust by the debtor was estate property.

The debtor replied that the trust was a valid spendthrift trust and that the corpus of the trust was not estate property because he was not the sole beneficiary. Furthermore, the debtor argued that the $20,000 he withdrew from the trust was not "acquired" by "bequest, devise, or inheritance" within 180 days of the time the debtor filed his petition. The debtor asserted that any acquisition occurred at his mother's death in 1994, eight years before he filed his bankruptcy petition.

The bankruptcy court held that while the debtor was the only beneficiary receiving distributions from the trust, the trust was a valid spendthrift trust under applicable law (that is, Arizona law). Therefore, the trust assets were not estate property.

Under the Bankruptcy Code, when a petition is filed, an estate is created comprising all property interests of the debtor. Nevertheless, the Bankruptcy Code excludes property from the estate that is subject to a restriction on the ability of the debtor to transfer the debtor's beneficial interest if such restriction is enforceable under applicable non-bankruptcy law. In other words, an anti-alienation provision in a valid spendthrift trust is an enforceable "restriction on the transfer of a beneficial interest of the debtor." Hence, the assets in such a trust should be excluded from the bankruptcy estate.

According to the Restatement (Second) of Trusts § 152(2), a spendthrift trust is a "trust in which by the terms of the trust or by statute a valid restraint on the voluntary and involuntary transfer of the interest of the beneficiary is imposed." Such a trust precludes a beneficiary from transferring the beneficiary's right to receive future distributions from the trust. Likewise, a creditor is also precluded from attacking a beneficiary's interest to satisfy the creditor's claim against the beneficiary. The fundamental premise of a spendthrift trust is to protect a beneficiary from the beneficiary and the beneficiary's creditors, that is, the basic reasons a debtor becomes subject to a bankruptcy proceeding.

According to the court, applicable non-bankruptcy law (that is, Arizona law) acknowledges the validity of spendthrift trusts. Under such law, to be a valid spendthrift trust the agreement must contain an enforceable restraint on the ability of a beneficiary to transfer his or her interest in the trust. The court cited Arizona Revised Statutes § 14-7706, which provides:

> A. A restraint on voluntary or involuntary transfer pursuant to section 14-7701 or 14-7702 is valid even if the beneficiary or one of the multiple beneficiaries of the trust is also one of the multiple trustees of the trust or if one of the multiple beneficiaries is the sole trustee of the trust.
>
> B. A restraint on voluntary or involuntary transfer pursuant to section 14-7701 or 14-7702 is invalid if the sole beneficiary of the trust is also the sole trustee of the trust.

Thus, under Arizona law, a valid spendthrift trust will not exist when the sole beneficiary also serves as the sole trustee.

In *Coumbe*, the bankruptcy trustee relied on *In re Pugh*, 274 B.R. 883 (Bankr. D. Ariz. 2002) to argue that the debtor's trust was not a valid spendthrift trust because of the sole beneficiary-sole trustee rule under Arizona Revised Statutes § 14-7706. Nevertheless, the court viewed this argument as "misplaced." The trust at issue in *Pugh*, included a spendthrift provision. The debtor was also the sole beneficiary of the trust, however, the terms of the trust provided that there must be a co-trustee serving before any distributions could be made to the debtor. The debtor could not exercise his discretion as a trustee to make distributions of principal without a co-trustee's consent. Following the grantor's death, the debtor appointed his sibling as a co-trustee, however, he never informed her about the appointment. After the debtor's sibling was appointed as a co-trustee, the debtor made distributions from a bank account held in the trust without his sibling's knowledge or consent. Based on the foregoing facts, the court in *Pugh* ruled that the debtor was the sole trustee because his sibling could not exercise "informed discretion" regarding the distributions that were made to the debtor. Thus, the court in *Pugh* held that the spendthrift provision was not valid under Arizona Revised Statutes § 14-7706(B).

In *Coumbe*, it was not disputed that the trust contained a spendthrift provision. The primary issue, however, was whether the debtor was the sole trustee and the sole beneficiary within the meaning of Arizona Revised Statutes § 14-7706(B). The trustee attempted to argue that the contingent interests of the debtor's children were illusory and, therefore, should be ignored in the same manner the co-trustee was ignored in *Pugh*. The court disagreed holding that the spendthrift trust was valid under Arizona Revised Statutes § 14-7706(B). It stated:

> although Debtor was appointed as the sole trustee of the Trust, the Trust agreement also named multiple beneficiaries. Specifically, Debtor and [his sister] were named the primary beneficiaries, and Debtor's children were named the secondary beneficiaries. After the Trust was divided, Debtor remained the trustee and primary beneficiary of his interest in the

> Trust. Likewise, Debtor's children remained the secondary beneficiaries of that interest. [The bankruptcy] Trustee did not point to, nor are we aware of, any authority that eliminates from consideration secondary beneficiaries. Under Arizona law, a spendthrift trust is valid "if one of the multiple beneficiaries is the sole trustee of the trust." A.R.S. § 14-7706(A). Here, we have multiple beneficiaries when both Debtor and his children are considered.

Hence, the trust was considered a valid spendthrift trust and the debtor's interest was not included in his bankruptcy estate.

The Bankruptcy Court ruled that the $20,000 distributed from the trust to the debtor was not part of the bankruptcy estate. The trustee, however, argued that such funds were part of the estate under § 541(a)(5)(A) of the Bankruptcy Code because the distribution was made within one hundred eighty days following the debtor's petition for bankruptcy. Under § 541(a)(5)(A) of the Bankruptcy Code an estate must include "[a]ny interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date by bequest, devise, or inheritance."

The Bankruptcy Code does not define the terms "bequest," "devise" or "inheritance." To interpret the meaning of those terms the court examined Black's Law Dictionary, providing:

> Traditionally, a "bequest" is "a gift (transfer) by will of personal property." Black's Law Dictionary 160 (6th ed. 1990). A "devise" is "a testamentary disposition of land or realty; a gift of real property by the last will and testament of the donor." *Id*. at 452. Finally, an "inheritance" is "[p]roperty which descends to heir on the intestate death of another." *Id*. at 782.

According to the court, the issue was whether the $20,000 distribution was a "bequest, devise, or inheritance" under § 541(a)(5)(A) of the Bankruptcy Code. The answer to that question depends on whether the $20,000 was corpus or income of the trust.

The principal of a spendthrift trust will not be property of a bankruptcy estate. Hence, a distribution of principal from such a trust should not be part of a bankruptcy estate. Interpreting § 541(a)(5)(A), however, most courts have held that income distributed from a testamentary spendthrift trust is a "bequest." Thus, such a distribution would be considered part of the bankruptcy estate. Furthermore, after such income is distributed to a debtor beneficiary, it is not subject to the protection of the spendthrift trust.

In *Coumbe*, the court held that the trust was a testamentary spendthrift trust, therefore, distribution of income to the debtor within 180 days following bankruptcy is considered property of the estate under § 541(a)(5)(A). Nevertheless, the court could not determine whether any part of the $20,000 the debtor received during the 180-day period was income or

principal. Thus, it remanded the case to the Bankruptcy Court to determine what part of the distribution was income and what part was principal.

Coumbe illustrates the enormous benefits of using discretionary spendthrift trusts as a vehicle to pass wealth to children, more remote descendants and other family members or beneficiaries. Such trusts can be used to effectively protect even nominal funds from the reach of a creditor or the bankruptcy estate. Careful consideration, however, must be given to the appointment of a beneficiary as a trustee and the powers given to a trustee-beneficiary.

c. See also *Wachovia Bank, NA v. Levin*, E.D. N.C., No. 4:09-CV-87-BO, 11/4/09, where the court held that remainder interests in certain trusts that were subject to spendthrift provisions were not property of the bankrupt estate and *In re Galen Lemar Amerson* 2016 WL 6310778 (10th Cir. 2016), holding that a debtor's interest in a spendthrift trust created by her late father was includable as part of the bankruptcy estate after a thorough analysis of § 541(c)(2) of the Bankruptcy Code.

d. In *In re Zuckerhorn* 484 B.R. 182 (9th Cir. 2012), the Appellate Panel of the Ninth Circuit affirmed a ruling that denied a motion by the chapter 7 trustee ("**T**") to compel turnover of all or some of the income distributed to debtor ("**D**") under a valid spendthrift trust (the "**Trust**"). T's motion raised issues regarding (1) the enforceability of the trust's choice of law clause designating Hawaii as the governing law, (2) the validity of the Trust's spendthrift clause, and (3) whether the postpetition income distributions to D became property of the estate under § 541(a)(5)(A) of the Bankruptcy Code.

On September 20, 2010, D filed a chapter 7 petition. On December 3, 2010, T filed a motion to compel turnover of twenty-five percent of the distributions paid to D pursuant to the Trust, contending that portion was property of the estate under Cal. Prob.Code § 15306.5. T argued that California law, rather than Hawaii law, should apply to the Trust because (1) California had the more substantial relation to the dispute and (2) enforcing the spendthrift provision under Hawaii law would violate the fundamental policies of California.

The bankruptcy court considered T's motion in two phases. First, it concluded on cross motions for summary judgment that the trust was governed by the Trust settlor's choice of Hawaii law. Second, after an evidentiary hearing held on August 11, 2011, the bankruptcy court concluded that none of the principal or interest paid or payable to D under the trust was property of the estate since the spendthrift provisions were fully enforceable under Hawaii law. The bankruptcy court further found that Section 541(a)(5)(A) of the Bankruptcy Code was inapplicable to the Trust because it was an inter vivos trust as opposed to a testamentary trust, and thus D's postpetition income distributions were not property of the estate. The bankruptcy court also found that the Trust was a valid spendthrift trust, and that ruling was not appealed. T's main complaint on appeal was that the bankruptcy court erred in upholding the Trust settlor's choice of Hawaii law when D was domiciled in California and filed bankruptcy there.

California limits the scope of the spendthrift protection under Cal. Prob.Code § 15306.5. That statute provides that a judgment creditor may obtain an "order directing the trustee to satisfy all or part of the judgment out of the payment to which the beneficiary is entitled under the [spendthrift] trust instrument" as long as the payment does not exceed

twenty-five percent of the funds otherwise available to the beneficiary. Since a bankruptcy trustee enjoys the powers of a hypothetical judgment creditor under Section 544(a)(1) of the Bankruptcy Code, the Ninth Circuit has held that the trustee can seek an order under Cal. Prob.Code § 15306.5 to obtain twenty-five percent of a valid spendthrift trust.

Federal courts in the Ninth Circuit and California state courts both look to the Restatement (Second) of Conflicts of Law (1971) (the "**Restatement**") for the choice of law rules. The appellate court held that the Restatement reflects a strong policy favoring enforcement of choice of law provisions and that under the Restatement, the Trust settlor's choice of Hawaii law should be respected if Hawaii has a substantial relation to the Trust. Restatement § 187(2)(a); § 270(a). Comment b of § 270 of the Restatement provides that a state has a substantial relation to a trust if at the time the trust is created: (1) the trustee or settlor is domiciled in the state; (2) the assets are located in the state; and (3) the beneficiaries are domiciled in the state.

Applying these contacts, the appellate court held that the State of Hawaii had a substantial relation to the Trust. At the time the Trust was settled, the trustee and settlor were domiciled in Hawaii, the settlor's assets were located in Hawaii, and D, one of the beneficiaries, was domiciled in Hawaii and remained a citizen of Hawaii for over 70 years. Furthermore, the Trust was administered by a Hawaii corporate trustee. These contacts sufficiently demonstrated that the settlor of the Trust had a reasonable basis for her choice of Hawaii law to govern the Trust. Because Hawaii had a substantial relationship to the parties and a reasonable basis otherwise existed for the choice of law, the court held that the settlor's choice of Hawaii law should be enforced unless T could establish (1) that the chosen law was contrary to a fundamental policy of California and (2) that California had a materially greater interest in the determination of the particular issue.

The appellate court held that there was no bright-line definition of a "fundamental policy" of California, and that there was inadequate authority to find that Cal. Prob.Code § 15306.5, standing alone, was a fundamental policy of California. The appellate court further held that even if California had a fundamental policy conflict with Hawaii, pursuant to the Restatement (Second) of Conflict of Laws § 187(2)(b), T still had to show that California had a materially greater interest than Hawaii in the determination of the particular issue.

T argued that California had a materially greater interest than Hawaii because (1) D was domiciled in California; (2) the chapter 7 petition was filed in California; and (3) some of D's scheduled unsecured creditors were located in California. However, the appellate court held that on balance, Hawaii had the more substantial relation to the trust and that the State of California had no relationship with the Trust other than the fact that D, one of the beneficiaries, lived in California. Under those circumstances, the appellate court held that California had a "materially greater" interest than Hawaii in the determination of the choice of law issue.

8. Federal Tax Liens

A spendthrift clause will not prohibit seizure of an beneficiary's interest in a trust in a Federal tax collection case. In C.C.A. 200614006, a trust ("**T**") was executed and funded by a taxpayer-beneficiary's ("**B**") parent ("**P**"). B was designated as a trustee of T. P died. The

terms of T provided that following the administration of P's probate estate, T would be divided into separate equal shares for each of P's children and grandchildren. Thus, one share of T was allocated to B to be held in further trust for B's benefit. Under the terms of the separate share trust, B is entitled to receive all of the income on a monthly basis from the trust and certain distributions of trust principal in the future. The terms of the separate trust for the benefit of B also contained a spendthrift provision that was apparently valid and enforceable under applicable state law. B had unpaid tax liabilities for certain tax years that the Service was attempting to collect.

Under § 6321 of Code, a federal tax lien will attach to all property and *rights to property* of a taxpayer who is delinquent in the payment of a tax liability. Whether a right under state law is considered property or a right to property under § 6321 of the Code is a matter determined under federal law. See *U.S. v. National Bank of Commerce*, 472 U.S. 713 (1985). The term "property" in § 6321 of the Code is broadly defined to include every type of right or interest protected by law and having an negotiable value. See *Drye v. U.S.*, 528 U.S. 49, 56 (1999). In *Drye*, the court noted the:

> Code's prescriptions are most sensibly read to look to state law for delineation of the taxpayer's rights or interests in the property the Government seeks to reach but to leave to federal law the determination of whether those rights or interests constitute "property" or "rights to property" under section 6321.

When a federal tax lien attaches to a taxpayer's property and/or rights to property, the Service will give notice and demand payment of the delinquent tax liability. If the taxpayer fails or refuses to pay such liability, the Service can levy on the delinquent taxpayer's property and rights to property. Under Regulation § 301.6331-1(a)(1), the levy seizes a delinquent taxpayer's property and rights to property as of the time of the levy, however, it will not accelerate a right to receive a payment in the future. According to Regulation § 301.6331-1(a)(1):

> Except as provided in section 301.6331-1(b)(1) with regard to a levy on salary or wages, a levy extends only to property possessed and obligations which exist at the time of the levy. Obligations exist when the liability of the obligor is fixed and determinable although the right to receive payment thereof may be deferred until a later date.

The term "determinable" has been construed to mean a sum that is capable of being determined. See *Reiling v. U.S.*, 77-1 U.S.T.C. paragraph 9269 (N.D. Ind. 1977). Accordingly, for purposes of a tax levy, the exact amount of an obligation must only be possible to measure at some point in the future. See *U.S. v. Hemmen*, 51 F.3d 883, 890 (9th Cir. 1995).

According to Revenue Ruling 55-210, 1955-1 C.B. 544, where a taxpayer has a fixed right to a stream of payments, a levy will seize the payments currently due and future payments that must be made to the taxpayer. Hence, where a taxpayer has a fixed right to receive periodic payments or a lump sum payment from a trust, a levy will seize the right to such payments immediately.

According to paragraph (18) of Section 103 of Article 1 of the UTC, a spendthrift provision is a provision in a trust that "restrains both voluntary and involuntary transfer of beneficiary's interest." Importantly, a spendthrift provision is a product of state law. As such, a spendthrift provision cannot overcome the reach of a federal tax lien. See, *e.g.*, *Northwestern Trust Company v. Com'r.*, 622 F.2d 387 (8th Cir. 1980); and *U.S. v. Rye*, 550 F.2d 682 (1st Cir. 1977). In holding that a taxpayer-beneficiary's interest in a spendthrift trust could be reached by a federal tax lien, *Leuschner v. First Western Bank and Trust*, 261 F.2d 705, 708 (9th Cir. 1958) provided "[t]here is no doubt that the paramount right to collect taxes of the federal government overrides a state statute providing for exemptions."

As a result of the foregoing, C.C.A. 200614006 held that the spendthrift provision in T (although it might be effective against the claims of other creditors under state law) was ineffective against insulating the assets of the separate trust for the benefit of B from levy by the federal government. Of course, B's interest in the trust still had to be determined to constitute "property" or a "right to property" of B.

In C.C.A. 200614006, B had the right to receive all of the income from the separate share trust. This mandatory right is a property right that can be subject to levy for delinquent taxes. Such a levy seizes all of the income payments from the separate trust, that is, all of the current income payments and all future income payments.

As with B's income interest, the distribution of trust principal is mandatory and not within the discretion of the trustee. Hence, the rights to these payments were also subject to levy by the Service.

Critically, when *inter vivos* gifts and inheritance are structured properly, such wealth may be protected from creditors, even from claims of the United States government. This is achieved through the use a properly designed discretionary trust, something that did not exist in C.C.A. 200614006.

Trustees also need to beware of the alternative holding in C.C.A. 200614006. In this case, B was also a trustee under T. The Service held that B, as trustee, could be held personally liable under applicable law, that is California law, for tortuous conversion. According to the Chief Counsel Advice, as alternative to a suit to impose a levy, the government could sue the trustee of the trust for tortuous conversion of the tax lien as the holder of the taxpayer's property. See *U.S. v. Henshaw*, 388 F.3d 738 (10th Cir. 2004). Under this theory, a party possessing a lien in California can sue a party who intentionally impairs a lienor's security. See *Nomellini Construction Co. v. U.S.*, 38 F. Supp. 1281 (E.D. Cal. 1971). In this case, where B receives a distribution from her separate trust, she will prejudice the rights of the government in regards to the tax lien if the government cannot recover the distribution from B. In other words, B, as the taxpayer and as a trustee has knowledge of the tax lien that encumbers her interest in the trust. If any funds received by B in such a distribution disappear into the stream of commerce, that would damage the government's rights under the tax lien. Under this theory, any trustee possessing knowledge of a tax lien could be held personally liable.

C.C.A. 200614006 provides an example of a "Federal Super Creditor," that is, the IRS asserting its authority to attach wealth pursuant to a specific federal statute. For an excellent discussion of Federal Super Creditors, see Merric, Bland & Monasky, "Beware of Federal Super Creditors," * Trusts & Estates 14 (July 2010).

B. Discretionary Trusts.

1. Florida common law recognizes the validity of a discretionary trust. *Bacardi v. White*, 463 So.2d 218 (Fla. 1985); *Southeast Bank of Sarasota v. Stone* 500 So.2d 737 (Fla. 1st D.C.A. 1987); *Phillips v. Trainor*, 100 So.2d 181 (Fla. 2d D.C.A. 1958). In *Bacardi*, the Court limited the right of garnishment for alimony over a spendthrift trust (a newly created exception by the court to a spendthrift provision) to disbursements that were *due* to be made or were actually made from the trust. *Bacardi* at 222 (emphasis added). However, if a trust is wholly-discretionary, a court cannot order a trustee to make a disbursement to a creditor. *Id*. Only if a trustee makes a discretionary distribution, may such distribution be subject to the writ of garnishment. *Id*. Therefore, discretionary interests in trusts are not attachable until a distribution is actually made from the trust to or for the benefit of the debtor-beneficiary.

2. As previously mentioned, Florida has adopted a modified version of the UTC that becomes effective on July 1, 2007. As held in *Bacardi*, a creditor cannot compel distributions subject to a trustee's discretion, even if (a) its discretion is expressed in the form of a standard of distribution or (b) the trustee has abused the discretion. F.S. § 736.0504(1) (2007). The fact that the discretionary trust is not a spendthrift trust is irrelevant. *Id*.

3. In *Berlinger v. Casselberry*, Case No. 2D12-6470, 6 (Fla. 2d DCA Nov. 27, 2013), the Florida Second District Court of Appeals upheld a writ of garnishment issued by a trial court against the trustee of a discretionary trust over any present and future distributions made to or for the benefit of a trust beneficiary. The holding is unique as it is the first case to interpret the Florida Trust Code spendthrift/discretionary trust provisions (since the Florida Trust Code became effective on July 1, 2007), and the first case to hold that *Bacardi* is still applicable to Florida trusts (both those protected by spendthrift clauses and those that are wholly discretionary).

Bruce Berlinger ("**Bruce**") and Roberta Casselberry ("**Roberta**") divorced in 2007. In accordance with a marital settlement agreement that was incorporated into a final judgment of dissolution of marriage, Bruce agreed to pay Roberta $16,000 per month in alimony. Thereafter, Bruce subsisted exclusively on distributions made from several third party trusts (collectively, the "**Trusts**") in the discretion of the trustee of the trusts (the "**Trustee**"). Although Bruce continued to live on the distributions from the Trusts, he stopped paying alimony in May of 2011. On July 21, 2011, Bruce conveyed interests in certain real property into an irrevocable life insurance trust (the "**ILIT**") that was not previously disclosed to Roberta. Roberta was unaware of these transfers. The deed stated that Bruce was the sole holder of the beneficial interest in the ILIT.

Roberta filed a motion to enforce payment of the alimony in arrears and for contempt. Thereafter, Bruce and Roberta reached a settlement in which Bruce agreed to satisfy his delinquent alimony obligations; however, after the settlement, $32,625.54 plus interest

remained owing to Roberta. The trial court then issued writs of garnishment to the trustee of the Trusts.

The writs provided that all distributions made directly or indirectly to, on behalf of, or for the benefit of Bruce by the trustee of any trusts to which Bruce was a beneficiary would instead be made payable to Roberta unless at the time of distributions there was no past due alimony payments owed to Roberta. Furthermore, the garnishment order provided that should a trustee desire to make distributions to Bruce beyond the amount of the then outstanding alimony obligation, the trustee was required to seek court approval before making any such distribution to ensure that there remained sufficient assets in the trust to secure the continued payment of alimony. Bruce appealed the trial court's order issuing the continuing writs of garnishment against the Trustee; however, the appellate court affirmed the trial court's ruling.

The court was wrong in *Berlinger*, that is, the court misapplied the *Bacardi* holding to a discretionary trust while ignoring the patent statutory distinctions between spendthrift trusts and discretionary trusts adopted in 2006 in the new Florida Trust Code.

Florida provides a creditor with the remedies of attachment and garnishment in Chapters 76 and 77 of the Florida Statutes. Florida Statutes §76.01 provides a judgment creditor with a right of "attachment at law against the goods and chattels, lands, and tenements of his or her debtor." Attachment is a remedy that gives a creditor a right to seize the property of the debtor in such debtor's possession. Additionally, Florida Statutes § 77.01 provides that any creditor with a judgment has the right to garnish "any tangible or intangible personal property of defendant in the possession or control of a third person" (*i.e.*, in this case, in the possession or control of the Trustee of the Trusts). A garnishment order provides a creditor with the right to seize the property of his, her or its debtor in the possession of a third party.

Through a series of statutes (see Part V of the Florida Trust Code, Florida Statutes §§ 736.0501–736.0507), Florida law addresses whether a judgment creditor can enforce its rights against the interest of a beneficiary of a trust. For instance, Florida Statutes § 736.0501 provides that:

> Except as provided in s. 736.0504, to the extent *a beneficiary's interest* is not subject to a spendthrift provision, *the court may authorize a creditor or assignee of the beneficiary to reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or by other means*. The court may limit the award to such relief as is appropriate under the circumstances. (Emphasis added.)

The key issue that seems to have been disregarded by the court in *Berlinger* is the statutory construction in Part V of the Florida Trust Code distinguishing "**spendthrift trusts**" from "**discretionary trusts**" as it relates to the claims of creditors of a beneficiary. As will be explained in detail below, it is essential to understand that as to a "**spendthrift trust**" - *i.e.*, a trust with a mandatory payout to a beneficiary (*e.g.*, "pay all of the income of the trust at least annually to the beneficiary") protected "only" by a spendthrift clause - the Florida Trust Code (Florida Statutes §§ 736.0501-.0503) specifically and clearly adopted the existing Florida public policy as expressed in the *Bacardi* case. Thus, as to "**spendthrift trusts**" (mandatory

trusts with spendthrift clauses), the Florida legislature in adopting the Florida Trust Code weighed and balanced the competing public policies, and adopted the approach in *Bacardi* that as to most creditors spendthrift clauses are to be respected (Florida Statutes §736.0502), however, pursuant to Florida Statutes §736.0503, there are certain exception creditors (*e.g.*, children or spouses for support) who should be able to reach the beneficiary's mandatory distributions from a trust (*i.e.*, the beneficiary's property). However, the Florida Trust Code then set out totally separate rules for "**discretionary trusts**" (*i.e.*, those where distributions are in the discretion of the trustee) and directed that regardless of having spendthrift clauses or not, discretionary trusts should be treated differently as to creditors of a beneficiary (the Florida legislature even pulled out those rules and included the rules in a separate statute - Florida Statutes, § 736.0504) which does not allow for exception creditors and specifically says the provisions relating to exception creditors (Florida Statutes §736.0503) do not apply.

As to spendthrift trusts, Florida Statutes § 736.0502 provides in relevant part that in a trust containing both mandatory distributions to a beneficiary (thus not a discretionary trust as described in detail below) and a spendthrift provision, "except as otherwise provided in this part...*a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before receipt of the interest or distribution* by the beneficiary." See F.S. § 736.0502(3). A spendthrift provision prohibits a beneficiary from transferring his or her right to distributions and prevents a creditor of a beneficiary from attaching the beneficiary's interest prior to actual receipt of a distribution from the trust. In jurisdictions that recognize a spendthrift provision, including Florida, such a provision will prevent creditors from reaching a beneficiary's interest in a trust with mandatory payments prior to the beneficiary's actual receipt.

Florida law also recognizes several statutory exceptions to the enforceability of a spendthrift provision. Florida Statutes § 736.0503 provides that a spendthrift provision cannot be enforced against certain classes of creditors (known as "**exception creditors**"), including a beneficiary's child, spouse or former spouse if such person has a court order for support or maintenance. See F.S. § 736.0503(2). The other exceptions creditors include a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust, the state of Florida to the extent Florida law so provides and the United States to the extent federal law so provides (which includes so-called "**super creditors**" such as the Internal Revenue Service and/or other federal agencies). See F.S. § 736.0503(2). Florida Statutes § 736.0503(3) allows exception creditors to obtain a court order attaching present or future distributions to or for the benefit of the beneficiary.

However, the legislature provided that avoiding spendthrift clauses should be the exception not the norm (under Florida law), specifically providing in Florida Statutes § 736.0503(3) that the ability of exception creditors (a beneficiary's child, spouse, former spouse, or a judgment creditor who has provided services for the protection of a beneficiary's interest in a trust) to pierce spendthrift trusts should apply "**only as a last resort** upon an initial showing that traditional methods of enforcing the claim are insufficient." (Emphasis added.)

Notwithstanding the right granted to exception creditors under Florida Statutes § 736.0503(3), Florida Statutes § 736.0504 provides that a creditor of a beneficiary of a discretionary trust, *regardless* of whether it includes a spendthrift provision, may not compel a

distribution or "[a]ttach or otherwise reach the interest, if any, which the beneficiary might have as a result of the trustee's authority to make discretionary distributions to or for the benefit of the beneficiary." See F.S. § 736.0504(2)(a)-(b). It seems logical that Florida Statutes § 736.0504 would prohibit the creditor of a discretionary beneficiary from attaching or otherwise reaching such beneficiary's interest because the beneficiary only has an expectancy or a mere possibility of receiving a distribution and no enforceable right to such distribution.

A close examination of this part of the Florida Trust Code (that is, Florida Statutes §§ 736.0503(3) and 736.0504(2)) strongly suggests a limited application of Florida Statutes § 736.0503(3). Florida Statutes § 736.0504(2) *prohibits* the creditor of a discretionary beneficiary from *attaching or otherwise reaching* the beneficiary's interest, yet Florida Statutes § 736.0503(3) *allows* exception creditors to obtain a court order attaching present or future distributions to or for the beneficiary "[e]xcept as otherwise provide in... s. 736.0504." To read Florida Statutes § 736.0503(3) in *pari materia* with Florida Statutes § 736.0504(2), it seems more logical to conclude that Florida Statutes § 736.0503(3) should only apply to *mandatory* distributions and other mandatory rights. In other words, Florida Statutes § 736.0503(3) should allow exception creditors to attach only *mandatory* distributions to or for the benefit of the beneficiary – and thus to pierce trusts which rely on a spendthrift trust for protection as opposed to those that are discretionary. This seems most logical since attachment applies to a beneficiary or debtor's property interests and a discretionary interest in a trust should not be construed as a property interest.

Furthermore, the foregoing analysis relating to Florida Statutes §§ 736.0503(3) and 736.0504(2) is supported by legislative history. The House of Representatives staff analysis of the 2007 amendments to Florida Statutes §§ 736.0501–736.0504 indicates that a purpose of the bill was to provide that "the exceptions to a spendthrift provision in a trust *do not override* the provisions relating to discretionary trusts in s. 736.0504, F.S." and "the protections given to the discretionary interest of a trustee *outrank* the interest of a creditor." See House of Representatives Staff Analysis to HB 1183 dated (March 8, 2007) (emphasis added).The analysis of the changes to Florida Statutes § 736.0501, which generally addresses the rights of a beneficiary's creditor to reach the beneficiary's interest, provides that "[t]he rights given to creditors under the section are limited to those cases where a beneficiary has a *right* to distributions [and if] distributions are discretionary a beneficiary has no 'attachable' trust interest." *Id.* This analysis supports the interpretation that the remedies provided to exception creditors in § 736.0503(3) only apply to a mandatory interest protected by a spendthrift clause.

Nevertheless, in analyzing Roberta's right to garnish Bruce's potential interest as a discretionary beneficiary, the court appears to misinterpret Florida Statutes §736.0504(2) and bases its decision on *Bacardi v White*, 463 So. 2d 218 (1985).

While noting that the creditor remedies provided in Florida Statutes § 736.0503(3) are subject to the exception found in Florida Statute § 736.0504(2), the court nevertheless concludes that Florida Statutes § 736.0504(2) "does not expressly prohibit a former spouse [a creditor] from obtaining a writ of garnishment against discretionary disbursements made by a trustee exercising its discretion." In its analysis the court determined that while Florida Statutes § 736.0504(2) prohibits a court order against a discretionary trustee either compelling a distribution or attaching the beneficiary's interest, it would *not* prohibit a court order granting a

writ of garnishment against discretionary distributions made by the trustee. Thus, the court's holding provides a writ of garnishment may attach to the beneficiary's interests in a trust, like a charging order applies in the context of a debtor's interest in a limited partnership or limited liability company.

However, the court appears to ignore the fact that a garnishment appears to be a subset of attachment when a third party holds or has possession of a debtor's property, and thus requires an underlying property interest to be enforceable – which is lacking in the context of a purely discretionary trust.

Nevertheless, the court gave great weight to the holding in *Bacardi*. In *Bacardi*, a husband and wife divorced and the husband was obligated pursuant to the dissolution of marriage judgment to pay the wife $2,000 per month in alimony until the earlier of the wife's death or her remarriage. *Bacardi v White,* 463 So. 2d 218, 220 (Fl. 1985). Thereafter, the husband stopped paying alimony and the wife obtained three judgments against him. *Id.* The wife served a writ of garnishment on the trustee of a spendthrift trust created by the husband's father for the benefit of the husband. *Id*. Additionally, the wife obtained a continuing writ of garnishment against the trust income for future alimony payments. *Id.* While the Third District Court of Appeals ruled that income from the trust was exempt from garnishment to satisfy court-ordered alimony, the Supreme Court of Florida quashed the decision and held that disbursements from spendthrift trusts are subject to garnishment when traditional remedies to enforce alimony obligations are not effective. *Id* at 222. Additionally, although really in *dicta*, the Supreme Court ruled that any discretionary distributions were subject to the writ of garnishment. *Id* at 223.

Based upon the differences in Florida Trust law from 1985 (when *Bacardi* was decided) to 2013 (when *Berlinger* was decided), the *Berlinger* court's reliance on *Bacardi* appears to have been inappropriate.

First, the *Bacardi* decision predates the existence of the Florida Trust Code (including Florida Statutes §§ 736.0501–736.0504) by more than twenty (20) years. While the *Bacardi* decision discusses at length the competing public policy of enforcing spendthrift provisions *versus* the enforcement of alimony and child support orders, it is important to note that this was an unsettled issue at the time. These competing public policies were also the subject of great controversy when the current version of the Uniform Trust Code (the "**UTC**") was originally promulgated. Many 504 of the UTC commentators viewed this provision of the UTC as a radical departure from long-standing common law principals of trusts and asset protection. Under common law a beneficiary of a purely discretionary trust was viewed as having virtually no enforceable right to receive a distribution from the trust. Such a beneficiary was able to enforce a right only upon a trustee's action in bad faith. Generally a purely discretionary trust was considered an effective means of protection of a beneficiary's interest because a creditor would only have the same right to enforce the distribution as the beneficiary. The UTC, however, arguably granted a class of exception creditors the right to compel distributions and attach to trust assets at a significantly lower threshold. See Merric & S. Oshins, "The Effect of the UTC on the Asset Protection of Spendthrift Trusts," 31 EP 375 (Oct. 2004).

The original version of § 504 in the UTC appeared to have created exception creditors for not only spendthrift trusts but also discretionary trusts. In response to the controversy, many states chose to modify this provision or in some cases repeal the UTC altogether. See, *e.g.*, the Oregon Uniform Trust Code (Oregon Revised Statutes §§ 130.001–130.910), which specifically omits section 504 of the UTC.

Second, the court in *Berlinger* ignored how the Florida legislature modified Florida's version of Section 504 of the UTC, Florida Statutes § 736.0504, in a number of ways. First, Florida Statutes § 736.0504 removes the exception for certain creditors. Section 504(b) of the UTC prohibits a creditor of a discretionary beneficiary from compelling a distribution, however, subject to the exceptions provided in paragraph (c) of Section 504 (which gives the court the power to compel or direct discretionary distributions to certain exception creditors if a trustee "has not complied with a standard of distribution or has abused a discretion."). Florida Statutes § 736.0504(2) not only removes the precatory phrase "[e]xcept as otherwise provided in subsection . . ." but also adds the phrase "including a creditor as described in s. 736.0503(2)" in an apparent attempt to clarify that the prohibited creditor actions are *not* subject to exceptions.

Additionally, Florida Statutes §736.0504(2) adds to the list of prohibited creditor actions (that are not, as discussed immediately above, subject to an exception). Section 504(b) of the UTC only includes "compel a distribution" in the list of creditor actions that are prohibited (subject to the exceptions); however, Florida Statutes § 736.0504(2) adds "[a]ttach or otherwise reach the interest, if any, which the beneficiary might have as a result of the trustee's authority to make discretionary distributions to or for the benefit of the beneficiary" in an obvious attempt to clarify that a creditor's attempt to attach or otherwise reach a beneficiary's interest is not only prohibited but also not subject to an exception. Thus, the Florida legislature appears to have addressed, subsequent to the *Bacardi* decision, the competing public policies at issue in *Bacardi* in the form of Florida Statute §§ 736.0503(3) and 736.0504(2) - and it chose to treat the issue of exception creditors differently for spendthrift trusts (trusts with mandatory distributions and spendthrift clauses) and discretionary trusts (trusts where distributions are not mandated but are solely made in the trustee's discretion).

Berlinger should be overturned on rehearing or appeal or the Florida Bar and legislature should act to repeal the holding.

If permitted to stand, the court's decision in *Berlinger* not only appears to violate the express terms of the Florida Trust Code and the legislative history surrounding its passage, it also appears to create an awkward public policy conundrum. Discussions with any corporate trustee would immediately identify the problem. If Berlinger stands, the trustee of the trust (a discretionary trust) cannot make a distribution for the benefit of the beneficiary (in this case, Bruce, but it also cannot make a distribution to the spouse (or other exception creditor) holding the support order (in this case, Roberta) because making such distribution would be a clear violation of the trustee's fiduciary duties. Thus, if *Berlinger* stands, any trustee of a discretionary trust against whom a writ of garnishment is issued would be forced to make no distributions to anyone - perpetually. A public policy that potentially creates two paupers (or wards of the state) rather than one is a poor policy.

Furthermore, while a spouse or ex-spouse of a beneficiary can qualify as an exception creditor under Florida Statutes §736.0503, the statute also provides for three other classes of exception creditors. As previously mentioned, these exception creditors include a beneficiary's child with a court order for support, a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust and the State of Florida or the United States to the extent permitted by law. At least in the case of three of these four additional exception creditors it may be difficult to conclude that the same public policy concerns exist to protect the interests of those creditors. Nonetheless, the holding in *Berlinger* would provide support for those creditors garnishing the purely discretionary interest of a beneficiary in a discretionary trust. This appears to establish a poor public policy.

Additionally, the *Berlinger* court focusing on one particular case fails to consider the inherent difficulties a trustee in Florida will encounter administering a discretionary trust because of this decision. If a trustee is aware of the possibility that a beneficiary's interest may be garnished in the future, the trustee certainly has a fiduciary duty to take action to protect the beneficiary's interest. Rather confusing and problematic, however, will be determining when the trustee has a duty to take such action. For instance, should every trustee of a discretionary trust governed by Florida law and/or administered in Florida immediately considering taking action by moving or transfer the situs of such trust to a more protective jurisdiction and change the governing law of the trust to such other jurisdiction? Should a trustee act when it learns that a beneficiary is in the process of getting married, is having marital difficulties, considering a divorce or is experiencing severe financial or personal difficulties? Would the answer to this question change if the exception creditor is the State of Florida or the United States government? Anyone can experience problems with the Internal Revenue Service. Certainly it seems odd to adopt a public policy that promotes trusts (or legitimate commerce) fleeing the state, and steps in such direction should fail for a number of reasons.

The decision has the potential of discouraging estate planning practitioners and trustees from recommending clients establish trusts in Florida. Arguably, a trustee of an existing trust has a fiduciary duty to transfer the situs of the trust to another jurisdiction and change the governing law. A number of jurisdictions have statutes that are designed to prevent exception creditors from reaching the interest of a trust beneficiary. See, *e.g.*, South Dakota Codified Laws §55-1-35 (providing that "[r]egardless of whether a beneficiary has any outstanding creditor, a trustee of a spendthrift trust may directly pay any expense on behalf of such beneficiary and may exhaust the income and principal of the trust for the benefit of such beneficiary. No trustee is liable to any creditor for paying the expenses of a beneficiary of a spendthrift trust."). See also, Nevada Revised Statutes §163.419(4) (providing that "[r]egardless of whether a beneficiary has an outstanding creditor, a trustee of a discretionary interest may directly pay any expense on the beneficiary's behalf and may exhaust the income and principal of the trust for the benefit of such beneficiary.").It is not difficult to envision the entire estate planning community recommending that our clients establish their trusts in more protective jurisdictions and move existing trusts to those jurisdictions.

Practitioners who continue to draft discretionary trust agreements that will be governed by Florida law should strongly consider including certain provisions in their trust agreements to provide sufficient flexibility to a trustee to address the concerns created by the *Berlinger* decision. Such provisions could, for example:

1. Give a trustee the power to move a trust to another jurisdiction and change the governing law of the trust.

2. Give a trustee the power to make decanting distributions from the trust to another trust governed by the law of a more protective state.

3. Grant a person a limited power of appointment that would allow the holder of the power to appoint trust assets to another more protective trust.

4. Include a class of beneficiaries of a discretionary trust rather than provide for a single beneficiary. If the trustee is unable to make a distribution to a beneficiary because of a garnishment order, distributions could still be made to the other beneficiaries. Such additional beneficiaries might include a qualified spouse of the debtor beneficiary (that is, an individual who is married to and living with the debtor-beneficiary at a particular time) or siblings of the debtor-beneficiary. A qualified spouse could receive distributions to pay for personal expenses that indirectly benefit the beneficiary. Similarly a beneficiary's siblings could receive distributions and use their annual exclusions to transfer the funds to benefit the debtor-beneficiary.

5. Grant a trustee or third party the power to add individuals and other trusts to the class of beneficiaries eligible to receive distributions to provide the same flexibility described in item 4.

6. Appoint an independent trustee or individual to control the foregoing powers.

The defendant in *Berlinger* filed a motion for rehearing in the Florida Second District Court of Appeals. If the motion for rehearing is granted the court will have an opportunity to revisit the case and hopefully overturn a poor decision. Should the *Berlinger* decision stand, it has the potential to do serious harm to both the beneficiaries of Florida trusts and to the trust industry in Florida.

If the *Berlinger* decision stands hopefully the Florida legislature will quickly act to enact legislation addressing this serious problem.

As further developments with respect to the *Berlinger* holding should be on the horizon (either by rehearing or legislative action), unless a trustee is concerned about a significant pending situation that requires immediate attention, it appears clients can (and perhaps should) wait for the final resolution of the *Berlinger* case to decide whether to take additional steps to further protect a beneficiary's interest in a trust.

4. A creditor can compel a distribution from a discretionary trust where a trustee who has the power to make distributions is also a beneficiary of such trust, unless the beneficiary-trustee's discretion is limited by an ascertainable standard (as defined in the Internal Revenue Code). F.S. § 736.0504(2) (2007).

The UTC, which was previously silent on such beneficiary-trustee issues, as concerned with the effect of Restatement (Third) of Trusts §60, comment g (approved by the American law Institute in 1999) that provided that the beneficial interest of a beneficiary-trustee may be

reached by the beneficiary-trustee's creditors. It determined that unless the UTC specifically addressed discretionary interests held by beneficiary-trustees, the new Restatement rule might also apply in states enacting the UTC.

5. Section 504 of the UTC deals with discretionary trusts. It provides in relevant part:

> (a) In this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another State. (b) Except as otherwise provided in subsection (c), whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if: (1) the discretion is expressed in the form of a standard of distribution; or (2) the trustee has abused the discretion. (c) To the extent a trustee has not complied with a standard of distribution or has abused a discretion: (1) a distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary's child, spouse, or former spouse; and (2) the court shall direct the trustee to pay to the child, spouse, or former spouse such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion.

a. The prefatory note in the UTC provides in relevant part, "The Uniform Trust Code was drafted in close coordination with the writing of the Restatement Third."

b. It should be noted that a group of commentators takes the position that the UTC and the Restatement (Third) of Trusts, taken together, greatly diminish the wealth protection that a traditional spendthrift trust and/or discretionary trust can provide even when such a trust is established and funded by one individual, that is, a settlor, for the benefit of another individual, that is, a third party beneficiary (someone other than the settlor). These commentators argue that the Restatement Third of Trusts and the UTC attempt to equate a wholly discretionary trust with a support trust by expanding the beneficiary's enforceable rights against the trustee of a discretionary trust to demand distributions. Under the common law such an enforceable right does not exist in a wholly discretionary trust. If the beneficiary of a third party discretionary trust has an enforceable right to demand a distribution from the trustee, the argument continues that a creditor of a beneficiary can step into the beneficiary's shoes to enforce the right. The position set forth by these commentators is not without merit as at least one state court has adopted a similar position relying on the authority of (a draft of) the Restatement (Third) of Trusts. See *Dwight v. Dwight*, 756 N.E.2d 17 (Mass. Ct. of App. 2001). See Merric & Oshins, "The Effect of the UTC on the Asset Protection of Spendthrift Trusts," (Part I) 31 EP 375 (Aug. 2004), (Part II) 31 EP 411 (Sept. 2004) & (Part III) 31 EP 478 (Oct. 2004); Merric, "The Uniform Trust Code's Affect On Protecting A Child's Inheritance;" Merric, Stein, & Freeman, Uniform Trust Code and Asset Protection in Non-Self Settled Trusts, Steve Leimberg's Asset Protection Planning Newsletter # 53.

c. According to one of the foregoing articles, a spendthrift provision will provide little assistance if the UTC and the Restatement (Third) of Trusts permit the interest of a beneficiary of a discretionary trust to be attached by a creditor. The article notes:

> Many asset protection attorneys have indicated that, with a spendthrift trust, all the trustee need do to avoid attachment and still support the beneficiary is to pay the debtor/beneficiary's expenses directly rather than making a distribution to the beneficiary. Both the UTC and Restatement Third end this possibility. Section 501 of the UTC [discussed *supra*] provides that a creditor may attach "present or future distributions *to or for the benefit of the beneficiary*." Section 60, Comment c and Illustration 4 of the Restatement Third provide that, "[i]f the trustee has been served with process . . . the trustee is personally liable to the creditor for any amount paid to or applied for the benefit of the beneficiary in disregard of the rights of the creditor."

Merric & S. Oshins, "The Effect of the UTC on the Asset Protection of Spendthrift Trusts," (Part III) 31 EP 375 (Oct. 2004).

d. As a result of the foregoing, it is advisable to draft trusts with caution on the premise either one or both the UTC and Restatement (Third) of Trusts may be applied as or influence the law governing a trust. (See Section C below, "**Designing a Third Party Trust to be More Debtor Friendly**.") To avoid this nonsense altogether that is so inherent in the United States legal system and to better protect family wealth, planners should strongly consider counseling clients to establish third party trusts in appropriate offshore jurisdictions. (Of course, planners must also consider the income tax consequences inherent with the use of foreign trusts and how to deal with such issues.)

7. Section 736.0504 of the Florida Statutes provides:

> Discretionary trusts; effect of standard.-
>
> (1) As used in this section, the term "discretionary distribution" means a distribution that is subject to the trustee's discretion whether or not the discretion is expressed in the form of a standard of distribution and whether or not the trustee has abused the discretion.
>
> (2) Whether or not a trust contains a spendthrift provision, if a trustee may make discretionary distributions to or for the benefit of a beneficiary, a creditor of the beneficiary, including a creditor as described in s. 736.0503(2), may not:
>
> (a) Compel a distribution that is subject to the trustee's discretion; or
>
> (b) Attach or otherwise reach the interest, if any, which the beneficiary might have as a result of the trustee's authority to make discretionary distributions to or for the benefit of the beneficiary.

(3) If the trustee's discretion to make distributions for the trustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee.

(4) This section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution.

8. Section 736.0814(1) of the Florida Statutes provides:

> Notwithstanding the breadth of discretion granted to a trustee in the terms of the trust, including the use of such terms as "absolute," "sole," or "uncontrolled," the trustee shall exercise a discretionary power in good faith and in accordance with the terms and purposes of the trust and the interests of the beneficiaries. A court shall not determine that a trustee abused its discretion merely because the court would have exercised the discretion in a different manner or would not have exercised the discretion.

C. Designing a Third Party Trust to be More Debtor Friendly.

1. Do not appoint a beneficiary as a trustee, or if a client insists that one or more beneficiaries serve as trustees, vest the distribution authority solely in an independent trustee. See §60 Restatement (Third) of Trusts. (An "**independent trustee**" should be defined as an (a) individual who is not the settlor, the settlor's spouse or a beneficiary of the trust and who is not related by blood or marriage to any of the foregoing individuals; and (b) an individual who, or trust company that, is not "**related or subordinate**" to the settlor and any beneficiary within the meaning of §672(c) of the Code.)

2. a. Make all interests in income and principal discretionary unless a mandatory income interest is required to qualify for a tax benefit as in the case of a qualified terminable interest property ("**QTIP**") trust or a qualified subchapter S trust ("**QSST**"). If a mandatory income interest is necessary to qualify for a tax benefit as in the case of a QSST or a QTIP trust, understand the parameters necessary to qualify for that tax benefit to design the trust to maximize the protection of its income and corpus from the claims of potential creditors of a beneficiary. (For example, see Section XVI *infra*.) Also, to qualify as a QSST §1361(d)(3) merely requires that all of the income of a trust (within the meaning of §643(b)) be distributed to the beneficiary, however, it does not require the trust to provide the beneficiary with a mandatory income interest.

b. Provide that distributions of income and principal may only be made in an independent trustee's **sole, absolute, uncontrolled, unfettered, unlimited** and **full** discretion. For an excellent article on the use of discretionary trusts in Florida see, Tiernan, "A Trustee's Duties and Responsibilities Under Discretionary Invasion Provisions," 79 The

Florida Bar Journal 50 (Oct. 2005). The article contains sample language that asset protection planners should consider including in a third party discretionary trust to ensure maximum protection of the wealth held in the trust from the claims of creditors. For an additional discussion on this issue see Brown & Mead, "Protecting Family Inheritances from Divorce," * Trusts & Estates 22 (June 2013). For an interesting discussion of a third party discretionary spendthrift trust in the context of the divorcing beneficiary's marital estate division, see *Pfannenstiehl v. Pfannenstiehl*, 2016 WL 4131248, (Mass. Aug. 4, 2016) (reversing the appellate court by holding that the beneficiary's interest was an expectancy too speculative to assign to the marital estate). For an excellent discussion on *Pfannenstiehl*, see, Pratt & Roshkind, "Massachusetts Supreme Judicial Court's Decision in *Pfannenstiehl*: Another Olympic Win!," **LISI** Estate Planning Newsletter #2451 (Sept. 1, 2016) at http://www.leimbergservices.com.

3. Do not provide a beneficiary with a withdrawal right over trust assets such as a five and five power unless such power is necessary to qualify transfers to the trust for the annual exclusion. If a withdrawal right is required by a client or for tax planning purposes, limit the period during which such a power may be exercised by the powerholder. For example, while an extended period might be prudent when the withdrawal power is necessary to qualify a gift for the annual exclusion, a five and five power in a credit shelter trust given to a surviving spouse can be designed to be exercisable on one day during any calendar year. If the trust must contain withdrawal rights, consider counseling a client to settle or move the situs and administration of the trust to a state with favorable law protecting the powerholder-beneficiary's interest in the portion of the trust subject to, or previously subject to, a withdrawal right. See *e.g.*, Tex. Code §112.035(e), Az. Stat. §14-7705, Tenn. Code Ann. 35-15-505 & M.R.S. §456.5-505(5). See also Subchapter VI of Chapter 35 of Part V of Title 12 of the Delaware Code.

4. Draft the trust to continue for a beneficiary's life rather than providing for outright distributions or unfettered withdrawal rights. For an additional discussion on this issue see Brown & Mead, "Protecting Family Inheritances from Divorce," * Trusts & Estates 22 (June 2013).

5. Do not give a beneficiary a testamentary general power of appointment unless it is required to qualify the trust for a tax benefit (such as is the case with a §2642(c) trust). If a testamentary general power of appointment is required to qualify the trust for a tax benefit, understand the parameters necessary to qualify for that benefit to design the trust to maximize the protection of its assets from the claims of potential creditors of a beneficiary. For an additional discussion on this issue see Brown & Mead, "Protecting Family Inheritances from Divorce," * Trusts & Estates 22 (June 2013).

6. Consider selecting a forum to settle the trust or move the situs of the trust (and change the applicable governing law) to a jurisdiction with more debtor friendly laws to maximize the protection of the corpus from the claims of potential creditors of a beneficiary. As a corollary to the foregoing rule, under the trust document give an independent trustee the flexibility to move the situs of the trust and change the governing law applicable to the trust in such trustee's sole, absolute and uncontrolled discretion. For an excellent example of a poor jurisdiction to establish a trust see *In Re Zukerkorn*, 484 B.R. 182 (9th Cir.BAP (Cal.) 2012).

a. Some states have specific legislation protecting property held in a non-self-settled spendthrift and/or discretionary trust. See *e.g.*, the trust law of Mississippi, Iowa, Alaska and Indiana. For an excellent discussion of the Alaska law see Blattmachr, *et. al*, "New Alaska Law Will Enhance Nationwide Estate Planning—Part 1," 40 EP 9 (Sept. 2013).

b. For example, in regards to a trust agreement that contains a spendthrift provision, §91-9-503 of the Mississippi Code provides in relevant part:

> if the trust instrument provides that a beneficiary's interest in income or principal or both of a trust is not subject to voluntary or involuntary transfer, the beneficiary's interest in income or principal or both under the trust may not be transferred and is not subject to the enforcement of a money judgment until paid to the beneficiary.

In regards to a discretionary trust, §91-9-507(1) of the Mississippi Code provides in relevant part:

> if the trust instrument provides that the trustee shall pay to or for the benefit of a beneficiary so much of the income or principal or both of a trust as the trustee in the trustee's discretion sees fit to pay, a transferee or creditor of the beneficiary may not compel the trustee to pay any amount from the trust that may be paid only in the exercise of the trustee's discretion. This subsection shall not be applied or construed to limit or otherwise diminish a restraint on transfer that is valid under Section 91-9-503.

Additionally, §91-9-507(2) of the Mississippi Code provides in relevant part:

> If the trustee has knowledge of a transfer of a beneficiary's interest in a trust or has been served with process in a proceeding for garnishment or attachment or the like by a judgment creditor seeking to reach a beneficiary's interest in a trust, and the trustee pays to or for the benefit of the beneficiary any part of the income or principal of the trust that may be paid only in the exercise of the trustee's discretion, the trustee is liable to the transferee or creditor to the extent that the payment to or for the benefit of the beneficiary impairs the right of the transferee or creditor. This subsection does not apply if the beneficiary's interest in the trust is subject to a restraint on transfer that is valid under Section 91-9-503.

Finally, §91-9-507(3) of the Mississippi Code provides, "This section applies regardless of whether the trust instrument provides a standard for the exercise of the trustee's discretion."

c. Also, in regards to a discretionary trust, § 55-1-43 of South Dakota Codified Laws provides:

> The following provisions apply only to discretionary interests:
>
> (1) A discretionary interest is neither a property interest nor an enforceable right. It is a mere expectancy;

(2) No creditor may require the trustee to exercise the trustee's discretion to make a distribution, or cause a court to foreclose a discretionary interest;

(3) A court may review a trustee's distribution discretion only if the trustee:

(a) Acts dishonestly;

(b) Acts with an improper motive; or

(c) Fails to act.

Words such as sole, absolute, uncontrolled, or unfettered discretion dispense with the trustee acting reasonably.

Absent express language to the contrary, in the event that the distribution language in a discretionary interest permits unequal distributions between beneficiaries or distributions to the exclusion of other beneficiaries, the trustee may distribute all of the accumulated, accrued, or undistributed income and principal to one beneficiary in the trustee's discretion.

Regardless of whether a beneficiary has any outstanding creditor, a trustee of a discretionary interest may directly pay any expense on behalf of such beneficiary and may exhaust the income and principal of the trust for the benefit of such beneficiary. No trustee is liable to any creditor for paying the expenses of a beneficiary who holds a discretionary interest.

7. Notwithstanding the holdings in Revenue Ruling 95-58, 1995-2 C.B. 191, *Wall Estate v. Commissioner*, 101 T.C. 300 (1993) and *Vak Estate v. Commissioner*, 973 F.2d 1409 (8th Cir. 1992), *reversing* T.C. Memo 1991-503, avoid giving a beneficiary the authority to remove and replace any trustee. See *United States v. Raymond Grant et ux.*, No. 00-8986, slip op. (S.D. Fla. Sep. 2, 2005); *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002); *In re Baldwin*, 145 B.R. 210 (1992); and *In re Hezig*, 167 B.R. 707 (1994).

8. Give the trustee the authority to distribute income or principal to multiple current beneficiaries rather than a single current beneficiary. Do not provide a statement in the trust document providing that any one of the current beneficiaries is a primary beneficiary or his or her interests must be considered first. Instead, a settlor or testator should consider giving the trustee precatory guidelines in a memorandum or letter of wishes.

9. Consider including provisions that might automatically eliminate or suspend a beneficiary's interest in the trust or give an independent trustee the authority to eliminate or suspend a beneficiary's interest in the trust. This is a common provision used in many foreign trusts.

10. Limit the beneficiary's access to all or a portion of the trust for the term of the trust or for certain periods (*e.g.*, until age sixty-five (65) the beneficiary can only receive distributions of income from the trust and not principal).

11. a. Consider giving an independent trustee the power to distribute the assets of the trust to the trustee of another trust (whether located within the same jurisdiction as the trust or a different jurisdiction). Following the distribution from one trust to the other, the terms of the distributing trust should permit the assets of such trust to be held, administered and disposed of in accordance with the terms of the trust receiving such assets. The independent trustee could also be given the authority to create a new trust to receive such assets. Either the receiving trust or the new trust could provide terms that significantly increase the protection of the wealth that was originally held in the first trust. Of course, any provision permitting such a distribution or appointment of trust property must be carefully drafted to avoid forfeiting a tax benefit. This type of provision is referred to as a "***decanting provision***" and is commonly found in foreign trusts. For a detailed discussion of decanting provisions see, Halperin and Wandler, "Decanting Discretionary Trusts: State Law and Tax Considerations," 29 T.M., Est. Gifts & Tr Jrnl. 219 (Sept.-Oct. 2004). See also, AS 13.36.157 (Alaska); 12 Del.C. § 3528 (Delaware); EPTL Section 10-6.6(b) (New York); T. C. A. § 35-15-816 (Tennessee); F.S. § 736.04117 (Florida) and *Phipps v. Palm Beach Trust Co.*, 142 Fla. 782, 196 So. 299 (Fla. 1940).

b. **Sample Decanting Provision**:

> Subject to the foregoing provisions of this Article, during the lifetime of the Settlor, the Independent Trustee may exercise its power under Section ____ of this Article to distribute the net income and principal of the trust by appointing any part or all of such principal and net income to the trustee of a Qualified Trust. The Independent Trustee may act under this provision without the approval or consent of any beneficiary of any trust under this agreement and without the approval or consent of any court. Any such distribution shall be in accordance with and subject to the powers and provisions of the Qualified Trust receiving such property; provided, however, such distribution shall not violate the rule against perpetuities, if any, that is applicable to this trust.
>
> The term "**Qualified Trust**" means a trust created under another instrument, including a trust with a situs in and governed by the laws of another jurisdiction, provided, however, that the only beneficiaries of such trust are any one or more of the Settlor, the Settlor's spouse and the Settlor's descendants living from time to time (except such trust may provide for an ultimate disposition of its assets in a manner similar to that provided in Article ____).

c. Alaska law contains a statutory decanting power. Section 13.36.157 of the Alaska Statutes provides:

> (a) Subject to (d) of this section, unless the terms of the instrument expressly provide otherwise, a trustee who has authority under the terms of an instrument or irrevocable inter vivos agreement to invade the principal of a trust for the benefit of a beneficiary who is eligible or entitled to the income of the trust may exercise without prior court approval the trustee's authority by appointing, whether or not there is a current need to invade the principal under any standard stated in the governing instrument, part or all of the principal of the trust in

favor of a trustee of another trust under an instrument other than that under which the power to invade was created if the exercise of this authority: (1) does not reduce any fixed income interest of a beneficiary of the invaded trust; (2) is in favor of the beneficiaries of the invaded trust; (3) does not violate the limitations on validity under AS 34.27.051 or 34.27.100; and (4) results, in the appointed trust, in a standard for invading principal that is the same as the standard for invading principal in the invaded trust.

(b) This section applies to a trust governed by the laws of this state, including a trust: (1) whose governing jurisdiction is transferred to this state; or (2) that has a trustee who is a qualified person, if the majority of the trustees sign an instrument that (A) provides that the primary administration of the trust will be located in this state; and (B) is acknowledged under AS 09.63 or the equivalent provision of the laws of another jurisdiction.

(c) The exercise of the power to invade the principal of a trust under (a) of this section is considered to be the exercise of a special power of appointment.

(d) The governing instrument of an appointed trust may provide that, after a time or an event specified in the governing instrument, the trust assets of the appointed trust remaining after the time or event shall be held for the benefit of the beneficiaries of the invaded trust on terms and conditions regarding the nature and extent of the interests of the beneficiaries of the invaded trust that are substantially identical to the terms and conditions governing the interests of the beneficiaries in the invaded trust.

(e) In this section, (1) "appointed trust" means the trust to which principal is appointed under (a) of this section; (2) "invaded trust" means the trust whose principal is invaded under (a) of this section.

For an excellent discussion of the new Alaska decanting statute see Blattmachr, *et. al*, "New Alaska Law Will Enhance Nationwide Estate Planning—Part 1," 40 EP 9 (Sept. 2013).

d. Section 3528 of the Delaware Code provides:

(a) Unless the terms of the instrument expressly provide otherwise, a trustee who has authority, under the terms of a testamentary instrument or irrevocable inter vivos trust agreement, to invade the principal of a trust (the "first trust") to make distributions to, or for the benefit of, 1 or more proper objects of the exercise of the power, may instead exercise such authority by appointing all or part of the principal subject to the power in favor of a trustee of a trust (the "second trust") under an instrument other than that under which the power to invade is created or under the same instrument, provided, however, that, except as otherwise provided in this subsection (a): (1) The exercise of such authority is in favor of a second trust having only beneficiaries who are proper objects of the exercise of the power; (2) In the case of any trust contributions to which have been treated as gifts qualifying for the exclusion from gift tax described in

§ 2503(b) [26 U.S.C. § 2503(b)| of the Internal Revenue Code of 1986 (26 U.S.C. § 1 et seq.) (hereinafter referred to in this section as the "I.R.C."), by reason of the application of I.R.C. § 2503(c) ›26 U.S.C. § 2503(c)], the governing instrument for the second trust shall provide that the beneficiary's remainder interest shall vest and become distributable no later than the date upon which such interest would have vested and become distributable under the terms of the governing instrument for the first trust; (3) The exercise of such authority does not reduce any income interest of any income beneficiary of a trust for which a marital deduction has been taken for federal tax purposes under I.R.C. § 2056 or § 2523 [26 U.S.C. § 2056 or § 2523] or for state tax purposes under any comparable provision of applicable state law; and (4) The exercise of such authority does not apply to trust property subject to a presently exercisable power of withdrawal held by a trust beneficiary who is the only trust beneficiary to whom, or for the benefit of whom, the trustee has authority to make distributions.

Notwithstanding the foregoing provisions of this subsection (a) of this section, the governing instrument for the second trust may provide that, at a time or upon an event specified in the governing instrument, the remaining trust assets shall thereafter be held for the benefit of the beneficiaries of the first trust upon terms and conditions concerning the nature and extent of each such beneficiary's interest that are substantially identical to the first trust's terms and conditions concerning such beneficial interests.

(b) The exercise of the power to invade the principal of the trust under subsection (a) of this section shall be by an instrument in writing, signed and acknowledged by the trustee and filed with the records of the trust.

(c) The exercise of the power to invade the principal of the trust under subsection (a) of this section shall be considered the exercise of a power of appointment (other than a power to appoint to the trustee, the trustee's creditors, the trustee's estate, or the creditors of the trustee's estate) and shall be subject to the provisions of Chapter 5 of Title 25 covering the time at which the permissible period of the rule against perpetuities begins and the law which determines the permissible period of the rule against perpetuities.

(d) The provisions of this section shall not be construed to abridge the right of any trustee who has a power of invasion to appoint property in further trust which arises under any other section of this chapter or under another statute or under common law. (74 Del. Laws, c. 81, § 3; 74 Del. Laws, c. 271, § 2; 75 Del. Laws, c. 300, § 2.)

e. Section 10-6.6(b) of the Estates, Powers and Trusts Law of the New York State Consolidated Laws provides:

(b) Unless the terms of the instrument expressly provide otherwise: (1) A trustee who has the absolute discretion, under the terms of a testamentary instrument or

> irrevocable inter vivos trust agreement, to invade the principal of a trust for the benefit of one or more proper objects of the exercise of the power, may exercise such discretion by appointing all or part of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument, provided, however, that the exercise of such discretion (A) does not reduce any fixed income interest of any income beneficiary of the trust, (B) is in favor of the proper objects of the exercise of the power, and (C) does not violate the limitations of 11-1.7; and (2) A trustee described in subparagraph (1) of this paragraph may act thereunder without consent of any interested person and without prior court approval but is also authorized to seek such court approval, and the court having jurisdiction of the trust, upon the petition of the trustee and upon notice to all persons interested in the trust, may direct the trustee to exercise its discretion by appointing all or part of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument, provided, however, that the exercise of such discretion (A) does not reduce any fixed income interest of any income beneficiary of the trust, (B) is in favor of the proper objects of the exercise of the power, and (C) does not violate the limitations of 11-1.7.

f. Section 35-15-816(b)(27) of the Tennessee Code Annotated provides:

> Unless the terms of the instrument expressly provide otherwise: (A) A trustee who has authority, under the terms of a testamentary instrument or irrevocable inter vivos trust agreement, to invade the principal of a trust to make distributions to, or for the benefit of, one or more proper objects of the exercise of the power, may instead exercise such authority by appointing all or part of the principal of the trust in favor of a trustee of a trust under an instrument other than that under which the power to invade is created or under the same instrument; provided, however, that the exercise of such authority: (i) Does not reduce any fixed income interest of any income beneficiary of the trust; and (ii) Is in favor of the proper objects of the exercise of the power; (B) The exercise of the power to invade the principal of the trust under subdivision (b)(27)(A) shall be by an instrument in writing, signed and acknowledged by the trustee and filed with the records of the trust; (C) The exercise of the power to invade principal of the trust under subdivision (b)(27)(A) shall not extend the permissible period of the rule against perpetuities that applies to the trust; and (D) The provisions of this section shall not be construed to abridge the right of any trustee who has a power of invasion to appoint property in further trust that arises under any other statute or under common law.

g. Florida recently passed a statutory provision permitting trustees of certain trusts to decant assets. See F.S. § 736.04117. This provision became effective July 1,2007. See also, Spivey, "'Decanting' From One Trust to Another: Why a New Trust Code Section," ActionLine at page 14 (Summer 2007). The Florida statute provides:

(1) (a) Unless the trust instrument expressly provides otherwise, a trustee who has absolute power under the terms of a trust to invade the principal of the trust, referred to in this section as the "first trust," to make distributions to or for the benefit of one or more persons may instead exercise the power by appointing all or part of the principal of the trust subject to the power in favor of a trustee of another trust, referred to in this section as the "second trust," for the current benefit of one or more such persons under the same trust instrument or under a different trust instrument; provided: 1. The beneficiaries of the second trust may include only beneficiaries of the first trust; 2. The second trust may not reduce any fixed income, annuity, or unitrust interest in the assets of the first trust; and 3. If any contribution to the first trust qualified for a marital or charitable deduction for federal income, gift, or estate tax purposes under the Internal Revenue Code of 1986, as amended, the second trust shall not contain any provision which, if included in the first trust, would have prevented the first trust from qualifying for such a deduction or would have reduced the amount of such deduction. (b) For purposes of this subsection, an absolute power to invade principal shall include a power to invade principal that is not limited to specific or ascertainable purposes, such as health, education, maintenance, and support, whether or not the term "absolute" is used. A power to invade principal for purposes such as best interests, welfare, comfort, or happiness shall constitute an absolute power not limited to specific or ascertainable purposes. (2) The exercise of a power to invade principal under subsection (1) shall be by an instrument in writing, signed and acknowledged by the trustee, and filed with the records of the first trust. (3) The exercise of a power to invade principal under subsection (1) shall be considered the exercise of a power of appointment, other than a power to appoint to the trustee, the trustee's creditors, the trustee's estate, or the creditors of the trustee's estate, and shall be subject to the provisions of s. 689.225 covering the time at which the permissible period of the rule against perpetuities begins and the law that determines the permissible period of the rule against perpetuities of the first trust. (4) The trustee shall notify all qualified beneficiaries of the first trust, in writing, at least 60 days prior to the effective date of the trustee's exercise of the trustee's power to invade principal pursuant to subsection (1), of the manner in which the trustee intends to exercise the power. A copy of the proposed instrument exercising the power shall satisfy the trustee's notice obligation under this subsection. If all qualified beneficiaries waive the notice period by signed written instrument delivered to the trustee, the trustee's power to invade principal shall be exercisable immediately. The trustee's notice under the subsection shall not limit the right of any beneficiary to object to the exercise of the trustee's power to invade principal except as provided in other applicable provisions of this code. (5) The exercise of the power to invade principal under subsection (1) is not prohibited by a spendthrift clause or by a provision in the trust instrument that prohibits amendment or revocation of the trust. (6) Nothing in this section is intended to create or imply a duty to exercise a power to invade principal and no inference of impropriety shall be made as a result of a trustee not exercising the power to invade principal conferred under subsection (1). (7) The provisions

of this section shall not be construed to abridge the right of any trustee who has a power of invasion to appoint property in further trust that arises under the terms of the first trust or under any other section of this code or under another provision of law or under common law.

h. Section 55-2-15 of the South Dakota Codified Laws provides:

Trustee authorized to distribute income or principal from first trust may appoint all or part in favor of trustee of second trust--Restrictions. Unless the terms of the instrument expressly provide otherwise, a trustee who has discretionary authority, under the terms of a testamentary instrument or irrevocable *inter vivos* trust agreement, to make a distribution of income or principal to, or for the benefit of, one or more beneficiaries of a trust (the "first trust"), may instead exercise such authority by appointing all or part of the income or principal subject to the power in favor of a trustee of a trust (the "second trust") under an instrument other than that under which the power to distribute is created or under the same instrument, in the event that the trustee of the first trust decides that the appointment is necessary or desirable after taking into account the purposes of the first trust, the terms and conditions of the second trust, and the consequences of the distribution. However, the following apply: (1) The second trust has as beneficiaries only one or more of those beneficiaries of the first trust to or for whom a discretionary distribution may be made from the first trust and who are proper objects of the exercise of the power, or one or more of those other beneficiaries of the first trust to or for whom a distribution of income or principal may have been made in the future from the first trust at a time or upon the happening of an event specified under the first trust; (2) No trustee of the first trust may: (a) Exercise such authority to make a distribution from the first trust if the trustee is a beneficiary of the first trust, or if any beneficiary may change the trustees of the first trust, unless the exercise of such authority is for health, education, maintenance, or support; or (b) Exercise such authority to the extent that doing so would have the effect either of (i) increasing the distributions that can be made in the future from the second trust to the trustee of the first trust or to a beneficiary who may change the trustees of the first trust, or (ii) removing restrictions on discretionary distributions imposed by the agreement under which the first trust was created, except that in either case participating in a change that is needed for the health, education, maintenance, or support of any such beneficiary is permitted; (3) In the case of any trust contributions which have been treated as gifts qualifying for the exclusion from gift tax described in § 2503(b) of the Internal Revenue Code of 1986, by reason of the application of I.R.C. § 2503(c), the governing instrument for the second trust shall provide that the beneficiary's remainder interest shall vest and become distributable no later than the date upon which such interest would have vested and become distributable under the terms of the governing instrument for the first trust; (4) The exercise of such authority does not reduce any income interest of any income beneficiary of a trust for which a marital deduction has been taken for federal tax purposes under I.R.C. § 2056 or § 2523 or for state tax purposes under any comparable provision of applicable

state law; and (5) The exercise of such authority does not apply to trust property subject to a presently exercisable power of withdrawal held by a trust beneficiary to whom, or for the benefit of whom, the trustee has authority to make distributions.

i. Section 36C-8-816.1 of the North Carolina General Statutes provides:

A trustee of an original trust may, without authorization by the court, exercise the discretionary power to distribute principal or income to or for the benefit of one or more current beneficiaries of the original trust by appointing all or part of the principal or income of the original trust subject to the power in favor of a trustee of a second trust. The trustee of the original trust may exercise this power whether or not there is a current need to distribute principal or income under any standard provided in the terms of the original trust. The trustee's special power to appoint trust principal or income in further trust under this section includes the power to create the second trust. For purposes of this section, the following definitions apply: (1) Current beneficiary.--A person who is a permissible distributee of trust income or principal; (2) Original trust.--A trust established under an irrevocable trust instrument pursuant to the terms of which a trustee has a discretionary power to distribute principal or income of the trust to or for the benefit of one or more current beneficiaries of the trust; and (3) Second trust.--A trust established under an irrevocable trust instrument, the current beneficiaries of which are one or more of the current beneficiaries of the original trust. The second trust may be a trust created under the same trust instrument as the original trust or under a different trust instrument. The terms of the second trust shall be subject to all of the following: (1) the beneficiaries of the second trust may include only beneficiaries of the original trust; (2) a beneficiary who has only a future beneficial interest, vested or contingent, in the original trust cannot have the future beneficial interest accelerated to a present interest in the second trust; (3) the terms of the second trust may not reduce any fixed income, annuity, or unitrust interest of a beneficiary in the assets of the original trust; (4) if any contribution to the original trust qualified for a marital or charitable deduction for federal income, gift, or estate tax purposes under the Internal Revenue Code, then the second trust shall not contain any provision that, if included in the original trust, would have prevented the original trust from qualifying for the deduction or that would have reduced the amount of the deduction; (5) if contributions to the original trust have been excluded from the gift tax by the application of section 2503(b) and section 2503(c) of the Internal Revenue Code, then the second trust shall provide that the beneficiary's remainder interest in the contributions shall vest and become distributable no later than the date upon which the interest would have vested and become distributable under the terms of the original trust; (6) if any beneficiary of the original trust has a power of withdrawal over trust property, then either: a. The terms of the second trust must provide a power of withdrawal in the second trust identical to the power of withdrawal in the original trust; or b. Sufficient trust property must remain in the original trust to satisfy the outstanding power of

withdrawal; (7) if a trustee of an original trust exercises a power to distribute principal or income that is subject to an ascertainable standard by appointing property to a second trust, then the power to distribute income or principal in the second trust must be subject to the same ascertainable standard as in the original trust and must be exercisable in favor of the same current beneficiaries to whom such distribution could be made in the original trust; and (8) the second trust may confer a power of appointment upon a beneficiary of the original trust to whom or for the benefit of whom the trustee has the power to distribute principal or income of the original trust. The permissible appointees of the power of appointment conferred upon a beneficiary may include persons who are not beneficiaries of the original or second trust. The power of appointment conferred upon a beneficiary shall be subject to the provisions of G.S. 41-23 covering the time at which the permissible period of the rule against perpetuities and suspension of power of alienation begins and the law that determines the permissible period of the rule against perpetuities and suspension of power of alienation of the original trust. A trustee may not exercise the power to appoint principal or income under subsection (b) of this section if the trustee is a beneficiary of the original trust, but the remaining cotrustee or a majority of the remaining cotrustees may act for the trust. If all the trustees are beneficiaries of the original trust, then the court may appoint a special fiduciary with authority to exercise the power to appoint principal or income under subsection (b) of this section. The exercise of the power to appoint principal or income under subsection (b) of this section: (1) shall be considered the exercise of a power of appointment, other than a power to appoint to the trustee, the trustee's creditors, the trustee's estate, or the creditors of the trustee's estate; (2) shall be subject to the provisions of G.S. 41-23 covering the time at which the permissible period of the rule against perpetuities and suspension of power of alienation begins and the law that determines the permissible period of the rule against perpetuities and suspension of power of alienation of the original trust; and (3) is not prohibited by a spendthrift provision or by a provision in the original trust instrument that prohibits amendment or revocation of the trust. To effect the exercise of the power to appoint principal or income under subsection (b) of this section, all of the following shall apply: (1) the exercise of the power to appoint shall be made by an instrument in writing, signed and acknowledged by the trustee, setting forth the manner of the exercise of the power, including the terms of the second trust, and the effective date of the exercise of the power. The instrument shall be filed with the records of the original trust; (2) the trustee shall give written notice to all qualified beneficiaries of the original trust, at least 60 days prior to the effective date of the exercise of the power to appoint, of the trustee's intention to exercise the power. The notice shall include a copy of the instrument described in subdivision (1) of this subsection; (3) if all qualified beneficiaries waive the notice period by a signed written instrument delivered to the trustee, the trustee's power to appoint principal or income shall be exercisable after notice is waived by all qualified beneficiaries, notwithstanding the effective date of the exercise of the power; and (4) the trustee's notice under this subsection shall not limit the right of any beneficiary

to object to the exercise of the trustee's power to appoint and bring an action for breach of trust seeking appropriate relief as provided by G.S. 36C-10-1001.

j. Section 14-10819 of the Arizona Revised Statutes provides:

Unless the terms of the instrument expressly provide otherwise, a trustee who has the discretion under the terms of a testamentary instrument or irrevocable inter vivos agreement to make distributions, regardless of whether a standard is provided in the instrument or agreement, for the benefit of a beneficiary of the trust may exercise without prior court approval the trustee's discretion by appointing part or all of the estate trust in favor of a trustee of a trust under an instrument other than that under which the power to make distributions was created if the exercise of this discretion: 1. does not reduce any fixed nondiscretionary income payment to a beneficiary; 2. does not alter any nondiscretionary annuity or unitrust payment to a beneficiary; 3. is in favor of the beneficiaries of the trust; 4. results in any ascertainable standard applicable for distributions from the trust being the same or more restrictive standard applicable for distributions from the recipient trust when the trustee exercising the power described in this subsection is a possible beneficiary under the standard; 5. does not adversely affect the tax treatment of the trust, the trustee, the settlor or the beneficiaries and 6. does not violate the limitations on validity under §§ 14-2901 and 14-2905. This section applies to a trust governed by the laws of this state, including a trust whose governing jurisdiction is transferred to this state. The exercise of the power to invade the principal of a trust under subsection A of this section is considered to be the exercise of a special power of appointment. The trustee, in the trustee's sole discretion, prior to or after the exercise of the trustee's discretion under this section, may request the court to approve the exercise.

k. Section 14163.556 of the Nevada Revised Statutes provides:

Unless the terms of a testamentary instrument or irrevocable trust provide otherwise, a trustee with discretion or authority to distribute trust income or principal to or for a beneficiary of the trust may exercise such discretion or authority by appointing the property subject to such discretion or authority in favor of a second trust for the benefit of one or more of those beneficiaries. Notwithstanding subsection 1, a trustee may not appoint property of the original trust to a second trust if: (a) the second trust includes a beneficiary who is not a beneficiary of the original trust. For purposes of this paragraph, a permissible appointee of a power of appointment exercised by a beneficiary of the second trust is not considered a beneficiary of the second trust; (b) appointing the property will reduce any current fixed income interest, annuity interest or unitrust interest of a beneficiary of the original trust. As used in this paragraph, "unitrust" has the meaning ascribed to it in NRS 164.700; (c) a contribution made to the original trust qualified for a marital or charitable deduction for federal or state income, gift or estate taxes or qualified for a gift tax exclusion for federal or state tax purposes and the terms of the second trust include a

provision which if included in the original trust would prevent the original trust from qualifying for the tax deduction or exclusion; (d) the property to be appointed is subject to a power of withdrawal which is held by a beneficiary of the original trust and may be executed at the time of the proposed appointment; (e) property specifically allocated for one beneficiary of the original trust is no longer allocated for that beneficiary under either or both trusts, unless the beneficiary consents in writing; (f) property held for the benefit of one or more beneficiaries under both the original and the second trust has a lower value than the value of the property held for the benefit of the same beneficiaries under only the original trust, unless: (1) the benefit provided is limited to a specific amount or periodic payments of a specific amount; and (2) the value of the property held in either or both trusts for the benefit of one or more beneficiaries is actuarially adequate to provide the benefit; and (g) Under the second trust: (1) discretionary distributions may be made by the trustee to a beneficiary or group of beneficiaries of the original trust; (2) distributions are not limited by an ascertainable standard; and (3) a beneficiary or group of beneficiaries has the power to remove and replace the trustee of the second trust with a beneficiary of the second trust or with a trustee that is related to or subordinate to a beneficiary of the second trust. Before appointing property pursuant to subsection 1, a trustee may give notice of a proposed action pursuant to NRS 164.725 or may petition a court for approval pursuant to NRS 153.031, 164.015 or 164.725. Any notice of a proposed action or a petition for a court's approval must include the trustee's opinion of how the appointment of property will affect the trustee's compensation and the administration of other trust expenses. Notwithstanding the provisions of subsection 2 or 3, the trust instrument of the second trust may: (a) grant a power of appointment to one or more of the beneficiaries of the second trust who are proper objects of the exercise of the power in the original trust. The power of appointment includes, without limitation, the power to appoint trust property to the holder of the power, the holder's creditors, the holder's estate, the creditors of the holder's estate or any other person; and (b) provide that, at a time or occurrence of an event specified in the trust instrument, the remaining trust assets in the second trust must be held for the beneficiaries of the original trust upon terms and conditions that are substantially identical to the terms and conditions of the original trust. The power to appoint the property of the original trust pursuant to subsection 1 must be exercised by a writing, signed by the trustee and filed with the records of the trust.

l. Section 564-B: 4-418 of the Revised Statutes of the State of New Hampshire provides:

> Unless the terms of the trust expressly provide otherwise, a trustee with the discretion to make distributions to or for the benefit of one or more beneficiaries of a trust (the "first trust") may exercise that discretion by appointing the property subject to that authority in favor of another trust for the benefit of one or more of those beneficiaries (the "second trust"). Notwithstanding the provisions of paragraph (a), the trustee may not decant property of the first trust

in favor of the second trust under any of the following circumstances: (1) the second trust includes a beneficiary that is not a beneficiary of the first trust. For purposes of this subparagraph, a permissible appointee of a power of appointment held by a beneficiary of the second trust is not considered to be a beneficiary of the second trust; (2) the exercise of the power to decant will reduce any current fixed income interest, annuity interest, or unitrust interest of a beneficiary of the first trust; (3) a contribution to the first trust qualified for a marital or charitable deduction for federal or state income, gift, or estate tax purposes or qualified for a gift tax exclusion for federal or state gift tax purposes, while the terms of the second trust include a provision which, if included in the terms of the first trust, would have prevented the first trust from qualifying for the deduction or exclusion; (4) the property is subject to a presently exercisable power of withdrawal held by a beneficiary of the first trust; or (5) under the terms of the second trust: (A) discretionary distributions may be made to a beneficiary or among a group of beneficiaries of the first trust; (B) the distributions are not limited by an ascertainable standard; and (C) the beneficiary or group of beneficiaries has the power to remove and replace the trustee of the second trust with the beneficiary or a member of the group of beneficiaries or with a trustee that is related or subordinate to the beneficiary or a member of the group of beneficiaries (as defined in section 672(c) of the Internal Revenue Code). Notwithstanding the provisions of paragraph (a), a trustee who is a beneficiary of the first trust may not exercise the authority to appoint property of the first trust in favor of the second trust under any of the following circumstances: (1) under the terms of the first trust or pursuant to the law governing the administration of the first trust: (A) such trustee of the first trust does not have the discretion to make or participate in making distributions to himself or herself; (B) such trustee's discretion to make or participate in making distributions to himself or herself is limited by an ascertainable standard; or (C) such trustee's discretion to make or participate in making distributions to himself or herself is exercisable only with the consent of a cotrustee or another person holding an adverse interest; while under the terms of the second trust, such trustee's discretion to make or participate in making distributions to himself or herself is not limited by an ascertainable standard and is exercisable without the consent of a cotrustee or another person holding an adverse interest; or (2) under the terms of the first trust or pursuant to the law governing the administration of the first trust, such trustee of the first trust does not have the discretion to make or participate in making distributions in a manner that will discharge such trustee's legal support obligations, while under the terms of the second trust, such trustee's discretion is not so limited. The trustee of the first trust shall notify in writing the director of charitable trusts of a proposed appointment in favor of a second trust at least 30 days in advance of the proposed appointment if, at the time the appointment is being proposed: (1) at least one charitable organization has the rights of a qualified beneficiary of the first trust; or (2) the director of charitable trusts has the rights of a qualified beneficiary of the first trust.

m. Virginia Law contains a decanting statute, as of April 4, 2012. § 55-548.16:1 provides, in pertinent part:

> The trustee of an original trust may, without court order, exercise the discretionary power to distribute principal or income to or for the benefit of one or more current beneficiaries of the original trust by appointing all or part of the principal or income of the original trust in favor of a trustee of a second trust, without a current need to distribute principal or income under any standard provided in the terms of the original trust. Under § 55-548.16:1(B), the trustee's power to appoint trust principal or income in further trust includes the power to create the second trust.
>
> The terms of the second trust shall be subject to the following conditions: 1. The beneficiaries of the second trust shall include only beneficiaries of the original trust; 2. If the power to distribute principal or income in the original trust is subject to an ascertainable standard, the power to distribute income or principal in the second trust shall be exercisable in favor of the same current beneficiaries as in the original trust and, unless the court approves otherwise, shall be subject to the same ascertainable standard as in the original trust; 3. A beneficiary who has only a future beneficial interest, vested or contingent, in the original trust shall not have the future beneficial interest accelerated to a present interest in the second trust; 4. The terms of the second trust shall not reduce any fixed income, annuity, or unitrust interest of a beneficiary in the original trust; 5. If any contribution to the original trust qualified for a marital or charitable deduction for federal income, gift, or estate tax purposes under the Internal Revenue Code, then the second trust shall not contain any provision that, if included in the original trust, would have prevented the original trust from qualifying for the deduction or that would have reduced the amount of the deduction; 6. If contributions to the original trust have been excluded from the gift tax by the application of 26 U.S.C. § 2503(b) or (c), the second trust shall provide that the beneficiary's remainder interest in the contributions shall vest and become distributable no later than the date upon which the interest would have vested and become distributable under the terms of the original trust; 7. If any beneficiary of the original trust has a power of withdrawal over trust property, then either: a. The terms of the second trust shall provide a power of withdrawal in the second trust identical to the power of withdrawal in the original trust; or b. Sufficient trust property shall remain in the original trust to satisfy the outstanding power of withdrawal; 8. The terms of the second trust may confer a power of appointment upon a current beneficiary of the original trust. The permissible appointees of the power of appointment conferred upon a beneficiary may include persons who are not beneficiaries of the original trust or the second trust. The power of appointment conferred upon a beneficiary shall be subject to the provisions of §§ 55-12.1 through 55-13.3, covering the time at which the permissible period of the rule against perpetuities begins and the law that determines the permissible period of the rule against perpetuities of the original trust; and 9. Notwithstanding subdivisions 1 through 8, the power

may be exercised to appoint a second trust that is a special needs trust, subject to the other provisions of this section.

A trustee who is an interested trustee may not exercise the power to appoint. The remaining cotrustee or a majority of the remaining cotrustees who are not interested trustees may exercise the power. If all the trustees are interested trustees, or at the request of any of the trustees, the court may appoint a special fiduciary with authority to exercise the power.

The exercise of the power shall be: 1. Subject to the fiduciary duties of the trustee of the original trust; 2. Treated for all purposes as the exercise of a power of appointment in a fiduciary capacity that is not a power exercisable in favor of the trustee individually, the trustee's creditors, the trustee's estate, or the creditors of the trustee's estate; 3. Subject to the provisions of §§ 55-12.1 through 55-13.3, covering the time at which the permissible period of the rule against perpetuities begins and the law that determines the permissible period of the rule against perpetuities of the original trust; and 4. Permitted regardless of whether the original trust has a spendthrift provision or prohibits amendment or revocation of the original trust.

The exercise of the power shall be made by a written instrument, signed and acknowledged by the trustee, setting forth the manner of the exercise of the power, the terms of the second trust, and the effective date of the exercise of the power. The instrument shall be filed with the records of the original trust.

At least 60 days prior to the effective date of the exercise of the power, the trustee of the original trust shall give written notice of the trustee's intent to exercise the power, including a copy of the written instrument made pursuant to subsection F, to (i) the grantor of the original trust, if living; (ii) without regard to the exercise of any power of appointment, the qualified beneficiaries of the original trust as determined under §§ 55-541.03 and 55-541.10, other than the Attorney General, and (iii) all persons acting as advisor or protector of the original trust. The representation provisions of §§ 55-543.01, 55-543.03, 55-543.04, and 55-543.05 shall apply to the notice under this subsection. If all qualified beneficiaries of the original trust waive the notice required by this subsection in a signed written instrument delivered to the trustee of the original trust, the trustee may exercise the power without providing the notice required by this subsection. The receipt of notice under this subsection shall not abrogate any right or remedy of any beneficiary against the trustee under [Virginia law] other than this section.

§ 55-548.16:1 does not create or imply a duty of the trustee to exercise the power granted in this section, and no inference of impropriety shall be made as a result of a trustee not exercising the power granted in this section, or limit the right of any trustee who has a power to appoint property in further trust under the terms of the original trust or by law.

> Section 55-548.16:1 shall be construed as pertaining to the administration of a trust and shall be available to any trust that is administered under [Virginia law], regardless of the date the trust was created, unless the governing instrument expressly prohibits the exercise of the [decanting] power.

n. On June 23, 2012, Rhode Island added § 18-4-31 to its Powers of Fiduciaries statute. The statute took effect immediately. The statute provides in pertinent part:

> Unless the trust instrument expressly provides otherwise or unless the trust is a "Special Needs Trust" or "Supplemental Needs Trust" created in accordance with 42 United States Code section 1396p(d)(4)(A), a trustee who has absolute power under the terms of a trust to invade the principal of the trust, referred to in this section as the "first trust," to make distributions to or for the benefit of one or more persons, may instead exercise the power by appointing all or part of the principal of the trust subject to the power in favor of a trustee of another trust, referred to in this section as the "second trust," for the current benefit of one or more of such persons under the same trust instrument or under a different trust instrument, provided: (i) The beneficiaries of the second trust may include only beneficiaries of the first trust; (ii) The second trust may not reduce any fixed income, annuity or unitrust interest in the assets of the first trust; and (iii) If any contribution to the first trust qualified for a marital or charitable deduction for federal income, gift or estate tax purposes under the Internal Revenue Code of 1986, as amended 26 U.S.C. section 1, et seq., the second trust shall not contain any provisions which, if included in the first trust, would have prevented the first trust from qualifying for such a deduction or would have reduced the amount of such deduction. For purposes of this [statute], an absolute power to invade principal shall include a power to invade principal that is not limited to specific or ascertainable purpose, such as health, education, maintenance, and support whether or not the term "absolute" is used. A power to invade principal for purposes such as best interests, welfare, comfort, or happiness shall constitute an absolute power not limited to specific or ascertainable purposes.

o. On August 10, 2012, Illinois amended § 16.4 of the Illinois Trusts and Trustees Act to allow decanting. The statute takes effect on January 1, 2013. The statute provides in pertinent part:

> An authorized trustee who has the absolute discretion to distribute the principal of a trust may distribute part or all of the principal of the trust in favor of a trustee of a second trust for the benefit of one, more than one, or all of the current beneficiaries of the first trust and for the benefit of one, more than one, or all of the successor and remainder beneficiaries of the first trust. If the authorized trustee exercises the power under this subsection, the authorized trustee may grant a power of appointment (including a presently exercisable power of appointment) in the second trust to one or more of the current beneficiaries of the first trust, provided that the beneficiary granted a power to appoint could receive the principal outright under the terms of the first trust. If

> the authorized trustee grants a power of appointment, the class of permissible appointees in favor of whom a beneficiary may exercise the power of appointment granted in the second trust may be broader than or otherwise different from the current, successor, and presumptive remainder beneficiaries of the first trust. If the beneficiary or beneficiaries of the first trust are described as a class of persons, the beneficiary or beneficiaries of the second trust may include one or more persons of such class who become includible in the class after the distribution to the second trust. An authorized trustee who has the power to distribute the principal of a trust but does not have the absolute discretion to distribute the principal of the trust may distribute part or all of the principal of the first trust in favor of a trustee of a second trust, provided that the current beneficiaries of the second trust shall be the same as the current beneficiaries of the first trust and the successor and remainder beneficiaries of the second trust shall be the same as the successor and remainder beneficiaries of the first trust.
>
> If the authorized trustee exercises the power under this [subsection], the second trust shall include the same language authorizing the trustee to distribute the income or principal of a trust as set forth in the first trust. If the beneficiary or beneficiaries of the first trust are described as a class of persons, the beneficiary or beneficiaries of the second trust shall include all persons who become includible in the class after the distribution to the second trust. If the authorized trustee exercises the power under [this subsection] and if the first trust grants a power of appointment to a beneficiary of the trust, the second trust shall grant such power of appointment in the second trust and the class of permissible appointees shall be the same as in the first trust.

12. Do not permit a beneficiary to assign any part or all of his or her beneficial interest in a trust to anyone, not even a limit class of individuals such as a beneficiary's descendants. The authors are aware of some spendthrift provisions that permit such assignments.

XXXVII. DESIGNING A QTIP TRUST TO BE MORE DEBTOR FRIENDLY.

A. A qualified terminable interest property ("**QTIP**") trust is a form of marital deduction trust permitted by §§ 2056(b)(7) and 2523(f) of the Code. Under §§ 2056(b)(7)(B) and 2523(f)(2) of the Code, QTIP is any property that is transferred by a donor or decedent spouse (a "**Donor**") in which a donee or surviving spouse (a "**Spouse**") has a "**qualifying income interest for life**" and which is subject to a QTIP election. A Spouse has a qualifying income interest for life if the Spouse is entitled to all of the income from the property in such trust, payable at least annually, and no person has the power to appoint any property in the trust to any person other than to the Spouse. In drafting a QTIP trust, estate planners often fail to consider methods of optimizing the asset protection aspects of the trust. This section discusses a checklist of issues to consider when drafting a QTIP trust to enhance the asset protection aspects of the trust.

B. Most QTIP trusts provide for the distribution of income on a quarterly or more frequent basis; however, mandating distributions in this manner is not required to qualify for the marital deduction. The terms of a QTIP trust or applicable local law need only direct the trustee to distribute income annually. More frequent distributions can be permitted under the terms of the trust, however, to enhance the asset protection aspects of the trust it is recommended that the discretion to make such distributions be given to a disinterested or independent trustee. For example, an income distribution provision in a QTIP trust could provide:

> The Trustees shall pay the net income from the QTIP Trust, at least annually or at such more frequent intervals as the Independent Trustee in its sole, absolute and uncontrolled discretion deems appropriate, to the Settlor's Spouse during his/her life.

A provision in the QTIP trust should also be included to fix the date for the mandatory distribution of income, *e.g.*, December 31 of each year, with all other potential distribution dates during the year being discretionary distribution dates. A marital deduction savings clause is also recommended for inclusion in the document. (See *e.g.*, Rev. Rul. 77-440, 1975-2 C.B. 372; TAM 199932001; and PLR 8440037.)

C. Under Regulations §§ 20.2056(b)-5(f)(4) and 25.2523(e)-1(f)(3), income from a QTIP trust can be applied by the trustee "**for the benefit of the spouse**" rather than making a direct distribution of such income to a Spouse. To enhance the asset protection aspects of a QTIP trust, give the trustee the flexibility to apply the income for the benefit of the Spouse.

D. To enhance the asset protection aspects of a QTIP trust, provide that an independent trustee can make distributions of principal to the Spouse in its sole, absolute and uncontrolled discretion or curtail a spouse's access to principal even further.

E. Many QTIP trusts provide for the payment of "**stub income**" to the Spouse's estate. Stub income is the income earned during the period immediately following the last distribution of income and ending at the Spouse's death. Under Regulations §§ 20.2056(b)-7(d)(4) and § 25.2523(f)-1(c)(1)(ii), distribution of such income is not required to qualify for QTIP treatment. To enhance the asset protection aspects of the trust, it should contain a provision directing its stub income to be distributed to the successor beneficiaries or successor trusts. A specific provision in the trust is recommended because the laws of many states direct stub income to be distributed to the Spouse's estate. For example, Subsection (2) of Florida Statute § 738.303 provides in relevant part:

> When a mandatory income interest ends, the trustee shall pay to a mandatory income beneficiary who survives that date, *or the estate of a deceased mandatory income beneficiary whose death causes the interest to end*, the beneficiary's share of the undistributed income that is not disposed of under the terms of the trust. (Emphasis added.)

By way of example, a provision in a QTIP trust directing stub income to be paid to the successor estate or beneficiary could provide:

> Upon the death of the Settlor's husband, the Trustee shall deal with the balance of the principal of the QTIP Trust, together with any net income then on hand, as provided in Article ____.

The stub income rule in Regulations §§ 20.2056(b)-7(d)(4) and § 25.2523(f)-1(c)(1)(ii) can also be used to enhance the creditor protection aspects of the Spouse's mandatory income interest in the QTIP trust. In this regard, Subsection (1) of §155 of the Restatement 2d of Trusts provides in relevant part:

> if by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply, a transferee or creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal.

Comment c to §155, however, provides that the foregoing rule applies only when the trustee may in its absolute discretion refuse to make any distribution to or for the benefit of a beneficiary. As previously mentioned, the income interest in a QTIP trust is a mandatory interest, meaning the income from the trust must be distributed to the Spouse annually as long as the Spouse is living. According to the comment, the rule set forth in §155 "is not applicable where the trustee has discretion merely as to the time of payment, and where the beneficiary is ultimately entitled to the whole or to a part of the trust property." According to the comment, the beneficiary's interest may be reached by a creditor if the provisions of the trust agreement require the trustee to distribute to or apply for a beneficiary any portion or all of the income or principal of the trust. Thus, the question is whether a mandatory income interest in a QTIP trust can be designed to avoid the exception to the rule in §155 that is set forth in comment c. If structured properly, this should be possible. The mandatory income interest in a QTIP trust should be able to be designed so that the Spouse is not entitled to receive anything from the trust, whether income or principal, unless living on the mandatory income distribution date. To accomplish this result the stub income must be directed to be distributed to a successor beneficiary or trust rather than the Spouse's estate. As previously explained, a QTIP trust may provide for distribution of its income on an annual basis and require the Spouse to be living on such date to receive the income. If the Spouse dies prior to the distribution date, the stub income can be required to be distributed to a beneficiary other than the Spouse's estate. In such a case, it is unlikely that a creditor should have the ability to reach the Spouse's income interest until its distribution from the trust. Comment e of §155 supports this conclusion, providing in relevant part:

> If by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply, and upon the death of the beneficiary shall pay to another person all of the income and principal not so paid or applied, a transferee or creditor of the beneficiary cannot compel the trustee to pay over any part of the trust property.

Of course, inclusion of a spendthrift provision (discussed *infra* in this section) can also help further protect a Spouse's income interest in a QTIP trust as well as a provision enabling the trustee to apply the trust income for the benefit of the Spouse.

F. Many QTIP trusts contain provisions granting a Spouse the right to direct the trustee to make all assets productive of income or direct the trustee not retain unproductive assets without the Spouse's consent. The genesis of such a provision is found in the language of Regulations §§ 20.2056(b)-7(d)(2), 20.2056(b)-5(f)(1), 25.2523(f)-1(c)(1)(i) and 25.2523(e)-1(f); however, such a provision is not required to qualify for QTIP treatment. (See *e.g.*, TAMs 8638004 and 9237009.) It is sufficient for the trust to manifest the Donor's intent that the Spouse be given the requisite income interest in other ways. To enhance the asset protection aspects of a QTIP trust, it is suggested that alternative provisions be used to ensure the Spouse is given the requisite income interest in the trust to qualify for QTIP treatment. For example, a provision in a QTIP trust could provide:

> To the extent that the Settlor's personal representative makes a QTIP election for the Marital Trust, the Settlor intends, by the provisions of this Article, to obtain for his/her estate the advantage of the marital deduction or other similar benefit, if any, that may be available under the Federal estate tax law applicable to the Settlor's estate. No provision of this Agreement shall apply to the Marital Trust to the extent that its being made applicable would defeat the intent expressed in the preceding sentence. Furthermore, the amount of net income distributed to the Settlor's Spouse from the Marital Trust shall never be less than the amount required to be treated as "**income**" under the marital deduction provisions of the Internal Revenue Code and the Treasury Regulations issued thereunder, and the composition of such net income shall include all items within the meaning of the term "**income**" in the marital deduction provisions of the Internal Revenue Code and the Treasury Regulations issued thereunder. Accordingly, the Settlor's Spouse shall have substantially that degree of beneficial enjoyment of the trust estate of the Marital Trust during his/her lifetime that the principles of the law of trusts accord to a person who is unqualifiedly designated as the life beneficiary of a trust and the Trustees shall not exercise their discretion or apply any provision of this Agreement in a manner that is not consistent with this intention. The Trustees shall invest the trust estate of the Marital Trust so it will produce for the Settlor's Spouse during his/her life an income or use that is consistent with the value of the trust estate and with its preservation.

G. A spendthrift provision that prohibits the voluntary or involuntary transfer of an interest in a trust by a Spouse will not cause the trust to fail to qualify for QTIP treatment. Such a provision is condoned by Regulations §§ 20.2056(b)-5(f)(7) and 25.2523(e)-1(f)(7). Nevertheless, a spendthrift provision that provides that a Spouse's income interest will be forfeited or converted to a discretionary interest would cause a trust to fail to qualify for QTIP treatment. See *e.g.*, *Miller v. U.S.*, 267 F. Supp. 326 (M.D. Fla. 1967); and TAM 8248008. To enhance the asset protection aspects, a trust should always include a spendthrift provision, however, care should be taken to ensure that the spendthrift provision does jeopardize

qualification for QTIP treatment. Additionally, do not permit the assignment of any beneficial interest in the trust.

H. Use of a *Clayton* style QTIP trust is condoned by Regulations §§ 20.2056(b)-7(d)(3) and 20.2056(b)-7(h), Example (6). Under the terms of a *Clayton* style QTIP trust, if a personal representative fails to make a QTIP election over all or a portion of the trust property, such property (or portion thereof) will be disposed of in an alternative disposition that typically would not qualify for a marital deduction such as to a wholly discretionary trust for the benefit of a Spouse and other beneficiaries. (A *Clayton* style QTIP trust gets its name from the trust in *Estate of Clayton v. Com'r.*, 976 F.2d 1486 (1992). A line of related cases with similar holdings also exist. See *e.g.*, *Robertson Est. v. Com'r.*, 15 F.3d 779 (8th Cir. 1994), rev'g 98 T.C. 678 (1992); *Spencer Est. v. Com'r.*, 3 F.3d 226 (6th Cir. 1995) , rev'g 64 T.C.M. 937 (1992); and *Clack Est. v. Com'r.*, 106 T.C. 131, acq. in result only, 1996-2 C.B. 1 (AOD 1996-011).) Many states have disclaimer statutes that prohibit a beneficiary from disclaiming an interest in property if the beneficiary is insolvent. See *e.g.*, § 739.402 of the Florida Statutes. Whether a disclaimer can defeat the claim of a creditor of an insolvent disclaimant may depend on applicable law, including federal tax law (see *e.g.*, *Drye v. United States,* 528 U.S. 49 (1999); *Choate v. Tubbs*, W.D. Tenn., No. 01-1288-T, 4/4/03; and *Laughlin v. Nouveau Body and Tan* (*In re Laughlin*), 5th Cir., No. 09-10622, 3/29/10). A Spouse's mandatory income interest in a QTIP trust is a valuable interest in property that could be the subject of a disclaimer. Although a spendthrift provision may prove helpful in thwarting the claims of potential creditors to reach a mandatory income stream, a Clayton style QTIP trust could provide additional flexibility to a Spouse experiencing creditor issues. Where applicable law might not permit an insolvent Spouse to disclaim a mandatory income interest, it may not be able to prevent a personal representative (particularly an independent party serving in such capacity) from failing to make a QTIP election, thereby diverting all or a portion of the trust assets to another more protected form of disposition. (Of course, this planning may come with a price, that is, the potential loss of the use of the credit for the tax on prior transfers under § 2013 of the Code and the loss of the benefit of the marital deduction.) To enhance the asset protection aspects of a QTIP trust, include Clayton style election provisions in the trust and grant the power to make or not make the QTIP election to an independent party.

I. For estate and gift tax purposes, Regulations §§ 25.2523(f)-1(d)(1) and (2) and 25.2523(f)-1(f) Examples (10) and (11) permit a Donor of an *inter-vivos* QTIP trust to retain a secondary life interest in the trust if the Donor survives the Spouse. (See also PLR 200406004.) Inclusion (or potential inclusion) in the Spouse's estate under Code § 2044 is deemed to cleanse the trust of any taxable strings under §§ 2036 and 2038 of the Code. This cleansing process is deemed to occur despite existing authority in the tax law that would seem mandate a different result. (See *e.g.*, *Herzog v. Com'r.*, 116 F.2d 591 (2d Cir. 1941) (but *c.f.*, *Vanderbilt Credit Corp. v. Chase Manhattan Bank, N.A.*, 100 AD2d 544, 473 N.Y.S.2d 242 (2d Dep't. 1984)); *Wells v. Com'r.*, T.C. Memo 1981-574; *Estate of Uhl*, 241 F.2d 867 (7th Cir. 1957); *Estate of German v. U.S.*, 85-1 U.S.T.C. ¶13,610 (Ct. Cl. 1985); *Outwin v. Com'r.*, 76 T.C. 153 (1981); *Paolozzi v. Com'r.*, 23 T.C. 182 (1954); *Estate of Paxton v. Com'r.*, 86 T.C. 785 (1986); Rev. Rul. 76-103, 1976-1 C.B. 293; Rev. Rul. 77-378, 1977-2 C.B. 347; PLR 9332006; PLR 8829030; PLR 8037116; PLR 9837007 and PLR 9332006.)

Under the trust law of most states, a Donor's creditors can reach the Donor's interest in the trust to satisfy claims against the Donor. (See Restatement Second Trusts Section 156(2) providing, "[w]here a person creates for his own benefit, a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit." As mentioned, this black letter rule is commonly referred to as the "**Self-Settled Trust Doctrine**.") In most jurisdictions in the United States, one should be mindful that, although the QTIP Regulations create this fiction for estate and gift tax purposes, a creditor's ability to "bust the trust" should remain the same. In other words the cleansing process for federal transfer tax purposes should not affect the self-settled nature of the trust for state law purposes. The application of the Self-Settled Trust Doctrine may be avoided by establishing (or moving) this type of QTIP trust in a jurisdiction that has reversed the doctrine. A few states have reversed this doctrine by statute. (See *e.g.*; Alaska Laws, SLA 1997, Ch. 6 (H.B. 101), A.S. §§13.12.205(2), 13.27.050(a), 13.36.035, 13.36.310, 13.36.390, 34.40.010, 34.40.110(a), 34.40.110 (Alaska); 12 Del. Code Ann. §§ 3570-3576 (1997) (The Qualified Dispositions in Trust Act) (Delaware); M.R.S. §§456.5-505.1 (Missouri); N.R.S. §166.040 (Nevada); Title 18, Chapter 9.2 of the General Laws of Rhode Island (The Qualified Dispositions in Trust Act) (Rhode Island); R.C.U. §25-6-14, H.B. 299 from 2003 Legislative Session (Utah); and 2005 SD S.B. 93 §2(2)(d) (South Dakota).) See also, Ariz. Rev. Stat. § 14-10505 wherein Arizona reversed the application of the self-settled trust doctrine where the settlor of an *inter vivos* QTIP trust retains a secondary life estate.) Additionally, effective July 1, 2010, Florida reversed the application of the self-settled trust doctrine where the settlor of an inter vivos QTIP trust retains a secondary life estate. Fla. Stat. § 736.0505(3). In 1997, Alaska and Delaware each revised its trust laws causing the use of domestic self-settled trusts to become a popular planning technique. In such states, a settlor, regardless of his or her state of residence, can establish a self-settled trust and remain eligible to receive discretionary distributions of income and/or principal from the trust. If the statutory guidelines of such states are followed and the formalities of the trust relationship are adhered to, it should be possible for a Donor to obtain some degree of creditor protection for a wholly discretionary interest in the secondary trust. Perhaps greater creditor protection can be achieved by structuring the arrangement in one of many foreign jurisdictions that permit asset protection trusts such as Nevis, the Cook Islands, the Bahamas or Belize.

If asset protection is important to the Donor, care should be taken in structuring this arrangement and selecting the appropriate jurisdiction to establish the trust. For instance, in the facts of Examples (10) and (11) of Regulation § 25.2523(f)-1(f), the Donor retains a mandatory right to receive income in the secondary trust. Under the laws of some asset protection trust jurisdictions the creditor protection benefits of an asset protection trust otherwise granted to a settlor may be negated by retention of a mandatory income interest; however, § 3570(10)b.4. of the QDTA seems to permit retention of a mandatory income interest in a trust by a settlor without the loss of the asset protection benefits granted by the act. See also Alaska Stat. §34.40.110(b)(3)(A); 2005 SD S.B. 93 §2(2)(d); Utah Code Ann. §25-6-14(1)(e)(iii).

To obtain asset protection benefits for a Donor's secondary life interest in an *inter-vivos* QTIP trust, a Donor will need to consider establishing the trust in a jurisdiction that has reversed the Self-Settled Trust Doctrine. Additionally, if the Donor retains a mandatory

income interest in the trust, the Donor may be even more limited in the jurisdictions where the trust can be established in order to secure creditor protection under local law.

Perhaps additional planning opportunities exist if the QTIP trust is designed to permit the donee spouse to assign his or her income interest in the trust. See *e.g.*, PLR 201243004; and Bramwell and Kanaga, **LISI** Estate Planning Newsletter #2040 (December 20, 2012) at http://www.leimbergservices.com.

J. Many states grant exemptions from the claims of creditors for assets held in certain retirement plan accounts. (See *e.g.*, F.S. § 222.21.) In some states such as Florida, this exemption applies not only to the plan participant or account owner but also the designated beneficiary of the account following the owner or participant's death. Designating a QTIP trust as the beneficiary of the proceeds of a retirement account may have an adverse effect by rendering a portion of the value of such account subject to the claims of a beneficiary's creditors, thus stripping away some of the benefit granted by the exemption. For instance, under Florida's statute, all of the income paid from a protected retirement plan continues to be exempt from the claims of a beneficiary's creditors after it is distributed from the plan. Nevertheless, if income from such an account is first required to be distributed to a QTIP trust, it will be necessary for the trustee to distribute such income to or for the benefit of the Spouse. If the Spouse receives the distribution outright, creditors may be able to seize the income in the hands of the Spouse because the Florida exemption may not protect such income. To enhance the asset protection aspects of a QTIP trust be certain to consider the effect of state law exemptions on the assets that may be used to fund the trust.

K. Maximizing a tax benefit is also a form of asset protection because it minimizes the depletion of family wealth by the tax system. Under Examples (7) and (8) of Regulation § 26.2652-1(a)(5), the estate tax liability imposed on the transfer of the value of the assets in a Reverse QTIP trust can be paid from a source other than the Reverse QTIP trust without adversely affecting the trust's inclusion ratio. For example, the tax liability can be paid from a non-exempt QTIP trust, if any, or from the Spouse's own assets. To the extent possible, the Donor's estate plan and the Spouse's estate plan should take advantage of this rule and properly apportion the payment of the estate tax liability on the assets in a Reverse QTIP trust to a source such as the non-exempt QTIP trust or the Spouse's own assets.

L. In F.S.A. 199920016, the issue was whether there had been a disposition of a Spouse's income interest in a QTIP trust under § 2519 of the Code because of an investment of the trust assets in a family limited partnership ("**FLP**"). The Spouse and her daughter were co-trustees of the QITP trust and the Spouse, her daughter, two of her daughter's children and the QTIP trust formed the FLP. The daughter and her two children received general partnership interests in exchange for capital contributions of cash to the FLP and the daughter also received a limited partnership interest in exchange for a capital contribution of certain assets to the FLP. The Spouse and the QTIP trust received limited partnership interests in exchange for capital contributions of cash and securities. The daughter was appointed as the managing partner of the FLP. As managing partner she possessed "sole discretion with respect to distribution decisions" from the FLP. (Presumably this discretion was subject to the business judgment rule under applicable state law.) The limited partners were prohibited from participating in the operation or management of the business of the partnership. Interests in the FLP were freely

transferable to parents and descendants of partners, however, a transfer to any other person or entity would trigger an option in the other partners to purchase the assigned interest for 70% of its fair market value. In holding that the contribution of trust assets to the FLP was not a disposition under § 2519 of the Code, the F.S.A. provided:

> [Spouse]'s conversion of the trust assets into FLP interests is not the typical disposal of the income interest envisioned under the provisions of section 2519. By converting the trust assets into FLP interests, she has disposed of the corpus rather than the qualifying income interest. Facially this appears to be a permissible conversion. Thus, in order to invoke 2519, the conversion of the trust assets must work such a limitation on her right to the income as to amount to a disposition of that income. Although the conversion to partnership interests could yield this result, it does not necessarily follow. An investment in a partnership, despite possible restrictions on distribution, could be, under the right circumstances, a very lucrative investment.

The ruling recognized that the managing partner had the power to withhold distributions from the FLP, however, under the facts the Spouse had continued to receive the same proportionate share of the income from the assets in the FLP. Additionally, the Spouse did nothing that affected her right to receive the income from the trust. Finally, the ruling recognized that a QTIP trust "can be originally funded with partnership interests or, for that matter, closely held stock" and those types of investments could possibly distribute no income in a given year. (See *e.g.*, PLR 199915052) According to the ruling, "The right to annual income is not tantamount to a fixed right to yearly income, rather it is a right to any income to the extent it exists, on at least an annual basis."

Providing the trustee of a QTIP trust with the flexibility to invest trust assets in limited liability entities such as corporations, limited partnerships and limited liability companies can enable the trustee to better protect the assets of the trust from potential creditors, provide additional flexibility to structure investment of the trust assets and provide opportunities to reduce the Spouse's estate and gift tax liability. As F.S.A. 199920016 demonstrates, providing the trustee with this discretion should not hinder the qualification of the trust for the marital deduction. Thus, to enhance the assets protection aspects of a QTIP trust, the trustee should be given the discretion to invest trust assets in limited liability entities such as corporations, limited partnerships and limited liability companies.

M. Perhaps additional planning opportunities exist if the QTIP trust is designed to permit the donee spouse to assign his or her income interest in the trust. See *e.g.*, PLR 201243004; and Bramwell and Kanaga, **LISI** Estate Planning Newsletter #2040 (December 20, 2012) at http://www.leimbergservices.com.

N. To qualify for the marital deduction, a QTIP trust must be drafted to meet the requirements set forth in the Code. For example, the Spouse must be given the right to receive all of the income from the trust at least annually and no other person is permitted to have a current interest in the trust during the Spouse's life. Nevertheless, too often QTIP trusts are drafted to provide the Spouse with interests or rights that can be attractive to creditors of the Spouse. These rights are not necessary to qualify the trust for the marital deduction and in

many respects are contrary to the fundamental purpose of a trust, that is, to the protect the trust assets from creditors, indiscretions and inability of the beneficiary.

XXXVIII. FRAUDULENT TRANSFERS.

A. Historical Background. In the United States, modern fraudulent transfer law first developed in 1918 with the promulgation of the Uniform Fraudulent Conveyance Act ("UFCA") by the Conference of Commissioners on Uniform State Laws. In 1984 the UFCA was revised and renamed the Uniform Fraudulent Transfer Act ("UFTA"). UFTA is currently the law in an overwhelming majority of the states, including Florida. The Statute of 13 Elizabeth of 1571 (13 Eliz. 1, c.5) (the "Statute") provides the foundation for the UFCA and UFTA. See Osborne & Schurig, Asset Protection: Domestic and International Law and Tactics § 2:01 (West Group 1995, 2007 Supp.).

1. Statute of 13 Elizabeth (1571). Much of the current law on fraudulent transfers has its roots in the Statute of 13 Elizabeth. The Statute is believed to be the first fraudulent transfer rule. It provides in relevant part:

> "Be it therefore declared . . . That all and every feoffment, gift, grant, alienation, bargain and conveyance of lands, tenements, hereditaments, goods and chattels, or of any of them, or of any lease, rent, common or other profit or charge out of the same lands, tenements, hereditaments, goods and chattels, or any of them, by writing or otherwise, (2) and all and every bond, suit, judgment and execution, at any time had or made . . . to or for any intent or purpose before declared and expressed, shall be from henceforth deemed and taken (only as against that person or persons, his or their heirs, successors, executors, administrators and assigns, and every of them, whose actions, suits, debts, accounts, damages, penalties, forfeitures, heroits, mortuaries and reliefs, by such guileful, covinous or fraudulent devices and practices, as is aforesaid, are, shall or might be in any wise disturbed, *hindered, delayed or defrauded*) to be clearly and utterly void, frustrate and of none effect; any pretence, color, feigned consideration, expressing of use, or any other matter or thing to the contrary notwithstanding." (emphasis added).

The Statute of Elizabeth was aimed at a practice by which overburdened debtors placed their assets in friendly hands thereby frustrating creditors' attempts to satisfy their claims against the debtor. After the creditors had abandoned the effort to recover on their claims, the debtor would obtain a reconveyance of the property that had been transferred. Such transactions operated as a fraud against the debtor's creditors because the debtor's estate was depleted without exchanging property of similar value from which the creditors' claims could be satisfied. *Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 644-45 (3d Cir. 1991).

The Statute of Elizabeth made a conveyance "devised and contrived of malice, fraud, covin, collusion or guile, to the end, purpose and intent, to delay, hinder or defraud creditors . . . to be clearly and utterly void, frustrate and of none effect . . . ."

The Statute of Elizabeth was also directed at tangible property ("as well of lands and tenements *as of goods and chattels*. . . ." Emphasis added).

The Statute is a draconian rule designed to provide a creditor with the ability to avoid almost any transfer of property made by a debtor. For an interesting early case on fraudulent transfer law see *Twyne's Case*, 76 Eng. Rep. 809 (Star Chamber 1601). In *Twyne*, Pierce ("**P**") was the debtor. P sold livestock to Twyne ("**T**"), however, P retained custody of the animals. As a result the court held that the livestock was subject to the claims of P's creditors.

After the United States won sovereignty, the Statute of Elizabeth 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.

2. Uniform Fraudulent Conveyance Act (1918). The original UFCA was promulgated by the Conference of Commissioners on Uniform State Laws in 1918 (the "Conference"). The UFCA had been adopted in 25 jurisdictions, including the Virgin Islands, and had also been adopted in the sections of the Bankruptcy Act of 1938 and the Bankruptcy Reform Act of 1978 that dealt with fraudulent transfers and obligations.

The original UFCA was a codification of the "better" decisions applying the Statute of Elizabeth. *See* Analysis of H.R. 12339, 74th Cong., 2d Sess. 213 (1936).

Since the intent to hinder, delay, or defraud creditors was seldom susceptible of direct proof, courts relied on "**badges of fraud**." The weight given these badges varied greatly between jurisdictions, and the Conference sought to minimize or eliminate the diversity by providing that proof of certain fact combinations would conclusively establish fraud. In the absence of evidence of the existence of such facts, proof of a fraudulent transfer was to depend on evidence of actual intent.

3. Uniform Fraudulent Transfer Act (1984). The Conference was persuaded in 1979 to appoint a committee to undertake a study of the UFCA with a view to preparing the draft of a revision.

The impetus behind the study was the recent enactment of the Bankruptcy Reform Act of 1978, which made many changes dealing with fraudulent transfers, the consequence of which was the a substantial lack of correlation between the original UFCA and federal bankruptcy law. Additionally, the Uniform Commercial Code, enacted in part by all 50 states, had substantially modified the creditor/debtor relationship in commercial transactions. Finally, the Model Rules of Professional Conduct, adopted in 1983, forbid a lawyer to counsel or to assist a client in conduct that the lawyer knows is fraudulent.

It was renamed to the Uniform Fraudulent Transfer Act ("**UFTA**") in recognition of its applicability to transfers of personal property as well as real property, "conveyance" having a connotation restricting it to a transfer of personal property.

UFTA has been adopted in all but the following six states: Alaska, Kentucky, Louisiana, Maryland, New York and South Carolina.

B. General. The law regarding fraudulent transfers characterizes a creditor as either a present creditor or a future creditor, the latter being further defined.

1. Present creditors. Present creditors are those creditors whose claims arose before the transfer. They are also referred to as "existing creditors." A debtor is aware of a present creditor when the debtor effectuates a transfer. A creditor does not have to possess a judgment to constitute a present creditor.

2. Future creditors. Future creditors are those credtiors whose claims arose after the transfer. They are also referred to as "subsequent creditors." For clarification, possible future creditors should be further divided into two distinct categories, only one of which is protected:

a. Foreseeable future creditors (protected). Foreseeable future creditors are those creditors whose specific claims did not exist prior to the transfer, but were anticipated or should have been anticipated. Such creditors include a creditor whose rights originated following a transfer where a debtor intended to conduct the debtor's activities or business in a fraudulent way or with reckless disregard for the rights of a potential creditor.

b. Unforeseeable future creditors (unprotected). An unforeseeable future creditor is a completely unidentifiable person or entity who a debtor was not aware existed at the time the debtor effectuated a transfer. As discussed *infra*, a unforeseeable future creditor cannot possess a claim against a debtor. Thus, a transfer made by a debtor should not be avoidable under the UFCA or the UFTA.

For an excellent general discussion of the law regarding fraudulent transfers see Stein, "Asset Protection May Risk Fraudulent Transfer Violations," 37 EP 8 (Aug. 2010).

C. Florida Uniform Fraudulent Transfer Act.

1. Florida's version of the Uniform Fraudulent Transfer Act ("**FUFTA**") was first enacted in 1987 and is set forth in Chapter 726 of the Florida Statutes. If FUFTA does not address a fraudulent transfer issue, "the principles of law and equity, including the law of merchant and the law relating to principal and agent, estoppel, laches, fraud, misrepresentation, duress, coercion, mistake, insolvency, or other validating or invalidating cause, supplement those provisions." F.S. § 726.111. Thus, a court can take into account equitable considerations. Section 726.112 of the Florida Statutes mandates that FUFTA "be applied and construed to effectuate its general purpose to make uniform" the fraudulent transfer law "among states enacting it."

2. To understand FUFTA it is important to understand the definitions of its important terms. See F.S. § 726.102. For purposes of FUFTA:

a. An "**affiliate**" is a:

i. Person who directly or indirectly owns, controls, or holds in conjunction with the power to vote, twenty percent (20%) or greater of the outstanding voting securities of a debtor. Notwithstanding the foregoing, a person is not an affiliate if that

person holds the securities as a fiduciary or agent and does not possess the sole discretionary power to vote the securities or the person holds the securities solely to secure a debt, provided the person has not exercised the power to vote.

ii. Corporation twenty percent (20%) or greater of which the outstanding voting securities are directly or indirectly owned, controlled, or held with the power to vote, by a debtor or a person who directly or indirectly owns, controls, or holds, with power to vote, twenty percent (20%) or greater of the outstanding voting securities of the debtor. Notwithstanding the foregoing, a person is not an affiliate if that person holds the securities as a fiduciary or agent without the sole power to vote the securities or holds the securities solely to secure a debt, provide that person has not exercised the power to vote.

iii. Person who has a business that is operated by a debtor under a lease or other arrangement, or a person substantially all of whose assets are under the control of the debtor.

iv. Person who conducts a debtor's business pursuant to a lease or other arrangement or controls substantially all of a debtor's assets.

b. An "**asset**" is <u>any</u> property of a debtor, ***however, the term does not include the following assets:***

i. Property to the extent it is encumbered by a valid lien;

ii. **Property to the extent it is *generally exempt* under nonbankruptcy law**. See *Rubenstein v. Com'r.*, 134 T.C. No. 13 (2010). (Florida homestead is not "generally exempt under nonbankruptcy law" when debtor is involved in a tax collection matter with the IRS.) For an excellent analysis and discussion of the *Rubenstein* case see, Baskies, "Recent Court Decision Highlights a Limit to Asset Protection Planning," 37 EP 9 (Sept. 2010).

iii. **An interest in property that is owned in tenancy by the entireties to the extent such property is not subject to process by a creditor who possesses a claim against only one tenant.** A transfer of non-exempt wealth into T by E does should not sheild a fraudulent transfer claim. See *e.g.*, *In re Titus*, 479 B.R. 362 (Bkrtcy. W.D. Pa.2012).

Thus, the fraudulent transfer rule in Florida does not apply to the transfer of and asset that is exempt from process. *In re Montemoino*, 491 B.R. 580 (Bankr. M.D. Fla. 2013); *Calarese v. Weissfisch*, 2012 WL 1859417 (Fla. Dist. Ct. App. 3d 2012). *In re Mathews*, 360 B.R. 732 (Bankr. M.D. Fla. 2007); *In re Wingate*, 377 B.R. 687 (Bankr. M.D. Fla. 2006); *In re Jennings*, 332 B.R. 465 (Bankr. M.D. Fla. 2005); *J.I. Kelly Co. v. Pollock & Bernheimer*, 57 Fla. 459, 49 So. 934 (1909); *Rigby v. Middlebrooks*, 102 Fla. 148, 135 So. 563 (1931); *In re Short*, 188 B.R. 857 (Bankr. M.D. Fla. 1995); *Bessemer Properties v. Gamble*, 158 Fla. 38, 27 So.2d 832 (1946); *Kitchens v. Kitchens*, 142 So.2d 343 (Fla. Dist. Ct. App. 2d Dist. 1962).

c. A "**claim**" is a right to payment, *whether or not it is reduced to judgment*, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

d. A "**creditor**" is a person who has a claim.

e. A "**debt**" is a liability on a claim.

f. A "**debtor**" is a person who is liable on a claim.

g. An "**insider**" includes:

i. For a debtor who is an **individual**:

(A) A relative of a debtor or of a general partner of a debtor;

(B) A partnership where a debtor is a general partner;

(C) A general partner in a partnership described in the foregoing subparagraph (B); or

(D) A corporation where a debtor is a director, officer, or person in control;

ii. For a debtor that is a **corporation**:

(A) A director of a debtor;

(B) An officer of a debtor;

(C) A person in control of a debtor;

(D) A partnership in which a debtor is a general partner;

(E) A general partner in a partnership described in the foregoing subparagraph (D); or

(F) A relative of a general partner, director, officer, or person in control of a debtor.

iii. For a debtor that is a **partnership**:

(A) A general partner of a debtor;

(B) A relative of a general partner of such partnership, a general partner of such partnership, or a person who is in control of the partnership;

(C) Another partnership in which the debtor-partnership is a general partner;

(D) A general partner in a partnership that is described in the foregoing subparagraph (C); or

(E) A person who is in control of the debtor-partnership.

iv. An affiliate, or an insider of an affiliate as if the affiliate were the debtor.

v. A managing agent of a debtor.

h. A "**lien**" is a charge against or an interest in property that secures the payment of a debt or the performance of an obligation. It includes a security interest created by agreement. It also includes a judicial lien that is acquired by legal or equitable process or proceedings, a common-law lien, or a statutory lien.

i. Under FUFTA use of the term "**person**" refers to an individual, partnership, corporation, association, organization, government or governmental subdivision or agency, business trust, estate, trust, or any other legal or commercial entity.

j. The term "**property**" refers to anything that can be the subject of ownership.

k. A "**relative**" is any individual related by consanguinity within the third (3rd) degree determined by the common law. It also includes a spouse, or an individual related to a spouse within the third (3rd) degree as so determined, and includes an individual in an adoptive relationship within the third (3rd) degree.

l. A "**transfer**" refers to any and every mode (direct or indirect), absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset. It includes payment of money, release, lease, and creation of a lien or other encumbrance. Interestingly, FUFTA does not define the term fraudulent transfer, however, a working definition is set forth in Section 202 of Volume 13 of the Second Edition of Florida Jurisprudence in the part on Creditors' Rights and Remedies. The definition provides that a fraudulent transfer is:

> a transaction by means of which the owner of real or personal property has sought to place the land or goods beyond the reach of his or her creditors or that operates to the prejudice of their legal or equitable rights, or a conveyance that operates to the prejudice of the legal or equitable rights of other persons, including subsequent purchasers.

m. References to "**valid lien**" means a lien that is effective against the holder of a judicial lien subsequently obtained by legal or equitable process or proceedings.

3. a. Section 726.103 provides the test to determine insolvency under FUFTA. Under this section a debtor is determined to be insolvent if the sum of the debtor's debts is more than the fair value (the statute uses the term "**fair valuation**") of all of the debtor's assets. A debtor who is generally not paying the debtor's debts as such debts become due is presumed to be insolvent.

b. Under the foregoing principles, a partnership is considered insolvent when the sum of its debts is more than the aggregate of:

i. all of the partnership's assets (as determined by using the fair valuation standard); and

ii. the sum of the excess of the value of each general partner's assets (other than partnership assets) over the general partner's debts (other than partnership debts).

c. Under the foregoing insolvency rule, "**assets**" will not include property that has been transferred, concealed, or removed with the intent to hinder, delay, or defraud creditors or that has been transferred in a manner making the transfer otherwise voidable under FUFTA. Furthermore, a debt will not include an obligation to the extent the obligation is secured by a valid lien on property owned by the debtor that is not included as an asset.

4. a. Section 726.104 of the Florida Statutes sets forth the valuation standards under FUFTA. This section provides that value may be considered to be exchanged in a transfer or when an obligation is incurred if property is transferred or a pre-existing debt is secured or satisfied in the transaction. Nevertheless, value will not be deemed to include an unperformed promise that is not made in the ordinary course of business of the person making the promise when the promise is to furnish support to the debtor or another person.

b. A transfer will be deemed made for present value when an exchange between a debtor and a transferee is intended by both parties to be made contemporaneously and the transfer is made in a substantially contemporaneous manner.

5. Section 726.105 of the Florida Statutes provides that a transfer made or obligation incurred by a debtor is considered fraudulent as to a creditor, whether the creditor's claim originated before or after the transfer or the obligation, if the debtor made the transfer or incurred the obligation:

a. With the actual intent to hinder, delay, or defraud any creditor of the debtor; or

b. Without obtaining "***reasonably equivalent value***" in exchange for the property that was transferred or the obligation that was incurred, and the debtor:

i. Was engaged or was about to engage in a business or a transaction for which the debtor's remaining assets were unreasonably small in relation to the business or transaction; or

ii. 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.

For purposes of the foregoing, a person is considered to give a reasonably equivalent value in an exchange if the person acquires an interest of the debtor in an asset pursuant to a noncollusive foreclosure sale or execution of a power of sale conducted in the regular course for the acquisition or disposition of the interest of the debtor who is in default under a mortgage, deed of trust, or security agreement.

c. In determining the actual intent of a debtor under this provision, the following factors (among others) can be taken into consideration:

i. Whether the transfer was made to or an obligation was incurred to an insider.

ii. Whether following the transfer a debtor retained possession or control of the property that was transferred.

iii. Whether the transfer or obligation was disclosed or concealed.

iv. Whether the debtor had been sued or threatened with a suit prior to making the transfer or incurring the obligation.

v. Whether the debtor transferred substantially all the debtor's assets.

vi. Whether the debtor absconded.

vii. Whether the debtor removed or concealed assets.

viii. Whether the debtor received consideration for the asset transferred or the obligation that was incurred that was "***reasonably equivalent***" to the value of the asset that was transferred or the amount of the obligation that was incurred.

ix. Whether the debtor was insolvent or became insolvent soon after the exchange was made or the obligation was incurred.

x. Whether a substantial debt was incurred shortly before or soon after a transfer was made by a debtor.

xi. Whether a debtor transferred essential assets of a business to a party holding a lien and that party transferred those assets to a person who is considered an insider as to the debtor.

6. a. Section 726.106 of the Florida Statutes provides that a transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim originated prior to the time the transfer was made or the obligation incurred if:

i. the transfer was made or the obligation was incurred by the debtor and the debtor did not receive anything of "***reasonably equivalent value***" in the exchange; ***and***

ii. the debtor was:

(A) insolvent when the transfer was made or the obligation was incurred; ***or***

(B) as a result of the transfer or obligation, the debtor became insolvent.

b. An exchange made by a debtor is also considered a fraudulent transfer as to a creditor whose claim originated prior to the transfer if:

i. the transfer was made to an insider for an antecedent debt;

ii. the debtor was insolvent at the time of the transfer; ***and***

iii. the insider had reasonable cause to believe the debtor was insolvent.

For purposes of the foregoing, a person is considered to give a reasonably equivalent value in an exchange if the person acquires an interest of the debtor in an asset pursuant to a noncollusive foreclosure sale or execution of a power of sale conducted in the regular course for the acquisition or disposition of the interest of the debtor who is in default under a mortgage, deed of trust, or security agreement.

7. Section 726.107 of the Florida Statutes defines when a transfer is considered to be made and an obligation incurred under FUFTA.

a. A transfer is considered to be made with regards to real estate when an exchange is perfected to such extent that a good faith buyer who purchases the property from a debtor against whom applicable law permits the transfer to be perfected cannot acquire an interest in the asset that is superior to the interest of the transferee. (The rule refers to recording of the real estate transaction in the public records.) If applicable law provides that a transfer can be perfected as provided under the foregoing rule and it is not so perfected prior to commencement of an action under FUFTA, the transfer is deemed made immediately prior to the filing of such action. If applicable law does not permit a transfer to be perfected in the foregoing manner, the transfer is deemed made when it becomes effective between a debtor and a transferee. The foregoing standard does not apply to a fixture, however, it does apply to the interest of a seller or purchaser under a contract for the sale of the asset. With regards to an asset other than real property (including a fixture), a transfer is considered to be made if it is perfected to such an extent that a creditor on a simple contract cannot acquire a judicial lien (except under FUFTA) that is superior to the interest of a transferee.

b. An oral obligation is considered to be incurred when such obligation becomes effective between the parties. A written obligation becomes effective when it is executed by the obligor and delivered to or for the benefit of the obligee.

8. Section 726.108 of the Florida Statutes provides the remedies for a creditor under FUFTA. The potential remedies may include:

a. Avoidance of the transfer or obligation (to the extent needed to satisfy a creditor's claim);

b. Attachment (or other provisional remedy) against the asset that was transferred or against other property of the transferee as provide under applicable law;

c. An injunction against further transfers by a debtor or a transferee, or both, of the asset that was transferred or against other property of the debtor or transferee;

d. Appointment of a receiver who would take control of a transferred asset or other property of the transferee.

e. Such other relief as the circumstances may require (that is, a catchall remedy). Note that a court in Pennsylvania has construed this provision to permit an award of punitve damages to a creditor. *Klein v. Weidner*, 729 F.3d 280 (3rd Cir. 2013). For a discussion of punitive damages in fraudulent transfer cases see Adkisson & Slenn, "*In re Cutuli*: $10 Million in Punitive Damages Result After Financially-Distressed Clients Seek Asset Protection Advice," LISI Asset Protection Planning Newsletter #229 (October 10, 2013) at http://www.leimbergservices.com and Gassman & Lawrence, "Imposing Punitive Damages on Fraudulent Transfer," LISI Asset Protection Planning Newsletter #235 (January 15, 2014) at http://www.leimbergservices.com.

f. If ordered by a court, a creditor who has obtains a judgment against a debtor may levy execution on a transferred asset or its proceeds.

9. Under F.S. § 726.109 a transfer or obligation will not be voidable if a transferee acquired property in good faith and for a reasonably equivalent value. Additionally, a transfer is not voidable under FUFTA if it is made in the ordinary course of business or financial affairs of a debtor and an insider or pursuant to a good faith effort to rehabilitate a debtor and the transfer is secured by present value given for that purpose as well as an antecedent debt.

10. According to F.S. § 726.110, a cause of action under F.S. § 726.105(1)(a) will be eliminated unless it is brought within four (4) years following the time a transfer was made or an obligation incurred or, if later, within one (1) year following the time a transfer or obligation was or could reasonably have been discovered by a claimant. Additionally, a cause of action under F.S. § 726.105(1)(b) or F.S. § 726.106(1) will be extinguished within four (4) years following the time a transfer was made or an obligation incurred and under F.S. § 726.106(2) within one (1) year following the time a transfer was made or an obligation incurred.

11. Section 726.201 of the Florida Statutes provides that fraudulent loans of goods and chattels can be avoided unless such loan of use or property were declared by a will or a deed in writing proved and recorded. It also provides that fraudulent reservations or limitations on the use of such property by way of condition, reversion, remainder or otherwise may be avoided unless such reservation or limitation of use or property were declared by a will or a deed in writing proved and recorded. The text of this statute is incredibly difficult to interpret.

12. Section 56.29(6)(a) of the Florida Statutes provides that when, within one year before the service of process on him or her, a debtor has had title to, or paid the purchase price of, any personal property to which the debtor's spouse, any relative, or any person on confidential terms with the debtor claims title and right of possession at the time of examination, the debtor has the burden of proof to establish that such transfer or gift was not made to delay, hinder, or defraud creditors. In *RREF SNV-FL SSL, LLC, v. Shamrock Storage, LLC*, 40 Fla. L. Weekly D2407a (Fla. 1st DCA Oct. 26, 2015), the court, in the context of a petition for supplemental relieft based on a fraudulent transfer claim, held that a judgment debtor has the burden of proving that a spousal transfer was not made to delay, hinder, or defraud creditors.

D. Uniform Fraudulent Transfer Act (1984).

1. To understand UFTA it is important to understand the definitions of its important terms.

a. An "**affiliate**" is a:

i. Person who directly or indirectly owns, controls, or holds in conjunction with the power to vote, twenty percent (20%) or greater of the outstanding voting securities of a debtor. Notwithstanding the foregoing, a person is not an affiliate if that person holds the securities as a fiduciary or agent and does not possess the sole discretionary power to vote the securities or the person holds the securities solely to secure a debt, provided the person has not exercised the power to vote.

ii. Corporation twenty percent (20%) or greater of which the outstanding voting securities are directly or indirectly owned, controlled, or held with the power to vote, by a debtor or a person who directly or indirectly owns, controls, or holds, with power to vote, twenty percent (20%) or greater of the outstanding voting securities of the debtor. Notwithstanding the foregoing, a person is not an affiliate if that person holds the securities as a fiduciary or agent without the sole power to vote the securities or holds the securities solely to secure a debt, provide that person has not exercised the power to vote.

iii. Person who has a business that is operated by a debtor under a lease or other arrangement, or a person substantially all of whose assets are under the control of the debtor.

iv. Person who conducts a debtor's business pursuant to a lease or other arrangement or controls substantially all of a debtor's assets.

b. An "**asset**" means property of a debtor, but does not include:

i. Property to the extent it is encumbered by a valid lien;

ii. **Property to the extent it is *generally exempt* under nonbankruptcy law**.

iii. **An interest in property that is owned in tenancy by the entireties to the extent such property is not subject to process by a creditor who possesses a claim against only one tenant**. A transfer of non-exempt wealth into T by E should not sheild a fraudulent transfer claim. See *e.g.*, *In re Titus*, 479 B.R. 362 (Bkrtcy. W.D. Pa.2012); *Klein v. Weidner*, 729 F.3d 280 (3rd Cir. 2013).

c. A "**claim**" is a right to payment, whether or not it is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

d. A "**creditor**" is a person who has a claim.

e. A "**debt**" is a liability on a claim.

f. A "**debtor**" is a person who is liable on a claim.

g. An "**insider**" includes:

i. For a debtor who is an **individual**:

(A) A relative of a debtor or of a general partner of a debtor;

(B) A partnership where a debtor is a general partner;

(C) A general partner in a partnership described in the foregoing subparagraph (B); or

(D) A corporation where a debtor is a director, officer, or person in control;

ii. For a debtor that is a **corporation**:

(A) A director of a debtor;

(B) An officer of a debtor;

(C) A person in control of a debtor;

(D) A partnership in which a debtor is a general partner;

(E) A general partner in a partnership described in the foregoing subparagraph (D); or

(F) A relative of a general partner, director, officer, or person in control of a debtor.

iii. For a debtor that is a **partnership**:

(A) A general partner of a debtor;

(B) A relative of a general partner of such partnership, a general partner of such partnership, or a person who is in control of the partnership;

(C) Another partnership in which the debtor-partnership is a general partner;

(D) A general partner in a partnership that is described in the foregoing subparagraph (C); or

(E) A person who is in control of the debtor-partnership.

iv. An affiliate, or an insider of an affiliate as if the affiliate were the debtor.

v. A managing agent of a debtor.

h. A "**lien**" is a charge against or an interest in property that secures the payment of a debt or the performance of an obligation. It includes a security interest created by agreement. It also includes a judicial lien that is acquired by legal or equitable process or proceedings, a common-law lien, or a statutory lien.

i. A "**person**" is any individual, partnership, corporation, association, organization, government or governmental subdivision or agency, business trust, estate, trust, or any other legal or commercial entity.

j. The term "**property**" refers to anything that may be the subject of ownership.

k. A "**relative**" is any individual related by consanguinity within the third (3^{rd}) degree determined by the common law. Additionally, it includes a spouse, or an individual related to a spouse within the third (3^{rd}) degree as so determined, and includes an individual in an adoptive relationship within the third (3^{rd}) degree.

l. A "**transfer**" refers to any and every mode (direct or indirect), absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset. It includes payment of money, release, lease, and creation of a lien or other encumbrance.

m. A "**valid lien**" means a lien that is effective against the holder of a judicial lien subsequently obtained by legal or equitable process or proceedings.

2. a. Section 2 of UFTA provides the test to determine insolvency under UFTA. Under this section a debtor is determined to be insolvent if the sum of the debtor's debts is more than the fair value (the statute uses the term "fair valuation") of all of the debtor's assets. A debtor who is generally not paying the debtor's debts as such debts become due is presumed to be insolvent.

b. Under the foregoing principles, a partnership is considered insolvent when the sum of its debts is more than the aggregate of:

i. all of the partnership's assets (as determined by using the fair valuation standard); and

ii. the sum of the excess of the value of each general partner's assets (other than partnership assets) over the general partner's debts (other than partnership debts).

c. Under the foregoing insolvency rule, "**assets**" will not include property that has been transferred, concealed, or removed with the intent to hinder, delay, or defraud creditors or that has been transferred in a manner making the transfer otherwise voidable under UFTA. Furthermore, a debt will not include an obligation to the extent the obligation is secured by a valid lien on property owned by the debtor that is not included as an asset.

3. a. Section 3 of UFTA sets forth the valuation standards under UFTA. This section provides that value may be considered to be exchanged in a transfer or when an obligation is incurred if property is transferred or a pre-existing debt is secured or satisfied in the transaction. Nevertheless, value will not be deemed to include an unperformed promise that is not made in the ordinary course of business of the person making the promise when the promise is to furnish support to the debtor or another person.

b. A transfer will be deemed made for present value when an exchange between a debtor and a transferee is intended by both parties to be made contemporaneously and the transfer is made in a substantially contemporaneous manner.

4. Section 4 of UFTA provides that a transfer made or obligation incurred by a debtor is considered fraudulent as to a creditor, whether the creditor's claim originated before or after the transfer or the obligation, if the debtor made the transfer or incurred the obligation:

a. With the actual intent to ***hinder***, ***delay***, or ***defraud*** ***any creditor of the debtor***; ***or***

b. Without obtaining "***reasonably equivalent value***" in exchange for the property that was transferred or the obligation that was incurred, and the debtor:

i. Was engaged or was about to engage in a business or a transaction for which the debtor's remaining assets were unreasonably small in relation to the business or transaction; or

ii. 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.

c. In determining the actual intent of a debtor under this provision, the following factors (among others) can be taken into consideration:

i. Whether the transfer was made to or an obligation was incurred to an insider.

ii. Whether following the transfer a debtor retained possession or control of the property that was transferred.

iii. Whether the transfer or obligation was disclosed or concealed.

iv. Whether the debtor had been sued or threatened with a suit prior to making the transfer or incurring the obligation.

v. Whether the debtor transferred substantially all the debtor's assets.

vi. Whether the debtor absconded.

vii. Whether the debtor removed or concealed assets.

viii. Whether the debtor received consideration for the asset transferred or the obligation that was incurred that was "***reasonably equivalent***" to the value of the asset that was transferred or the amount of the obligation that was incurred.

ix. Whether the debtor was insolvent or became insolvent soon after the exchange was made or the obligation was incurred.

x. Whether a substantial debt was incurred shortly before or soon after a transfer was made by a debtor.

xi. Whether a debtor transferred essential assets of a business to a party holding a lien and that party transferred those assets to a person who is considered an insider as to the debtor.

For an excellent case where the debtor prevailed on a fraudulent transfer issue involving the badges of fraud see *Glassman v. O'Brian* (*In re Valley Building & Construction Corp.* Bankr. E.D. Pa., No. 08-0080, 8/5/10). See also, *The Tonnelier Construction Group, Inc. v. Shema*, 35 Fla. L. Weekly D2574, Case No. 1D09-4820 (1st D.C.A., 2010). For a case where transfers in a divorce decree were set aside and deemed fraudulent see *United States v. Schippers*, 982

F.Supp.2d 948 (C.D. Iowa 2014). See also *Planned Consumer Marketing, Inc. v. Coats and Clark, Inc*., 522 N.E.2d 30, (N.Y.App., 1988); *In re Goldschein*, 241 B.R. 370 (Bk.D.Md., 1999) where creditors successfully set aside debtor fraudulent transfers to ERISA plan despite plan administrator anti-alienation argument.

In *U.S. v. Rominski,* 2014 WL 5310485 (N.D. Ill. 2014), a debtor was found to have validly transferred a residence to his spouse for legitimate estate planning and asset protection planning purposes. The transfer occurred several years before the federal govenrment obtained a judgment against the debtor for unpaid taxes. The debtor and his spouse subsequently divorced. Though the transfer was not avoided under any fraudulent transfer theory, the court upheld a tax lien on the residence because the government had proven by a preponderance of the evidence that at all times since their divorce, title to the residence had been held by the debtor's spouse as the debtor's nominee. See *also In re Richards,* 231 B.R. 571 (E.D. Pa. 1999). For a case where a debtor's family trust survived the government's motion for summary judgment based on a nominee argument, see *United States v. Kimball*, 2016 WL 3566199 (D. Me. June 24, 2016). For a brief discussion of *Kimball* see Oshins & Keebler, "*U.S. v. Kimball, Jr.* and the U.S.'s Attempt to Attach a Tax Lien to a Gift Trust," **LISI** Asset Protection Planning Newsletter #326 (July 19, 2016) at http://www.leimbergservices.com (describing the strong creditor protection of both complete and incomplete gift trusts). See also *Duckett v. Enomoto et al.*, 117 AFTR 2d. 2016-1999 (D. Ariz. 2016) (denying IRS motion to alter or amend judgment to distribute all of the funds from a testamentary trust to satisfy a tax lien, of which taxpayer was a discretionary beneficiary in light of the variable, and therefore fluid, distribution scheme of the trust).

5. a. Section 5 of UFTA provides that a transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim originated prior to the time the transfer was made or the obligation incurred if:

i. the transfer was made or the obligation was incurred by the debtor and the debtor did not receive anything of "***reasonably equivalent value***" in the exchange; ***and***

ii. the debtor was:

(A) insolvent when the transfer was made or the obligation was incurred; ***or***

(B) as a result of the transfer or obligation, the debtor became insolvent.

b. An exchange made by a debtor is also considered a fraudulent transfer as to a creditor whose claim originated prior to the transfer if:

i. the transfer was made to an insider for an antecedent debt;

ii. the debtor was insolvent at the time of the transfer; ***and***

iii. the insider had reasonable cause to believe the debtor was insolvent.

6. Section 6 of UFTA defines when a transfer is considered to be made and an obligation incurred under UFTA.

a. A transfer is considered to be made with regards to real estate when an exchange is perfected to such extent that a good faith buyer who purchases the property from a debtor against whom applicable law permits the transfer to be perfected cannot acquire an interest in the asset that is superior to the interest of the transferee. (The rule refers to recording of the real estate transaction in the public records.) If applicable law provides that a transfer can be perfected as provided under the foregoing rule and it is not so perfected prior to commencement of an action under UFTA, the transfer is deemed made immediately prior to the filing of such action. If applicable law does not permit a transfer to be perfected in the foregoing manner, the transfer is deemed made when it becomes effective between a debtor and a transferee. The foregoing standard does not apply to a fixture, however, it does apply to the interest of a seller or purchaser under a contract for the sale of the asset. With regards to an asset other than real property (including a fixture), a transfer is considered to be made if it is perfected to such an extent that a creditor on a simple contract cannot acquire a judicial lien (except under UFTA) that is superior to the interest of a transferee.

b. An oral obligation is considered to be incurred when such obligation becomes effective between the parties. A written obligation becomes effective when it is executed by the obligor and delivered to or for the benefit of the obligee.

7. Section 7 of UFTA provides the remedies for a creditor under UFTA. The potential remedies may include:

a. Avoidance of the transfer or obligation (to the extent needed to satisfy a creditor's claim);

b. Attachment (or other provisional remedy) against the asset that was transferred or against other property of the transferee as provide under applicable law;

c. An injunction against further transfers by a debtor or a transferee, or both, of the asset that was transferred or against other property of the debtor or transferee;

d. (Appointment of a receiver who would take control of a transferred asset or other property of the transferee.

e. Such other relief as the circumstances may require (that is, a catchall remedy). In Pennsylvania this provision has been construed to permit a court to award a creditor punitve damages. *Klein v. Weidner*, 729 F.3d 280 (3rd Cir. 2013). For a discussion of punitive damages in fraudulent transfer cases see Adkisson & Slenn, "*In re Cutuli*: $10 Million in Punitive Damages Result After Financially-Distressed Clients Seek Asset Protection Advice," LISI Asset Protection Planning Newsletter #229 (October 10, 2013) at http://www.leimbergservices.com; and Gassman & Lawrence, "Imposing Punitive Damages on Fraudulent Transfer," LISI Asset Protection Planning Newsletter #235 (January 15, 2014) at

http://www.leimbergservices.com. If ordered by a court, a creditor who has obtains a judgment against a debtor may levy execution on a transferred asset or its proceeds.

8. Section 8 of UFTA provides a transfer or obligation will not be voidable if a transferee acquired property in good faith and for a reasonably equivalent value. Additionally, a transfer is not voidable under UFTA if it is made in the ordinary course of business or financial affairs of a debtor and an insider or pursuant to a good faith effort to rehabilitate a debtor and the transfer is secured by present value given for that purpose as well as an antecedent debt.

9. Section 9 of UFTA provides a cause of action under UFTA will be eliminated unless it is brought within four (4) years following the time a transfer was made or an obligation incurred or, if later, within one (1) year following the time a transfer or obligation was or could reasonably have been discovered by a claimant. Additionally, a cause of action under UFTA or UFTA will be extinguished within four (4) years following the time a transfer was made or an obligation incurred and under UFTA within one (1) year following the time a transfer was made or an obligation incurred.

10. In *Fannie Mae v. Grossman*, 2013 WL 6223564 (Minn.App., Dec. 2, 2013), the appellate court affirmed an order holding appellant Andrew C. Grossman ("**AG**") in constructive civil contempt of court and ordering him to be confined with purge conditions to pay judgments to respondent Fannie Mae ("**FNMA**").

AG argued that the district court: (1) erred by entering an order requiring him to deliver the judgment amount to FNMA; (2) abused its discretion by finding him in constructive civil contempt of court; and (3) abused its discretion by awarding reasonable attorney fees to FNMA.

In 2007 and 2008, an Oklahoma district court entered two judgments against AG in favor of FNMA to enforce AG's personal guarantee of a commercial mortgage loan. In February 2010, FNMA moved the district court for a temporary restraining order to prevent AG from transferring or disposing of any interest in money, property, or other assets AG had received or was due to receive as a result of his father's death the previous month. AG had transferred assets to a foreign trust after the Oklahoma judgments were entered against AG. The district court granted the temporary restraining order and later converted it to a temporary injunction.

AG testified in a deposition that his father's trust distributed approximately $11 million to him on May 22, 2012, and that AG immediately transferred the money to an account solely in his name at a bank in Switzerland ("B"). AG testified that he did not have plans to transfer the money and there were no pending orders requiring him to do so. FNMA moved the district for a temporary restraining order. The district court granted the temporary restraining order which prohibited AG from transferring or disposing of any interest he had in the account at B. Following a hearing, the district court converted the temporary restraining order into a preliminary injunction and ordered AG to disclose certain information about the funds in B.

In August, FNMA sought an order to apply some of AG's property in satisfaction of the judgment against AG. The court ordered AG to issue a request to B to transfer the judgment amount from AG's account to FNMA. B responded by letter stating that the request could not be processed because AG's account had a zero ($0) balance. FNMA filed an emergency motion requesting that the district court reaffirm its preliminary injunction order, order AG to deliver the money under threat of contempt, and require AG to provide information to the district court about when, by whom, and to where the money was transferred. After a hearing, the district court issued an order on November 8 requiring AG to deliver $10,533,489.83, plus $1,299.59 per day, to FNMA. Shortly after AG reported to the district court that he sent a letter to the financial manager of the entity where the funds were invested asking for information about his funds at B and requesting that the funds be transferred to FNMA. In response B sent a letter to AG stating, "Pursuant to the recommendation of your investment advisor, your account funds were used on 23 May 2012 to purchase membership units in your name in a limited liability company ... [t]he Company engages in long-term fixed income investments...." The financial manager attached a copy of the operating agreement for the limited liability company, called LSPG Shoreline 2012, LLC ("**LSPG**"). FNMA moved the district court to hold AG in contempt of court and for an award of attorney fees. At an evidentiary hearing AG testified that he established an account at B in in anticipation of receiving funds from his father's estate, and he assumed that B would invest the money for him. He testified that he was not aware that the money at B had been invested in LSPG. AG claimed that he first found out that he did not have any funds at B when he received the letter from the bank in October 2012. He testified that he had not received any bank account statements from B or any documents regarding the investment in LSPG. Following the hearing, the district court granted both of FNMA's motions.

The court's examination of the record established that there was significant evidence that the money was under AG's "possession or control." The court held that it was "highly probable that he continued to have possession or control over the money" because AG was the only accountholder.

The court also found ruled that the contempt order did not improperly order AG to be imprisoned for failing to pay a debt. The court disagreed with AG's contention that the contempt order was entered against him was invalid because it impermissibly imprisoned him for failing to pay a debt. The district court did not find AG in contempt for failing to pay a debt; instead, the district court found AG in contempt for failing to comply in good faith with a court order. AG argued that he did not have the ability to comply with the district court's November 8 order because the money invested in LSPG was not liquid. The district court found that AG did not meet his burden of establishing his inability to comply in good faith with the November 8 order. The district court found that: (1) AG was the only member of LSPG; (2) the company was formed to shield AG's distribution from his father's trust from collection by FNMA; (3) nothing legally prevented AG from accessing his investment in the company; and (4) his conditional confinement was reasonably likely to produce compliance with the order.

The operating agreement for LSPG provided that AG may be liable for damages if he withdrew his investment, but it did not state that it is impossible for AG to do so. For this reason, the record also supports the district court's finding that conditionally confining AG was reasonably likely to compel his compliance with the order.

AG argued that FNMA's only remedy was to obtain a charging order under Minn.Stat. sec. 322B.32 (2012). This argument failed because the court held that the statute only applies to Minnesota limited liability companies. A Minnesota limited liability company is "a limited liability company, other than a foreign limited liability company, organized or governed by this chapter." Minn.Stat. sec. 322B.03, subd. 28 (2012). LSPG was organized in and governed by the laws of the Cook Islands. Therefore, chapter 322B was not applied. This portion of the court's opinion would seem inappropriate under the language of § 322B of the Minnesota Statutes.

The court also ruled that based on the district court's findings and its decision to hold AG in constructive civil contempt, the district court had determined that AG acted in bad faith and did not abuse its discretion by awarding reasonable attorney fees to FNMA.

E. Fraudulent Transfers under the Bankruptcy Code.

1. Section 548(a) of the Bankruptcy Code contains a fraudulent transfer rule that is applicable in a bankruptcy case. Except as provided in paragraph 2, under this rule a bankruptcy trustee is given the power to avoid particular:

a. transfers effectuated by a debtor that are made within ***two (2) years*** prior to the date that a bankruptcy case is filed; and

b. obligations that are entered into by a debtor within ***two (2) years*** prior to the date that a bankruptcy case is filed.

2. Notwithstanding the foregoing rule set forth in Section 548, Section 544(b)(1) of the Bankruptcy Code provides in relevant part:

> ***the trustee may avoid any transfer of an interest of the debtor in property*** or any obligation incurred by the debtor ***that is voidable under applicable law*** by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

3. a. The fraudulent transfer rule under § 548(a) and (b) of the Bankruptcy Code is modified by §548(e)(1) in the case of a "**self-settled trust**." (Recall that a classic self-settled trust is a trust in which the settlor, *i.e.,* the donor, remains eligible to receive distributions of income and/or principal from the trust. Nevertheless, the Bankruptcy Code does not provide an express definition of the term self-settled trust.) The provision addresses the use of a classic wealth protection trust - both foreign and domestic. Section 548(e)(1) provides:

> In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if-(A) such transfer was made to a self-settled trust or similar device; (B) such transfer was by the debtor; (C) the debtor is a beneficiary of such trust or similar device; *and* (D) ***the debtor made such transfer with actual intent to hinder, delay, or defraud***

> any entity to which the debtor was or became, on or after the date that such transfer was made, indebted. (Emphasis supplied.)

Section 548(e)(2) of the Bankruptcy Code expounds upon the meaning of the term "**transfer**" in §548(e)(1), providing:

> a transfer includes a transfer made in anticipation of any money judgment, settlement, civil penalty, equitable order, or criminal fine incurred by, or which the debtor believed would be incurred by-(A) any violation of the securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47))), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws; or (B) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 781 and 78o(d) or under Section 6 of the Securities Act of 1933 (15 U.S.C. 77f).

Section 101(15) of the Bankruptcy Code provides "The term 'entity' includes person, estate, trust, governmental unit, and United States trustee.

b. **Comment**: The terminology used in the statute is confusing and repetitive. It refers to a self-settled trust in three (3) separate ways. As mentioned, a self-settled trust is a trust in which the donor-settlor (in this case, the debtor), remains eligible to receive distributions of income and/or principal from the trust. The statute, however, refers to a transfer made to "**a self-settled trust**" "**by the debtor**" in which "**the debtor is a beneficiary**." What type of interest in the trust is required to make it a "**self-settled trust**" or "**similar device**?" Can a transfer only be avoided under this provision to the extent the trust is self-settled? Suppose the debtor transfers property to a trust and retains only the right to receive income (such as a common law grantor retained income trust) or annuity payments (such as a grantor retained annuity trust) from the trust for a term of years or for life or suppose the debtor can only receive such payments in the discretion of an independent trustee. Query whether a qualified personal residence trust is self-settled and to what extent. Suppose the settlor and the residence are located in Florida and the settlor's interest in the trust would otherwise qualify for protection under the Florida homestead exemption. (See Fla. Const. Article X, §4.) Consider the case of a transfer of wealth to a charitable lead trust established in a jurisdiction such as Delaware with asset protection legislation where the remainder interest is directed to be distributed to a trust in which the debtor is a discretionary beneficiary of the income and/or principal. Suppose the term of the lead trust extends over ten (10) years. Query whether this is a self-settled trust under the statute. Would the asset protection trust's vested remainder interest in the charitable lead trust be considered an attachable property interest under this rule? This would seem to be the correct result. See *In re Yerushalmi*, 487 B.R. 98 (Bankr. E.D. N.Y. 2012).

Although the provision was clearly not drafted by a trusts and estates lawyer, it does seem to be a step in the right direction. It appears to condone the use of a self-settled trust established under appropriate circumstances. The self-settled trust has been misunderstood by bankruptcy judges and lawyers alike (and some practicing and non-practicing trust and estate

lawyers too) and this has caused serious concern (sometimes too much) among practitioners who assist clients in establishing such trusts under appropriate circumstances. Cases such as *In re Portnoy*, 201 B.R. 685 (S.D. N.Y. 1996) and *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002) are good examples of this problem where although the holding of each court was correct, the legal analysis was severely flawed. The new provision should force bankruptcy judges and creditors' counsel to consider the validity of the trust and analyze conflicts of law principles - which has been lacking with no apparent basis in the bankruptcy decisions to date. This is the product of judges reviewing cases with egregious facts. (Note that this problem is not limited to self-settled trust cases in the bankruptcy court system. In many cases it is apparent that bankruptcy judges and bankruptcy lawyers simply lack a sufficient knowledge of local trust, estate and property law principles. To often this has led to inequitable results which sometimes (but not always) do not get overturned on appeal. See *e.g.*, *In re Planas*, 199 B.R. 211, 217 (Bankr. S.D. Fla. 1996), *aff'd. in part*, *rev'd. in part*, 1988 WL 757988 (Bankr. S.D. Fla. 1988) and *In re: Bosonetto*, 271 B.R. 403 (2001).

Another twist that may cause interpretation problems is the inclusion of §548(e)(2). Does this provision limit the scope of §548(e)(1) to transfers made in anticipation of the potential matters addressed in this provision or is §548(e)(1) of far broader reach applying to any potential transfer made to a self-settled trust?

Finally, maintaining a record of the reasons a client establishes and funds an asset protection trust is critical under this provision because the settlor may be forced to prove that his or her transfer of wealth to the trust was not made with the "actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted." For instance, was the foreign self-settled trust established to enable the settlor to gain access to certain investments not available to investors in the United States or was the trust established for certain estate planning reasons.

For an excellent discussion of how the Bankruptcy Act may effect domestic asset protection trusts, see Shaftel & Bundy, "Impact of New Bankruptcy Provision on Domestic Asset Protection Trusts," 32 E.P. 28 (July 2005). For a discussion of the meaning of the term "**similar device**" see *In re Porco*, 447 B.R. 590 (S.D. IL 2011). See also, Bove & Langa, "*In re Porco*: Case of First Impression Interprets Similar Device for Purposes of Section 548(e) of Bankruptcy Code," **LISI** Asset Protection Planning Newsletter #184 (October 12, 2011) at http://www.leimbergservices.com.

c. Resolving a circuit split regarding whether "actual fraud" requires a debtor in bankruptcy to have made a false representation, the Supreme Court in *Husky Int'l Elecs., Inc. v. Ritz*, *(In re Ritz)*, No. 15-145, slip. op. (U.S. May 16, 2016), clarified that the term "actual fraud" in §523(a)(2)(A) includes fraudulent conveyence schemes even when a false representation is not involved.

d. *Battley v. Mortensen, et al.*, (*In re Mortensen*), 2011 WL 5025249 (Bankr. D. Alaska), is a case of first impression involving an Alaska Bankruptcy Court's interpretation of Section 548(e) of the Bankruptcy Code. In *Mortensen*, Thomas Mortensen ("**D**") was a resident of Alaska and a self-employed project manager who held a master's degree in geology. He did not work in geology, however, instead managing the

environmental aspects of construction projects. D purportedly contracted with major oil companies for work.

In 1994, D and his spouse (now his former spouse) acquired 1.25 acres of real property located in a remote area near Seldovia, Alaska (the "**Seldovia Property**") for $50,000. When D and his former spouse divorced D received his former spouse's interest in the Seldovia Property. Following the divorce D added some improvements to the Seldovia Property. On February 1, 2005, D deeded his interest in the Seldovia Property to a "self-settled trust," which became the "focal point" of this case.

D's divorce was apparently a bitterly contested matter. Additionally, D's income "fluctuated substantially" following his divorce. Both the divorce and the economy adversely affected D's financial situation.

Through "casual conversation" D learned about Alaska's laws providing an individual with asset protection over property transferred to a self-settled trust. (The court inappropriately referred to such laws using the derogatory term "scheme.") D investigated the subject further and using a form he uncovered in his research (one he probably located searching the internet) drafted a trust document he called the Mortensen Seldovia Trust (the "**Trust**"). D intended the Trust to qualify as an asset protection trust under Alaska's asset protection trust law. D purportedly asked an attorney to review the Trust and represented that the attorney only suggested "minor changes" be made to the document following the attorney's review.

The court noted:

> The express purpose of the trust was "to maximize the protection of the trust estate or estates from creditors' claims of the Grantor or any beneficiary and to minimize all wealth transfer taxes." The trust beneficiaries were Mortensen and his descendants. Mortensen had three children at the time the trust was created.

Mortensen appointed his brother and a friend as trustees and designated his mother as the protector. The protector was given the power to remove trustees and appoint successor trustees and could designate a successor protector. The protector could not designate herself as a trustee.

As required by Alaska law, the Trust was registered with the state on February 1, 2005 and Mortensen provided an affidavit that stated:

> 1) he was the owner of the property being placed into the trust, 2) he was financially solvent, 3) he had no intent to defraud creditors by creating the trust, 4) no court actions or administrative proceedings were pending or threatened against him, 5) he was not required to pay child support and was not in default on any child support obligation, 6) he was not contemplating filing for bankruptcy relief, and 7) the trust property was not derived from unlawful activities.

D transferred the Seldovia Property to the Trust by executing a quite claim deed on the same date the Trust was registered with the state. According to the terms of the Trust the

Seldovia Property was "a special family place that should not be sold and should remain in the family."

The Seldovia property was worth approximately "$60,000" when it was deeded into the Trust by D. Interestingly, D's mother sent him checks totaling $100,000 following the transfer of the Seldovia Property into the Trust. D argued that he and his mother had entered into an agreement for him to transfer the Seldovia Property to the Trust to preserve it for his children and that the payment was made in consideration for the transfer. The foregoing testimony was corroborated by certain notes that D's mother sent to him with two checks. D's mother sent him two checks for $50,000 each on February 22, 2005 and April 8, 2005.

D claimed he used some of the funds his mother paid him to pay existing debts and transferred approximately $80,000 to a brokerage account in the name of the Trust as "seed money" for operating expenses related to the property. According to D he lent the $80,000 to the Trust, however, no promissory note was ever entered into evidence.

According to D, the Seldovia Property was recreational property used by him and his children and sometimes by other family members. Prior to creating and funding the Trust D lived on the property full time and argued that he could have claimed the property was exempt from seizure to satisfy his creditors at that time by claiming the state's homestead exemption.

Following the creation and funding of the Trust D's financial condition deteriorated and his income was "sporadic." According to the court:

> [D] used the cash he received from his mother and his credit cards to make speculative investments in the stock market and to pay living expenses. His credit card debt ballooned after the trust was created. In 2005, total credit card debt ranged from $50,000 to $85,000. When he filed his petition in August of 2009, Mortensen had over $250,000 in credit card debt. The $100,000 he received from his mother has been lost.

D claimed that he always had the ability to make the minimum payments required on his credit card debt until he became sick in April of 2009. At that time he required surgery and hospitalization for two weeks followed by a prolonged period of convalescence. Following his illness D stated that he attempted to return to work, however, he was on medication that inhibited his cognitive abilities which in turn caused him to lose several contracts.

D filed for bankruptcy on August 18, 2009. He did not list the Seldovia Property as part of his assets and he listed $251,309.16 in debt from twelve separate credit cards. He also listed $8,140.84 in medical debt.

The bankruptcy trustee alleged that D failed to create a valid asset protection trust because he was not solvent when the Trust was established and funded. After some analysis regarding this issue the court concluded that D was solvent when he established and funded the Trust and therefore recognized the validity of the Trust.

The court then turned its analysis to the bankruptcy trustee's claim that the transfer of the Seldovia Property to the Trust violated Section 548(e) of the Bankruptcy Code. The

fraudulent transfer rule under Section 548(a) and (b) of the Bankruptcy Code was modified by Section 548(e)(1) in the case of a "**self-settled trust**." Section 548(e) was added to the Bankruptcy Code by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("**BAPCPA**"). It addresses the transfer of assets to an asset protection trust providing:

> In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if-(A) such transfer was made to a self-settled trust or similar device; (B) such transfer was by the debtor; (C) the debtor is a beneficiary of such trust or similar device; *and* (D) ***the debtor made such transfer with actual intent to hinder, delay, or defraud*** any entity to which the debtor was or became, on or after the date that such transfer was made, indebted. (Emphasis supplied.)

The court held that D's transfer to the Trust violated the extended ten year fraudulent transfer rule under Section 548(e). Some practitioners have been quick to reach the conclusion that *Mortensen* should be read broadly as enabling a bankruptcy trustee to reach any assets transferred to a self-settled trust during the ensuing ten (10) year period. Caution is warranted for anyone quick to reach this conclusion for the following reasons:

(1) The court's holding in *Mortensen* can be read narrowly. The court appeared to reach the proper conclusion (assuming D was actually the settlor of the portion of the Trust relating to the Seldovia Property).

(2) D's counsel appears to have missed an important argument in this case. D's counsel could have argued with credibility that D's mother was the grantor of the portion of the trust attributable to the Seldovia Property. This argument is consistent with the record. Of course, had D and his mother sought the advice of competent counsel to assist in originally structuring this transaction such counsel would have certainly advised D's mother to purchase the land from D and then contribute it to the Trust herself or some variation of this structure. On motion for rehearing in the case D did in fact argue that his mother was the settlor of the Trust, however, the court declined to accept this argument.

(3) The debtor could have argued Section 548(e) is unconstitutional because it violates the 10th Amendment of the Constitution of the United States which provides "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." Until the BAPCPA was enacted the fraudulent transfer rule in the Bankruptcy Code was only two years and in certain cases the trustee could use the longer period provided by applicable state law. The two year period did not exceed the shortest period provided to question fraudulent transfers under the laws of any state. Defining property rights and how such rights are governed (including rules related to avoiding the transfer of assets) are traditionally considered reserved to the states.

(4) The judge's ruling is too broad. Except for a small portion of D's debt, the creditors in question, that is, under D's twelve credit cards, existed and *were contemplated* when the Trust was created and funded, regardless of whether D was solvent when the Trust was created. This appears to be the most important fact and supports the court's decision under

Section 548(e). D gave away a substantial portion of his net worth in this case. Such action was certainly odd for someone in his financial situation who was not contemplating placing such assets beyond the reach of a foreseeable creditor. D does not represent the typical client most estate planning attorneys who specialize in asset protection assist in their practice. In fact, D did not even retain counsel to assist in structuring this transaction, rather only to review a trust he drafted himself. Section 548(e) should not reach a future creditors who are not contemplated when a trust is created and funded. No existing fraudulent transfer statute is that broad nor should it be interpreted that broadly. Accepting such a broad interpretation would bring into the question the finality of too many transactions and is not good policy. One would also have to question why congress would choose to enact a fraudulent transfer rule as opposed to simply enacting a blanket limitation that captures all transfers to a self-settled trust for the ten (10) year period.

> **In this regard, the law regarding fraudulent transfers generally characterizes a creditor as either a present creditor or a future creditor.**
>
> **Present creditors are those creditors whose claims arose *before* the transfer. They are also referred to as "existing creditors." A debtor is aware of a present creditor when the debtor effectuates a transfer. A creditor does not have to possess a judgment to constitute a present creditor. In *Mortensen*, D was clearly aware that he was indebted to certain credit card companies.**
>
> **Future creditors are those creditors whose claims arose *after* the transfer. They are also referred to as "subsequent creditors." For clarification, possible future creditors should be further divided into two distinct categories, only one of which is protected:**
>
> **Foreseeable future creditors**. Foreseeable future creditors are those creditors whose specific claims did not exist prior to the transfer, but were anticipated or should have been anticipated. Such creditors include a creditor whose rights originated following a transfer where a debtor intended to conduct the debtor's activities or business in a fraudulent way or with reckless disregard for the rights of a potential creditor. In *Mortensen*, D was clearly contemplating that he would continue to be indebted to certain credit card companies and it can be inferred from the facts that he intended to increase such debt following the creation and funding of the Trust. In fact, the court noted that his annual expenses exceeded his annual income.

Unforeseeable future creditors. An unforeseeable future creditor is an unidentifiable person or entity who a debtor was not aware existed at the time the debtor effectuated a transfer. An unforeseeable future creditor cannot possess a claim against a debtor. Thus, a transfer made by a debtor should not be avoidable by an unforesseable future creditor under any existing fraudulent transfer rule including Section 548(e).

(5) The judge's references to Senator Charles Schumer's statement in the legislative history of Section 548(e) is misplaced because it is not relevant to the provision that was ultimately passed by the senate. Senator Schumer lobbied for the BAPCPA to include a significant dollar limitation on the amount that a settlor could protect by transferring assets to

an asset protection trust. Senator Schumer's proposed amendment was defeated and his commentary on the issue was thus rendered completely irrelevant (along with Charles Shumer).

(6) Section 522(o) of the Bankruptcy Code contains a substantially similar ten (10) year fraudulent conversion rule applicable to debtors who convert non-exempt wealth to homestead. This rule provides that if within the ten (10) years prior to filing a petition a debtor converts non-exempt property to homestead with the actual intent to hinder, delay, or defraud a creditor, the value of the homestead is reduced by the value of such converted property. The existing cases involving this rule have not applied it as broadly as some commentators suggest Section 548(e) should be applied. See *e.g.*, *In re Addison*, 8th Cir., Nos. 07-2064, 07-2727, 8/7/08 and *In re Osejo*, U.S. Bankruptcy Court, S.Dist. Florida, Case No. 10-31218-BKC-JKO, Chapter 7, 22 Fla. L. Weekly Fed. B727a (2011). It would seem highly unlikely that congress intended to pass two substantially similar statutes involving fraudulent transfers and conversions with each statute to be applied in a completely different manner. Arguably, use of a homestead exemption to shelter wealth in this context is significantly more "abusive" than the use of a self-settled trust. The ten (10) year fraudulent transfer rule applicable to the homestead exemption is not interpreted so broadly and neither should the substantially similar rule for self-settled trusts.

One has to question the necessity of a legislative body enacting a fraudulent transfer rule rather than a rule with a blanket limitation if it is to be interpreted so broadly. No other existing fraudulent transfer rule in the United States has been applied in such a broad manner. The result in *Mortensen* can certainly be reconciled with a more appropriate and narrow interpretation of Section 548(e). While the authors are not proponents of using domestic asset protection structures, they do not believe that Section 548(e) will be applied in a manner that will vitiate the use of domestic asset trusts if such trusts are created and funded under appropriate circumstances.

Mortensen does, however, strengthen the argument that practitioners should advise clients to implement and use properly structured foreign trust structures. This is because of the uncertainty of the immediate application of Section 548(e). Where such uncertainty is immediately removed by using a foreign trust structure it can only be removed through case law or legislative mandate with domestic trusts. Such is unacceptable in asset protection planning where certainty is a necessity. Nevertheless, planners who assist clients in implementing foreign asset protection trusts should never assist those clients in making transfers that violate any fraudulent transfer rules. A significantly broader interpretation of Section 548(e) would seem to be problematic for ethical planners who desire to avoid knowingly contravening this rule. It is doubtful, however, that Section 548(e) will be interpreted in such a manner. Offshore trust structures are superior because such structures remove significant legal uncertainty that may exist for the next several decades when using a domestic trust and because there is such a significant difference in the economics of using a foreign asset protection structure versus a domestic structure. Defending a domestic structure will almost certainly prove much more costly.

It is clear that we are in a different period in regards to asset protection trusts. No longer is a bankruptcy court permitted to dismiss such a trust as a sham when faced with

questionable facts. As has been pointed out in prior commentaries, the bankruptcy court is now forced to consider the validity of the trust because of the addition of Section 548(e). This is true regardless of how this provision is ultimately interpreted. It also means we should absolutely counsel our clients to create and fund asset protection trusts. The earlier the better because ten (10) years later that fund should be safe from even the reach of a bankruptcy court.

Also important to the general estate planning community, a broad interpretation of Section 548(e) could have a devastating effect on many new and now commonly used estate planning techniques such as the use of a discretionary tax reimbursement provision that is included in a wholly owned grantor trust and a successor-backend self-settled trust used in *inter vivos* QTIP trust to benefit a donor-spouse who survives the donee-spouse. Many states have laws that specifically provide for a special exception to the self-settled trust doctrine related to these trusts. See *e.g.*, F.S. § 736.0505(1)(c) and § 736.0505(3). Finally, many individuals are contemplating or have established self-settled completed gift dynasty trusts as a vehicle to take advantage of the increased gift tax exemption of $5,000,000. The overwhelming majority of these trusts are taxed as wholly owned grantor trusts. In the same manner as a trust with a discretionary tax reimbursement provision, each payment by a grantor of the income tax liability attributable to the income generated by the assets held in such a trust is arguably an additional contribution and transfer of wealth to the trust. Each such contribution raises the possibility of the application of Section 548(e) to at least a portion of the trust for an additional ten (10) year period.

(7) For an excellent analysis of *Mortensen*, see Shaftel, "Court Finds Fraudulent Transfer to Alaska Asset Protection Trust," 39 EP 15 (April 2012); Sulivan, Merric, Gillen, Bove & Nenno, "Fraudulent Transfer Claims," * Trusts & Estates 43 (Dec. 2011); and "Gopman & Rubin: Further Analysis on *In re Mortensen*," LISI Asset Protection Planning Newsletter #187 (November 7, 2011) at http://www.leimbergservices.com. See also, "Oshins & Keebler on *Mortensen*: No, the Sky Isn't Falling for DAPTs!," LISI Asset Protection Planning Newsletter #186 (October 31, 2011) at http://www.leimbergservices.com; and "Adkisson & Riser on Mortensen: Alaska Asset Protection Trust Fails To Protect Future Assets in Bankruptcy under New Section 548(e) Against Future Creditors," LISI Asset Protection Planning Newsletter #185 (October 20, 2011) at http://www.leimbergservices.com.

In *In re Huber*, 493 B.R. 798 (Bankr. W.D. Wash 2013), the Bankruptcy Court for the Western District of Washington held that a debtor's prepetition transfer of assets to a self-settled Alaska trust for the benefit of himself and his children was void under Washington law.

The debtor, Donald G. Huber ("**D**"), was involved in real estate development and management in Washington for over forty (40) years. In 1968, D founded United Western Development, Inc. ("**UWD**") in Washington. D invested in and developed real estate through UWD. D served as the President of UWD, however, beginning in 2001, D's oldest son, Kevin ("**Kevin**"), served as a Vice President of UWD and had become primarily responsible for the operations of UWD prior to the time that D petitioned for bankruptcy.

Generally, D would own real estate through a corporation or limited liability company separate and apart from UWD, with D owning all, or a portion, of such entity. D was required to sign as guarantor on loans in favor of third party lenders on many projects. Many of the

lenders were local banks. All of the real estate held in D's various entities was located in Washington.

D established the Donald Huber Family Trust on September 23, 2008 (the "**Trust**"). The record before the Court demonstrated that the Trust was established to "protect a portion of [D's] assets from [D's] creditors." The beneficiaries of the Trust were D, D's eight children and stepchildren, and D's grandchildren. The Trustees of the Trust were Kevin, D's stepdaughter, Amber Haines, and the Alaska USA Trust Company ("**AUSA**"). The Trust was created in Alaska and designated Alaska law to govern the Trust.

At the time D established the Trust, UWD was in default on numerous loans of which D was a guarantor. The Court gave four examples of loans that were described by the Court as "fragile at best" which were in existence when D established the Trust. Those loans all came due prior to February 10, 2011, when D petitioned for bankruptcy. At the time of the Court's decision, those loans remained outstanding in the amounts of $1,659,245.46, $1,706,000, $588,250, and $1,101,750, respectively.

D transferred $10,000 in cash and his ownership interests in over twenty-five (25) entities to DGH, LLC ("**DGH**"), an Alaska limited liability company, established on September 4, 2008. D transferred ninety-nine percent (99%) of DGH to the Trust and Kevin owned one percent (1%), who also served as its manager. D also transferred his shares of UWD to the Trust. D's residence in Washington was conveyed to an Alaska corporation, the shares of which were then transferred by D to DGH. D then leased the residence back from the corporation, and the Trust made the mortgage payments for the residence. In sum, most of D's valuable assets were transferred to the Trust.

The Court noted that there was only one asset held in the Trust in Alaska, which was a certificate of deposit of $10,000 transferred by D to a bank account in Alaska held in the name of the Trust. The Court stated that all other assets were located in Washington. The Court may be grossly wrong on this point. D transferred Washington assets to an Alaska corporation and a limited liability company. Generally, the situs of intangible assets, such as stock or a membership interest in a limited liability company, is where its owner is. Therefore, when the stock or membership interest were transferred to the trustee of the Trust, they should have had a situs in Alaska. The Court ignored any discussion of this question.

The Trust generated $345,248 in net income in 2010, and $360,000 in 2009. The total amount distributed from the Trust to the beneficiaries of the Trust between October 1, 2010, and July 30, 2012, was $571,332.81. From the date of the filing of the petition on February 10, 2011, through July 30, 2012, the amount of the distributions to the beneficiaries of the Trust was $406,837.27.

The Bankruptcy Trustee ("**T**") contended that D made requests for disbursements from Kevin, who then prepared a request for a payment, and AUSA approved the disbursement, without any inquiry. D asserted, however, that Kevin at times refused D's requests for disbursements. The Court stated that the record indicated that AUSA did nothing to become involved with the preservation or protection of the assets of the Trust and acted merely as a "straw man," approving all distributions of assets.

D filed a voluntary petition for bankruptcy on February 10, 2011. The Court examined two principal issues related to whether the assets of the Trust were part of the estate and should be distributable to D's creditors. First, whether the Trust should be invalidated under Washington law, and second, whether D's transfer of assets to the Trust should be avoided under 11 U.S.C. § 548(e)(1) and/or under 11 U.S.C § 544(b)(1). Clearly, the Court could have based its decision solely on a fraudulent transfer analysis.

T contended that D's transfers to the Trust should be invalidated under Washington State law. Although the Trust was established under Alaska law, Washington did not recognize the efficacy of a self-settled trust for asset protection purposes. See RCW 19.36.020. Under RCW 19.36.020 all transfers made by a person in trust for the use of the transferor are void as to "the existing or subsequent creditors of such person." The Court (inappropriately) examined choice of law rules to determine which state law applied.

The Court examined Section 270 of the Restatement (Second) of Trusts ("**Restatement 270**") to address the validity of the Trust. Restatement 270 states:

> "[a]n inter vivos trust of interests in movables is valid if valid . . . under the local law of the state designated by the settlor to govern the validity of the trust, provided that this state has a substantial relation to the trust and that the application of its law does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6."

Furthermore, comment b of Restatement 270 provides certain criteria for determining if a state has a substantial relation to the trust. According to comment b:

> "A state has a substantial relation to a trust when it is the state, if any, which the settlor designated as that in which the trust is to be administered, or that of the place of business or domicil of the trustee at the time of the creation of the trust, or that of the location of the trust assets at that time, or that of the domicil of the settlor, at that time, or that of the domicil of the beneficiaries."

The Court stated that, under Restatement 270, D's choice of Alaska law designated in the Trust should be upheld if Alaska had a substantial relation to the Trust. The Court noted that D and the Trust beneficiaries were not domiciled in Alaska. The Trust was to be administered in Alaska and the location of one of the trustees, AUSA, was in Alaska, however, the Court noted that, except for a $10,000 certificate of deposit, all of the assets of the Trust were located in Washington. (Although this conention was at best questionable.) Therefore, the Court held that Alaska did not have a substantial relation to the Trust, applying the standards set forth in Comment b.

The Court also held that, pursuant to RCW 19.36.020, Washington had a "strong public policy" against self-settled asset protection trusts. Again, however, the public policy of Washington in regard to a self-settled trust seems rather questionable under the rules set forth in Restatement 270.

As a result of the foregoing, the Court disregarded D's choice of Alaska law, and applied Washington law to determine the validity of the transfers to the Trust. Under RCW 19.36.020, the assets of the Trust could be reached by D's creditors.

The Court also held that D's transfers were fraudulent under 11 U.S.C. § 548(e)(1), which provides that a trustee may avoid any transfer of an interest of a debtor made on or within ten (10) years of the date of the filing of the petition, if (A) such transfer was made to a self-settled trust or similar device; (B) such transfer was by the debtor; (C) the debtor is a beneficiary of such trust or similar device; and (D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted. Under the facts of this case, it seems far more appropriate for the Court to have based its decision under §548(e)(1) rather than under its alternative choice of law analysis (that rested on rather dubious grounds).

Under its fraudulent transfer analysis, the Court found that five badges of fraud existed. First, at the time D transferred his assets into the Trust, there was threatened litigation against D. The Court stated that it appeared that "foreclosure of several properties for which D had guaranteed the bank loans was becoming increasingly certain" and D was not making timely payments on those loans. Second, D transferred all or substantially all of his property into the Trust. Third, D was significantly in debt at the time of the transfers to the Trust. Fourth, the Court held that there was a special relationship between D and the trust in that D was both the grantor and a beneficiary of the Trust. Fifth, the Court held that D effectively retained the property transferred into the Trust. Substantially all of D's requests for distributions were granted. On average D received approximately $14,500 per month in distributions from the Trust. The only party to review D's requests for distributions was his son Kevin. The Court stated that, based on the evidence, the only reasonable conclusion was that D continued to use and enjoy the assets of the Trust as he did before the transfers. Based on these badges of fraud, the Court held that D had the actual intent to hinder, delay, or defraud his current or future creditors, and therefore D's transfers to the Trust should be avoided.

Additionally, under Section 544(b)(1) of the Bankruptcy Code, T could avoid fraudulent transfers under state law. Under Washington's version of the Uniform Fraudulent Transfer Act ("**UFTA**"), a transfer is fraudulent if the debtor acts with actual intent to hinder, delay, or defraud a creditor, or transfers "[w]ithout receiving a reasonably equivalent value in exchange for the transfer or obligation." RCW 19.40.041(a)(1)–(2). The Court held that D had actual fraudulent intent to hinder, delay, or defraud his current or future creditors under UFTA, and therefore D's transfers to the Trust should be avoided based on UFTA.

For a discussion of the *Huber* case see, Blattmachr, "*In re Huber*: Alaska Self-Settled Trust Held Subject to Claims of Creditors of Grantor-Beneficiary," **LISI** Asset Protection Planning Newsletter #225 (May 22, 2013) at http://www.leimbergservices.com; and Riser & Adkisson, "On *In re Huber*," **LISI** Asset Protection Planning Newsletter #226 (June 18, 2013) at http://www.leimbergservices.com.

e. *In re Porco, Inc.* (*Quality Meat Products, LLC v. Porco, Inc.*), 447 B.R. 590 (2011); 2011 Bankr. LEXIS 1098; Bankr. L. Rep. (CCH) P81,989; 54 Bankr. Ct. Dec. 153, was the first case where the court addressed the meaning of term "similar

device." In *Porco*, the court held that a constructive trust and a resulting trust did not constitute a similar device under Section 548(e) noting "the 'similar device' language in Section 548(e) also requires an express trust." For a discussion of *Porco* see "Bove & Langa on *In re Porco*: Case of First Impression Interprets Similar Device for Purposes of Section 548(e) of Bankruptcy Code," LISI Asset Protection Planning Newsletter #184 (October 12, 2011) at http://www.leimbergservices.com. For an interesting discussion of permissible discovery of a co-trustee involving a fraudulent transfer in the co-trustee's individual capacity, see *Mona v. Eighth Judicial District Court of the State of Nevada*, 2016 WL 5723762 (Nev. Sup. Ct. 2016) (holding that wife co-trustee in her individual capacity was a distinct legal person and stranger to wife-cotrustee in her representative capacity as co-trustee of the family trust in preventing discovery of her personal assets).

f. In *In re: Castellano*, 2014 WL 3881338 (Bk.N.D.Ill.) ("***Castellano I***"), rev'd at 2015 WL 1911130 (N.D. Ill. 2015) ("***Castellano II***"), the United States Bankruptcy Court for the Northern District of Illinois found that a trustee's transfer of a remainder beneficiary's interest to a spendthrift trust created by the trustee should be avoided as a fraudulent transfer under 11 U.S.C. Sec. 548(e). On appeal to the United States District Court for the Northern District of Illinois, Judge Manish S. Shah reversed and terminated the civil case filed by the bankruptcy trustee.

Faith F. Campbell ("**Faith**") created a living trust (the "**Living Trust**") governed by South Carolina law on February 18, 1997. The Living Trust provided that the trust would terminate upon Faith's death and upon settlement of her estate, at which time the remaining assets would to be distributed in equal shares to Faith's surviving children. Additionally, a spendthrift clause (the "**Spendthrift Clause**") in the Living Trust provided as follows:

> If any beneficiary should attempt to alienate, encumber, or dispose of all or any part of the income or principal of this Trust before it has been delivered by the Trustee, or if by reason of bankruptcy or insolvency or any attempted execution, levy, attachment, or seizure of any assets remaining in the hands of the Trustee under claims of creditors or otherwise, all or any part of the income or principal might fail to be enjoyed by any beneficiary or might vest in or be enjoyed by some other person, then the interest of that beneficiary shall immediately terminate. Thereafter, the Trustee shall pay to or for the benefit of that beneficiary only those amounts that the Trustee, in its sole and absolute discretion, deems advisable for the education and support of that beneficiary until the death of the beneficiary or the maximum period permissible under the South Carolina rule against perpetuities, whichever first occurs.

Faith died on February 11, 2011 survived by four children, including Linda K. Castellano (the "**Debtor**"). Under the terms of the Living Trust, Bank of America was appointed trustee upon Faith's death. Bank of America declined its appointment and the Debtor and her siblings appointed J.T. Del Alcazare (the "**Trustee**"), the Debtor's nephew by marriage, as successor trustee.

In a letter to the Trustee's attorney dated October 5, 2011 (the "**Letter**"), the Debtor's attorney indicated that the Debtor was insolvent, intended to file for bankruptcy protection and

asked the Trustee to "exercise his authority consistent with the provisions of the [Spendthrift Clause]." Upon receiving the letter, the Trustee opened a Merrill Lynch account titled the "Faith F. Campbell Spendthrift Trust f/b/o Linda Castellano" and deposited the Debtor's ¼ share into this account (the "**Spendthrift Trust**").

On November 18, 2011, the Debtor filed a Chapter 7 petition (the "**Petition**") in the United States Bankruptcy Court for the Northern District of Illinois. In Schedule B of her Petition, the Debtor listed herself as the "[b]eneficiary of deceased mother's trust protected by spendthrift provision" in the amount of $400,000. Roy Safrada was appointed as the Chapter 7 trustee (the "**Chapter 7 Trustee**").

On November 21, 2011, the Debtor executed a Receipt and Release instrument (the "**R&R**"). In the R&R, the Debtor was referred to as "a life-time, limited beneficiary at the sole discretion of the trustee of the Faith F. Campbell Spendthrift Trust created under the Campbell Living Trust." Additionally, the R&R provided that the Debtor's status as a named beneficiary under the Living Trust had terminated, and that the Debtor was a limited beneficiary whose rights were subject to the sole discretion of the Trustee.

The Chapter 7 Trustee filed a complaint (the "**Complaint**") against the Debtor and the Trustee. The Complaint sought to avoid the alleged fraudulent transfer to the Spendthrift Trust under § 548(e)(1) of the Bankruptcy Code. Additionally the Complaint sought turnover of the assets under §§ 543 and 550 of the Bankruptcy Code.

Section 548(e)(1) of the Bankruptcy Code provides:

> (e)(1) [T]he trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if—
>
> (A) such transfer was made to a self-settled trust or similar device;
>
> (B) such transfer was by the debtor;
>
> (C) the debtor is a beneficiary of such trust or similar device; and
>
> (D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that the transfer was made, indebted.

Section 101(54) of the Bankruptcy Code provides:

> The term "transfer" means—
>
> (A) the creation of a lien;
>
> (B) the retention of title as a security interest;

(C) the foreclosure of a debtor's equity of redemption; or

(D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with—

(i) property; or

(ii) an interest in property

The court in ***Castellano I***, citing *In re Porco,* 447 B.R. 590 (Bankr. S.D. Ill. 2011), noted that Section 548(e) was enacted to avoid the deleterious results of certain state laws that permitted debtors to shelter assets in self-settled spendthrift trusts (or similar devices) shortly before filing for bankruptcy.

The court analyzed whether the transaction satisfied the four prongs of Section 548(e)(1). The court held that the Debtor transferred an interest in property. The court, noting that the Debtor could have received her outright interest in the Trust and subsequently conveyed such interest to a self-settled spendthrift trust, found that the Debtor accomplished an equivalent result by rejecting her outright interest and "recruit[ing] the . . . Trustee" to establish the Spendthrift Trust. The court somehow equated the Debtor's request contained in the Letter with a transfer. Additionally, the court interpreted the R&R as the Debtor's admission that the effect of the Letter was the establishment of the Spendthrift Trust. It is difficult to find a "transfer" in these facts given the plain language in the Living Trust.

Perhaps the Debtor would have been better served having retained an expert of South Carolina trust law to opine on the operative effect of the language in the spendthrift clause.

The court also found that the Spendthrift Trust was self-settled by the Debtor. Citing *In re Porco*, the court noted that Congress intended the term "similar device" contained in Section 548(e) to be interpreted broadly so that "crafty lawyers" could not avoid the application of the statute by drafting devices that are not technically self-settled trusts. The court based its finding that the Spendthrift Trust was a device similar to a self-settled spendthrift trust based on three considerations. The court pointed to the Letter and the language of the R&R as evidence that the Debtor caused the creation of the Spendthrift Trust by "coaching" the Trustee to so act. However, to properly carry out his duties, the Trustee would have needed to conduct a thorough analysis of the Debtor's financial circumstances. Additionally, the court noted that the familial relationship between the Debtor and the Trustee and the absence of court supervision resulted in (A) the Trustee not actually having independent discretion and (B) the Debtor's ability "to exercise a significant degree of control" over the assets. Finally, the court noted that that Section 548(e)(1)(A) does not require proof of a self-settled trust, rather only proof of a similar device. The court found that the Chapter 7 Trustee adequately proved the existence of a similar device based on the fact that: (A) similar to a self-settled spendthrift trust, the Spendthrift Trust was created in part to shield the Debtor's assets from her creditors and to preserve the right of the Debtor to receive future distributions, (B) the Debtor indirectly caused the creation of the Spendthrift Trust by her instructions to the Trustee in the Letter and

(C) it is irrelevant under Section 548(e) whether the formal requirements for establishing a trust under South Carolina law were established.

The court also held that the Debtor was a beneficiary of the Spendthrift Trust. The court noted that the Trustee, in his sole discretion, could make distributions from the Spendthrift Trust to the Debtor. Additionally, the court concluded that the lack of judicial oversight and the close familial relationship of the Debtor and the Trustee resulted in the Trustee having unfettered discretion to make distributions. Where fiduciary relationships are concerned, the familial ties of a trustee to the beneficiaries of the trust should be irrelevant.

Finally, the court determined that the Debtor made the transfer with the actual intent to hinder, delay or defraud her creditors. The court noted that the distributions of the remainder interests, which should have been made shortly after Faith's death, were delayed for months. The court noted that the Debtor was insolvent at the time the Trustee made the distribution to the Spendthrift Trust, and further that that Debtor admitted that the purpose of the Spendthrift Trust was to prevent creditors from reaching her interest in the trust. The court concluded that the facts suggested that the Debtor and the Trustee actively planned and timed the transaction to shield the assets from the Debtor's creditors.

Having determined that the transfer to the Spendthrift Trust was avoidable by the Trustee, the court found that the Chapter 7 Trustee was entitled to recover the value of the Debtor's interest. Additionally, because the Spendthrift Trustee was acting as custodian of the Spendthrift Trust, the court found that Spendthrift Trustee was required to turn over the Debtor's property to the Chapter 7 Trustee and file an accounting.

The court's holding in ***Castellano I*** was questionable for a number of reasons. Interestingly, however, South Carolina does not permit the creation of self-settled asset protection trusts except in one limited situation. While South Carolina does provide for a special exception to the self-settled trust doctrine in the form of a successor back end *inter vivos* QTIP trust for the benefit of the donor spouse who survives the donee spouse (a "**SQIT**"[SM]), this exception would not apply to the facts of *Castellano*. *See* S.C. Code Ann. § 62-7-505(a)(2). If the court had been correct that the Spendthrift Trust was self-settled by the Debtor, the application of South Carolina law should have ended the analysis at that time. Section 62-7-505 of the South Carolina Code would allow a bankruptcy trustee to access the trust assets and there should have been no need for the court to discuss Section 548(e) of the Bankruptcy Code. The same would have been the case applying the law of Illinois. *See Rush University Medical Center v. Sessions*, 980 N.E.2d 45 (Ill. 2012).

It is always better to provide that family wealth is passed in wholly discretionary trusts for as long as possible under applicable law. If the trust assets must be distributed outright, practitioners may wish to draft the trust to clearly provide that the beneficiaries will have no right to such distributions until the end of the trust or estate administration process. Additionally, practitioners may wish to give either the trustee or trust protector discretion over the timing of the distribution and the ability to withhold distribution if such fiduciary is aware of distributee creditor issues. In those states that have adopted Section 504 of the Uniform Trust Code ("**UTC**") or the equivalent, practitioners should suggest that a settlor consider a

lifetime spendthrift trust with the beneficiary as Trustee. Such a trust would include an ascertainable standard for distributions and name a trust protector with protective authority.

Section 504 of the UTC provides:

> (a) In this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another State.
>
> (b) Except as otherwise provided in subsection (c), whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if:
>
> (1) the discretion is expressed in the form of a standard of distribution; or
>
> (2) the trustee has abused the discretion.
>
> (c) To the extent a trustee has not complied with a standard of distribution or has abused a discretion:
>
> (1) a distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary's child, spouse, or former spouse; and
>
> (2) the court shall direct the trustee to pay to the child, spouse, or former spouse such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion.
>
> (d) This section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution.
>
> (e) If the trustee's or cotrustee's discretion to make distributions for the trustee's or cotrustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee or cotrustee.

Additionally, the court in ***Castellano I*** held that under Section 548(e), the Spendthrift Trustee was not required to show that a valid trust was established under applicable law and could alternatively show that a "similar device" was established. The court found that Spendthrift Trustee met the statutory requirements by showing "an account that was directly or indirectly created by the Debtor to shield her assets from her creditors while retaining a right to receive the assets from that account," holding that "[a]ny more restrictive interpretation than that would have the effect of reading the 'or-similar-device' language out of § 548(e)." In

doing so, the court ignored the fact that the trust *was* valid under applicable state law and was created by a third party. The court's interpretation of "or-similar-device" would call into question the place in question the effectiveness of many third party trusts.

Faith created her South Carolina Living Trust in 1997, at which time South Carolina recognized distinctions between third-party created discretionary trusts and first-party created spendthrift trusts. *See McLean v. McLean*, 273 S.C. 571 (1979). By including the Spendthrift Clause in her Living Trust, Faith likely intended for a beneficiary's share of her trust to automatically become a discretionary trust prior to distribution by the trustee if the trustee determined that the beneficiary was bankrupt, insolvent or otherwise subject to creditor levy. The Trustee, regardless of familial relationship, appeared to have a fiduciary duty to not distribute the funds outright to the Debtor.

Practitioners should also carefully consider applicable state law in drafting spendthrift provisions. Most of the Spendthrift Clause contained fairly typical language ("*Thereafter, the Trustee shall pay to or for the benefit of that beneficiary only those amounts that the Trustee, in its sole and absolute discretion, deems advisable…*"), however, it also included language ("*… for the education and support of that beneficiary until the death of the beneficiary…*") that might create a support trust.

South Carolina adopted the UTC effective January 1, 2014. With regard to discretionary trusts, section 62-7-504 of the South Carolina Code provides:

> (b) Except as otherwise provided in subsection (c), a creditor of a beneficiary may not compel a distribution from a trust in which the beneficiary has a discretionary trust interest, even if:
>
> (1) the discretion is expressed in the form of a standard of distribution.

The *Reporter's Comment* to this statute provides that it applies only if the trust is not protected by a spendthrift provision or if the creditor is an exception creditor. The *Reporter's Comment* to Section 62-7-504 states:

> This section addresses the ability of a beneficiary's creditor to reach the beneficiary's discretionary trust interest, whether or not the exercise of the trustee's discretion is subject to a standard. This section, similar to the Restatement, eliminates the distinction between discretionary and support trusts, unifying the rules for all trusts fitting within either of the former categories. See Restatement (Third) of Trusts Section 60 Reporter's Notes to cmt. a (Tentative Draft No. 2, approved 1999). This section could have limited application. Pursuant to Section 62-7-502, the effect of a valid spendthrift provision, where applicable, is to prohibit a creditor from collecting on a distribution prior to its receipt by the beneficiary. Only if the trust is not protected by a spendthrift provision, or if the creditor falls within one of the exceptions to spendthrift enforcement created by Section 62-7-503, does this section become relevant.

Even if Faith did not create a spendthrift trust under South Carolina law, if she intended to create a discretionary trust Section 62-7-504 might have been invoked to prevent the bankruptcy court's invasion of the trust. Section 62-7-1106(a)(3) of the South Carolina Code provides that the Trust Code applies retroactively unless the court finds that "application of a particular provision of this article would substantially interfere with the effective conduct of the judicial proceedings or prejudice the rights of the parties."

Castellano I can be a lesson to practitioners as to what should and should not be included in a spendthrift provision. A spendthrift provision should clearly provide that the beneficiary may not voluntary and involuntary transfer such beneficiary's interest. There is no reason to incorporate a support standard (*e.g.*, HEMS) where the beneficiary is not the trustee. Finally, the trustee can be permitted to take actions or make expenditures that benefit the beneficiary that are not distributions, such as purchasing a residence for the beneficiary to occupy rent free.

In light of ***Castellano I***, practitioners should give some thought to trustee succession. The court's conclusion that that the Debtor made a transfer was based in part on the familial relationship between the Debtor and the Trustee. Section 101(14) of the Bankruptcy Code provides:

> The term "disinterested person" means a person that—
>
> (A) is not a creditor, an equity security holder, or an insider;
>
> (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and
>
> (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

The Trustee would seem to fall squarely in the definition of "disinterested person" as it is hard to see how the he had any kind of relationship with the debtor so as to have "an interest materially adverse to the interest of the estate or any class of creditors." The court simply took it as a given that the Debtor had control of the Trustee, and its conclusion that the Debtor made a transfer based on her familial relationship with the Trustee has no apparent basis in fact or law.

Many states have adopted some variation of Section 504 of the UTC, which provides that a creditor may not compel a distribution for the trustee's own benefit where the trustee's discretion is subject to an ascertainable standard.

As mentioned above, the Spendthrift Trustee appeared to have had a fiduciary duty under the Living Trust to not make an outright distribution to the Debtor under South Carolina law.

Practitioners should be leery of relying on the protection provided by any of the above statutes. Where asset protection is a concern, it is best to appoint an unrelated third party as trustee and specify that any successor should be similarly unrelated. Where a related party must be used as trustee, practitioners should carefully word the ascertainable standard. It may also be helpful to use an independent trust protector to appoint successor trustees to avoid any argument that the beneficiaries put a "controlled" trustee in place.

The court's conclusion that that the Debtor made a transfer was based in part on the wording of the Letter, which provided that the Spendthrift Trustee had an obligation to establish the Spendthrift Clause. Practitioners should advise any beneficiary in financial distress to carefully word communications with the trustee and avoid using any language that could be misinterpreted as a direction.

For an interesting analysis of ***Castellano I*** see, Bove, "The Wrong Result for the Right Reasons," LISI Asset Protection Planning Newsletter #270, (November 20, 2014) at http://www.LeimbergServices.com ("What neither of the two newsletters focused on in their analysis, however, was the fact that the case may not have been lost had the debtor's attorney not interfered with the trustee's duties under the spendthrift provision. If the trustee simply complied with the terms of the trust, as he had a duty to do, it is unlikely the court would have ruled the trust was self-settled. Unfortunately, because of the unnecessary, overt acts of the beneficiary and her attorney, which the court could not ignore, the court was led to the wrong decision for the right reasons."); Adkisson, Slenn & Martino "In re Castellano: A Wake-Up Call for Self-Settled Trusts and Spendthrift Provisions," LISI Asset Protection Planning Newsletter #258, (September 8, 2014) at http://www.LeimbergServices.com; and Vandenack & Wintz, "Drafting Considerations for the Third-Party Spendthrift Trust after In re Castellano," LISI Asset Protection Planning Newsletter #259, (September 10, 2014) at http://www.LeimbergServices.com.

In ***Castellano II***, the district court reviewed the bankruptcy court's proposed findings of fact and conclusions of law de novo. The court (1) reviewed Safanda's claims under § 541 and 548 of the Bankruptcy Code, (2) sustained Linda's and Del Alcazar's objections, (3) entered a judgment in Linda and Del Alcazar's favor, and (4) terminated the civil case filed by Safanda.

Unlike the court in ***Castellano I***, the court in ***Castellano II*** dedicated a majority of the analysis in its opinion to § 541(c)(2) of the Bankruptcy Code. Section 541(c)(2) states that: "a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title." This section was not discussed in ***Castellano I***, where the bankruptcy court's analysis instead focused on § 548(e), which seemed inappropriate and flawed. When a debtor files bankruptcy, a bankruptcy estate is created and contains "all legal or equitable interests of the debtor in property as of the commencement of the case." However, property of a debtor in bankruptcy is not transferred to the bankruptcy estate if (1) such property consists of a beneficial interest in a trust, (2) the trust agreement contains language restricting the transfer of the interest, and (3) the transfer restriction is enforceable under applicable nonbankruptcy law. If a debtor's interest in a trust is

excluded from the bankruptcy estate under § 541(c)(2) of the Bankruptcy Code, the bankruptcy trustee has no basis to set aside a transfer of such an excluded interest.

The court explained that if § 541(c)(2) applied to exclude Linda's interest in the Trust, Safanda could not pursue any transfer and turnover claims regarding such interest. While Linda did not claim an exemption of the Spendthrift Trust Account § 541(c)(2) in her bankruptcy petition, property interests under § 541(c)(2) need not be listed on Schedule C of a bankruptcy petition, as such property is entirely excluded from the bankruptcy estate, not merely exempted from the bankruptcy estate.

To successfully argue that § 541(c)(2) did not apply to exclude Linda's interest in the Trust from the bankruptcy estate, Safanda had to prove by a preponderance of the evidence that Linda did not have an interest in the Trust when Linda filed for bankruptcy, or, in the alternative, that the Trust did not restrict transfers of Linda's interest in the Trust under applicable state law.

The court dismissed Safanda's claim that Linda had no interest in the Trust, and also foreclosed the bankruptcy court's conclusion that the Trust somehow ended and was considered to have been distributed outright to the beneficiaries instantly upon Faith's death. The terms of the Trust stated that "[u]pon the death of Faith F. Campbell and upon settlement of her "estate", [the Trust] shall terminate."

Safanda argued that because the Trust did not define the term "estate," such term referred to Faith's probate estate, and since a probate estate was never opened, Safanda argued that the Trust terminated immediately upon Faith's death. Safanda's interpretation of the Trust's termination provisions would lead to the result that at the time Linda filed her bankruptcy petition, Linda did not have an interest in the Trust.

The court noted that the purpose in interpreting a trust is to discover a settlor's intent. Section 4.10 of the Trust allowed the trustee to make loans from the "Trust Estate" to the executor or other representative of the "Trustor's estate." This provision indicated to the court that Faith intended her estate and the Trust's assets to be separate entities. Numerous other provisions of the Trust instructed the trustee to accomplish certain tasks, before final distribution of the Trust's assets to the remainder beneficiaries (including Linda). The court noted that Safanda's interpretation of the Trust's termination provisions was inconsistent with the remaining terms of the Trust, after reiterating that the Trust should be read to best reflect Faith's overall intent. Thus, the court ruled that on the date Linda filed for bankruptcy, (1) the Trust was still in effect and (2) Linda had a beneficial interest in the Trust.

The Trust had Spendthrift and Discretionary Provisions Which Restricted Transfers of Beneficiaries' Interests

The court noted that the Parties and the bankruptcy court failed to identify that (1) the Trust contained a spendthrift provision (in the traditional sense), and (2) the Trust also contained a provision purporting to convert a beneficiary's interest into a discretionary interest if such beneficiary was bankrupt or insolvent. The court interpreted the spendthrift provision

and the discretionary holdback provision to mean that the Trust sought to restrict assignment of the beneficiaries' interests twice.

The Trust Contained Valid Spendthrift and Discretionary Trust Provisions under South Carolina Law, Illinois Law, and Wisconsin Law

The court had to decide if the relevant restrictions on the assignment of the beneficiaries' interests in the Trust were valid under applicable state law such that the Spendthrift Trust Account would be excluded from the bankruptcy estate. The court noted that the result would be the same under South Carolina law (the situs of the Trust), Illinois law (the state where the Castellanos filed bankruptcy), and Wisconsin law (the state where certain property owned by the Trust was located): at the time Linda filed for bankruptcy, the assignment of her interest in the Trust was validly restricted by the spendthrift and holdback discretionary trust provisions.

Analysis under Section 548(e)

Section 548(e)(1) of the Bankruptcy Code provides:

(e)(1) [T]he trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if—

(A) such transfer was made to a self-settled trust or similar device;

(B) such transfer was by the debtor;

(C) the debtor is a beneficiary of such trust or similar device; and

(D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that the transfer was made, indebted.

Section 101(54) of the Bankruptcy Code provides:

The term "transfer" means—

(A) the creation of a lien;

(B) the retention of title as a security interest;

(C) the foreclosure of a debtor's equity of redemption; or

(D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with—

(i) property; or

(ii) an interest in property.

The terms of the Trust allowed Del Alcazar to transfer a portion of the Trust's assets from one account to another. The court ruled that transferring assets of the Trust between accounts did not terminate the Trust's ownership of such assets, or constitute a distribution to Linda, or otherwise create a new trust. According to the court, Linda's share of the Trust "remained the property of the Trust in the custody of Merrill Lynch." The court ruled further that without a "transfer" (as defined in §101(54) of the Bankruptcy Code) of an interest to Linda, § 548(e) did not apply. The court thus rejected the bankruptcy court's application of § 548(e) of the Bankruptcy Code.

Unlike the court in ***Castellano I***, the court in ***Castellano II*** did not provide extensive analysis on what a transfer of an "interest in property" delineates or what a "similar device" is or is not.

According to the court in ***Castellano I***, Linda's "interest" in "property" was "her share of the Trust assets." In ***Castellano II***, the court noted that Linda had no interest; the $400,000 in the Spendthrift Trust Account was an interest in property of the Trust. Section 548(e)(1) of the Bankruptcy Code uses the term "interest," as further modified by the phrase "of the debtor in property that was made on or within 10 years before the date of the filing of the petition"; while not explicitly defined elsewhere in the statute, the term "interest" was interpreted in In re Mortensen. The court in Mortensen, quoting Butner v. U.S., remarked that "[o]rdinarily, it is state law, rather than the Bankruptcy Code, which creates and defines a debtor's interest in property. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." However, the Mortensen court noted that Congress codified a federal "interest" in passing Section 548(e)(1) which required an interpretation of "interest" different from state law as articulated in Butner.

What type of interest in the trust is required to make it a "self-settled trust" or "similar device?" Can a transfer only be avoided under this provision to the extent the trust is self-settled? Suppose a debtor transfers property to a trust and retains only the right to receive income (such as a common law grantor retained income trust) or annuity payments (such as a grantor retained annuity trust) from the trust for a term of years or for life or suppose the debtor can only receive such payments in the discretion of an independent trustee where the trust is settled in a jurisdiction such as Delaware with asset protection legislation. Is an inter vivos QTIP trust a self-settled trust or similar device where the beneficiary spouse is given a power to appoint assets back to the grantor spouse?

Consider the case of a transfer of wealth to a charitable lead trust established in a jurisdiction such as Delaware with asset protection legislation where the remainder interest is directed to be distributed to a trust in which the debtor is a discretionary beneficiary of the income and/or principal. Suppose the term of the lead trust extends over ten (10) years. Query whether this is a self-settled trust under the statute or a similar device. Would the asset protection trust's vested remainder interest in the charitable lead trust be considered an

attachable property interest under this rule? This would seem to be the correct result. It appears that the retention of a certain amount of control over the trust assets is an indication of the trust being classified as "something like" a similar device.

Neither the phrase "self-settled trust or similar device," nor the individual words "self-settled trust" or "similar device" are defined in the Bankruptcy Code. ***Castellano I*** cited to Black's Law Dictionary for the definition of a self-settled trust, which states that a self-settled trust is "[a] trust in which the settlor is also the person who is to receive the benefits from the trust, usually set up in an attempt to protect the trust assets from creditors." It appears that Congress intended that the courts turn to state law for these definitions, as articulated by Representative Chris Cannon, R-Ut.:

Under the Restatement of Trusts, a self-settled trust is a trust created by a person for his or her own benefit with a provision restraining the voluntary or involuntary transfer of person's interest, so the Restatement provides that such trust can be pierced by the person's creditors… . So what is an asset protection trust or self-settled trust? Neither the Internal Revenue Code nor the entire United States Code contain any reference to either of these terms. This is a matter of State law.

In *In re Porco*, the court highlighted commentary in Collier on Bankruptcy that states: "[t]he congressional decision to leave these terms [self-settled trust or similar device] undefined indicates an intent for courts to interpret the statute broadly so as to effectuate its aims; even if crafty lawyers draft devices that are not technically 'self-settled trust[s],' a court will have the power to scrutinize them under the 'similar device' provision." The Porco court ultimately stated that "consideration should be given to Congress's purpose in enacting § 548(e)… to reverse the actions of state legislatures that had overturned the common law that a self-settled spendthrift trust could be reached by creditors or a trustee in bankruptcy."

Cases may give practitioners some insight into what a "similar device" might be. In Porco, a 2011 decision, the court noted that years after Section 548(e) of the Bankruptcy Code had been enacted (2005), no bankruptcy court opinions had yet to construe the words "self-settled" or "similar device." Relying on the legislative history of Section 548(e) and Collier on Bankruptcy, the court determined that a resulting or constructive trust was not a "self-settled trust or similar device." The court noted that self-settled spendthrift trusts "generally require (1) an irrevocable trust; (2) an independent trustee; (3) absolute discretion; and (4) distributions to beneficiaries, including the settlor." According to the court, the four elements contemplate the creation of an express trust. The court went on to reason that if the purpose of Section 548(e) was to reverse actions of state legislatures overturning the common law ban on self-settled spendthrift trusts and self-settled spendthrift trusts are express trusts, the language in Section 548(e) requires an express trust; therefore, resulting or constructive trusts are not express trusts within the purview of Section 548(e)… resulting and constructive trusts are created by the courts and not by the express grant of a settlor. The court in ***Castellano II*** noted that in Del Alcazar's creation of the Spendthrift Trust Account and holding of the $400,000 at Merrill Lynch, there was no act of distribution or creation of a new trust; there was merely a division of the property of the Trust pursuant to the terms of the Trust. Thus, the court

in ***Castellano II*** reached the correct result in holding that there was no transfer of an interest, and that § 548(e) does not apply.

Finally, it is worth noting that perhaps the term "similar device" refers to a trust that is not technically considered a "self-settled trust" nevertheless, the settlor retains (or likely retains) some significant benefit or benefits that are not necessarily apparent from the terms of the trust agreement, however, are either apparent from the facts and circumstances that occur after the trust is created and funded or because of powers and authority granted to certain parties who are closely related to the settlor or over whom a settlor can exert strong influence. Thus, for example, a trust for the benefit of a settlor's spouse and descendants would not be considered a self-settled trust. Nevertheless, where the terms of the trust agreement grant the settlor's spouse a broad special power of appointment that could be exercised in favor of the settlor, such a trust may be considered a "similar device." A trust for the benefit of the settlor's descendants may be considered a similar device where the settlor retains substantial control over the capital through broad investment authority either granted under the terms of the trust agreement or de facto control based on the facts and circumstances. For additional commentary on ***Castellano II***, see "Gopman, Beadle, Sneeringer, Kaufman & Gassman on Safanda v. Castellano: District Court Tells Bankruptcy Court to Cast-away-no," LISI Asset Protection Planning Newsletter #297 (May 26, 2015) at http://www.leimbergservices.com. See *In re Lewiston*, 2015 WL 3894609 (Bankr. E.D. Mich. June 24, 2015), where the court held that a debtor's beneficial interest in a Trust was not excluded from his bankruptcy estate under § 541(c)(2) of the Bankruptcy Code where a restriction in the trust was unenforceable under Michigan law.

B. ***In re Lewiston***. In *In re Lewiston*, 2015 WL 3894609 (Bankr. E.D. Mich. June 24, 2015), the Chapter 7 trustee (the "**Trustee**") sought to include a trust settled by the debtor, **Richard M. Lewsiton** ("**Richard**"), and his wife, **Lois C. Lewiston** ("**Lois**") as property of Richard's bankruptcy estate. Richard and Lois entered into the Lois and Richard Lewiston Living Trust (the "**Trust**") on September 10, 1986. Richard and Lois were the initial trustees with Richard being nominated as the initial managing trustee. Following an amendment on February 15, 2008, either Richard or Lois, acting alone, would be the managing trustee of the Trust. Richard and Lois were the only beneficiaries of the Trust. The Trust was revocable during Richard and Lois' joint lifetimes and became irrevocable upon the first spouse's death. The Trust contained a spendthrift clause as follows:

> The right of any beneficiary to receive distributions under this Agreement shall not be subject to any conveyance, transfer or assignment by any beneficiary, or be pledged as security for the debts of any beneficiary, and the same shall not be subject to any claims by creditors of any beneficiary through legal process or otherwise. It is RICHARD's intention to place the absolute title to the property held in trust, together with all income, accruals and increases thereof, in the Trustees, with power and authority to pay out the same only as authorized hereby.

Richard filed a bankruptcy petition August 13, 2012. He disclosed the Trust, however, he claimed that the disclosure was for notice purposes only, and that the Trust was not property of his bankruptcy estate. The Trustee alleged that the Trust was property of the bankruptcy

estate, specifically because the spendthrift provision of the Trust was not enforceable under Michigan law and the Trust was against public policy and unenforceable because it was a self-settled trust. The Trustee argued that the Trust was self-settled as Richard was both a settlor and beneficiary of the Trust, and therefore, the spendthrift provision restricting the transfer of Richard's interest in the Trust was unenforceable under Michigan law. Excerpts of the trial on an objection to Richard's Chapter 7 discharge submitted the Trustee demonstrated that Richard consistently took distributions from partnerships and corporate interests transferred to the Trust (depositing the distributions in his personal bank account rather than the Trust), routinely signed documents of the partnerships and corporations without designating that he was signing in his capacity as Trustee, and made no distinction between his individually owned business interests and business interests transferred to the Trust. Richard argued that the spendthrift provision of the Trust was enforceable under Michigan law because the Trust was irrevocable in that Richard could not revoke the Trust without the consent of Lois.

The court applied § 541(c)(2) of the Bankruptcy Code to the spendthrift provision contained in the Trust to hold that Richard's beneficial interest in the Trust was not excluded from his bankruptcy estate where the restriction in the Trust was unenforceable under Michigan law. The court cited to a Michigan Supreme Court case, *Fornell v. Fornell Equipment Inc.*, 390 Mich. 540, 213 N.W.2d 172, 176 (1973), for the proposition that there is a public policy exception to the validity of a spendthrift trust where the settlor and the beneficiary are the same person. The court then reviewed the Michigan Trust Code (the "**MTC**"). It noted that:

> While the MTC expressly recognizes the validity and enforceability of a spendthrift provision, it does not state whether a spendthrift provision may be used by an individual who creates a trust, places their own assets in it, and also designates themselves as a beneficiary of the trust. Nor does the statute state whether it abrogates or continues to recognize the public policy exception against a self-settled trust...

Although Richard argued that the MTC abrogated the holding of *Fornell* and other cases that followed by allowing self-settled spendthrift trusts, the court found his argument misplaced and instead recognized that the MTC neither authorizes self-settled spendthrift trusts nor abrogates Michigan common law public policy regarding self-settled spendthrift trusts. The court specifically mentioned:

> As explained in the common law in *Estate of Edgar*, and in the MTC in § 700.7502(3), a spendthrift provision is a restriction on the ability of a beneficiary to transfer his or her beneficial interest in trust property, not a restriction on a settlor. In contrast, § 700.7506 focuses on the rights of a creditor of a settlor, without regard to the identity of any beneficiary. This section of the statute does not either explicitly or implicitly limit the rights of a creditor of a beneficiary who is also a settlor of a trust with a spendthrift provision. It does not support the Defendants' contention that the MTC somehow permits a self-settled spendthrift trust.

The court went on to point out that:

> The plain text of §§ 700.7105 and .7404 makes it clear that the MTC recognizes that a trust may only be created in Michigan if it is not contrary to public policy. The statute does not attempt to survey the public policy in Michigan. But neither
> does it state that it intends to change existing public policy in Michigan. Instead, the statute merely recognizes that the public policy of the State of Michigan continues to serve as a limitation upon trusts created and governed by the MTC. . . . Because the MTC does not state that it abrogates the common law in Michigan regarding the enforceability of a spendthrift provision in a self-settled trust, well established principles of statutory construction in Michigan compel the Court to conclude that the common law prohibition against self-settled spendthrift trusts, as articulated in *Fornell*, retains its vitality. The Court declines Richard's invitation to hold that the MTC by implication abrogates the common law in Michigan. Instead, the Court holds that the MTC neither authorizes self-settled spendthrift trusts nor abrogates Michigan common law public policy regarding self-settled spendthrift trusts. The public policy against self-settled spendthrift trusts. . . remains intact and continues to limit the purposes for which a trust can be created in Michigan.

Richard also repeated an earlier argument (rejected by the court in earlier arguments) that he and Lois owned their beneficial interests in the Trust as a tenancy by the entireties. On the original schedule C that he filed in his Chapter 7 case, Richard listed the Trust and claimed an exemption in it as a tenancy by the entireties under Michigan law. Richard argued that he had no right to use the Trust assets without permission from Lois. The court, however, took notice of the trial excerpts and the lack of evidence presented by Richard to the contrary to demonstrate that Lois and he disregarded any restrictions on Richard's use and enjoyment of the assets in the Trust. The court noted that Richard basically treated the assets of the Trust as his own personal property for all purposes. In doing so, Richard could not seek to avoid the legal consequences that flowed from such facts countering his contention that he had no legal right to use the Trust assets without permission from Lois.

Lewiston is a mere bankruptcy court decision that has relatively insignificant precedential value. However, unlike *Castellano*, it is an example of a bankruptcy judge applying the bankruptcy law correctly in regards to applicable state law. While not relevant to the court's holding, *In re Erskine,* 2016 WL 1644483 (Bankr. W.D. Tenn. April 8, 2016) illustrates a departure from the correct analysis of the fraudulent transfer rule.

In ***Castellano I***, had the Bankruptcy Court been correct that the debtor was the "transferor" within the meaning of § 548(e) of the Bankruptcy Code (which she was not), the South Carolina self-settled trust statute should have been applied and § 548(e) should have been irrelevant. In Lewiston, the court never referred to or mentioned § 548(e). This indicates that the Lewiston court understood that there was not a change in title or control under Michigan state law. This is important because § 548(e) only applies if there is a "transfer" within the meaning of the fraudulent transfer statute. The court's holding in ***Castellano I*** was

questionable for a number of reasons. South Carolina law governed the trust in *Castellano* and it does not permit the creation of self-settled asset protection trust except in one limited situation inapplicable to the facts of *Castellano*. If the court had been correct that the spendthrift trust in *Castellano* was self-settled by the debtor, the application of South Carolina law should have ended the analysis at that time, because Section 62-7-505 of the South Carolina Code would allow a bankruptcy trustee to access the trust assets, negating the need for the court to analyze § 548(e) of the Bankruptcy Code. The same would have been the case applying the law of Illinois, where the *Castellano* debtor filed her bankruptcy petition.

a. Although Michigan law recognizes tenancy by the entireties, the Lewiston court disregarded Richard's tenants by the entireties argument as misplaced. Furthermore, Michigan's tenancy by the entireties doctrine is not buttressed by a specific statute authorizing the creation of a trust funded with tenancy by the entireties property whereby the property transferred and held in such a trust would be treated as retaining its character as tenancy by the entireties property thus limiting a judgment creditor of only one spouse from satisfying its judgment against a debtor-spouse's interest in property held in tenancy by the entireties. Jurisdictions such as Delaware and Nevis have specific statutes on point that permitting such statutory tenancy by the entireties trusts and although Richard's argument was one of a desperate (if not smart) lawyer grasping for straws, if married settlors wish to have property transferred to a trust continue to be treated as a tenancy by the entireties property, such settlors would be better severed establishing such a trust in a jurisdiction that has a statute permitting such a trust.

b. In *In re Ferrante*, CC-14-1222-KiTaPa (Bankr.C.D. Ca. Aug. 26, 2015), Robert Ferrante (the "**Debtor**") created a 20 year qualified personal residence trust ("**QPRT**") in 1994 titled the "518 Harbor Island Drive Trust agreement" (the "**Trust**"). The Trust was created to receive as a gift the Debtor's personal residence, located in Newport Beach, California, and valued at $7.495 million at the time of the gift. The Trust contained the following provisions:

> Paragraph II: Irrevocability. This trust and all interests in it are irrevocable, and the grantor has no power to alter, amend, revoke, or terminate any trust provision or interest whether under this instrument or any statute or rule of law.
>
> ***Paragraph III A.4.: Option to Purchase Residence. The Grantor shall have the option to acquire all or part of the Residence from the trust immediately prior to the expiration of the trust. The option price will be the then fair market value of the Residence then held by this Trust.***
>
> Paragraph III B. When the Trust Terminates. The Trust terminates only as provided in this paragraph:
>
> 3. Cessation of Personal Residence Trust Status. Unless the Trustee makes a timely election under subparagraph III [C.], this trust shall terminate when it ceases to be a Qualified Personal Residence Trust ("QPRT"), ***and on such termination the Trustee shall distribute all of the trust assets to the Grantor*** . . . .

> 4. The date on which the Residence . . . ceases to be used or held for use as a personal residence shall be known as the "Cessation Date."
>
> Paragraph III C. Conversion to a Grantor Retained Annuity Trust. Within thirty (30) days from the date on which this trust would otherwise terminate under subparagraph III [B.3.], the Trustee may elect to convert the trust to a Grantor Retained Annuity Trust ("GRAT") . . . . [*emphasis added*].

On December 23, 1997, the IRS adopted regulation 26 C.F.R. § 25.2702-5(c)(9) ("**Treas. Reg. §**," or, as the case may be, the "**Regulations**"). Treas. Reg. § 25.2702-5(c)(9) provides:

> (9) Sale of residence to grantor, grantor's spouse, or entity controlled by grantor or grantor's spouse. ***The governing instrument must prohibit the trust from selling or transferring the residence, directly or indirectly, to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse during the retained term interest of the trust, or at any time after the retained term interest that the trust is a grantor trust.*** For purposes of the preceding sentence, a sale or transfer to another grantor trust of the grantor or the grantor's spouse is considered a sale or transfer to the grantor or the grantor's spouse; however, a distribution (for no consideration) upon or after the expiration of the retained term interest to another grantor trust of the grantor or the grantor's spouse pursuant to the express terms of the trust will not be considered a sale or transfer to the grantor or the grantor's spouse if such other grantor trust prohibits the sale or transfer of the property to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse. In the event the grantor dies prior to the expiration of the retained term interest, this paragraph (c)(9) does not apply to the distribution (for no consideration) of the residence to any person (including the grantor's estate) pursuant to the express terms of the trust or pursuant to the exercise of a power retained by the grantor under the terms of the trust. Further, this paragraph (c)(9) does not apply to an outright distribution (for no consideration) of the residence to the grantor's spouse after the expiration of the retained trust term pursuant to the express terms of the trust. For purposes of this paragraph (c)(9), a grantor trust is a trust treated as owned in whole or in part by the grantor or the grantor's spouse pursuant to sections 671 through 678, and control is defined in § 25.2701-2(b)(5)(ii) and (iii). [*emphasis added*].

Treas. Reg. §25.2702-5(c)(9) applies to trusts created after May 16, 1996. The preamble to the Regulations states: "Treasury and the IRS wish to clarify that the IRS will apply these regulations only to post-effective date trusts. Nevertheless, Treasury and the IRS have the authority to apply established legal doctrines to disqualify a pre-effective date trust in cases where the statutory purpose has clearly been violated." Treas. Reg. § 25.2702-5(a)(2) provides:

> (2) Modification of trust. ***A trust that does not comply with one or more of the regulatory requirements under paragraph (b) or (c) of this section will, nonetheless, be treated as satisfying these requirements if the trust is modified, by judicial reformation (or nonjudicial reformation if effective under state law), to comply with the requirements.*** In the case of a trust created after December 31, 1996, the reformation must be commenced within 90 days after the due date (including extensions) for the filing of the gift tax return reporting the transfer of the residence under section 6075 and must be completed within a reasonable time after commencement. If the reformation is not completed by the due date (including extensions) for filing the gift tax return, the grantor or grantor's spouse must attach a statement to the gift tax return stating that the reformation has been commenced or will be commenced within the 90-day period. ***In the case of a trust created before January 1, 1997, the reformation must be commenced within 90 days after December 23, 1997 and must be completed within a reasonable time after commencement.*** [*emphasis added*].

In 2004, one of the former Trustees of the Trust ("**Creditor**") obtained a judgment against Debtor. In 2008, Creditor filed an action in the California probate court to revoke the Trust. Creditor contended that the Trust was a sham to avoid creditors' claims and that Debtor reserved the power to revoke it. The California probate court dismissed Creditor's action on the motion of Debtor's former wife as guardian for the remainder beneficiaries of the Trust. Creditor appealed and the California Court of Appeal affirmed by dismissing any argument of trust revocability stating that "a judgment creditor cannot establish that an irrevocable trust is revocable based on subsequent conduct of the settlor." This decision was referred to in the *In re Ferrante* opinion as *Seay v. Ferrante*.

Debtor filed bankruptcy in 2010 and received a discharge in 2012. Subsequent to the bankruptcy discharge, Creditor filed an adversary complaint against Debtor, the Trust and others for turnover of estate property, declaratory relief and revocation of Debtor's bankruptcy discharge. Creditor filed a motion to declare the Trust revocable and to sell the property for the benefit of creditors. Following Creditor's motion, the bankruptcy trustee ("**Trustee**") sought to revoke the Trust and compel Debtor to turn over the Trust property to Debtor's bankruptcy estate. Trustee argued the Trust ceased and the property of the Trust reverted to Debtor. As an example, Trustee pointed to Debtor's power to revoke the Trust at will. Alternatively, Trustee contended the Trust terminated when Debtor ceased using the property as his personal residence as evidenced by a lease between the trustee of the Trust and the Trust, in order for the property to be the trustee's residence for two years.

Debtor countered that the Trust could only terminate upon his death, expiration of the term of the Trust or cessation of the QPRT status of the Trust, and none of these events occurred. Debtor contended that the lease was never effectuated. Importantly, Debtor contended that even though the Trust contained the prohibited "buy-back" language, the Regulation was promulgated after the Trust was created and did not apply. Additionally, Debtor contended that under California law he could not "turn an irrevocable trust into a

revocable one with his post-creation conduct; it could only be set aside by petition of all beneficiaries."

The bankruptcy court ruled for the Trustee on two grounds. First, the court held that the QPRT status of the Trust ceased. It opined that QPRTs are not irrevocable trusts because a grantor can terminate QPRT status by ceasing to reside in the trust property. The court emphasized that the Trust contained language that provided that if the trust failed to qualify as a QPRT, it terminated and all assets were to be distributed to Debtor. Since Debtor could terminate the Trust at his discretion, so could the trustee of the Trust. Thus, it was the court's opinion that "QPRTs are gift and estate tax delay devices, not estate planning or creditor protection devices."

The second ground was that the "buy-back" provision violated the QPRT requirements and established revocability or terminability. The court reasoned that if the trustee of the Trust could terminate it, he or she could revoke or terminate it for the benefit of creditors.

On a motion for reconsideration filed by Debtor, the court focused solely on the effect of the noncompliance under Treas. Reg. § 25.2702-5(a)(2). Under Treas. Reg. § 25.2702-5(b)(1):

> (1) In general. A personal residence trust is a trust the governing instrument of which prohibits the trust from holding, for the original duration of the term interest, any asset other than one residence to be used or held for use as a personal residence of the term holder and qualified proceeds (as defined in paragraph (b)(3) of this section). A residence is held for use as a personal residence of the term holder so long as the residence is not occupied by any other person (other than the spouse or a dependent of the term holder) and is available at all times for use by the term holder as a personal residence. A trust does not meet the requirements of this section if, during the original duration of the term interest, the residence may be sold or otherwise transferred by the trust or may be used for a purpose other than as a personal residence of the term holder. ***In addition, the trust does not meet the requirements of this section unless the governing instrument prohibits the trust from selling or transferring the residence, directly or indirectly, to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse, at any time after the original duration of the term interest during which the trust is a grantor trust.*** For purposes of the preceding sentence, a sale or transfer to another grantor trust of the grantor or the grantor's spouse is considered a sale or transfer to the grantor or the grantor's spouse; however, a distribution (for no consideration) upon or after the expiration of the original duration of the term interest to another grantor trust of the grantor or the grantor's spouse pursuant to the express terms of the trust will not be considered a sale or transfer to the grantor or the grantor's spouse if such other grantor trust prohibits the sale or transfer of the property to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse. In the event the grantor dies prior to the expiration of the original duration of the term interest, this

> paragraph (b)(1) does not apply to the distribution (for no consideration) of the residence to any person (including the grantor's estate) pursuant to the express terms of the trust or pursuant to the exercise of a power retained by the grantor under the terms of the trust. Further, this paragraph (b)(1) does not apply to any outright distribution (for no consideration) of the residence to the grantor's spouse after the expiration of the original duration of the term interest pursuant to the express terms of the trust. For purposes of this paragraph (b)(1), a grantor trust is a trust treated as owned in whole or in part by the grantor or the grantor's spouse pursuant to sections 671 through 678, and control is defined in § 25.2701-2(b)(5)(ii) and (iii). Expenses of the trust whether or not attributable to trust principal may be paid directly by the term holder of the trust. [*emphasis added*].
>
> Debtor argued the Regulation did not apply because it was added in 1997 after creation of the Trust in 1994. However, the court rejected Debtor's argument. The court noted that since the Trust was never modified to comply with the third sentence of Treas. Reg. § 25.2702-5(b)(1), the Trust did not comply with the Regulations and ceased to be a QPRT. As the Trust ceased to be a QPRT, the Trust property (the $7.495 million Newport Beach, California, property) reverted back to Debtor pursuant to Paragraph III B.3. of the Trust.

During oral argument Debtor asked the court whether the decision in *Seay v. Ferrante* had any effect on its decision. The court opined that "it had no preclusive effect . . . no one represented the estate in that action." Additionally, the court:

> [D]istinguished the two non-controlling cases cited by Appellants that reviewed QPRTs in bankruptcy and determined them to be irrevocable and not property of the estate. In the court's opinion, those cases focused on different issues, such as fraudulent conveyance, and did not engage in any real analysis of "what exactly does it mean to be 'irrevocable' in this context with the teaching that anything the Debtor . . . could do so can his trustee. . . ."

Debtor submitted a declaration from the drafting attorney of the Trust who stated that the Trust "constituted an irrevocable trust and did not terminate if it deviated from QPRT laws." However, the court did not attach any weight to this argument. It instead paid particular attention to the argument of the Trustee:

> [T]he reformation had to be commenced within ninety days after December 23, 1997, and had to be completed within a reasonable time after commencement. No evidence existed showing that Debtor modified the 518 Trust or began any compliance modification. As a result, argued Trustee, the buy-back provision alone invalidated the 518 Trust's QPRT status. Trustee further argued that the 518 Trust could not be converted to a GRAT when it ceased to be a QPRT because its terms did not comply with 26 C.F.R. § 25.2702-5(c)(8)(C)(ii), which prohibits additional contributions to the trust; the 518 Trust contained no such prohibition. . . we need not address Appellants' other argument that the

> bankruptcy court erred in ruling that the 518 Trust is, and QPRTs in general are, revocable trusts as a matter of law.

Debtor and his attorney would receive a failing grade in estate planning 101. While we cannot go back as attorneys and step into the shoes of either party in this transaction, what should have happened in 1996 would have been a letter from the estate planning attorney to all of his clients indicating the change in the law. This letter should have specifically been addressed to clients such as Debtor whom the estate planning attorney would have reason to known to have been involved with this particular estate planning transaction. Still, Debtor deserves much of the blame. Following the initial decision in *Seay v. Ferrante*, Debtor should have sought counsel to address the Trust and determine whether further planning should have been initiated. A simple savings clause could have prevented much of Debtor's problems. For example:

> The Trustee shall have the power, acting alone, to amend the Trust to the extent provided in Reg. §25.2702-5(a)(2) in any manner required for the sole purpose of ensuring that the Trust is at all times a Qualified Personal Residence Trust for purposes of Code Sec. 2702(a)(3)(A) and Reg. §25.2702-5(c) (including with respect to the grantor retained annuity trust administered hereunder and the qualification of the annuity interest under Code Sec. 2702(b)(1) and Reg. §25.2702-3).

For everyone else, caution is warranted when drafting a new QPRT or in administering QPRTs to avoid any arguments that an existing provision that permits the return of assets creates a self-settled trust issue and causes issues as to whether the grantor has made a completed gift. QPRTs should contain provisions that mandate there shall be no return of assets to the grantor, only a conversion to a grantor retained annuity trust ("**GRAT**"). For example:

Within thirty (30) days after the date on which the trust has ceased to be a Qualified Personal Residence Trust or has ceased to be a Qualified Personal Residence Trust with respect to particular assets, the trust property (or such assets) shall be converted to a qualified annuity interest meeting the requirements of Reg. §25.2702-5(c)(8)(ii) and shall be held in a separate share of the Trust. The separate share shall be disposed of under the terms of the Article entitled "**Payment of Annuity Amount**." With respect to the annuity payable from such share, "**cessation date**" means the date of sale of the residence, the date of damage to or destruction of the residence, or the date on which the residence ceases to be used or held for use as a personal residence, as the case may be. "**Conversion date**" means the date that the assets comprised in such share are converted to a qualified annuity interest pursuant to this paragraph. Because it may be possible to have more than one cessation of qualification during the term of the Qualified Personal Residence Trust, the Trustee shall create and fund a separate annuity trust for each cessation and each such Trust shall be administered as a separate share of the Trust in accordance with the Article entitled "**Payment of the Annuity Amount**."

It is also noteworthy that there was no reference in this case of § 548(e) of the Bankruptcy Code. Recall the facts of *In re Lewiston*, 2015 WL 3894609 (Bankr. E.D. Mich.

June 24, 2015), and other recent bankruptcy cases involving a revocable trust. The court in *Lewiston* never referred to § 548(e) as it understood there was no change in title or control under Michigan state law when the debtors in that case funded the Trust. Section 548(e) only applies if there is a "transfer" within the meaning of that fraudulent transfer statute. See also, *In re Pollack*, 2016 WL 270012, 2016 BNH 002 (Bankr. NH, Jan. 20, 2016) providing in part:

> Further, even if the Court were to find that the settlement agent was merely a conduit and the property was in fact transferred *to* the NH Revocable Trust, the record does not support a finding that the NH Revocable Trust is a "self-settled trust or similar device" under the Bankruptcy Code. "A self-settled trust has been defined as '[a] trust in which the settlor is also the person who is to receive the benefits rom the trust, usually set up in an attempt to protect the trust assets creditors.' " *Id.* at 561; *see* H.R.Rep. No. 109–31, 109th Cong., 1st Sess. 449–50 (2005) (statement of Rep. Cannon) (explaining that a self-settled trust is a trust created by a person for his or her own benefit with a provision restraining the voluntary or involuntary transfer of the person's interest) (quoted in 5 *Collier on Bankruptcy* ¶ 548.07 [3][a] n.4). The record is clear that the NH Revocable Trust is not an irrevocable trust or a spendthrift trust. It does not contain any provisions that would restrict the trustee's ability to make distributions or that would protect the trust assets from claims of creditors. The Trustee conceded as much during his counsel's closing argument.

A self-settled trust is a trust in which the settlor, i.e., the grantor, remains eligible to receive distributions of income and/or principal from the trust. *See also* Restate. (2d.) of Tr. § 156(2) (1959); Restate. (3d.) of Tr. § 25. When a QPRT permits the return of assets to the grantor, the QPRT should be considered a self-settled trust. California law does not provide any protection from creditors of the grantor of a self-settled trust. *See* Cal. Prob. Code § 15304(a). Cal. Prob. Code § 15304 would allow a bankruptcy trustee to access the trust assets, negating the need for the court to analyze § 548(e) of the Bankruptcy Code. For additional commentary on *In re Ferrante*, see Riser & Adkisson, "In re Ferrante: Tax-Flawed QPRT Ruled Part of Bankruptcy Estate in Voluntary Chapter 7 Bankruptcy Case," LISI Asset Protection Planning Newsletter #310 (November 3, 2015) at http://www.leimbergservices.com; and Gopman, Ruiz-Gonzalez, Beadle, Sneeringer & Kaufman, "*In re Ferrante*: Not Modifying Trust to Comply with Tax Law Creates Bankruptcy Nightmare," LISI Asset Protection Planning Newsletter #3__ (November _, 2015) at http://www.leimbergservices.com.

F. Ethics

1. Applicable Model Rules of Professional Conduct.

The following are the Model Rules of Professional Conduct that may be applied by a state bar committee in analyzing whether an attorney's conduct was unethical for assisting or counseling a client in a transaction deemed to be a fraudulent transfer.

Model Rule 1.2(d) provides:

> A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or ***fraudulent***, **but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law**.

Model Rule 4.4(1) provides:

> In representing a client, a lawyer shall not use means that have no substantial purpose other than to embarrass, ***delay***, or ***burden a third person***, or use methods of obtaining evidence that violate the legal rights of such a person.

Model Rule 8.4(c) provides:

> It is professional misconduct for a lawyer to:
>
> (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another;
>
> (b) commit a criminal act that reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer in other respects;
>
> (c) ***engage in conduct involving dishonesty, fraud, deceit or misrepresentation***;
>
> (d) ***engage in conduct that is prejudicial to the administration of justice***;
>
> (e) state or imply an ability to influence improperly a government agency or official or to achieve results by means that violate the Rules of Professional Conduct or other law; or
>
> (f) knowingly assist a judge or judicial officer in conduct that is a violation of applicable rules of judicial conduct or other law.

2. State Ethics Opinions.

In Connecticut Informal Opinion 91-23, a lawyer sought an opinion on whether the lawyer could ethically recommend and/or assist a client in making a transfer of the client's jointly owned residence to the client's wife while the client was insolvent. Based on the Model Rules of Professional Responsibility, the Connecticut Bar Association's Committee on Professional Ethics stated that:

> A lawyer may not counsel or assist a client to engage in a fraudulent transfer that the lawyer knows is either intended to deceive creditors or that has no substantial purpose other than to delay or burden creditors.

The committee further stated:

> whether or not a particular transaction is a fraudulent transfer as a matter of substantive law is not the decisive factor in applying the Rules. The decisive factors are whether the lawyer knows that the transfer constitutes conduct having a purpose to deceive (see Rule 1.2(d)) or whether in counseling or assisting the client the lawyer is using means that have no substantial purpose other than to embarrass, delay or burden third parties (see Rule 4.4).

The committee concluded that although all fraudulent transfers are thought of as illegal, the Model Rules do not apply to all illegal conduct and only apply to conduct that is "known" to be criminal or fraudulent. As a result, following the reasoning in Connecticut Informal Opinion 91-23, if a lawyer assists or counsels a client in a transaction "known" to be a fraudulent transfer, the attorney's conduct would be unethical.

In South Carolina Bar Ethics Advisory Opinion 84-02, the ethics committee considered whether the model code prohibited a lawyer from transferring a client's property from client's name to the client's spouse's name in anticipation of the possibility that an adverse judgment would be rendered against the client. The committee held that "a lawyer may not transfer a client's property from the client's name to the client's spouse's name in order to avoid the likely possibility that the client's creditors could recover the property if a judgment were rendered against the client." The committee held that this conduct would be prohibited because it violates DR 7-102(A)(7) which states that "in his representation of a client, a lawyer shall not counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent."

The committee further stated:

> The critical issue would be whether or not the transfer took place with a reasonable prospect that a judgment would be obtained against the client, or whether or not the transfer took place to avoid some possibility in the distant future. If the transfer was solely for the purpose of avoiding creditors, it could not be done by an attorney for a client. If, however, there does not exist the immediate reasonable prospect of a judgment being entered against the client, the transfer merely to avoid the possibility of an action by a creditor or creditors would not be in violation of DR 7-102(A)(7).

Therefore, based on South Carolina Bar Ethics Advisory Opinion 84-02, if a transfer is only for the purpose of avoiding the "possibility" of a judgment against the client, it would

probably not be a violation of the canons; however, if the transfer is made with the sole purpose to avoid the "likely probability" of a judgment, then such a transfer would be a violation.

In Ethics Opinion 1993-1 of the Legal Ethics and Unlawful Practice Committee of the San Diego County Bar Association the issue of the extent an attorney may advise or assist a client with respect to an avoidance of existing and identifiable creditors' rights and a protection of the client's assets. A potential client sought advice to protect the client's personal assets from existing and identifiable creditors. The client expressed an intent to transfer the assets beyond the reach of the client's creditors to the attorney and requested that the attorney advise, prepare and assist in the implementation of an asset protection plan, which may include trusts, family limited partnerships and similar techniques.

The committee cited Rule 3-210 of the State Bar of California Rules of Professional Conduct:

> A member shall not advise the violation of any law, rule, or ruling of a tribunal unless the member believes in good faith that such law, rule or ruling is invalid. A member may take appropriate steps in good faith to test the validity of any law, rule, or ruling of a tribunal.

The Uniform Fraudulent Transfer Act provides a remedy to creditors to whom its provisions apply for transfers deemed fraudulent. Civil Code § 3439.04(a) sets forth that a transfer made or 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 the actual intent to hinder, delay or defraud the creditor. The committee viewed an attorney's "knowing" assistance in fraudulent transfers as contrary to civil law and would subject an attorney to discipline.

Furthermore, to the extent that the attorney participates in the transfer, the attorney and the client may be subject to criminal sanctions under Penal Code § 154. It imposes a criminal misdemeanor on a debtor's fraudulently transferring property out of state or transferring with the "intent to defraud, hinder or delay creditors." Penal Code § 531 provides:

> Every person who is a party to a fraudulent conveyance of any lands, tenements, or hereditaments, goods, or chattels, or any rights or interest issuing out of the same, or to any bond, suit, judgment, or execution, contract or conveyance, had, made or contrived with intent to deceive and default others, or to defeat, hinder or delay creditors or others or their just debts, damages, or demands; or who, being a party as aforesaid, at any time wittingly and willingly puts in, uses, avows, maintains, justifies, or defend the same, or any of them, as true, and done, had, or made in good faith, or upon good consideration, or aliens, assigns or sells any of the lands, tenements, hereditaments, goods, chattels, or other things before mentioned, to him or them

> conveyed as aforesaid, or any part thereof, is guilty of a misdemeanor.

The Business and Professions Code § 6128 also indicates that an attorney is guilty of a misdemeanor when guilty of any deceit or collusion or consents to any deceit or collusion with an intent to deceive the court or any party. Based on the foregoing statutes, the committee concluded that if the attorney assisted the client in the fraudulent transfer, such conduct would also result in criminal sanctions relative to the client and the attorney.

3. Aiding and Abetting Liability for a Fraudulent Transfer.

Florida does not recognize an action for aiding and abetting a fraudulent transfer by third-party non-transferees of the property in question. See *Freeman v. First Union National Bank*, 865 So.2d 1272 (Fla. 2004); *Danzas Taiwan, Ltd. v. Freeman*, 28 Fla. L. Weekly D 1163 (3d DCA 2003); *BankFirst v. UBS Paine Webber*, 842 So 2d 155 (5th DCA 2003); *Yusem v. South Florida Water Management District*, 770 So. 2d 746 (4th DCA 2000).

In *Yusem v. South Florida Water Management District*, 770 So. 2d 746 (4th DCA 2000), South Florida Water Management District ("**SWFWMD**") obtained a judgment against Henry Yusem ("**D**") in the amount of $224,695.42. D failed to make any payment on the judgment. In April 1998, D's attorneys settled a legal malpractice action for D receiving $244,701.11. D directed his attorneys to wire the funds into a tenancy by the entireties bank account of D and his wife ("**W**"). D then initiated a wire transfer of $210,000 to an offshore trust account which D held in his name. This money was lost in a foreign currency investment. SWFWMD filed a suit against D and W, alleging that D engaged in a fraudulent asset conversion in violation of section 222.30 of the Florida Statutes.

The court reasoned that D was the debtor and D's offshore trust account was the transferee. W was not a debtor because the judgment was not entered against W. W was also not a transferee because the funds were only momentarily transferred into the tenancy by entireties account without her knowledge and there was no evidence that W benefited from the transfer in any way. As a result, the court held that there was no basis in the law to hold W liable for the fraudulent conversion made by D. The court further stated:

> The trial court misapprehended the purpose and scope of a fraudulent conveyance action. **A fraudulent conveyance action is simply another creditors' remedy**. It is either an action by a creditor against a transferee directed against a particular transaction, which, if declared fraudulent, is set aside thus leaving the creditor free to pursue the asset, or it is an action against a transferee who has received an asset by means of a fraudulent conveyance and should be required to either return the asset or pay for the asset (by way of judgment and execution). A fraudulent conveyance action, under section 726.108, is not an action against a debtor for failure to pay an amount owing from a prior judgment (emphasis added).

In *Freeman*, First Union (the "**Defendant**") was sued by investors (the "**Plaintiffs**") in Unique Gems International Corp. ("**Unique Gems**"). Unique Gems conducted a Ponzi scheme involving jewelry assembly. The Plaintiffs alleged that the Defendant, as a banking institution servicing Unique Gems' financial transactions, aided and abetted Unique Gems in the fraudulent transfers of money causing harm to the Plaintiffs. The Eleventh Circuit Court of Appeals certified the following question for the Florida Supreme Court:

> Under Florida law, is there a cause of action for aiding and abetting a fraudulent transfer when the alleged aider-abettor is not a transferee?

The Plaintiffs argued that the Florida Uniform Fraudulent Transfer Act ("**FUFTA**") encompasses a separate tort for aiding and abetting a fraudulent transfer by including the words "[a]ny other relief the circumstances may require" in the language of the statute. The Plaintiffs contended that FUFTA is broad enough to allow a claim for money damages against the Defendant, which allegedly facilitated the fraudulent transfers. The Defendant responded that FUFTA is strictly limited to relief against a "transferee" and the Defendant was not a transferee. The court reasoned:

> On the face of the statute, there is no ambiguity with respect to whether FUFTA creates an independent cause of action for aiding-abetting liability. There simply is no language in FUFTA that suggests the creation of a distinct cause of action for aiding-abetting claims against non-transferees. Rather, it appears that FUFTA was intended to codify an existing but imprecise system whereby transfers that were intended to defraud creditors could be set aside.

The Florida Supreme Court held that FUFTA was not intended to create a cause of action against a non-transferee party for monetary damages arising from the non-transferee's alleged aiding-abetting of a fraudulent transfer and the court answered the certified question in the negative.

4. ***Grupo Mexicano de Desarrollo, S.A. de C.V. v Alliance Bond, 527 U.S. 308 (1999)***:

Grupo Mexicano de Desarrollo, S.A. ("**GMD**") is a Mexican holding company. In February 1994, GMD issued $250 million of 8.25% unsecured guaranteed notes due in 2001. Interest payments were due in February and August of every year. Four GMD subsidiaries guaranteed the notes. Several investment funds invested approximately $75 million in the notes (the "**Investors**"). Due to the downturn in the Mexican economy, in mid-1997 GMD was in serious financial trouble and missed its interests payments in August 1997. GMD attempted to restructure its debt between August and December 1997. On October 28, 1997, GMD announced that it was placing in trust its right to receive $17 million of Toll Road Notes to cover employee compensation payments and that it had transferred its right to receive $100 million of Toll Road Notes to the Mexican government.

On December 11, 1997, the Investors accelerated the principal amount of the notes and on December 12, 1997 filed suit for the amount due. The Investors' complaint alleged:

> GMD is at risk of insolvency, if not insolvent already; that GMD was dissipating its most significant asset, the Toll Road Notes, and was preferring its Mexican creditors by its planned allocation of Toll Road Notes to the payment of their claims, and by its transfer to them of Toll Road Receivables; and that these actions would frustrate any judgment respondents could obtain.

The Investors requested a preliminary injunction restraining GMD from transferring the Toll Road Notes or Receivables. The Investors contended that the preliminary injunction issued was analogous to a creditors bill. GMD argued that a creditors bill could only be brought after a creditor has a judgment. The United States Supreme Court held that the courts had no authority to issue a preliminary injunction preventing GMD from disposing of its assets pending the adjudication of the contract claim for money damages. The Court stated:

> **The requirement that the creditor obtain a prior judgment is a fundamental protection in a debtor-creditor law-rendered all the more important in our federal system by the debtor's right to a jury trial on the legal claim** (emphasis added).

The Court further stated:

> There are other factors which likewise give us pause: The remedy sought here could render Federal Rule of Civil Procedure 64, which authorizes use of state prejudgment remedies, a virtual irrelevance. Why go through the trouble of complying with local attachment and garnishment statutes when this all-purpose prejudgment injunction is available? More, importantly, by adding, through judicial fiat, a new and powerful weapon to the creditor's arsenal, the new rule could radically alter the balance between debtor's and creditor's rights which has been developed over centuries through many laws-including those relating to bankruptcy, fraudulent conveyances, and preferences. Because any rational creditor would want to protect his investment, such a remedy might induce creditors to engage in a "race to the courthouse" in cases involving insolvent or near-insolvent debtors, which might prove financially fatal to the struggling debtor.

5. *Morganroth & Morganroth v. Norris, McLaughlin & Marcus, P.C.*, 331 F.3d 406 (3rd Cir. 2003):

In *Morganroth*, the Third Circuit allowed a Michigan law firm ("**P**") to pursue its claims against a New Jersey law firm and two other attorneys ("**D**") for engaging in acts of fraud to hinder P's ability to collect a judgment in excess of $6 million against John DeLorean

and a corporation controlled by him. More than one year after P filed its suit against DeLorean, D assisted DeLorean in the formation of a corporation, Genesis, and conveying his New Jersey farm to it. Soon thereafter the transfer was set aside as a fraudulent conveyance. Two years after it brought its suit against DeLorean, P obtained its judgment against DeLorean. Almost immediately, D took a series of actions impeding P's ability to collect. First, D prepared and recorded a confirmatory deed that purported to transfer the farm to Genesis the prior year. Two months later, D prepared a Memorandum of Life Lease having Genesis acknowledge the purported existence of a 1987 lease of the farm between DeLorean, as lessor, and DeLorean as guardian for his children, as lessee. After recording the memorandum, D prepared and recorded a corrective deed purporting to transfer the farm to Genesis. In addition, D sent a deceptive letter to the clerk of courts in the county where the farm was located. The face of the letter indicated that the judge had dissolved an injunction order, which resulted in the clerk indicating such in the records. Finally, D asked the attorney of a company owned by DeLorean's brother to not communicate with P about DeLorean moving some furniture to that company's warehouse to avoid a writ of execution. The court held that the plaintiff stated a viable claim against an attorney who knowingly and intentionally participated in a client's unlawful conduct to hinder, delay, and/or fraudulently obstruct the enforcement of a judgment, regardless of whether the attorney made a misrepresentation with or without detrimental reliance on such misrepresentation.

6. Although in Florida based on *Yusem* and *Freeman* it is clear a third party non-transferee may not be held liable under the FUFTA for assisting a client in making a fraudulent transfer, an attorney may separately be subject to Bar discipline depending on how the Florida Bar (or any other state bar) interprets and applies the Rules of Professional Conduct 1.2(d), 4.4(1) and/or 8.4(c) in a fraudulent transfer situation. Based on the state ethics opinions discussed above, it appears that there exists a reasonable basis that a state bar may subject an attorney to discipline if the attorney "**knows**" he is assisting a client in making a fraudulent transfer.

7. **Other Potential Liability;** See *e.g.*, *Elie v. Smith*, 2011 WL 9349985 (Cal. Super. Napa, Oct. 13, 2011); http://goo.gl/UzNQaX; *In re Cutuli*, 2013 WL 5236711 (S.D. Fla., Sept. 16, 2013); http://goo.gl/t9Wjzd; *Cevdet Aksut v. Cavusoglu*, 2015 WL 4318131 (D.N.J., Unpublished, July 14, 2015), full opinion at http://goo.gl/YGAqnj; Trustee v. Rupprecht, Trustee's Second Amended Complaint (Cal.Super.Napa., Feb. 6, 2013); http://goo.gl/QeRqgh. For a discussion of this group of cases see Adkisson & Slenn, "In re Cutuli: $10 Million in Punitive Damages Result After Financially-Distressed Clients Seek Asset Protection Advice," LISI Asset Protection Planning Newsletter #229 (October 10, 2013) at http://www.leimbergservices.com; and Gassman & Lawrence, "Imposing Punitive Damages on Fraudulent Transfer," LISI Asset Protection Planning Newsletter #235 (January 15, 2014) at http://www.leimbergservices.com.

8. **To avoid assisting clients in making fraudulent transfers, it is crucial to have sufficient due diligence procedures established and adhered to that allow you to identify existing and/or potential claims or sources of liability prior to counseling and assisting clients transfer assets into asset protection structures.**

XXXIX. GOVERNING LAW & SITUS.

A. 1. Section 107 of the UTC provides:

> The meaning and effect of the terms of a trust are determined by: (1) the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue; or (2) in the absence of a controlling designation in the terms of the trust, the law of the jurisdiction having the most significant relationship to the matter at issue.

2. Section 103(9) of the UTC provides that the term "**jurisdiction**," with respect to a geographic area, includes a "**state or country**."

B. Section 403 of the UTC provides:

> A trust not created by will is validly created if its creation complies with the law of the jurisdiction in which the trust instrument was executed, or the law of the jurisdiction in which, at the time of creation: (1) the settlor was domiciled, had a place of abode, or was a national; (2) a trustee was domiciled or had a place of business; or (3) any trust property was located.

C. 1. Section 736.0103(11) of the Florida Statutes provides that the term "'Jurisdiction' with respect to a geographic area, includes a state or country."

2. Section 736.0103(18) of the Florida Statutes provides that the term "'State' means any state of the United States and includes the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession subject to the legislative authority of the United States."

3. Section 736.0107 of the Florida Statutes provides:

> The meaning and effect of the terms of a trust are determined by: (1) The law of the jurisdiction designated in the terms of the trust, provided there is a sufficient nexus to the designated jurisdiction at the time of the creation of the trust or during the trust administration, including, but not limited to, the location of real property held by the trust or the residence or location of an office of the settlor, trustee, or any beneficiary; or (2) In the absence of a controlling designation in the terms of the trust, the law of the jurisdiction where the settlor resides at the time the trust is first created. Notwithstanding subsection (1) or subsection (2), a designation in the terms of a trust is not controlling as to any matter for which the designation would be contrary to a strong public policy of this state.

3. Section 736.0108 of the Florida Statutes provides:

> (1) Terms of a trust designating the principal place of administration of the trust are valid only if there is a sufficient connection with the designated jurisdiction. Without precluding other means for establishing a sufficient connection, terms

of a trust designating the principal place of administration are valid and controlling if: (a) A trustee's principal place of business is located in or a trustee is a resident of the designated jurisdiction; or (b) All or part of the administration occurs in the designated jurisdiction. (2) Unless otherwise validly designated in the trust instrument, the principal place of administration of a trust is the trustee's usual place of business where the records pertaining to the trust are kept or, if the trustee has no place of business, the trustee's residence. In the case of cotrustees, the principal place of administration is: (a) The usual place of business of the corporate trustee, if there is only one corporate cotrustee; (b) The usual place of business or residence of the individual trustee who is a professional fiduciary, if there is only one such person and no corporate cotrustee; or otherwise (c) The usual place of business or residence of any of the cotrustees as agreed on by the cotrustees. (3) Notwithstanding any other provision of this section, the principal place of administration of a trust, for which a bank, association, or trust company organized under the laws of this state or bank or savings association organized under the laws of the United States with its main office in this state has been appointed trustee, shall not be moved or otherwise affected solely because the trustee engaged in an interstate merger transaction with an out-of-state bank pursuant to s. 658.2953 in which the out-of-state bank is the resulting bank. (4) A trustee is under a continuing duty to administer the trust at a place appropriate to its purposes and its administration. (5) Without precluding the right of the court to order, approve, or disapprove a transfer, the trustee, in furtherance of the duty prescribed by subsection (4), may transfer the trust's principal place of administration to another state or to a jurisdiction outside of the United States. (6) The trustee shall notify the qualified beneficiaries of a proposed transfer of a trust's principal place of administration not less than 60 days before initiating the transfer. The notice of proposed transfer must include: (a) The name of the jurisdiction to which the principal place of administration is to be transferred. (b) The address and telephone number at the new location at which the trustee can be contacted. (c) An explanation of the reasons for the proposed transfer. (d) The date on which the proposed transfer is anticipated to occur. (e) The date, not less than 60 days after the notice is provided, by which the qualified beneficiary must notify the trustee of an objection to the proposed transfer. (7) The authority of a trustee to act under this section without court approval to transfer a trust's principal place of administration is suspended if a qualified beneficiary files a lawsuit objecting to the proposed transfer on or before the date specified in the notice. The suspension is effective until the lawsuit is dismissed or withdrawn. (8) In connection with a transfer of the trust's principal place of administration, the trustee may transfer any of the trust property to a successor trustee designated in the terms of the trust or appointed pursuant to s. 736.0704.

D. 1. Restatement (Second) of Conflicts of Laws Section 270 provides:

An *inter vivos* trust of interests in movables is valid if valid (a) under the local law of the state designated by the settlor to govern the validity of the trust,

provided that this state has substantial relation to the trust and that the application of its law does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6, or (b) if there is no designation under the local law of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6.

2. Restatement (Second) of Conflicts of Laws Section 6 provides:

(1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.

(2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include

(a) the needs of the interstate and international systems,

(b) the relevant policies of the forum,

(c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,

(d) the protection of justified expectations,

(e) the basic policies underlying the particular field of law,

(f) certainty, predictability and uniformity of result, and

(g) ease in the determination and application of the law to be applied.

3. a. Restatement (Second) of Conflicts of Laws Section 3 defines the term "**state**." According to this section, the term "'state' denotes a territorial unit with a distinct general body of law." Under Comment a. to this section, the term "state" includes each state of the United States as well as each territory of the United States such as the District of Columbia, Puerto Rico, Guam and the United States Virgin Islands. For an extensive analysis of the viability of well drafted self-settled discretionary trusts in the context of conflicts of law, see Thomas E. Greene III, **LISI** Asset Protection Newsletter #328 (August 17, 2016) at http://www.leimbergservices.com

b. Comment c. of this section makes it clear that the term state also includes foreign states. Thus, the principles set forth in the Restatement (Second) of Conflicts of Laws apply to both domestic and foreign issues.

E. For a brief, but excellent discussion of the conflict of laws rules in relation to trusts, see Nenno, Lunger & Hickok, "Structuring CRTs as Delaware APTs to Provide Protection from Creditors and Surviving Spouses," 46 T.M. Memorandum 483 (Oct. 2005). For an interesting discussion of the Uniform Law Commission's revised commentary

pertaining to self settled trusts established by settlors residing in states that do not recognize asset protection trusts as voidable transfers *per se*, see Daniel S. Rubin, **LISI** Asset Protection Newsletter #327 (August 15, 2016) at http://www.leimbergservices.com.

F. "The law is settled that, in suits against the trustee affecting trust property, the trustees as well as the cestuis que trustent should be made parties defendant." *First Nat'l. Bank of Hollywood v. Broward Nat'l. Bank of Fort Lauderdale*, 265 So.2d 377, 378 (Fla. 4th DCA 1972) (quoting *Griley v. Marion Mortgage Co.*, 182 So. 297, 305 (Fla. 1937). See also, *Andreas v. Stisser*, 932 So.2d 400 (Fla. 2nd DCA 2006). The general rule is a that a trustee is an indispensable party in all proceedings affecting an estate. *Id*.

G. For an interesting examination of diversity jurisdiction requirements in the context of litigation in the federal court system, see *Kozel v. Kozel*, 2016 WL 4163562 (M.D. Fla. August 4, 2016). One of the defendants involved, a foreign trust, caused the court to invoke the look-through rule to look past the trustee of the trust to the beneficiaries of the trust for purposes of determining whether the diversity requirements of the parties involved had been met for purposes of the federal rules of civil procedure. The trust, named Gokana, had been the subject of a series of unfavorable decisions involving an ex-wife's claims against the settlor. Hoping that a different court setting might aid the outcome, the trust along with other named defendants moved to change venue. However, the court held that the trust as a defendant must meet more stringent look-through rules which required each trust beneficiary to be an out of state resident because the plaintiff was a Florida resident. Citing insufficiency regarding the citizenship of the parties, the court remanded to state divorce court.

XL. IS A FOREIGN TRUST A VIABLE WEALTH PROTECTION STRATEGY - ABSOLUTELY!!!!

Although clearly the best and most flexible wealth protection strategy available, the foreign asset protection trust has been one of the most maligned strategies in recent years. Unfortunately, misperception can produce a dominating influence over the legal profession and other professionals who advise clients on estate planning matters. Similar to any area of the law, however, the better lawyers have the ability to separate fact from fiction. For an excellent discussion on this issue, see Bove, "Offshore Asset Protection Trusts, Have the Rumors of Their Death been Greatly Exaggerated?," * Trusts & Estates 67 (Nov. 2010).

The strongest objection to the use of a foreign wealth protection trust seems to be that implementing such a strategy will cause an individual to be incarcerated. This premise is false and without any basis. Proponents of this "**incarceration position**" obtain the basis for this argument from two published cases where individuals who established and funded foreign trusts were incarcerated under the facts of the case. Many opponents to the use of foreign asset protection trusts claim that there are numerous cases where individuals have established offshore trusts and been incarcerated, however, to date, only a limited number of such cases exist and ***in none of these cases did the creation or funding of the trust cause the settlor to be incarcerated***.

The following discussion is intended to review these cases and some additional cases involving foreign asset protection trusts and hopefully debunk the myths (that is, separate fact

from fiction) regarding the efficacy of implementing this wealth protection strategy. As this discussion illustrates, similar to any other area of the law, practitioners in the asset protection area should exercise caution in assisting clients with implementing any wealth protection strategy. Nonetheless, competent practitioners should continue to recommend clients implement offshore strategies under appropriate circumstances. In exercising caution practitioners should implement some level of know your client ("**KYC**") procedures.

Importantly, honest people seek legitimate wealth protection by using foreign trusts that are created and funded under appropriate circumstances. When properly structured and established under appropriate circumstances, foreign trusts can be one of the most effective wealth protection strategies. It is important to recognize that the law permits individuals, businesses and other organizations to plan to protect assets and income from the claims of future unforeseen creditors. It is equally important to recognize that lawyers have a duty to zealously represent their clients, including lawyers who practice in the estate planning area. Zealous representation mandates that practitioners discuss all available planning wealth protection strategies and convey sufficient accurate information regarding such strategies so clients can make informed decisions.

The following are tips to live by when counseling clients on asset protection strategies:

(i) Counsel clients to establish wealth protection plans as part of the estate planning process. We live in a litigious society because of a justice system that permits the use (if not abuse) of the contingency fee. It is possible that any client who has amassed wealth will become involved in litigation. Will such a client return one day to the office of the client's estate planning attorney inquiring why the client did not receive advice regarding wealth protection strategies. Wealth protection planning should be part of the general estate planning process in the same manner that estate planners counsel clients in legally reducing their estate and gift tax liabilities.

(ii) As a corollary to the foregoing, clients should plan only at appropriate times and under appropriate circumstances and attorneys should only assist clients under such conditions. Many people seek advice about wealth protection strategies because they are involved or concerned that they are about to become involved in serious litigation. This may be the wrong time to plan or valuable opportunities may be foreclosed without raising serious fraudulent transfer issues. As a general rule, if assisting a client with a particular strategy raises an issue as to a fraudulent transfer do not proceed or proceed with a great caution. Bad things can happen to good people if planning is done under inappropriate circumstances. This does not mean that we cannot ethically assist clients who are involved in litigation (or concerned that litigation is imminent). However, it does mean exercise discretion. As a result of the jurisdiction where a client resides or may want to reside, the manner in which a client owns certain property interests (for example, homestead or tenancy by the entirety) or expected inheritance or gifts, it may be possible to achieve significant wealth protection for a client involved in litigation or concerned that litigation is imminent.

(iii) Any client who implements a foreign trust should receive written advice regarding the preparation of and filing of all appropriate tax compliance with the IRS. It should be clear to a client implementing a foreign trust that it is not an income tax savings or

tax avoidance device. A US taxpayer who creates and funds a foreign trust is responsible under the grantor trust rules for paying the income tax liability on all of the income generated by the foreign trust and will be required to file certain information returns with the IRS. Failure to comply with these filing requirements can result in significant penalties.

(iv) Following the creation and funding of a foreign trust or any other wealth protection strategy filing bankruptcy should be viewed as an option of last resort notwithstanding that the planning may have been completed under appropriate circumstances. This is not to say that a properly implemented foreign trust structure or other wealth protection strategy cannot survive a challenge in a bankruptcy proceeding. Nonetheless, it is clear from a few bad fact cases that the present environment in the Bankruptcy Court system is hostile toward certain wealth protection strategies. Unfortunately, bankruptcy judges typically have the pleasure of reviewing bad fact cases involving foreign trusts. Additionally, bankruptcy counsel and judges typically possess insufficient knowledge of trust law, property law and conflicts of law rules to reach the proper technical result in most cases. Experience demonstrates that judges in bad fact cases usually reach the proper result; however, the legal analysis is faulty. This faulty analysis has significantly damaged public perception regarding legitimate wealth protection planning.

(v) A foreign trust should not be used as a tool to violate any law. An individual who attempts to use a foreign trust to evade tax or violate any other law should be prepared to pay the ultimate price for such conduct. Reputable offshore service providers would never knowingly assist an individual in violating the law of any sovereign nation. The IRS or any other government agency is never a desired litigant. As important, however, bad people can violate the law using domestic as well as foreign planning vehicles. The foreign aspect may make reporting a bit more exciting though.

(vi) An individual should be prepared to answer questions candidly and produce any documentation related to a wealth protection plan that may be required in a court proceeding. This does not mean that it is necessary to disclose such information if it is not required in a legal proceeding, however, a quality wealth protection plan will withstand scrutiny and should not require or be based upon any concealment.

(vii) When implementing a foreign trust structure, a client should be strongly counseled not to serve as a co-trustee, protector, advisor or in any other fiduciary capacity. A client should be prepared to relinquish control of the client's assets that will be transferred into the structure. Use only reputable trustees and reputable financial institutions located in an appropriate foreign jurisdiction that maintain nominal or no contact with the US. It may also be prudent not to retain any investment discretion and to custody the assets in such a structure in an appropriate foreign jurisdiction. Importantly, a provincial statement by an individual intimating that a logical person would not relinquish control of millions of dollars to an offshore service provider ignores reality and implies that quality wealth management only exists in the US. Sophisticated investors understand that there is no validity to such a position.

(viii) A client should always be prepared to use a wealth protection structure as a tool to forge a favorable settlement with a creditor. Most bad fact cases prove that even a foreign trust structure with a faulty design can provide significant protection for the assets held in the

structure. *Federal Trade Commission v. Affordable Media*, 179 F.2nd 1228 (9th Cir. 1999) is a perfect example. The FTC spent years pursuing a nominal sum held in this foreign structure. It is believed that the corpus of this trust never exceeded $2,000,000 in value. Arguably, that structure had significant design faults. Furthermore, the trust had the world's worst creditor pursuing its assets (that is, an agency of the US government). In the end, the FTC could not bust the trust. The agency settled with the trustee of the Cook Islands trust. It is believed that following this settlement a substantial portion of the original corpus remains under administration of the trust. While *Affordable Media* involved bad facts, it should serve as an excellent example of how well (and economical) a properly implemented offshore structure works to protect the assets held in the structure. Any creditor represented by qualified counsel should immediately recognize the insurmountable barrier that stands between the creditor satisfying its judgment.

(ix) Know your client and document the reasons your client is establishing an offshore structure. Reputable banks, trust companies and other financial institutions in quality foreign jurisdictions are required to conduct extensive due diligence before accepting a new client relationship. This process is generally far more extensive and impressive than the due diligence required by domestic institutions. A client may be required to prove source of wealth and substantiate that funding the structure will not result in a fraudulent transfer issue.

From a moral and legal perspective it is acceptable to protect wealth using a properly implemented foreign wealth protection structure. When properly structured and implemented under appropriate circumstances, an offshore trust is the most effective and versatile wealth protection strategy available. In a mobile world where professional and business opportunities require clients to move from one jurisdiction to another, such trusts enable a client to protect wealth without relying on arbitrary local law exemptions that differ from one jurisdiction to the next. Additionally, for the sophisticated investor an offshore trust will be far more attractive as a wealth protection vehicle in comparison to most other strategies such as investment in annuities and insurance contracts (investment vehicles that are potentially exempt in one form or another from the claims of creditors under laws of many states). The cost and limitations of using such vehicles will not be palatable to many sophisticated clients.

Importantly, the bad fact cases must be viewed in proper perspective. The following is intended to provide a summary of some of the more significant cases involving offshore trusts and asset protection:

1. *Riechers v. Riechers*, 178 Misc.2d 170, 679 N.Y.S.2d 233 (1998).

a. Summary: In *Riechers v. Riechers*, 178 Misc.2d 170, 679 N.Y.S.2d 233 (1998), plaintiff ("**P**") and defendant ("**D**") were seeking to terminate their long standing marriage. D was a practicing physician (a urologist). Sebrasveral years before the commencement of their divorce proceeding D established a Cook Islands trust for asset protection purposes. The trust was funded with a ninety-nine percent (99%) interest as a limited partner in a Colorado limited partnership. D owned the remaining one percent (1%) of the limited partnership as its sole general partner. The trust's share of the partnership had a value of approximately $4,000,000. According to the court, D maintained that he considered establishing the trust "as a result of three (3) separate malpractice lawsuits filed against him

between 1984 and 1988." P confirmed that P and D were concerned about these cases, however, she denied having ever been consulted regarding D's asset protection planning. P testified that she only became aware of the existence of the trust after she filed for divorce.

D was a beneficiary of the trust as were D's and P's children. P was a beneficiary of the trust as the "Spouse of the Settlor," however, immediately upon the termination of the marriage her interest in the trust terminated. P maintained that she was entitled to a portion of the trust as part of the equitable distribution of the marital assets because the trust was funded with marital property.

In holding in D's favor by respecting the validity of the trust, the court stated:

> It cannot be said with any degree of certainty that the formation of the limited partnership and the Riechers Family Trust [that is, the Cook Islands trust] was an attempt by [D] to avoid the consequences of equitable distribution of marital assets in contemplation of divorce by secreting marital assets or by deliberate dissipation of marital assets. [Citations omitted.] . . . Assuming arguendo that this Court had jurisdiction over the corpus of the Riechers Family Trust, which it does not, a cause of action would not lie to set aside the trust since the trust was established for the legitimate purpose of protecting family assets for the benefit of the Riechers family members.

b. Analysis: The trust was created under appropriate circumstances and at an appropriate time. The court did not find the trust offensive even though asset protection was the primary purpose for the creation and funding of the trust. It is no surprise that when you have these facts, that the validity and governing law of the trust was respected by the court and the settlor was never under any threat of incarceration.

2. *Eulich v. United States*, 2004 WL 1844821 (N.D. Tex. 2004). In *Eulich*, the tone of the case is set forth in the second paragraph, which provides:

> The Internal Revenue Service ("IRS") is investigating Eulich and his wife, Virginia, (collectively "the Eulichs") for the tax years of 1995, 1996 and 1997. As part of its investigation, the IRS seeks documents relating to a Bahamian trust, the Mona Elizabeth Mallion Settlement Trust No. 16 ("the Trust"), and to various corporations controlled by the Trust. To that end, the IRS issued formal document requests ("FDRs") and summonses seeking that information.

The most valuable lesson one can learn from this case is that a foreign trust should never be used as a tool to evade tax or violate any other law. In fact, following the creation of a foreign trust by a US taxpayer substantial tax compliance is required to be filed annually with the IRS to report all transfers to and distributions from the trust and all income derived from the assets held in the trust. Following the establishment of a foreign trust structure, a qualified practitioner will work closely with the settlor's accountant and other financial advisors and the trustee to ensure all tax compliance is prepared and filed in a timely manner.

The issue in *Eulich* was whether the defendant should be held in contempt for failing to comply with the court's enforcement order. *Eulich* asserted that he had made all reasonable

efforts to comply with the court's order. In particular, *Eulich* was appealing a magistrate's determination that he:

(1) failed to add members to the trust's Advisory Committee (an act the court believed would enhance the likelihood that the defendant could obtain the documentation required by its order);
(2) failed to file a lawsuit in the Bahamas seeking to obtain this documentation;
(3) compromised payments due to him from the trust pursuant to an annuity contract and created an impossibility to comply with the court's order; and
(4) prevented the trustee from disclosing the documentation required to be produced to the court.

The government also appealed certain aspects of the magistrate's holdings, most notably requesting the court to increase the amount of the potential fine for Eulich's failure to comply with the court order and the circumstances under which application of this fine could be tolled. The magistrate held that Eulich's fine for failing to comply with the court's enforcement order should be tolled if Eulich files or causes to be filed a lawsuit in the Bahamas to compel disclosure of the documents by the trustee.

The IRS attempted to obtain certain documents related to the Trust from Eulich for over five (5) years prior to the date of this decision.

An individual who establishes a foreign trust under legitimate circumstances should always be able to obtain sufficient information from a trustee (whether a Bahamian trust company or a trust company in another jurisdiction) to comply with applicable tax laws. It is rare that a qualified practitioner who assists a client in creating and funding a legitimate foreign trust encounters any problem obtaining this information. The presence of this issue in any litigation matter should immediately raise a red flag and cause significant concern that the trust was established for an illegitimate purpose.

The court stated that a person seeking a civil contempt order needs to prove by clear and convincing evidence:

> "(1) that a court order is in effect; (2) the order required certain conduct by the respondent; and (3) that the respondent failed to comply with the court's order." [Citations omitted.]…Once the movant has shown a prima facie case, the respondent can defend it by showing a present inability to comply with the subpoena or order. [Citations omitted.] "While the court is bound by the enforcement order, it will not be blind to evidence that compliance is factually impossible. Where compliance is impossible, neither the moving party nor the court has any reason to proceed with civil contempt action." [Citation omitted.] "It is settled, however, that in raising this defense, the defendant has a burden of production."

The court was not persuaded that Eulich made a good faith effort to comply with its order. According to the court, Eulich could have attempted to appoint additional members to

the Trust's "Advisory Committee." (Apparently this committee may have had the authority to require the trustee to produce the requested documentation.) Furthermore, the court found that Eulich could have filed an action in a Bahamian court to attempt to compel production of the documents requested by the IRS. The court refused to give any credibility Eulich's defense that filing such an action was expensive and futile.

According to the court:

> Although Eulich has requested the documents in question from the parties who likely have physical possession of those documents, he has not exhausted other avenues for obtaining the requested documents, such as adding members to the Advisory Committee of the Trust or filing a lawsuit in the Bahamas to compel the disclosure of the requested documents….The court thus determined that Eulich failed to exhaust all reasonable efforts to comply with the enforcement order.

As previously mentioned, it is the experience of most qualified practitioners in this area that reputable trust companies will assist a settlor with the settlor's duty to comply with the US tax law. Compliance with US tax law is generally a high priority among such trust companies. It is bizarre that the settlor was not able to obtain the necessary information from the trustee to comply with the court's order. Nevertheless, it is important to note that Eulich was given two opportunities to use "all reasonable efforts to comply" with the court's order to avoid further problems related to the contempt order (such as potential incarceration for failing to comply). First, he could attempt to appoint additional members to the Trust's Advisory Committee – perhaps individuals selected or approved by the court. Second, he could file an action in Bahamian court seeking to compel the trustee to provide him with the necessary documentation. Pursuing this course of action will most likely avoid further problems for Mr. Eulich.

It should be noted the Andersons in *Affordable Media* were given a similar opportunity to comply with the court's enforcement order. After being incarcerated for several months the Andersons chose to cooperate with the court and Federal Trade Commission ("**FTC**") in an effort to comply with the court's order. Accordingly, the Andersons worked with the FTC in an effort to remove the trustee of their Cook Islands trust and appoint a private trust company established by the FTC as trustee. Their efforts proved futile and were foreclosed in a Cook Islands court. At that point the Andersons were deemed to have exhausted all reasonable efforts to comply with the court's order. Thus, further incarceration under the court's civil contempt order was no longer permissible, and the Andersons were purged of their contempt and released.

One Troubling Statement from the Eulich Court:

> Eulich made a conscious decision to set up the Trust in the Bahamas. He thus created the present dilemma regarding the disclosure or nondisclosure of the documents in question. Therefore, even if Bahamian law would prevent disclosure of the requested documents by

> new members of the Advisory Committee, which is in dispute, Eulich cannot benefit from a situation that he himself created.

By itself this statement could be troubling to anyone who establishes a foreign trust. Nonetheless, taken in proper context it should not be read to be so broad because doing so would misstate the law in this area. It can be reconciled on the theory that Eulich is impeding the efficient administration of the tax law by failing to cooperate with the production of such documentation. Additionally, referring to the foregoing statement the court itself states:

> Accordingly, the court overrules Eulich's objection with regard to the magistrate judge's finding that he failed to exhaust all reasonable efforts to comply with the enforcement order *because he did not add or attempt to add members to the Advisory Committee*. (Emphasis added.)

This is significantly different than stating that "The court made clear it will not allow the impossibility defense where the impossibility has been created by the settlor." Clearly, even in this bad fact case the judge leaves Eulich with an option to avoid incarceration by "exhausting all reasonable efforts" to obtain such documentation by attempting to add members to the Advisory Committee of the Trust and by filing a lawsuit in the Bahamas to compel disclosure. There is nothing in the record of the case that indicates that good faith effort by Eulich pursuing such actions would not be acceptable to the court if such effort later proves futile.

The court sustained the government's objection that Eulich's fine should be tolled if he filed or caused to be filed a lawsuit in the Bahamas seeking disclosure of the required documentation. The court felt it would be unnecessarily burdensome to require the court to monitor the Bahamian lawsuit and that "Tolling the sanctions would thus serve only to reward Eulich's conduct for failing to use all reasonable efforts to comply with the court's enforcement order."

Finally, the court agreed to sustain the government's objection to the amount of the magistrate's fine increasing the fine from $1,500 to $5,000 per day recognizing that the Trust had a corpus valued at between $75,000,000 to $100,000,000. Further, if Eulich fails to comply with the court's order within thirty (30) days, the fine would be increased to $10,000 per day.

The court also granted Mr. Eulich forty-five (45) days to comply with its order or it would set a date for a subsequent hearing:

> to determine whether Eulich was in compliance and, if he is not, whether the daily fine should be increased or whether Eulich should be incarcerated to obtain compliance with the enforcement order.

Separating Myth from Reality: As many times as one reads the *Eulich* decision (and *Federal Trade Commission v. Affordable Media*, 179 F.2d 1228 (9th Cir. 1999) and *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002) for that matter), it will not be possible to find a statement that says it is illegal to create and/or fund a foreign trust. This is the case even if asset protection may be the primary motivation for an individual to establish such a trust.

Furthermore, no statute exists in any jurisdiction that proscribes such conduct and it is not likely that such a statute will ever exist. In fact, it is the opinion of several prominent practitioners that a properly structured foreign wealth protection trusts are the most effective wealth protection technique available when implemented under appropriate circumstances.

The Problem: *Eulich*, and cases like it, should be carefully examined because such cases teach valuable lessons. It is equally important, however, for lawyers, financial professionals and clients to interpret these cases in a proper perspective. When implemented in an appropriate manner a foreign trust can protect wealth well. Nonetheless, there are certain things a foreign trust was never intended to do – at least when implemented as part of legitimate estate planning. Importantly, it is rare that one reads about a "good fact" cases in the asset protection area, whether the planning involves the implementation of a domestic or international planning technique. Often the facts of the case involve someone transferring property at an inappropriate time (that is, a fraudulent transfer) or retaining significant control over the trust. Furthermore, one should never lose sight of the fact that on one side of the matter you have a creditor who is entitled to collect a debt that is founded on a judgment. On the other side you have a debtor who does not want to satisfy the particular judgment. With rare exception, even if the debtor has engaged in legitimate wealth protection planning, the debtor is never going to win this public relations battle.

Epitaph: In the end Mr. Eulich complied with the court's order.

3. *Duttle v. Bandler & Kass*, 1992 WL 162636 (1992 SDNY).

In *Duttle*, the wife of the defendant ("**D**") settled The Casa Trust, an irrevocable trust, under the laws of Liechtenstein for her and D's benefit. The court found that D used his wife to transfer to the trust all of his assets, including jewelry and artwork, over several years during pending litigation that resulted in a $3.8 million judgment against D. A magistrate judge found that the trust was merely a device to hide the true ownership of the assets. Although D claimed that his wife owned various bonds that were transferred to the trust and jewelry that was transferred to a corporation owned by the trust, ***the record showed that D exercised absolute control over the bonds and purchased the jewelry with his own funds***. Since the court treated D as having transferred his assets to the trust during the pending litigation without having received fair consideration, the court found the transfers fraudulent because D did not have enough assets available outside the trust to satisfy the judgment. Therefore, the court held the trust invalid as to the judgment creditor and it assets subject to execution (in a footnote, the court also found the trust invalid as it was "created with the unlawful purpose of evading creditors"). D countered that the court lacked personal jurisdiction over the trustee, ***however, because the trustee had two or three meetings in New York and held most of its assets in New York, the court found that through these and other connections, it acquired jurisdiction over the trustee***.

4. *In re Portnoy*, 201 B.R. 685 (SDNY 1996).

In *Portnoy*, the bankruptcy court denied the debtor's ("**D**") motion for summary judgment to be discharged from bankruptcy on the basis of concealment of an irrevocable trust established under Jersey Law with a Jersey trust company as sole trustee. The court posed the

possibility that it might not have jurisdiction over the trust, however, it could still determine whether an interest retained in the trust was a concealed property interest. D was the president and sole shareholder of a business and personally guaranteed any business indebtedness to Marine Midland Bank. Approximately two and one-half years later, D began transferring substantially all of his assets to the trust. The last of the transfers was made *before* one year prior to the date of the bankruptcy petition. D was the primary beneficiary of the trust and his children were additional beneficiaries. The trustee had absolute discretion as to the distribution of trust assets although it could consider, but was not bound by, D's written wishes. Additionally, the trustee could exclude any person as a beneficiary of the trust. ***D retained the power to remove and replace trustees and appoint successor trustees***.

During settlement negotiations, D lied about having been financially ruined by expensive experimental cancer treatments, stating that everything except encumbered real property was gone. Further, although D had a $150,000 salary, he claimed that he only earned $1,700 per month. These lies did not engender good will from the court despite the validity of the foreign trust. The court held that under both federal law and state law principles, the law of the jurisdiction having the greatest interest in the litigation applied. Although the trust was settled in Jersey, specifically required its interpretation and administration to be under the laws of Jersey, and had a Jersey resident serve as trustee, the court held that New York had the greater interest in determining whether D's rights retained in the trust could be considered a property interest. Even though the court based its decision in part on the fact that the interested creditors were all US domiciliaries and D had the greatest contact with the US when he settled the trust, it added its *belief* that the application of Jersey law would be repugnant to New York and federal policy. The court went further by lauding US policy against self-settled trusts and accusing Jersey of implementing opposing laws to drum up business. The court added a second reason for not recognizing Jersey law, that being that equity would not allow a choice of law provision under an agreement to be given effect to the detriment of a stranger to the agreement, *i.e.*, creditors. Thus, the bankruptcy court determined that D's discretionary interest in the self-settled trust under New York law subjected the entire trust to creditors.

5. *In re Brooks*, 217 B.R. 98 (Bankr.D.Conn. 1998).

Brooks ("**D**") transferred stock in Connecticut corporations to his wife, who then transferred the stock to irrevocable foreign trusts settled in Bermuda and Jersey eight (8) and twelve (12) days later, respectively. Each trust designated the local law of its respective country as controlling. D was named the sole income beneficiary and the trustees had discretion to distribute principal for D's health, comfort, support and his personal and investing needs. The court treated the so-called "**scheme**" as a two-step transaction and determined the trusts to be self-settled as to D. D argued that the applicable foreign law, recognizing self-settled trusts, should control per the trust instruments. The bankruptcy court referred to a rule established by the Connecticut Supreme Court that although public policy supports spendthrift trusts created for the benefit of another, other overriding considerations will not support the same conclusion for the settlor, namely the evasion of debts. Since under Connecticut law creditors can reach a maximum amount a trustee could pay or apply for the benefit of a settlor-beneficiary, the court held that all of the assets in the trust were property of D's bankruptcy estate.

6. *Federal Trade Commission v. Affordable Media, LLC*, 179 F.3d 1228 (9th Cir. 1999).

In *Affordable Media*, a husband and wife, the Andersons, had earned $6.3 million in commissions promoting, via telemarketing, a Ponzi scheme that eventually unraveled. In 1997, the Andersons formed Financial Growth Consultants, LLC to market "**media units**" which allowed purchasers to share in the profits of The Sterling Group, a Las Vegas company that sold unusual gadgets through late-night commercials. Two years prior the Andersons created an irrevocable trust for the benefit of their children under the law of the Cook Islands, ***appointing themselves and Asiatrust Limited*** ("**Asiatrust**") ***as co-trustees***. Additionally, the Andersons were the protectors of the trust. Six months later, the Andersons were added as beneficiaries of the trust. Subsequently, the Andersons transferred the profits from their commissions to the trust. In April 1998, the Federal Trade Commission (the "**FTC**") requested and the district court granted a preliminary injunction and temporary restraining order ("**TRO**") requiring the couple to repatriate any assets held for their benefit outside the US. Specifically, the TRO required the Andersons to "transfer to the territory of the United States all funds, documents and assets in foreign countries held either (1) by them; (2) for their benefit; or (3) under their direct or indirect control, jointly or singly." Soon thereafter, the couple faxed a letter to Asiatrust requesting the trust assets to be repatriated to the US. Upon receiving the request letter, by reason of an "**event of duress**" as defined under the trust deed, the Andersons were automatically terminated as co-trustees, leaving Asiatrust as the sole trustee. Asiatrust refused to repatriate the assets since it would benefit the FTC as an "**Excluded Person**" (as defined under the trust deed) and breach its duty to act in the best interest of all the beneficiaries of the trust.

In an effort to avoid civil contempt, the Andersons attempted to appoint their children as trustees, but Asiatrust immediately removed them from acting because of the continuation of the event of duress. Upon failure to comply with the TRO by repatriating the trust assets, the district court found the Andersons in civil contempt. The court reasoned that the Andersons, as protectors, could certify whether an event of duress had occurred. The judge ordered the Andersons to be jailed in June 1998. The couple remained in jail until just before Christmas when they promised to replace Asiatrust with a Cook Islands company formed by the FTC ("**CI FTC**"). However, Asiatrust rejected the maneuver as invalid. Finally, the Andersons resigned as protectors and attempted to appoint CI FTC as their successor, but Asiatrust refused to recognize the appointment of CI FTC as protector.

The Ninth Circuit held that the district court did not abuse its discretion in finding the Andersons in contempt. To find a party in civil contempt, the moving party must first prove by clear and convincing evidence that the contemnors violated a specific and definite order of the court, and, if the moving party is successful, the burden shifts to the contemnors to demonstrate they are unable to comply. A party's inability to comply with a contempt order constitutes an absolute defense to civil contempt. The Andersons claimed that compliance with the TRO was impossible because Asiatrust, in accordance with the terms of the trust, could not repatriate the trust assets.

In *dicta*, the Ninth Circuit avoided determining if the terms of a foreign asset protection trust should serve as a defense to a civil contempt charge given that such trusts are designed to

frustrate the jurisdiction of domestic courts. Instead, the Circuit Court applied a heightened burden to the impossibility defense in the context of asset protection trusts and held that the Andersons did not satisfy their elevated burden that compliance was impossible. The court agreed that the Andersons could force the repatriation of the trust assets because, as protectors, they had the power to determine whether an event of duress had occurred. With that power the court resolved that the Andersons could have ordered the trust assets repatriated by certifying that no event of duress had occurred. The court suggested that if the Andersons had succeeded in removing themselves as protectors, they still may have retained sufficient control over the trust, however, the court did not need to resolve whether other facts would support such a conclusion. In affirming the district court's contempt order, the Ninth Circuit identified a court's contempt powers as the only way to coerce settlors of foreign asset protection trusts to repatriate assets.

Soon after the Ninth Circuit's decision, Asiatrust brought an action before the High Court of the Cook Islands seeking a declaration as to the administration of the trust, specifically, the effectiveness of (i) its removal as trustee, (ii) excluding the FTC from the definition of Excluded Persons, and (iii) the appointment of the FTC as substitute protector. Determining that the purpose of the three actions was designed to repatriate the trust assets for the benefit of the FTC, an Excluded Person, it held the three documents invalid. Consequently, Asiatrust, alone, would have the powers of the protector until the court could appoint a new protector. Ultimately, it is believed that Asiatrust entered into a settlement with the FTC of approximately $1 million to resolve its end of the dispute.

7. *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002).

The Eleventh Circuit affirmed the bankruptcy court and the district court's finding that Stephen Jay Lawrence ("**D**") was in civil contempt for failure to repatriate the assets held by a self-settled foreign trust. D filed for bankruptcy in June 1997. Prior to October 19, 1987, D, an MIT graduate, had been a successful options trader, using Bear, Stearns as his clearinghouse. As a result of "**Black Monday**," D suffered a margin call from Bear, Stearns. ***Upon the conclusion of an arbitration dispute, Bear, Stearns was awarded $20.4 million, however, only sixty-six (66) days prior to the arbitration award being entered in favor of Bear Stearns, D settled a trust in Jersey with more than ninety percent (90%) of his liquid assets. A month later, that is, only thirty-six (36) days prior to the award, the trust was amended to make it a spendthrift trust and to change its governing law and administration to Mauritius***. (The law of Mauritius imposes criminal penalties on a trustee that discloses information about the trust.) The bankruptcy court rejected D's claim that the arbitration played no role in the creation of the foreign trust.

The trust granted the trustee absolute and uncontrolled power to (i) exclude D as a beneficiary, (ii) name additional beneficiaries, and (iii) disregard any inquiries by a beneficiary. Additionally, the trustee had absolute discretion as to the distribution of trust principal. A second amendment in 1993 added an "**anti-duress**" provision, restricting D's powers upon an event of duress, and provided that his income interest would terminate upon becoming bankrupt. In March 1995, the trustee of the trust executed a declaration of trust that added D as an "**Excluded Person**," preventing him from receiving any benefit of the trust. A June 1999 clarification sought to confirm D's exclusion status as irrevocable but was held void

in violation of a stay order. Outside an event of duress, D retained the absolute power to remove and replace trustees or add new trustees and to add and exclude beneficiaries.

Citing the public policy rationale of *Portnoy* and *Brooks*, the bankruptcy court held that D's rights and obligations under the trust were governed by Florida and federal law and included the trust property in D's bankruptcy estate. Almost one year after the initial motion to compel, the bankruptcy court issued a Turn Over Order, directing D to repatriate the trust assets and provide a full accounting, otherwise D would be held in contempt. ***The bankruptcy court referred to D's unfettered ability to replace trustees as its primary reason for determining that D was not powerless to repatriate the trust assets***. It also would not accept that anyone would voluntarily transfer $7 million to a "stranger" in a remote country and give him absolute discretion over the administration of the property.

The bankruptcy court concluded that D had not successfully established the defense of impossibility to complying with its order. More importantly, the court stated that the defense of impossibility is not available when the impossibility was self-created. Consequently, D was held in contempt and ordered incarcerated until he turned over the trust assets and fined $10,000 per day until he purged the contempt. The district court affirmed the turn over order, the contempt order, and the incarceration order. ***In determining whether the trust should be included in the bankruptcy estate, the district court focused on its perception that D had the apparent power to replace or add trustees (despite the anti-duress provision added under the second amendment)***. It refused to consider the effect of the anti-duress provision as to D's powers because it "contravene[d] clear public policy against allowing a debtor to shield money . . . from creditors." Furthermore, the district court refused to recognize the exclusion of D as a beneficiary since there was a question as to whether the exclusion was revocable. Thus, according to the district court, D's absolute control over the trustees gave him *de facto* control over the trust. Due to D's record of evasiveness, the district court also was not convinced that it was impossible for D to repatriate the trust assets. Even if it was impossible, the court found that the creation and funding of the trust was done in bad faith to shelter assets from his creditors, and, thus, the "**good faith transfer exception**" to the self-created impossibility bar was not available. D had faxed a letter to the trustee demanding it turn over the trust assets, appointed another individual as the new trustee, and executed an amendment to the trust purporting to appoint the bankruptcy trustee as the sole successor trustee. The district court did not deem the "half-hearted, last-minute" attempts sufficient to purge the contempt. It adopted *Affordable Media*'s ruling that settlors of asset protection trusts faced a heightened burden to prove impossibility.

In affirming the lower courts' decisions, the Eleventh Circuit agreed with the Ninth Circuit's holding in *Affordable Media* that it would not respect self-settled spendthrift trusts because such trusts violated public policy. It also found that the district court did not clearly err in determining the anti-duress amendment void under Florida law when included in a self-settled spendthrift trust. Without considering the effect of the anti-duress provision, the Circuit Court decided that D retained the requisite power to control the trustees in a way to repatriate the trust assets as ordered. In reviewing the self-creation exception to the impossibility defense, the Eleventh Circuit took issue with D having created the impossibility just prior to the arbitration award even though the turn over order was issued over eight (8) years later. Despite the affirmation, the Eleventh Circuit added that a contempt order may only be used to

coerce compliance; at some point, the order switches from coercive to punitive in violation of the contemnor's due process rights.

After more than six (6) years, D was released from the federal detention center holding him for civil contempt. U.S. District Judge Alan Gold (who had affirmed the contempt order in 2000) entered the order on December 12, 2006, ending the standoff that captured the attention of estate planning practitioners and the media. Despite the bankruptcy trustee's opposition, Judge Gold ruled that the continued indefinite incarceration of D no longer served the civil purpose of coercion.

In August 2006, D filed a motion for Release from Contempt Incarceration. The magistrate to whom the motion had been assigned found that D had failed to meet his burden to show that (1) the contempt order was no longer coercive and (2) there exists no realistic possibility of compliance. The magistrate judge issued its report recommending that D's request for release be denied and that the matter should continue to be revisited by the bankruptcy court at reasonable intervals. After a hearing held on December 8, 2006, Judge Gold rejected the magistrate's recommendation that the court deny D's motion for Release from Contempt Incarceration.

Citing the Eleventh Circuit's opinion in *Commodity Futures Trading Com'n v. Wellington Precious Metals, Inc.*, 950 F.2d 1525 (11th Cir. 1992) (the same case the Eleventh Circuit cited in *Lawrence* for the proposition that a contemnor must establish that he has made in good faith all reasonable efforts to meet the terms of the court order), the bankruptcy trustee insisted that the length of incarceration should not alone be enough to prove that there exists no realistic possibility that one can comply with a court's contempt order. However, the contemnor in *Wellington* had been incarcerated for only three (3) months. Furthermore, D had been incarcerated for less than two (2) years when the Eleventh Circuit issued its opinion. Judge Gold did not base his ruling solely on the period of incarceration. He said that it was a factor in reaching his decision and that, based on the totality of the circumstances, he was obligated to release D from incarceration since there was no realistic possibility that D would comply with the contempt order. Consequently, the incarceration no longer served the civil purpose of coercion. In the court's opinion, D valued his money more than his liberty.

Although Judge Gold directed the Clerk of Court to close the case, he permitted the bankruptcy trustee to file with the bankruptcy court within ten (10) days of his order a request for additional protections as the trustee deems necessary to prevent D from having access to the trust assets. The District Court left open the possibility of further contempt proceedings should D fail to comply with any further order of the bankruptcy court. Moreover, Judge Gold added that his Order did not affect the monetary portion of the contempt sanction (that is, $130,000) ordered to be paid by Chief Bankruptcy Judge Jay Cristol.

Planning Tips: (1) Bankruptcy judges must give due consideration to self-settled trusts because of the new fraudulent transfer rule under section 548(e)(1) of the Bankruptcy Code. This provision sets forth the standards by which transfers to self-settled trusts are permissible. Thus, this rule condones the use of self-settled trusts established under appropriate circumstances.

(2) While the authors dispute the accuracy of Judge Cristol's application of Florida trust law in *Lawrence*, even Judge Cristol's argument that such trusts violate public policy under Florida law has been weakened by Florida's new trust code. Although the new Florida trust code adopts § 505(a) of the UTC, it also contains a provision that modifies the application of § 505(a) to certain types of trusts. This provision is found in F.S. § 736.0505(1)(c). This provision provides in relevant part:

> the assets of an irrevocable trust may not be subject to the claims of an existing or subsequent creditor or assignee of the settlor, in whole or in part, solely because of the existence of a discretionary power granted to the trustee by the terms of the trust, or any other provision of law, to pay directly to the taxing authorities or to reimburse the settlor for any tax on trust income or principal which is payable by the settlor under the law imposing such tax.

As a result of this provision (and Florida Statutes § 736.0505(3) discussed below), the Florida Legislature has added Florida to the list of asset protection trust states. This occurs because there is no time limit set on the trustee's ability to reimburse the settlor for such taxes. Thus, in theory a trustee can accrue a reimbursement account for several decades and reimburse the settlor for a tax liability incurred many years in the past.

Furthermore, Florida Statutes § 736.0505(3) now provides:

> Subject to the provisions of s. 726.105, for purposes of this section, the assets in: (a) A trust described in s. 2523(e) of the Internal Revenue Code of 1986, as amended, or a trust for which the election described in s. 2523(f) of the Internal Revenue Code of 1986, as amended, has been made; and (b) Another trust, to the extent that the assets in the other trust are attributable to a trust described in paragraph (a), **shall, *after* the death of the settlor's spouse, be deemed to have been contributed by the settlor's spouse and not by the settlor**.

This provision creates another exception to the self-settled trust doctrine protecting the assets in a self-settled trust from the claims of a creditor of the settler. The exception relates to any trust for the benefit of the settlor that is established after the death of the settlor's spouse when the settler created and funded an *inter vivos* general power of appointment or QTIP marital trust for the initial benefit of the settlor's spouse. A settlor can fund an *inter vivos* QTIP trust for the settlor's spouse by gifting assets to such trust. A QTIP election ***must*** be made with respect to any gift to this QTIP trust. As a result of the QTIP election the trust will be includible in the estate of the settlor's spouse for estate tax purposes. See § 2044. The gift by the settlor to the trust will (must - it would seem) qualify for the unlimited marital deduction. The *inter vivos* QTIP trust may contain provisions that provide for the donor-settlor following the donee-spouse's death. The trust assets should not be subject to the claims of the donor's creditors although the trust is self-settled. According to F.S. § 736.0505(3), the settlor would ***not be treated*** as the settlor of the trust.

(3) Finally, it worth noting that about four (4) years prior to reaching his decision regarding the self-settled trust in *Lawrence*, where Judge Cristol so vehemently attacked the strategy, even he recognized the possibility that such a trust should be respected by a court when created under appropriate circumstances and designed in an

appropriate manner. He stated in *In re Wheat*, "the stated policy against self-settled spendthrift trusts is not as compelling in situations where, as here, the settlor-beneficiary's control is relatively limited." Thus, *Lawrence* was more likely a case of bad facts than a condemnation of all asset protection trusts by Judge Cristol.

8. *Braswell v. Ryan Investments, Ltd.* (No. 3D06-2827, Fla. App. 3 Dist., July 9, 2008).

Braswell v. Ryan Investments, Ltd. (No. 3D06-2827, Fla. App. 3 Dist., July 9, 2008), involved litigation originating from a divorce proceeding involving Glenn Braswell ("**FH**")) and his former wife, Renee Braswell ("**FW**"). FW obtained approximately $24,000,000 in judgments against FH because FH failed to make payments that were required by a marital settlement agreement entered into in calendar year 2000. (See ***Braswell** v. **Braswell**,* 881 So.2d 1193 (Fla. 3d DCA 2004).) At the time this case was issued by the court FH had died. In 1997 during their marriage, FH established a company called Ryan Investments, Ltd. (the "**Company**"). The Company acquired a multi-million dollar residence located in Miami-Dade County, Florida.

In an effort to satisfy a portion of her judgments against FH, FW attempted to execute against the residence owned by the Company claiming that the Company was FH's alter ego. FW claimed that FH acquired the residence through the Company to defraud her; therefore, the court should permit her to execute on the residence using a legal theory known as "outsider reverse corporate piercing." This theory has previously been recognized in Florida case law. (See *Estudios, Proyectos e Inversiones de Centro America*, *S.A. (EPICA) v. Swiss Bank Corp. (Overseas) S.A.,* 507 So.2d 1119 (Fla. 3d DCA 1987), review denied, 518 So.2d 1274 (Fla.1987).) According to the court in *Estudios*:

> A corporation's veil will be pierced where the corporation's controlling shareholder formed or used the corporation to defraud creditors by evading liability for preexisting obligations. The usual result of piercing the corporate veil is that the controlling shareholder or shareholders become liable for the corporate liabilities. *The remedy is equally available, however, to hold the corporation liable for the debts of controlling shareholders where the shareholders have formed or used the corporation to secrete assets and thereby avoid preexisting personal liability*. (Emphasis added.)

Id. at 1120 (citations omitted); see also *Sweeney, Cohn, Stahl & Vaccaro v. Kane,* 6 A.D.3d 72, 773 N.Y.S.2d 420 (2004), leave to appeal dismissed, 3 N.Y.3d 751, 788 N.Y.S.2d 661, 821 N.E.2d 965 (2004) (applying Florida law); contra *Postal Instant Press, Inc. v. Kaswa Corporation*, 162 Cal.App.4th 1510, 77 Cal.Rptr.3d 96 (2008); see generally 2 A.L.R.6th 195. The trial court ruled in favor of the Company holding that FW could not execute on the residence (that is, a corporate asset) to satisfy any of her outstanding judgments.

The appellate court affirmed the ruling of the trial court because:

(1) the remedy permitted when outsider reverse corporate piercing is applicable is available only "where the shareholders have formed or used the corporation to secrete assets

and thereby avoid *preexisting* personal liability" (emphasis added). *Estudios,* 507 So.2d at 1120; and

(2) the preexisting personal liability condition was not met in this case.

The appellate court recognized that the Company acquired title to the residence well before FW's claims arose and the obligations upon which her lawsuit was based. The court quoted the trial court with approval:

> Even more importantly, [FW] did not, and simply cannot argue that [FH] used [the Company] to "secrete" the La Brisas property [the former marital home] from her "pre-existing debts" (which did not exist) as is required by the *Estudios* case. *It is undisputed that title to the La Brisas property was placed in [the Company] from inception in 1997, years before the divorce case was commenced or [FW]'s claims against [FH] arose. Whether or not [FW] knew how her marital home was titled at the time, it is indisputable that [the Company] took title in 1997, years before [FW]'s claims arose*. This is not a situation in which [FH] transferred title of Las Brisas to [the Company] after [FW]'s claims arose or even when the winds of divorce were blowing, as required in *Estudios* for reverse piercing. [Emphasis added.]

Accordingly, it was impossible for FW to establish that the Company was used to avoid execution on a liability because FH's obligations under the marital settlement (executed in calendar year 2000) did not exist when the residence was acquired by the Company (in calendar year 1997). This fact was fatal to FW's claim. (See *Mason v. E. Speer & Assocs., Inc.,* 846 So.2d 529, 534 (Fla. 4th DCA 2003), review denied, 857 So.2d 196 (Fla.2003); *Bookworld Trade, Inc. v. Daughters of St. Paul, Inc.,* 532 F.Supp.2d 1350, 1361 (M.D.Fla.2007) (case applied Florida law); see also *Dania Jai-Alai Palace, Inc. v. Sykes,* 450 So.2d 1114, 1118 (Fla.1984); *Barnes v. Liebig,* 146 Fla. 219, 238, 1 So.2d 247, 254 (1941); *Select Creations,Inc. v. Paliafito Am., Inc.,* 852 F.Supp. 740, 774 (E.D.Wis.1994). See generally 1 , (rev. 2006).

The court recognized that the rule that permits outsider reverse corporate piercing is applicable only when it has caused "cognizable damage" to a creditor. See *Gasparini v. Pordomingo,* 972 So.2d 1053, 1055 (Fla. 3d DCA 2008); *Priskie v. Missry,* 958 So.2d 613, 614-15 (Fla. 4th DCA 2007); *Seminole Boatyard, Inc. v. Christoph,* 715 So.2d 987, 990 (Fla. 4th DCA 1998), review denied, 727 So.2d 903 (Fla.1998). In *Braswell* FW suffered no cognizable damages unlike the plaintiff in *Estudios*. In *Estudios*, a guarantor of an existing debt established a corporation and transferred his farm to it to conceal his personal assets and defraud his creditors. For outsider reverse corporate piercing to apply a nexus must exist between a judgment creditor's loss and the "debtor's intentional and improper financial maneuvering, which caused [the judgment creditor's] inability to collect the default judgment." *Sea-Land Servs., Inc. v. Pepper Source,* 993 F.2d 1309, 1313 (7th Cir.1993). *Litchfield Asset Mgmt. Corp. v. Howell,* 70 Conn.App. 133, 799 A.2d 298, 314-15 (2002), cert. denied, 261 Conn. 911, 806 A.2d 49 (2002); *Olen v. Phelps,* 200 Wis.2d 155, 163-64, 546 N.W.2d 176 (1996), review denied, 201 Wis.2d 436, 549 N.W.2d 732 (1996).

Importantly, the *Braswell* court noted:

> Looking at the "piercing the veil" doctrines from a broader perspective which may serve to resolve the narrower problem with which we are now concerned, it seems to us that the rule is, perhaps *sub silentio*, based on the idea that *when one enters into an agreement with another entity, whether individual or corporate, which calls for future performance, it is in presumed reliance on the ability to look to all of that party's existing assets to satisfy any damage caused by his failure to perform and to require this reliance*. *The direct and reverse piercing doctrines are respectively designed to prevent a fraudulent breach of that understanding which occurs when a contracting individual* ***later fraudulently transfers his assets*** *to a controlled corporation or a contracting corporation does so to a controlling individual. Obviously the considerations do not exist when the contracting party (in this case [FH]) did not have title to the asset in question ([the Company] did) when he made the promises sued upon*. (Emphasis added.)

The facts necessary to support the application of outsider reverse corporate veil piercing did not exist in *Braswell* because:

(1) The Company owned the home prior to the dissolution of the marriage of FW and FH.
(2) FW was aware that the Company owned the residence when she entered into the marital settlement agreement.
(3) In the settlement agreement FW released her interest in the residence regardless of how the residence was titled (although the court did recognize that FW executed this release in part for FH's "promise to pay her large sums, the breach of which gave rise to the judgments she is now attempting to satisfy").

Finally, the court recognized in closing, "Bearing in mind that all corporate piercing is based on equitable principles, it would be highly inequitable now, in effect, to give [FW] the home through other means." See *Barineau v. Barineau,* 662 So.2d 1008, 1009 (Fla. 1st DCA 1995).

If you read the *Braswell* decision one might ask why an attorney specializing in wealth protection planning would be interested in a collection case that involves a corporate law issue, that is, outsider reverse corporate veil piercing. Nonetheless, the most interesting aspects of the *Braswell* case involve the facts that the court failed to include in its written decision. Upon further investigation it appears that a significant portion of the story is missing from the decision published by the appellate court.

Three aspects of the *Braswell* decision are particularly interesting.

(1) First, the case cites other related reported appellate decisions in this highly contentious matter. Unfortunately, none of these other published decisions provides sufficient information to supply the reader with the necessary facts to obtain the full story regarding the instant case.

(2) Second, the court failed to provide any supporting information regarding the Company, such as the jurisdiction where the Company was formed and granted its legal existence or the names of the individuals who serve as its officers and directors. In reading the decision one might reach the conclusion that the Company was formed in Florida. This conclusion would seem to be buttressed by the fact that the seminal issue in the case involves Florida corporate law. Nonetheless, a review of the public filings in Florida (available online at www.sunbiz.org) indicates that the Company is neither a Florida entity nor qualified to conduct business in Florida.

(3) Finally, in reading the decision one might reach the conclusion that FH was the sole owner of the stock of the Company. Of course, if this was the case, the next logical question an attorney should ask is why FW did not attempt to execute on the stock of the Company to satisfy her outstanding judgments. Strangely enough, FW was arguing that the Company was FH's alter ego. By obtaining extraneous facts regarding this case, however, it was revealed that FH did not own any of the stock in the Company.

Perhaps the foregoing is enough to provide the basis for a mystery novel? (Probably not.) Nevertheless, it does lead for some interesting speculation regarding the whole story behind the *Braswell* decision. After all, it seemed strange that the reported decision neglected to include this information. Thus, the author decided to contact counsel for the Company to inquire about the missing information. This conversation revealed two important details about this case. First, it was revealed that the Company was formed in the Cayman Islands, a foreign jurisdiction, and continues its legal existence under the laws of that jurisdiction. Furthermore, the stock of the Company is held in a trust known as "**The Prince Trust**," which was settled and continues to be administered in the Cook Islands. (Presumably the law of the Cook Islands governs the trust.) None of these facts gave the court any pause in reaching its decision in favor of the Company, which was implicitly in favor of both of the Cook Islands trust, the legal title holder of the Company, and the settlor of the trust, FH, the actual beneficial owner of the Company.

According to counsel for the Company, the beneficiaries of the trust during its settlor, FH's life, were FH, FH's girlfriend and FH's son. (FH's girlfriend was probably added as a beneficiary after the dissolution of FH's marriage to FW. FW was probably removed as a beneficiary of the trust on or before that date.)

One cannot say with any certainty that the trial or appellate courts implicitly recognized the validity FH's self-settled asset protection trust structure, however, silence on the issue suggests a willingness to respect the validity of the structure or at least consider appropriate arguments concerning its validity.

No information was available concerning any other assets that are held in the foreign trust; however, one can presume that the cost of litigation in this case was paid from other assets in the trust structure.

Also of interest is the fact that the Florida real estate owned by the Company was left and defended intact. It is the author's understanding that at the time of this case the Company was not able to sell the residence and obtain an acceptable price due to the market conditions

for real estate in South Florida. Additionally, no credit line or financing arrangement was sought in an attempt to "strip the equity" from the property. Many asset protection planners would strongly encourage a foreign trustee under these circumstances to take whatever action was necessary to sell such real estate or engage in equity stripping so as to transfer value of the wealth that was otherwise invested in real estate to an appropriate foreign custodian, where it could be held beyond the jurisdiction of a domestic court system. Nonetheless, this recommended course of action should have no relevance to the efficacy of defending a properly implemented trust structure. It is simply a prudent strategy and in many cases could provide additional leverage in settlement negotiations. A maxim of quality wealth protection planning is to recommend a client implement a strategy that provides the greatest degree of certainty the client's wealth will be protected from future unforeseen creditors.

Although we cannot speculate about the manner in which FH used the residence owned by the Company during his life, a few words of caution are helpful. If domestic real estate is held in a structure in this manner, an asset protection planner should recommend that Company lease the residence to FH. The lease should be structured with terms that reflect an arm's length transaction with fair market value rent paid for the use of the residence.

The author also had some brief conversations with counsel for FH's estate that were helpful in understanding some facts in this continuing saga. According to counsel for the estate, no issues related to the offshore trust have been litigated yet. The trust was settled and funded some time in or after calendar year 2000 and before the death of FH in 2003. The estate is currently being administered for the benefit of its creditors with FW being the most significant creditor. Counsel for the estate also sought instructions from the court regarding any action it must take regarding the offshore trust, however, to date the court has refused to issue any order. Whether action against the trust would be practical, economical or produce any positive financial benefit for the estate is unknown. It was also learned that despite current economic conditions, the residence was sold. The proceeds from the sale, however, have been frozen by court order.

Counsel for the estate also disclosed that FW's divorce counsel is considering pursuing the assets held in the trust, perhaps by attempting to avoid the transfer of those assets to the trust as fraudulent. Such an action would not be successful in the Cook Islands (see Section 13B of the International Trusts Act 1984); however, since the proceeds of the sale of residence are frozen by court order this action can be pursued in a court in Florida at least as to the shares of stock in the Company (see Chapter 726 of the Florida Statutes). If the court bases its decision on the fraudulent transfer rule, it will implicitly recognize the validity of the Cook Islands trust as separate and apart from its settlor, that is, not as a sham arrangement. Thus, regardless of the party ultimately prevailing in this continuing saga, planners should be watching with interest. The analysis the court applies to reach its decision will be the most important part of this case, not the ultimate result. Applying a fraudulent transfer analysis, that is, respecting the validity of the trust, would be consistent with the analysis applied by the court in this case respecting the validity of the Company and the ownership of the residence by the Company.

It should also be noted that FH had a rather checkered past. He served time for mail fraud and perjury following a conviction in 1983 and also obtained a pardon from President

Clinton in the final days of his presidency in January of 2001. He received pardon while being investigated for money laundering and tax evasion. (See Moss, Michael, "Officials Say Investigation Will Go On Despite Pardon," *The New York Times*, 2001-02-08.) FH paid about $200,000 to Hugh Rodham, Hillary Clinton's brother, to assist him in obtaining the pardon. Rodham refunded this money when this arrangement become public. (See Walsh, Salon.com, Unpardonable, Feb. 23, 2001. Retrieved Jan. 13, 2008. CNN, Rodham says he has repaid fees for clemency cases, February 24, 2001. Retrieved Jan. 13, 2008.)

The lesson to be learned from *Braswell* is that notwithstanding the opposition, offshore asset protection trusts are a viable planning strategy and will produce a positive result for a settlor who implements and funds the trust structure under appropriate circumstances. Most knowledgeable practitioners in the asset protection area uniformly agree with this position. As the old adage states, "it was not raining when Noah built the ark." On the other hand, knowledgeable practitioners in this area also understand the reasons why many of the bad fact cases that involve foreign asset protection trusts produce such results. (See *e.g.*, *Federal Trade Commission v. Affordable Media*, 179 F.2d 1228 (9th Cir. 1999) and *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002)). It should be understood that *Braswell* is a rare case in the asset protection area. "Good fact" cases normally do make it into case reporters; most creditors are unwilling to litigate cases that appear to doomed to fail.

On a basic level, a result similar to this phase of the *Braswell* litigation should be available to any client with a properly implemented foreign wealth protection trust structure, regardless of the residence of the settlor and regardless of the forum, that is, state court, federal court or bankruptcy court.

9. *Dahl v. Dahl*, Civil No. 090402989 (2011); 779 Utah Adv. Rep. 13 (Jan. 30, 2015).

In *Dahl v. Dahl*, Civil No. 090402989 (2011), a Utah trial court in Provo, Utah denied a spouse's request to consider the assets of a domestic asset protection trust (the "**Trust**"), established in Nevada and created by her husband, in the division of marital assets. Note that Utah is a DAPT state. See Article X, above.

Dr. Charles F. Dahl ("**Charles**") and Kim Dahl ("**Kim**") married in 1992 and were living in Utah during their marriage. In 2002, Charles created the Trust, naming his brother, C. Robert Dahl, as investment trustee (the "**Trustee**"). The discretionary beneficiaries of the Trust were Charles, Kim, their issue and organizations to be designated by Charles. Shortly after the Trust was created, Charles transferred 97% of a Utah LLC to the Trust, retaining a 1% interest for himself and 1% for each of his two children. The LLC owned brokerage accounts valued at just under $1 million. In 2003, Charles and Kim transferred their primary residence to the Trust.

Beginning in 2006, Charles and Kim became embroiled in a highly-contested divorce. While the divorce was still pending, Kim brought an action in the Fourth Judicial District Court, Appellate Court in Utah County (the "**Court**") seeking to attack the Trust on a number of grounds. In her petition, Kim sought the following relief from the Court with regard to the Trust: (i) a determination that the Trust should be null and void, (ii) a determination that Kim

had an immediate interest in the Trust and (iii) a determination that the Trust was revocable. The Court granted Charles' Motion for Summary Judgment on all three issues.

On the first claim, the Court ruled that "null and void" is not a formal cause of action. The Court noted that under the law set out in *Ockey v. Lehmer*, 189 P.3d 51 (Utah 2008), contracts that offend an individual, such as those arising from fraud, misrepresentation, or mistake, are voidable, and only contracts that offend public policy or harm the public are void ab initio. Kim failed to accuse Charles of anything actionable under Ockey. Therefore, the Court found no basis on which to find the Trust "null and void."

With regard to the second claim, the Court noted that Trust distributions could only be made in the absolute discretion of the Trustee and, additionally, were subject to Charles' veto power. Kim was merely a discretionary beneficiary. Therefore, the Court found that Kim had no immediate interest in the Trust corpus.

Regarding the third claim, the Court ruled that the language used in the Trust reserved a statutory right to amend with the consent of all beneficiaries and did not, as Kim argued, create a general right to amend or alter the terms of the Trust. On the contrary, the Court noted that the Trust clearly reflected Charles' intention that it be irrevocable. The Court pointed out that the "most compelling" counter-argument was based on the relevant Nevada statute, NRS 163.560, which provided that a trust explicitly declared to be irrevocable is irrevocable for all purposes. The Court noted that under *Innerlight, Inc. v. Matrix Group, LLC*, 2009 UT 31, choice of law and choice of forum provisions in contracts and legal document are enforceable. The Court upheld Charles' choice of Nevada law and found that it was irrevocable under NRS 163.560.

Kim appealed ruling on August 7, 2012, making the following arguments:

(1) The Trust was revocable under Utah law;

(2) The Court erred in resorting to Nevada law as an alternative basis to find the Trust irrevocable because the application of Nevada law leads to a result that violates Utah's public policy;

(3) The Court abused its discretion in entering summary judgment on Kim's alter ego theory without allowing her to conduct discovery; and

(4) The Court erred in issuing a hypothetical ruling that cause of action not before him would have been barred by the state of limitations.

At one point, this case was noteworthy as a post-Huber (see Section N in Article VIII ("Alaska Law"); see also Section E in Article XXIX ("Fraudulent Transfers")) ruling by a court in a settlor's home state that the law of a DAPT state will apply to protect the trust assets from the claims of the settlor's creditors. Kim inexplicably failed to attack the trust on a number of seemingly obvious grounds. For example, the residence was transferred to the trust prior to the passage of Utah's asset protection statute. Despite the fact that the transfer would likely be avoided under Utah law, Kim failed to raise a conflicts of law issue. For additional

background on the case, see the commentary by Steve Oshins and Jeremy Spackman in LISI Asset Protection Planning Newsletter #227 (July 3, 2013) at http://www.leimbergservices.com.

Upon Kim's appeal to the Supreme Court of Utah, the court held that Utah law applies, that the Trust was revocable as a matter of law, and that Kim was entitled to withdraw her share of the marital property she contributed to the Trust as a settlor.

Kim asserted that the district court erred when it declared that she had no enforceable interest in Trust assets, the Court reversed the district court, determining that Utah law applied because of its strong public policy interest in the equitable division of marital assets, and that Utah state law should apply to the trust even though the stated choice of law in the trust was Nevada. The Court's opinion cited to *Waddoups v. Amalgamated Sugar Co.*, 2002 UT 69, ¶ 14, 54 P.3d 1054, for the authority that Utah choice-of-law rules apply whereby although Utah will generally enforce a choice-of-law provision contained in a trust document, it would not do so if such a reading would undermine a strong public policy of the State of Utah, see UTAH CODE § 75-7-107 & cmt. ("This section does not attempt to specify the strong public policies sufficient to invalidate a settlor's choice of governing law."); see also Jacobsen Constr. Co. v. Teton Builders, 2005 UT 4, ¶ 19, 106 P.3d 719 (refusing to allow parties to "employ choice of law provisions to force forum states to enforce contractual terms wholly repugnant to local public policy"). Thus, the court refused to enforce a settlor's choice-of-law since doing so undermined Utah's strong public policy goals.

Kim argued that the Trust was revocable under Utah law, despite the Trust stating "Trust Irrevocable," because Charles reserved in the Trust an unrestricted power to amend the Trust as the Trust stated "Settlor reserves *any power whatsoever* to alter or amend *any* of the terms or provisions hereof. Emphasis added)." Charles argued that the stated Trust lanaguge did not give him a right to unilaterally amend, alter or terminate the trust without consent from all beneficiaries. Charles did not argue that there may have been a typographical error (i.e., using the term "any" instead of the term "no"); this may have been the better argument of the two. The Supreme Court of Utah was unpersuaded, analyzing secondary sources (Restatement (Second) of Trusts and The Law of Trusts and Trustees) and citing to Utah law (Utah Code Ann. § 75-7-605) for the proposition that an unrestricted power to amend any and all provisions of a trust renders a trust revocable under Utah Law.

After holding that the Trust was revocable under Utah law, the Supreme Court of Utah dismissed Charles' argument that Kim had no enforceable interest in the trust because Utah law prohibited her from withdrawing her assets from an irrevocable trust under Utah Code Ann. § 75-7-605(2). Charles argued that Kim could not revoke the Trust with regards to the portion of Trust property attributable to her sepearate property or any marital property. The Supreme Court of Utah concluded that Kim was a settlor of the Trust, despite having nothing to do with the preparation of the Trust and not signing the Trust or related documents. A trust under Utah law is created by the transfer of property by the owner to another person acting as trustee. Utah Code Ann. § 75-7-401(1)(a). It was indisputable that Kim contributed property to the Trust. Kim neither knowingly nor intentionally forfeited her status as a settlor. As a settlor of the Trust, Kim could revoke that portion of the Trust funded with either her marital or separate property. See Utah Code Ann. § 75-7-605(2).

This case now falls into the category of cases where domestic asset protection trust cases have not fared well in domestic courts, see *e.g.*, *Battley v. Mortensen, et al*., (*In re Mortensen*), 2011 WL 5025249 (Bankr. D. Alaska); *Parrott v. Sasaki*, Del. Ch., C.A. No. 7227-VCL (Filed Feb. 7, 2012); and *In re Huber*, 493 B.R. 798 (Bankr. W.D. Wash 2013). For additional background on the Utah Supreme Court case, see the commentary by Steve Oshins and Jeremy Spackman in LISI Asset Protection Planning Newsletter #283 (February 12, 2015) at http://www.leimbergservices.com. See also Jay Adkisson in LISI Asset Protection Planning Newsletter #291 (Apr. 16, 2015) at http://www.leimbergservices.com.

10. *United States v. Grant,* 2008 WL 2894826 (May 27, 2008).

In 1983 and 1984, Raymond Grant ("**Raymond**") established two foreign trusts (the "**Trusts**") for himself and for his wife, Arline Grant ("**Arline**") (Raymond and Arline collectively are referred to as the "**Defendants**"). One trust was settled in Bermuda and the other trust was settled in Jersey. Raymond was the settlor of both of the Trusts. In 1991 and 1993, the IRS assessed several million in unpaid tax against the Defendants for the years 1977 through 1982 and 1984 through 1987 based on income generated by the assets held in the Trusts. Initially, the Defendants entered into an installment agreement with the IRS where they were to pay $3,000 per month until their tax liability was fully paid. This installment agreement was terminated, however, and on March 21, 2003, a final judgment was entered against the Defendants for over $36 million in unpaid tax.

The terms of both Trusts provide that should the beneficiary die, the surviving spouse would become the beneficiary. Raymond died in January, 2005, therefore, Arline became the beneficiary of both Trusts.

The Bermuda trust provides:

> During the lifetime of the Grantor, he (or, following his death, his said spouse, ARLINE GRANT, if she shall survive him) shall have the right, at any time, to discharge an existing or acting Trustee (including the Trustee executing this Agreement) and to appoint such other Trustee in any jurisdiction throughout the world, as he (or his said surviving spouse) may in his (or her) sole and unreviewable discretion determine . . .

The Jersey trust contains a substantially identical provision.

The Bermuda trust further provides:

> if in the course of time, a successor or substitute Trustee is appointed pursuant to the foregoing provisions of this Indenture, which is organized and is located and functions under the laws of a jurisdiction other than Bermuda, then and thereafter for so long as such successor or substitute Trustee shall remain in such capacity, the rights and duties of all persons with an interest in the Trust Estate . . . shall for all purposes be interpreted and construed exclusively in accordance with the laws of such other jurisdiction and the courts thereof shall be the sole forum for all purposes requiring judicial determination in the execution, operation or termination of the trusts herein created.

The Jersey trust does not contain a similar provision. The Jersey trust provides that the law governing the trust shall be that of England, unless the Grantor declares it to be different.

In 2005, the United States Department of Justice Tax Division (the "**DOJ**") filed a motion for repatriation of assets requesting the court to order Arline to appoint a United States ("**US**") trustee of the Trusts, or alternatively to otherwise repatriate the assets held in the Trusts. In response to the DOJ's motion for repatriation of assets, Arline argued that her power to appoint a new trustee of the Trusts is "limited to such trustees as she in her sole and unreviewable discretion determines." Arline further argued that a court order mandating her to exercise her removal and replacement power would violate the terms of the Trusts because Arline does not have a wish to appoint a US trustee and such appointment would not be one that is made in Arline's sole and unreviewable discretion.

The court agreed with the DOJ and reasoned that the Trusts have no limitations on the beneficiary's power preventing her from acting; therefore, Arline's powers over the Trusts are extensive and as a result the court's powers are co-extensive. The court reasoned that if Arline has the power to change trustees or repatriate assets, she cannot avoid the obligation by stating, "I choose not to do so." The court held that Arline has unreviewable discretion to change the trustees and the present trustee must comply with such a directive.

Similarly, the court also notes that Arline has the virtual power to cause the withdrawal of any or all of the trust principal of at least the Bermuda trust. It is in dispute whether Arline may withdraw all of the principal of the Jersey trust; however, the Jersey trust makes it clear that Arline may withdraw at least ten percent (10%) of the principal annually. The Bermuda trust provides:

> In addition to the distribution of the net income made hereunder to Grantor's spouse, ARLINE GRANT, the Trustee may, in its sole discretion, at any time or from time to time during the lifetime of the said ARLINE GRANT pay to or apply for her sole use or benefit so much of the principal of the Trust Estate as the Trustee shall deem necessary, advisable or appropriate for her health, comfort. maintenance and living expenses (without any duty to take into account other resources of Grantor's said spouse or of any other person, whether or not legally obligated to support Grantor's said spouse); provided, however, that in making any determination as to the distribution of any portion of the principal of the Trust Estate pursuant to paragraph (B), the Trustee shall be entitled to rely absolutely upon any written statement of facts made to it by Grantor's said spouse without necessity for an independent verification thereof by the Trustee.

The Jersey trust provides:

> If Grantor's spouse, Arline Grant, shall survive him then upon and following the death of the Grantor the Trustee shall pay to, or apply the benefit of, the said Arline Grant during her lifetime, at least annually, all of the net income of the Trust Estate and in addition thereto, such amounts or proportions of the Trust Estate as the Trustee, in its sole discretion, shall at any time or from time to time

> deem necessary or appropriate for her health, support, benefit and living expenses. In making its determination as to any distribution out of principal of the Trust Estate to the Grantor's said spouse, Arline Grant, pursuant to this Paragraph (B), the Trustee shall be entitled to rely absolutely upon any written statement of facts made to it by the said Arline Grant without necessity for an independent verification thereof by the Trustee.

The court reasoned that although the Trusts give each trustee the sole discretion to invade the corpus, by giving Arline total unreviewable authority over the discharge and appointment of trustees, Arline actually controls the corpus of the Trusts. The Trusts provide that the trustee may rely on Arline's unsupported statements of her needs without the necessity of independent verification. Additionally, there is no showing that either trustee ever declined Arline's request for a distribution.

On September 2, 2005, the court granted the DOJ's motion for repatriation of assets and ordered Arline to appoint a US trustee of the Trusts, or alternatively, to repatriate the assets held in the Trusts.

In 2008, after Arline failed to comply with the court's order to appoint a US trustee of the Trusts or to otherwise repatriate the assets held in the Trusts, the DOJ filed a motion for Arline to show cause why she should not be held in contempt for failure to comply with the repatriation order issued on September 2, 2005. In response to the DOJ's motion, Arline asserted that she made significant efforts to comply with the repatriation order and that she was unable to comply with such order after those efforts. First, Arline on January 12, 2006, within one month of when the repatriation order was formally issued, sent a letter to the Jersey trustee enclosing the repatriation order and seeking information about the procedure to repatriate funds. The Jersey trustee's lawyers responded:

> that any attempted exercise by you of your right to remove our client as trustee of the Trust and to appoint U.S. resident trustee in its place would not be a valid exercise of [Mrs. Grant's power as trust beneficiary] and would therefore be void and of no effect, which means that our client will remain the trustee of the trust, notwithstanding your attempted exercise of your power.

This response was based on the trustee's purported obligation to protect the interests of "other beneficiaries" who will become entitled to the Trust assets following Arline's death. The DOJ, however, argued that this was not a significant effort to comply with the repatriation order because Arline never sent an actual petition to the trustee to repatriate funds. The court noted that no actual petition was necessary as the Jersey trustee's lawyers made it clear from the initial response that any such petition would be ineffective to repatriate funds.

Second, Arline also contacted the trustee for the Bermuda trust and received a similar response from the trustee. The trustee in Bermuda noted:

> The Trustees of the above trust have considered your request to transfer the entire trust fund to you. We wish to advise that at this time we cannot comply with your request.

Finally, Arline sent letters to numerous financial institutions, requesting such institutions to serve as transferee trustees. All of Arline's requests were rejected because of the possibility that the offshore trustees will fight any attempt to repatriate the assets.

On May 27, 2008, the court held that Arline sufficiently established that she is not able to repatriate the funds in the Trusts and that her failure to repatriate such funds was not for a lack of effort. The court denied the DOJ's motion for an order to show cause (the "**Denial Order**.")

Despite the fact that the court found Arline unable to comply with the repatriation order due to her significant efforts to repatriate the funds to the United States (to no avail) the DOJ filed a second motion for an order to show cause on January 13, 2012. The DOJ did so after learning that Arline had received over $221,000 in principal from the two offshore trusts since the time of the Denial Order. The court granted the DOJ's second motion to show cause as to why Arline should not be held in contempt for her failure to comply with the repatriation order upon receiving over $221,000 in principal from the trusts. Arline filed a motion to discharge the order to show cause, which the court denied and held Arline in contempt on March 22, 2013.

On April 22, 2013, the court granted the DOJ's Motion for Permanent Injunction, which ordered that: (1) Arline request on a quarterly basis that the trustees of her offshore trusts transfer all available income to accounts held in her name (or in the name of the other beneficiaries) within the United States; (2) Arline and any other person acting in concert with her to provide to the United States all funds that have been transferred in the past directly or indirectly from the icnome of her offshore trusts to accounts held in her name (or in the name of the other beneficiaries); (3) Arline and any other person acting in concert with her, to provide to the United States all funds transferred directly or indirectly from the offshore trusts to any United States account in the future; (4) neither Arline and anyone acting in concert with her are prohibited from spending, transferring, or otherwise dissipating any assets of the offshore trusts; and (5) Arline and anyone acting in concert with her or anyone seeking to help Arline shield her assets from going toward the payment of her tax liabilities, are prohibited from communicating to the trustees that the distributions being requested are compelled. *U.S. v. Grant,* 2013 WL 1729380 (April 22, 2013).

Epitaph: See Riser & Adkisson, "84-Year Old Widow Held in Contempt for Receiving Money Indirectly Through Her Offshore Trusts," LISI Asset Protection Planning Newsletter #223 (May 7, 2013) at http://www.leimbergservices.com.

11. *S.E.C. v. Solow*, 682 F.Supp.2d 1312 (S.D. Fla. 2010).

Jamie L. Solow (the "**Defendant**") engaged in a fraudulent trading scheme involving the sale of inverse floating rate collateralized mortgage obligations. The Securities and Exchange Commission (the "**SEC**") obtained a judgment against the Defendant for seven violations under the Securities Exchange Act. The final judgment issued on January 31, 2008, found the Defendant liable for $2,646,485.99, together with prejudgment interest of $778,302.91, for a total of $3,424,788.90 and a civil penalty of $2,646,485.99. Furthermore, the Defendant was enjoined from attempting to register as a broker-dealer or investment

adviser or being associated with or seeking to be associated with a broker-dealer or an investment adviser.

On February 4, 2008, the Defendant's wife retained the law firm of Donlevy-Rosen & Rosen, P.A., of Coral Gables, Florida, to assist her establishing a Cook Islands trust known as the Gina P. Solow Trust (the "**Cook Islands Trust**"). South Pac Trust International was appointed as the trustee. Thereafter, the Defendant and his wife proceeded with the transfer of various securities accounts and joint checking accounts held in tenancy by the entirety to accounts in the sole name of the Defendant's wife. On March 24, 2008, the Defendant's wife executed a mortgage on a beachfront condominium located in Fort Lauderdale, Florida (the "**Fort Lauderdale Condo**") for $1,187,500 and the Defendant and his wife each executed a mortgage on their Hillsboro Beach residence (the "**Hillsboro Beach Residence**") in the amount of $5,261,289. The lender for both mortgages was Federation Advances Corp., a Nevis limited liability company. The funds loaned pursuant to each mortgage were assigned to the Cook Islands Trust and held in a certificate of deposit owned by the Cook Islands Trust. On April 21, 2008, the Defendant's wife traveled to Zurich, Switzerland to deposit cash and jewelry in a safe deposit box established by the Cook Islands Trust.

The Defendant claimed he and his wife purchased the Hillsboro Beach Residence as tenants by the entirety in 2002, prior to any wrongdoing alleged by the SEC. The Defendant argued that the $5,261,289 mortgage received on the Hillsboro Beach Residence was an "in-kind" transaction that did not result in any cash being conveyed to the Defendant or his wife. The mortgage funds were invested solely in a certificate of deposit held by the Cook Islands Trust. The trust is irrevocable and there is no provision made for the Defendant to exercise any control over the trust property. The Defendant further claimed that the Fort Lauderdale Condo was purchased in June 2003 by JSolow Condo One, Inc., which is a corporation owned entirely by the Defendant's wife. As a result, the Defendant argued that the Fort Lauderdale Condo was never available to the SEC for satisfaction of its judgment since the judgment was only against the Defendant.

Additionally, from February 7, 2008, to March 7, 2008, a total of $820,000 was deposited in the Defendant's and his wife's checking account from Highland Financial Group, Inc. and from Arlene Zayas, the wife of Highland's principal officers, James Riggio. The Defendant emphasized that these funds were either those belonging to his wife alone or were owned by the Defendant and his wife as tenants by the entirety and that in either case these assets were beyond the reach of the SEC. The Defendant further argued that these funds were used to pay tax liabilities owed by the Defendant and his wife in the amount of $556,632 and the payment of the tax liability and legal expenses depleted these funds. In a second series of transactions that occurred on February 29, 2008, March 10, 2008 and April 8, 2008 the Defendant and his wife transferred $777,000 from their joint checking account to a Bank of America checking account titled in the sole name of the Defendant's wife. The Defendant claimed that the funds in the joint checking account were held by the Defendant and his wife as tenants by the entirety and therefore the SEC could not satisfy its judgment by seizing such account.

The Defendant made three partial payments totaling $2,639.24 toward the judgment from the Defendant's separate property. Upon the Defendant's failure to pay the judgment, the

SEC motioned for the Defendant to show cause for failure to pay the judgment. The defendant argued that the assets the SEC sought to satisfy its judgment against him are all property that were held in tenancy by the entirety by the Defendant and his wife and that such property was not reachable by the SEC because the judgment was not against the Defendant's wife. The various transfers made to his wife; therefore, did not constitute fraudulent transfers because the SEC could not otherwise reach these assets. Additionally, the Defendant argued that he had insufficient assets to satisfy the judgment and based on the judgment he could not engage in his profession as a broker-dealer or investment adviser. As a result, the Defendant argued he lacked sufficient assets and/or income to satisfy the judgment.

The SEC responded to the Defendant's argument by arguing that the court possessed equitable powers based on *S.E.C. v. Yun*, 208 F.Supp2d 1279 (M.D. Fla. 2002) to enable it to disregard the protection provided under state law by tenancy by the entirety in the enforcement of a disgorgement order. As a result, the SEC argued that since it could reach the Defendant's interest in such property by disregarding state law regarding tenancy by the entirety the prior transfers to the Defendant's wife were available to satisfy the disgorgement order. The SEC also noted that all the property that constituted the entireties estate was derived exclusively from the earnings of the Defendant and his wife contributed no amount toward any of the tenancy by the entirety property.

The SEC also responded to the Defendant's argument that he lacked the ability to pay the judgment by arguing that the Defendant himself created any inability to pay the final judgment. The SEC noted that from 2003 to 2006, the Defendant's earned income was between $1 million to $2 million per year and his earnings were the exclusive source of his wife's investments, savings and securities. Furthermore, the Defendant had trading authority on his wife's financial accounts, however, claimed to lack of knowledge of her financing dealings. Citing both *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002) and *SEC v. Bilzerian*, 112 F. Supp2d 12 (D.D.C. 2000), the SEC argued that the impossibility the Defendant experienced was self-created and the defense of impossibility was, therefore, unavailable to him. In *Bilzerian*, the defendant, Mr. Bilzerian, claimed to not have the ability to pay a disgorgement order. Mr. Bilzerian's assets were transferred to his wife, a web of corporations and ultimately to a Cook Islands trust. The SEC argued that Mr. Bilzerian attempted to conceal his ability to comply with the disgorgement order by transferring assets he held directly into offshore trusts and other entities in which he continued to maintain an indirect beneficial interest. The court found Mr. Bilzerian's failure to disclose his indirect beneficial interests to be misleading and held that it may consider Mr. Bilzerian's beneficial interest in the Cook Islands trust in determining his ability to comply no matter the origin of the assets in the trust.

The SEC argued that similar to the defendants in *Lawrence* and *Bilzerian*, the Defendant divested control over his assets through the use of an offshore asset protection trust and then represented to the judge that it was impossible for him to make his court-ordered payments. Similar to the defendant in *Lawrence*, the Defendant divested himself of his assets in anticipation of the judgment that was about to be entered against him.

The SEC emphasized that even if it were impossible for the Defendant to comply with the judgment such impossibility was self-created by him and the defense is unavailable to a

charge of civil contempt when the impossibility is self-created. The court noted that if the Defendant cannot convince his wife to return his assets to him, that is a problem of the Defendant's own doing and he is consequently in contempt of court. The court held that the mortgage executed by the Defendant on March 24, 2008 established that the Defendant has not made a good faith effort to pay the amounts ordered and his claimed inability to use the Hillsboro Beach Residence to obtain funds to pay the disgorgement order was self-imposed because he executed the mortgage on the Hillsboro Beach Residence. This demonstrated the Defendant's ability to extract $5.2 million from the Hillsboro Beach Residence.

The court held the Defendant in contempt of court for failure to comply with its order for the Defendant to pay the judgment rendered against him. The Defendant was ordered to be incarcerated until such time as he complies with the court's order to pay the judgment.

12. *Advanced Telecommunication Network, Inc. v. Allen*, 2011 WL 3585827 (Bkrtcy. M.D. Fla.).

In *Advanced Telecommunication Network, Inc. v. Allen*, 2011 WL 3585827 (Bkrtcy. M.D. Fla.), the court held:

> Indeed, the facts of this case are nearly identical to the facts in *Lawrence*. Both involve a self-settled trust created or funded in a remote foreign jurisdiction during pending litigation, funded with over 90% of the settler's assets for "estate planning" purposes, and administerd by a stranger supposedly having total control over the turst *res*. Both also invovle settlers who, when pressed by the Bankruptcy Court to turn over trust assets, implausibly claimed their inability to do so under the provisions of the trust documents, including the choice of law provisions designating foreign law as controlling. Finally, both cases involve reviewing courts [*sic*] relying upon the trial court's determination that the settler's impossibility defense to turnover was itself impossible to believe because the alleged impossibility was self-created. Accordingly, consistent with *Lawrence*, and because Judge Briskman's findings were made after a full evidentiary hearing on adquate notice to the parties, this Court adopts Judge Briskman's previous findings as set forth above and orders Daniel Allen *again* to repatriate any funds held in the Shingle Oak Family Trust.

13. *Tasarruf Mevduati Sigorta Fonu v. Merrill Lynch Bank and Trust Company, et al.*, Privy Council of the Cayman Islands, Appeal No. 0036 of 2010, decided June 21, 2010.

Tasarruf Mevduati Sigorta Fonu v. Merrill Lynch Bank and Trust Company, et al., Privy Council of the Cayman Islands, Appeal No. 0036 of 2010 was decided on June 21, 2010. In *Tasarruf*, the Appellant Tasarruf Mevduati Sigorta Fonu ("**TMSF**") was a corporation established by Turkey to restructure and administer failed banks. TMSF acquired two banks which respondent Demirel had formerly controlled. TMSF sued Demirel and obtained a personal Turkish judgment in the amount of $30 million, based on fraudulent loan transactions.

Demirel established two revocable trusts in the Cayman Islands. Merrill Lynch ("**ML**") was the Trustee of both trusts, and each trust provided the Trustee with the discretionary power to distribute trust assets to Demirel, his wife, and his issue. At all times relevant in the case Demirel had no issue. Combined, the two trusts held $24 million in assets. The assets of both trusts were shares of Cayman companies. All trust assets were located in the Cayman Islands. By the terms of the trusts, Demirel retained the power to revest the assets of the trust in himself. All parties agreed that the trusts were validly executed and in force under Cayman law.

After TMSF learned of the existence of the trusts, it sought the appointment of a receiver in the Cayman Islands that would take possession of the "property" in Demirel's possession to satisfy the judgment. Under Cayman law, a Cayman receiver may only collect "property" in the possession of a judgment debtor.

The court noted that under Cayman law there is no legal principle whereby a court may look through the form of a trust and treat the assets of a revocable trust as if such assets belonged to the settlor individually. The court noted that under the law of all except one jurisdiction in the United States, a court would settle the issue in this case by looking through the formalities of the trust to treat its assets as if such assets were owned by the settlor personally. However, under Cayman law, that legal argument is unavailable.

TMSF's Argument: TMSF argued that Demirel's power to revoke the trusts was tantamount to a property interest. Further, Demirel could delegate or appoint the power to revoke the trusts, because it was a personal power and not a fiduciary power. Therefore, TMSF sought an order that would appoint a receiver who would, in essence, take possession of Demirel's power to revoke the trusts. Thereafter, the receiver could revoke the trusts, collect the assets of the trusts (*i.e.*, the capital share of the Cayman companies and the assets of the companies), and vest the assets of the trusts in TMSF.

Demirel's Argument: Demirel resisted the appointment of a receiver based on the following chain of legal arguments: (1) a receiver could only be appointed over property; (2) a power of revocation was in the same category as a general power of appointment; (3) it had long been understood that, in the absence of legislative provision to the contrary, a power of appointment was not property; (4) the order could only be effective if the receiver were authorized to revoke the trusts on Demirel's behalf and/or Demirel were ordered to revoke the trusts; and (5) as a matter of law, the power to revoke was not delegable and the court had no jurisdiction to order the exercise of the power of revocation.

Two lower courts denied TMSF the appointment of a receiver. These courts held that Demirel's power to revoke the trusts was not "property." Their reasoning was that a power was distinct from property. Also, they reasoned that, at common law, a power could not be treated as if it were a property interest, out of respect for the formalities of trusts. Cayman legislative law crafted several exceptions to the general rule that a power is not a property interest. However, in the absence of legislative direction, courts would not treat a power as a property interest.

Holding: On appeal, the Privy Council reversed the lower courts, holding in favor of TMSF and ordering the appointment of a receiver to revoke the trust and vest the trust assets in TMSF. The court relied heavily on *Masri v. Consolidated Contractors International (UK) Ltd. (No. 2)*, an English case decided in 2008. In *Masri*, the appointment of a receiver was not limited to actual assets, but also extends to whatever is considered in equity to be assets.

The court decided that Demirel's power was tantamount to a property interest for several reasons: (1) the power to revoke was conferred by Demirel on himself at the time he formed the trusts, Demirel reserved the power to revoke; (2) the power to revoke was a personal power, not a fiduciary power, *i.e.*, Demirel owed no duty of trust or confidence to any other person, and no act personal to Demirel was required to be performed, and therefore the power could be delegated and/or assigned by Demirel to another person; and (3) there is no rule that a person holding personal power cannot be ordered to exercise it. Of these three reasons, the court focused extensively on the second. The court held that the power to revoke, where unfettered, is tantamount to a property right.

14. *Goldberg v. Rosen* (*In re Niroomand*), 11th Cir., No. 12-11231, Oct. 17, 2012.

An overly aggressive, imprudent and perhaps poorly advised bankruptcy trustee pursued the legal fee charged by an attorney who specialized in asset protection. The trustee pursued the legal fee on a fraudulent transfer theory and argued that the attorney committed malpractice. As the facts of the case demonstrated, however, the attorney did his job in collecting sufficient due diligence prior to assisting the client with the planning. Collection of due diligence by the attorney included requiring his client to execute an affidavit of solvency. On the other hand and a bit refreshing from an asset protection planner's standpoint, the bankruptcy trustee found himself in hot water along with his attorney who are each now defending a malicious prosecution action and the trustee's attorney had to respond to a bar complaint. This time the good guy won!!!! Although the bar complaint was dismissed, the bankruptcy trustee and his attorney have been unable to bring the litigation to a close. "[Rosen's attorney] and [Rosen], on the other hand, as can be gleaned from their desire to take pointless depositions, their filing of numerous, groundless motions, want to continue the litigation even after obtaining a final, appellate victory. It is therefore abundantly clear that their intent is to exacerbate the litigation and harass and malign Plaintiffs." *See In re Niroomand*, Case No. 09-12141-AJC, Bankr. S.D. Fla., Pls.' Opp'n to Defs.' Emerg. Mot. to Compel (Dec. 4, 2012).

In *Goldberg v. Rosen* (*In re Niroomand*), 11th Cir., No. 12-11231, Oct. 17, 2012, Alan Goldberg ("**T**") was the bankruptcy trustee in the Chapter 7 bankruptcy of the debtor, Akram Niroomand ("**D**"). D was being pursued by Great American Insurance Company ("**C**"), which commenced a bond indemnity action on June 8, 2007 in the Southern District of Florida. Nearly a year later in May of 2008, C obtained a judgment against D in the amount of $2,930,899.97 (the "**Judgment**").

Approximately one (1) year prior to the Judgment and eighteen (18) months prior to filing for bankruptcy protection, D engaged the law firm Donlevy-Rosen & Rosen, P.A. ("**Rosen**") to create and fund an offshore asset protection trust structure. (Interestingly, Alan

Goldberg was also the bankruptcy trustee in *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002), another famous "bad" fact case involving a foreign asset protection trust.) According to D, Rosen advised her to establish the Niroomand Family Trust, dated July 6, 2007 (the "**Trust**") in the Cook Islands to protect her assets. The pending claim was disclosed to Rosen.

After establishing the Trust, D transferred $500,000 to it, however, following this initial transfer D requested the trustee to return approximately $325,000. D used the funds that were distributed to her to pay down mortgages on her home in Florida. (Applying funds to pay down a mortgage on a primary residence is a common asset protection technique used in Florida when a debtor has an existing outstanding claim. Under Section 4 of Article X of the Florida Constitution a debtor can shelter such wealth even though such act represents a fraudulent conversion or transfer as to an existing creditor. See *e.g.*, *Havoco of America, Ltd. v. Hill*, 790 So.2d 1018 (Fla. 2001), *Republic Credit Corporation, Inc. v. Upshaw*, 4th Dist. Case No. 4D08-1591 (March 25, 2009); *Palm Beach Savings & Loan Ass'n. v. Fishbein*, 619 So.2d 267 (Fla. 1993); *Jones v. Carpenter*, 106 So. 127 (Fla. 1925); *Craven v. Hartley*, 135 So. 899 (Fla. 1931); *LeMar v. Lechlider*, 185 So. 833 (Fla. 1939); *Sonneman v. Tuszynski*, 191 So. 18 (Fla. 1939); *In re: Gosman*, 382 B.R. 826 (S.D.Fla. 2007). Of course, following the enactment of the Bankruptcy Reform Act of 2005 the ability to shelter such wealth using this strategy was greatly reduced by the addition of several new statutes specifically designed to prevent the use of an unlimited homestead exemption to shelter such wealth immediately prior to filing for bankruptcy. See § 522(b)(3)(A) (730 day residency rule), § 522(p) (the value of the homestead of a debtor (other than farmers) in excess of $146,450 (as adjusted for inflation pursuant to § 104(b)(1) and (2) of the Bankruptcy Code) is no longer exempt until 1,215 days (that is, three (3) years and four (4) months) after the debtor *acquired an interest* in the home) and § 522(o) (if within the ten (10) years prior to filing a petition a debtor converts non-exempt property to homestead with the actual intent to hinder, delay, or defraud a creditor, the value of the homestead is reduced by the value of such converted property).) Following receipt of the first distribution D then requested the trustee in the Cook Islands to terminate the Trust and repatriate the funds to the United States and the trustee complied with D's request. D made this request because presumably she was concerned that a court would eventually order her to repatriate such funds and then hold her in contempt if she failed to comply with such order. (In some cases involving egregious fact patterns where such orders have been issued to debtors courts have order such debtors incarcerated for failing to comply with such orders. See *e.g.*, *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002) and *Federal Trade Commission v. Affordable Media*, 179 F. 2nd 1228 (9th Cir. 1999). The authors strongly urge readers to review such cases carefully to understand the reasons such debtors were incarcerated. In each such case no debtor ***was ever*** incarcerated for creating and funding such a trust. Incarceration was ordered to remedy what the court deemed to be serious problems in the design or timing of the funding of such trusts.)

Based on the foregoing, T, in furtherance of his statutory duties as bankruptcy trustee, alleged D's payment of legal fees constituted a fraudulent transfer to Rosen (such transfers alleged to be both actually and constructively fraudulent). (According to T, the payment of legal fees for Rosen's advice, which T claimed was negligent, was not justified and did not constitute reasonably equivalent value.) Under Section 548 of the Bankruptcy Code, such transfers would be avoidable by T. T also alleged Rosen committed malpractice in assisting D

in establishing the Trust and was unjustly enriched from the payment of legal fees. According to T, D was insolvent when she paid for such legal services.

The only evidence T presented to the bankruptcy court to prove his case was D's testimony. (However, according to T's Initial Brief, "extensive documentary evidence was introduced, for the most part, by stipulation." T further stated, "the Bankruptcy Court made manifest error by not considering the documentary evidence that establishes that the Debtor made the transfers to the Appellees in exchange for less than reasonably equivalent value…" Notwithstanding T's objections, the 11th Circuit did not find any support in the record for T's claim that the bankruptcy court did not consider the documentary evidence in reaching its conclusions.) D testified she was insolvent when she transferred assets to the trust. T did not present any expert testimony regarding the alleged malpractice claim. Rosen, however, presented "voluminous documentary and testimonial evidence" that D was solvent when she transferred assets to the Trust. This evidence included D's affidavit of solvency in which D testified she was solvent and could pay her anticipated debts, including any judgment that might be incurred in a lawsuit. The affidavit of solvency was used to impeach D's testimony and the court found her testimony lacked credibility. As a result of D's lack of credibility, the court found T's case "woefully lacking" any evidence to support its allegations. The credible evidence supported finding D was solvent when she transferred assets to the Trust. The court found no fraudulent transfer and no evidence of malpractice or unjust enrichment.

According to the Bankruptcy Court:

> The plaintiff's case consisted of one witness, which in the first place the Court did not find credible, but, in addition, the evidence presented is rather clear.
>
> While, I never found any evidence about legal malpractice, I'm looking for what could possibly be argued as unjust enrichment. As to the constructive fraud, fraudulent transfer, the Court thinks it's abundantly clear that there's been no establishment of insolvency.
>
> In fact, the record is abundant with records of solvency. The witness signed a solvency affidavit, which she said she did not read, *but the Court notes-noted that the witness could remember some things in the way of financial numbers of a rather complicated structure down to the penny, and other things, she couldn't remember at all*. (Emphasis added.)

On appeal, the district court upheld the bankruptcy court's findings. The 11th Circuit affirmed these decisions on Oct. 17, 2012. The court found no error in the bankruptcy court's findings. The bankruptcy court heard D's testimony and discredited it, which left T without any credible evidence to support his case. The bankruptcy court was entitled to find D was solvent at the time of the transfers because the credible evidence supported that finding. There was no indication that the Bankruptcy Court looked beyond the solvency badge to other indicia that established fraudulent intent. T's unwillingness to stop litigating after the Bankruptcy Court's dismissal apparently fueled a significant amount of animosity between Rosen and T. (Rosen and his attorney filed suit against T and T's attorney for malicious prosecution. See Case No. 12-10693CA23 filed in the Circuit Court of the Eleventh Judicial Circuit, Miami-

Dade County. See paragraph 7 of T's Motion to Dismiss and for Sanctions, which amounts to three words, that is, "Shame on them" (referring to Rosen and his attorney). T accused Rosen and his attorney of engaging in a "vexatious, frivolous attempt to intimidate" T and his attorney in T's Motion to Dismiss.) Rosen moved for sanctions against T and in doing so, noted T's "evident personal disdain (and/or that of his counsel) for [Rosen's] area of practice --- "asset protection" --- cannot form a principled basis for an otherwise meritless appeal." (See Appellees' Reply in Support of Their Motion for Sanctions under Rule 38, and Appellees' Response to Appellant's "Cross-Motion" for Sanctions, filed June 8, 2012.) T's rationale for his appeals is set forth below by cause of action.

Negligence & Unjust Enrichment. Rosen cited *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999) to justify its willingness to assist D with this planning. (A discussion of *Grupo Mexicano* is beyond the scope of this outline.) T disagreed with Rosen's reliance on this case. T's Civil Appeal Statement indicated that the determination of the appeal would turn on the interpretation of *Grupo*. Indeed, Rosen engaged in planning based on his interpretation of *Grupo*, which was articulated in the pleadings that stated:

> I have sort of a general feeling about it, that once there's a judgment, there probably are restrictions on how you can transfer property, okay, that don't exist pre-judgment, at least according to the U.S. Supreme Court in *Groupo* [*sic*] *Mexicano*, so that's sort of been like the guideline for us…

However, T correctly countered that *Grupo*'s holding did *not* evaporate remedies available to creditors prior to obtaining a judgment providing:

> Although *Grupo* held there was no common law authority entitling a plaintiff the right to a pre-judgment injunction preventing a debtor from transferring their property as they see fit, it specifically noted there may be one or more statutory basis that may nevertheless preclude a debtor from doing so, but that was not before the Court.

Indeed, the Supreme Court acknowledged pre-judgment remedies available to creditors under UFCA and UFTA. "Several States have adopted the Uniform Fraudulent Conveyance Act (or its successor the Uniform Fraudulent Transfers Act), which has been interpreted as conferring on a nonjudgment creditor the right to bring a fraudulent conveyance claim. See generally P. Alces, Law of Fraudulent Transactions & ¶ 5.04[3], p. 5–116 (1989). Insofar as Rule 18(b) applies to such an action, the state statute eliminating the need for a judgment may have altered the common-law rule that a general contract creditor has no interest in his debtor's property. Because this case does not involve a claim of fraudulent conveyance, we express no opinion on the point." See also, *American Surety Co. v. Conner*, 251 N.Y. 1, 166 N.E. 783, 65 A.L.R. 244 (1929), "We think the effect of these provisions is to abrogate the ancient rule whereby a judgment and a lien were essential preliminaries to equitable relief against a fraudulent conveyance. The Uniform Act has been so read in other states."

T argued that Rosen's advice, which grossly misinterpreted *Grupo*, was negligent, resulted in a fraudulent transfer of fees paid to Rosen, and allowed Rosen to be unjustly enriched. D's planning amounted to legal fees of $41,000 that accomplished nothing (and

according to T, could have subjected D to civil contempt) and such fees should have been part of the bankruptcy estate. T felt Rosen should have known a creditor has remedies that involve reversing transfers pre-judgment and refusal to comply with a court order could result in D being held in civil contempt.

Rosen also argued that their inclusion of a "loophole" (commonly referred to as a "Jones Clause") negated liability on his part for alleged negligence in providing advice to create the Trust. (For a discussion of Jones Clauses see LISI Asset Protection Planning Newsletter #212 (October 30, 2012) at http://www.leimbergservices.com.) It should be noted, however, that the Jones Clause included in the Trust would have required T to file a law suit in a court in the Cook Islands and obtain a determination that T was entitled to a remedy. Nonetheless, the Cook Islands does not give full faith and credit to judgments entered by a court in the United States. Thus, any ruling issued by a court in the United States would not be respected under the law of the Cook Islands. As a result, it would seem strained to argue that the Jones Clause in the Trust assuaged a fraudulent transfer concern. To the contrary, it seems clear that it had the effect of hindering or delaying T from collecting on its debt.

T also disagreed with Rosen's view on the application the "impossibility defense" if D became subject to a court order involving the Rosen's planning. T cited Rosen's memorandum to file which included the note, "I told her that the law in the US is such that one can not be incarcerated for failing to do that which is [im]possible to do, even if one has created the impossibility, no matter how reprehensible the conduct…" (See page 27 of T's Notice of Appeal to the United States Court of Appeals for the Eleventh Circuit, citing Defendants' Exhibit Register, Bankruptcy Court, ECF 99, Exhibit "L.")

Fraudulent Transfer. The court's ruling on the fraudulent transfer issue rendered the negligence argument asserted by T nugatory. As previously mentioned, T argued that the Supreme Court did not intend to eviscerate creditor remedies under the Uniform Fraudulent Transfer Act ("**UFTA**") in its holding in *Grupo Mexicano*. While the authors firmly believe this position is correct, the 11th Circuit accepted the Bankruptcy Court's findings that a fraudulent transfer simply *did not* exist in this case. Thus, the issue of whether *Grupo Mexicano* applied to UFTA became immaterial.

T also cited *Martinez v. Hutton (In re Harwell)*, 628 F.3d 1312, (11th Cir. 2010) in his Initial Brief for his 11th Circuit appeal and asserted a similar course of conduct between Rosen and the attorney in *Harwell*. (For a discussion of *Harwell*, see LISI Asset Protection Planning Newsletter #168 (January 13, 2011) at http://www.leimbergservices.com. See also, Gassman, "In re Harwell: Years of Bankruptcy Court Litigation End Badly for Lawyer Who Allowed His Trust Account to be Used for Transfers to Avoid Creditors," LISI Asset Protection Planning Newsletter #243 (April 24, 2014 at http://www.leimbergservices.com.) However, in *Harwell*, the issue before the 11th Circuit was whether the attorney (who the court determined was an initial transferee) was entitled to use the conduit defense while failing to meet a good faith standard. (The attorney in *Harwell* faces strict liability for various fraudulent transfers amounting to nearly $400,000.) In *Niroomand*, Rosen avoided transferee status due to D's solvency. Furthermore, D did not use the Rosen's trust account as a vehicle to orchestrate fraudulent transfers. Instead, D paid Rosen for services rendered which normally would constitute "reasonably equivalent value" in a fraudulent transfer analysis. T's argument was

essentially that the fees could not be reasonably equivalent value because the advice was negligent. According to T in his pleadings, "It is inconceivable that the Debtor received any value from Appellees when the facts are that Debtor could have been held in contempt for hiding behind the Trust in an attempt to avoid payment of her debts. Obviously, the Debtor realized such and repatriated the balance of the funds, after incurring substantial losses related to the creation and termination of the Trust." (See page 22 of T's Notice of Appeal to the United States Court of Appeals for the Eleventh Circuit, filed March 7, 2012.) As noted, however, the Bankruptcy Court dismissed the fraudulent transfer argument based on D's solvency.

Niroomand illustrates several important points that should be considered as part of the asset protection planning process. The following are also tips to live by when counseling clients on asset protection strategies.

First, timing is a critical aspect of effective asset protection planning. Given the existence of a claim, the creation and funding of an offshore trust was not appropriate. Clients should plan only at appropriate times and under appropriate circumstances and attorneys should only assist clients under such conditions. Many people seek advice about wealth protection strategies because they are involved or concerned that they are about to become involved in serious litigation. This may be the wrong time to plan or valuable opportunities may be foreclosed without raising serious fraudulent transfer issues.

As a general rule, if assisting a client with a particular strategy raises an issue as to a fraudulent transfer do not proceed or proceed with a great caution. Bad things can happen to good people if planning is done under inappropriate circumstances. This does not mean that we cannot ethically assist clients who are involved in litigation (or concerned that litigation is imminent). However, it does mean exercise discretion. Contrary to Rosen's stated practice, *Grupo Mexicano* should not be interpreted as providing an attorney and his or her client the ability to engage in aggressive planning so long as its completed before judgment.

Second, as a result of the jurisdiction where a client resides or may want to reside, the manner in which a client owns certain property interests (for example, homestead or tenancy by the entirety), it may be possible to achieve significant wealth protection for a client involved in litigation or concerned that litigation is imminent. In *Niroomand*, it was only after tens of thousands of dollars were wasted on an offshore trust structure that D eventually followed advice to pay down her mortgage – which ultimately may have been a much safer strategy for D and a far less expansive. Nonetheless, D would have also most likely found it necessary to avoid finding herself in a bankruptcy proceeding for many years following the payment of the mortgages on her primary residence.

Third, carefully consider the consequences of using a "Jones Clause" in an asset protection trust. If the clause is substantially similar to the one used in the Trust, that is, it creates substantial hurdles for a creditor, it probably will not work to protect the client (or the attorney).

Fourth, following the creation and funding of a foreign trust or any other wealth protection strategy, filing bankruptcy should be viewed as an option of last resort

notwithstanding that the planning may have been completed under appropriate circumstances. This is not to say that a properly implemented foreign trust structure or other wealth protection strategy cannot survive a challenge in a bankruptcy proceeding. Nonetheless, it is clear from a few bad fact cases that the present environment in the Bankruptcy Court system is hostile toward certain wealth protection strategies. Unfortunately, bankruptcy judges typically have the pleasure of reviewing bad fact cases involving foreign trusts. Experience demonstrates that judges in bad fact cases usually reach the proper result; however, the legal analysis is faulty. This faulty analysis has significantly damaged public perception regarding legitimate wealth protection planning. It is clear, however, that §548(e)(1) of the Bankruptcy Code (that is, the ten (10) year fraudulent transfer rule that applies to self-settled or classic asset protection trusts) mandates that bankruptcy courts respect the validity of such trust structures. Gone are the days when bankruptcy judges could wrongfully dismiss such trust structures as shams. Instead, the court must now engage in an analysis of whether a debtor's transfer of assets to such a trust constituted a fraudulent transfer. (See *e.g.*, *Battley v. Mortensen, et al*., (*In re Mortensen*), 2011 WL 5025249 (Bankr. D. Alaska). For an excellent discussion of *Mortensen* see Shaftel, "Court Finds Fraudulent Transfer to Alaska Asset Protection Trust," 39 EP 15 (April 2012); Sulivan, Merric, Gillen, Bove & Nenno, "Fraudulent Transfer Claims," 150 Trusts & Estates 43 (Dec. 2011); and "**Gopman & Rubin: Further Analysis on *In re Mortensen*,"** LISI Asset Protection Planning Newsletter #187 (November 7, 2011) at http://www.leimbergservices.com. See also, "**Oshins & Keebler on Mortensen: No, the Sky Isn't Falling for DAPTs!,"** LISI Asset Protection Planning Newsletter #186 (October 31, 2011) at http://www.leimbergservices.com and "**Adkisson & Riser on Mortensen: Alaska Asset Protection Trust Fails To Protect Future Assets in Bankruptcy under New Section 548(e) Against Future Creditors,"** LISI Asset Protection Planning Newsletter #185 (October 20, 2011) at http://www.leimbergservices.com.) The importance of obtaining an affidavit of solvency should not be ignored in this context. If a debtor's financial situation and affidavit is such that a transfer would not render the debtor insolvent, it would seem difficult for a creditor to argue that a debtor possesses the *actual* intent to hinder, delay or defraud such creditor from collecting on its judgment.

Fifth, reliance on *Grupo Mexicano* for the proposition that a creditor has no pre-judgment remedies seems misplaced. Clearly, a creditor does have pre-judgment rights and can exercise such rights to a client's detriment. These rights should be disclosed to a client prior to assisting a client with making any transfers. Additionally, the issue of civil contempt should be discussed in these situations emphasizing that a judge may order incarceration in certain circumstances. It is important to advise a client in the context of using a foreign trust that it is likely that the client will remain in the United States within the jurisdiction of a court here.

It is just as important, however, to recognize that honest people seek legitimate wealth protection by using foreign trusts that are created and funded under appropriate circumstances. When properly structured and established under appropriate circumstances, foreign trusts are one of the most (if not the most) effective wealth protection strategies available. It is also important to recognize that the law permits individuals, businesses and other organizations to plan to protect assets and income from the claims *of future unforeseen creditors*. It is equally important to recognize that lawyers have a duty to zealously represent their clients, including lawyers who practice in the estate planning area. Zealous representation mandates that

practitioners discuss all available planning wealth protection strategies and convey sufficient accurate information regarding such strategies so clients can make informed decisions.

Finally, collection of due diligence should never be viewed primarily as a method of impeaching a client's testimony as addressed by the court. Properly collecting due diligence to ensure that an attorney is not assisting a client with a fraudulent transfer should not only protect the attorney by proving the planning was done under appropriate circumstances, it should also protect the client by enabling the attorney, as the client's advocate, to prove to the court that such planning should be respected and accepted by the court.

In assisting a client with the implementation of an effective wealth protection plan a firm should have due diligence-client intake procedures (know your client ("KYC") procedures) in force that are used as a matter of common business practice in all cases.

An individual should be prepared to answer questions candidly and produce any documentation related to a wealth protection plan that may be required in a court proceeding. This does not mean that it is necessary to disclose such information if it is not required in a legal proceeding, however, a quality wealth protection plan will withstand scrutiny and should not require or be based upon any concealment.

Know your client and document the reasons your client is establishing an offshore structure. Reputable banks, trust companies and other financial institutions in quality foreign jurisdictions are required to conduct extensive due diligence before accepting a new client relationship. This process is generally far more extensive and impressive than the due diligence required by domestic institutions. A client may be required to prove source of wealth and substantiate that funding the structure will not result in a fraudulent transfer issue. Collect extensive financial information on a client who is engaging you to provide wealth protection advice, including a financial statement prepared by a reputable accounting firm that has extensive knowledge of the client's financial condition, individual and corporate tax returns for at least the three past tax years and extensive information regarding the source of the client's wealth and employment or business history. Demand reference letters from professionals who have worked with the client such as attorneys, accountants, bankers and financial advisors. Finally, conduct an extensive background check on the client using Lexis-Nexis, WorldCheck, Google and any one or more of the deep web search engines available. Properly using these data bases should enable a planner to uncover civil and criminal cases involving the client as well as any tax liens, administrative proceedings and civil penalties that may have been imposed against the client.

From a moral and legal perspective it is acceptable to protect wealth using a properly implemented foreign wealth protection structure. When properly structured and implemented under appropriate circumstances, an offshore trust is one of the most effective and versatile wealth protection strategies available. In a mobile world where professional and business opportunities require clients to move from one jurisdiction to another, such trusts enable a client to protect wealth without relying on arbitrary local law exemptions that differ from one jurisdiction to the next. Additionally, for the sophisticated investor an offshore trust will be far more attractive as a wealth protection vehicle in comparison to most other strategies such as investment in annuities and insurance contracts (investment vehicles that are potentially

exempt in one form or another from the claims of creditors under laws of many states). The cost and limitations of using such vehicles will not be palatable to many sophisticated clients.

Goldberg v. Rosen does represent an important victory for attorneys who assist clients with asset protection planning. It also teaches planners a valuable lesson, that is, engage in an appropriate level of due diligence in relation to your clients to help ensure that you are advising clients to engage in appropriate planning. Notwithstanding the foregoing, despite Mr. Rosen's testimony regarding the application of the holding in *Grupo Mexicano*, we believe it would be unwise to view this case (or *Grupo Mexicano* for that matter) as permitting free transferability of assets in disregard of existing or foreseeable claims that have not been reduced to judgment. Such reliance could place an attorney in a difficult position. This case also fires a warning shot at aggressive creditors counsel and bankruptcy trustees to proceed with caution and ensure that they have a strong basis for asserting claims against other professionals. In this case T and his attorney found themselves on the wrong end of a nasty malicious prosecution law suit and T's attorney on the wrong end of a complaint that was filed with The Florida Bar.

Good practitioners understand full well that we do not collect due diligence on the theory that it will later be used to impeach a client's credibility. Quite the contrary, such due diligence is collected to protect a client's interest and prove why a structure and sound planning should be respected. What transpired in *Niroomand* regarding the use of the affidavit of solvency to discredit D is no different than a tax lawyer providing a letter that explained the risks of a transaction that is later being questioned by a client. Asset protection planning, when done properly, helps the client *and* the attorney. In this case, it only helped the attorney.

15. *Rush University Medical Center v. Sessions*, 2012 WL 4127261 (Illinois).

In *Rush*, the Illinois Supreme Court held that assets in a decedent's self-settled spendthrift trust were subject to the claims of a decedent's creditor under Illinois law. In 1994, Robert W. Sessions ("**D**") created the Sessions Family Trust (the "**Trust**") in the Cook Islands. At the time D created the Trust, he funded it with a 99% interest as a limited partnership in a Colorado limited partnership and real property located in Hinsdale, Illinois (the "**Illinois Real Property**"). At the time of D's death, these assets were valued at more than $16.2 million and $2.7 million, respectively. D was the settlor and a lifetime beneficiary of the Trust. Also, at the time of D's death, there was a trustee in the Cook Islands and two trustees located in Illinois (the "**Illinois Trustees**"). The trust was irrevocable, and authorized the trustees to make distributions to D of both income and principal for his "maintenance, support, education, comfort and wellbeing, pleasure, desire and happiness." The Trust also named D as the trust protector, giving him the absolute power to appoint or remove trustees and to veto any of their discretionary actions. D also had the power to appoint or change beneficiaries, by will or codicil, under the Trust upon his death. The Trust also contained a spendthrift provision that prohibited any trust assets from being used to pay creditors of D or D's estate.

In the fall of 1995, D made an irrevocable pledge to Rush University Medical Center ("**P**") of $1.5 million (the "**Pledge**") for the construction of a new president's house on P's campus in Chicago. D then executed successive codicils to his will providing that any amount remaining unpaid on the Pledge as of his death would be distributed to P at his death. On

September 30, 1996, D sent P a letter stating that the Pledge was "made in order to induce [P] to construct a [presidential residence]."

In reliance on the Pledge, P constructed the president's house at a cost in excess of $1.5 million. The house has been used as a residence for P's president and as a center for conferences and other university events. P named the house the "Robert W. Sessions House" and held a public dedication honoring D for his generosity. D did not make any payments to P toward the Pledge during his lifetime.

In February 2005, D was diagnosed with late-stage lung cancer. D blamed P for not diagnosing the cancer sooner. On March 10, 2005, about six weeks before he died, D executed a new will that made no provision for any payment to P toward the Pledge. On April 19, 2005, six days before D died, he created a new revocable trust and transferred his interest as a general partner in the Colorado limited partnership, valued at $164,205, to it. D died on April 25, 2005.

After D's death, P filed a claim in the probate court against D's estate for payment of the Pledge. D's estate contained less than $100,000. Thus, P filed a supplemental complaint against the Illinois Trustees seeking to reach the assets of the Trust to satisfy the Pledge. (The Cook Islands trustee was never made a party to these proceedings). In particular, P sought to reach the Illinois Real Property, the value of which would likely satisfy its claim against D's estate. The circuit court granted summary judgment to P as to the claim against D's estate.

The circuit court also granted summary judgment in P's favor as to P's claim against the Illinois Trustees, finding that the Trust was void as to P's judgment against D's estate. The circuit court's holding was based on the common law rule that a trust created for the settlor's benefit is void with respect to the settlor's creditors, who may satisfy their claims out of the trust's assets (the "**common law rule**").

The Illinois Court of Appeals disagreed with the trial court and reversed its ruling, holding that the common law rule was abrogated in Illinois by the Fraudulent Transfer Act (the "**FTA**"). Under the FTA:

> A transfer made or 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:
>
> (1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or
>
> (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
>
> (A) 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

> (B) intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they came due.

The Illinois Trustees argued (1) the FTA supplanted the common law rule; and (2) the FTA provided specific mechanisms for proving a fraudulent transfer. The Illinois Trustees argued that the standard of proof under the FTA was not met because the Trust was established and funded without "actual intent to hinder, delay, or defraud any creditor" of D. The Court of Appeals agreed with the Illinois Trustees.

The Illinois Supreme Court held that the FTA did not abrogate the common law rule. Rather, the FTA and the common law rule should be read together. The Court noted that both the common law rule and the FTA had as a general purpose the protection of creditors, but that the common law rule "addresses the specific situation where an interest is retained in a self-settled [spendthrift] trust." The Court cited the Restatement (Second) of Trusts § 156, that the common law rule is "applicable although the transfer is not a fraudulent conveyance . . . and it is immaterial that the settlor-beneficiary had no intention to defraud his creditors." The Court held that the common law and the FTA were supplementary, not contradictory. The Court noted, "[b]oth laws have a general purpose of protecting creditors. But the common law [rule] focuses on the additional matter of the interest *retained* by the settlor of a specific kind of trust, and not simply the fraudulent *transfer* of an asset or the fraudulent *incurring* of a debt, as does the statute" (emphasis in original).

The Court also noted policy reasons for the common law rule to apply. The Court stated:

> [T]he policy behind the common law rule is not limited solely to deterring fraud, as it prevents the distinct injustice of allowing a person to use a trust as a vehicle to park his assets in a way that preserves his own ability to benefit from those assets, while keeping them outside the reach of his present and future creditors. If the law were otherwise, "it would make it possible for a person free from debt to place his property beyond the reach of creditors, and secure to himself a comfortable support during life, without regard to his subsequent business ventures, contracts, or losses."

The Illinois Trustees contended that the common law rule operated only to negate the effect of the spendthrift clause and not the entire trust. Further, the Illinois Trustees also argued that the common law rule did not apply in this case because P did not become a judgment creditor before D's death. They argued that the common law rule only applies to a settlor's lifetime interest, and that when a settlor dies, creditors may not reach assets that could have been, but were not, distributed during life.

The Court responded that the provisions of the Trust gave the trustees of the Trust authority to distribute unlimited amounts of the assets of the Trust to D. Therefore, D's interest in the Trust extended to the entire trust. The Court also noted D's retained power to remove and replace the trustees at will and veto trustee decisions through D's service as trust protector.

The Court also found that D was a debtor of P during his lifetime. The Court stated that it was beyond question that D incurred an obligation to pay P, even if it was to be paid upon his death as a debt. Also, the facts precipitating P's claim occurred during D's lifetime. D clearly incurred the obligation to P during his lifetime. Therefore, the Court held that the common law rule applied despite the fact that P did not obtain a judgment before D's death.

The Court reversed the Court of Appeals and held that the FTA did not displace or abrogate the common law rule in Illinois and that P was a creditor of D for purposes of the common law rule. The Court remanded the case to the circuit court for further proceedings consistent with the Court's holding.

Commentary: The trust in this case was faulty in a number of ways. First, the trust had trustees located in Illinois. Second, D retained an excessive degree of control over the trust. Finally, the trust owned sufficient real estate in Illinois to satisfy P's claim. Even a court in the Cook Islands, let alone an Illinois court, would apply Illinois trust law in regards to a Cook Islands trust owning such real estate. Basic conflicts of law rules in regards to trust law would dictate such a result too. These facts appear to have made it next to impossible for the trustee to adequately present an argument that the court in Illinois should accept the validity of the trust based on conflicts of law rules. *See* Restatement (Second) of Conflict of Laws § 222–223 and Uniform Trust Code § 107. For Illinois law, *see e.g. Aurora Gasoline Company v. Coyle*, 174 F.Supp. 331, 336 (E.D. Ill. 1959).

16. *U.S. Bank v. Rose*, 4 N.E.3d 601 (Ill. App. 3d 2014).

In *U.S. Bank v. Rose* the Illinois 3rd District Court of Appeals (the "**Court**") found that the defendant ("**D**") engaged in fraudulent contracting by failing to inform the plaintiff and creditor ("**C**") that D had established a trust in the Cook Islands (the "**Trust**") and concealing the transfer of significant assets to the Trust in violation of an anti-assignment covenant in an existing promissory note (the "**Note**"). The Court also found that D engaged in actual fraud as D's transfer of significant assets to the Trust would have been material to C's decision to extend an existing loan.

In September 2002, D borrowed $500,000 from C (the "**Loan**") and executed the Note. The Note contained a covenant in which D agreed not to "sell, transfer, mortgage, assign, pledge, lease, grant a security interest in, or encumber any of [D's] assets" without prior written consent from C (the "**Covenant**"). By 2009, C claimed that D was liable to C on various obligations that were in default amounting to approximately $37,000,000.

In February 2009, D formed MHR Estate Plan, LLC, a Delaware limited liability company (the "**LLC**"), and initially funded the LLC with $120,000 cash. Thereafter, D gifted his interest in the LLC to the Trust. The settlement establishing the Trust excluded any Trust assets from being used to satisfy claims or judgments of a court of law outside of the Cook Islands.

In October 2009, D assigned his interests in a mobile home park and two limited liability companies (the "**Interests**") to the LLC. In exchange, D received two 15-year interest-only notes with a combined face value of $2,000,000. D did not report this transfer to C

(which, as noted, C claimed was in violation of the Covenant). C further claimed that the Interests had a fair market value of at least $6,850,000, while D claimed a value of just under $2,000,000.

In April 2010, D and C modified the Loan (the "**Modification**") by adjusting the principal of the Note to $529,000 and extending the Note's maturity date to September 1, 2012. As part of the Modification, D represented to C that he had not previously breached the Covenant.

D later defaulted on other obligations owed to C and C learned of the existence of the Trust and the transfer of the Interests to the LLC. C filed a complaint containing three claims. First, C sought to foreclose on the Note claiming D had defaulted on it. Second, C sought monetary and injunctive relief under the Uniform Fraudulent Transfer Act, claiming D fraudulently transferred the Interests to the LLC. Finally, C sought a monetary judgment based on D's guaranty of a separate loan that had matured. C also sought prejudgment attachment against all of D's assets and all of the LLC's assets. C's motion argued that attachment was justified by four causes under Illinois Attachment Act (the "**Attachment Act**"):

(1) D was not a resident of Illinois;
(2) D had concealed himself from service of process of the underlying complaint;
(3) D and the LLC were about to fraudulently conceal, assign, or otherwise dispose of property as to hinder C as a creditor from collecting on a valid debt; and
(4) D had fraudulently contracted for the Loan.

The trial court held that C failed to establish any element of cause. C appealed, and the Court held that prejudgment attachment should have been granted because C established both an element of cause and a probability of success on the merits.

Under the Attachment Act, to qualify for an order for prejudgment attachment, a plaintiff must establish both cause and a probability of success on the merits. Cause is established if at least one element of cause is found. The Court focused on C's argument that D "fraudulently contracted for" the Loan. To establish this element of cause, a claim of actual fraud must be established. A claim of actual fraud contains five elements, that is:

(1) a false statement of material fact;
(2) by one who knows or believes it to be false;
(3) made with the intent to induce action by another in reliance on the statement;
(4) action by the other in reliance on the truthfulness of the statement; and
(5) injury to the other resulting from that reliance.

The Court found all five elements of actual fraud to be present in this case. It noted that D made a false statement when he represented in the Modification that he had not breached the Covenant because D did not inform C of the existence of the Trust or the transfer of the Interests to the LLC. D had actively concealed the transfer of the Interests. Further, the Court found that D knew that his statement was false because he personally entered into the Covenant and transferred the Interests to the LLC, and the Court determined that D's false statement was made with the intent to induce C to enter into the Modification. Also, the Court stated that C

suffered injury because after transferring the Interests to the LLC D was less likely to pay a potential judgment if he defaulted on the Loan.

The Court also ruled that C had a probability of success as to all three of its claims. First, C provided documentation establishing that D defaulted on the Note, and D did not provide evidence of an affirmative defense to this claim. Second, the Court found a probability of success of C's claim under the Uniform Fraudulent Transfer Act based on the documentation C provided regarding the formation of the Trust by D and transfer of the Interests to the LLC. Third, C also provided documentation establishing that the separate loan had matured and D had guaranteed that loan.

The Court found that C had established both requirements for prejudgment attachment, that is, cause and probability of success. Therefore, the judgment of the trial court was reversed and remanded.

Rose is another example of a desperate individual in financial distress taking inappropriate actions at an inappropriate time and under inappropriate circumstances. It seems highly suspect that a knowledgeable attorney with significant experience in asset protection planning should have assisted the individual with such planning.

Importantly, the underlying planning in the case should not fail because D used a foreign asset protection trust as his vehicle of choice to protect his wealth. Rather, the planning should fail because D's actions were clearly a fraud against the rights of C. Such planning should fail as a fraudulent transfer whether D used a foreign trust, a domestic asset protection trust or any other vehicle as his vehicle of choice to attempt to protect such wealth.

This commentary is based on the facts presented in the reported case in which we recognize that the appellate court reversed the trial court's ruling denying the plaintiff's request for prejudgment attachment. It is our understanding that this case will be appealed to the Illinois Supreme Court as to the issue of prejudgment attachment. Regardless of the outcome of a further appeal, the case does remind planners that we can and should take steps and implement procedures in our practice to avoid assisting individuals similarly situated to D with inappropriate asset protection planning.

The process starts with appropriate collection of due diligence and appropriate analysis under all applicable fraudulent transfer statutes. If your clients fail to pass your due diligence procedures or cannot make a transfer that would be respected by a court without being avoided under an applicable fraudulent transfer statute, do not assist that client with such planning.

Appropriate due diligence procedures include searches using:

1. LexisNexis (Accurint) and Westlaw (CLEAR);
2. Civil and criminal dockets;
3. Search engines such as Google, PIPL, and Wikipedia; and
4. The databases of the Federal Bureau of Prisons and any relevant department of corrections.

Also, such due diligence includes collecting:

1. Copies of state and federal income tax returns that the client filed for the past three years;
2. The name and contact information of the client's:
    a. Accountant;
    b. Money manager, financial consultant and/or stock broker;
    c. Bank;
    d. Personal attorney; and
    e. Two individuals who the client has known and who have known the client personally for many years;
3. A personal financial statement;
4. A description of any litigation in which the client is currently involved;
5. A description of any potential legal claims that the client believes could be asserted against the client;
6. A description of the employment history for the client;
7. A copy of a recent utility or phone bill addressed to the client at the client's current home address;
8. Copies of the client's:
    a. Passport; and
    b. Driver license;
9. The client's full legal name and any other name or names that the client uses or may have used in the past;
10. Whether the client has ever been convicted of a crime;
11. Whether the client has ever been arrested or the subject of a criminal investigation;
12. Whether the client has ever had a professional license revoked;
13. Whether the client has ever been subject to a proceeding that could have resulted in a professional license being revoked;
14. Whether the client has ever been reprimanded or otherwise punished by a state licensing board; and
15. Whether the client has ever been the subject of an investigation by a local, state, federal or other governmental agency.

Asking for this information and requesting your client to respond to such questions and then confirming the accuracy of your client's responses is extremely important.

In addition to the foregoing, in a case like *Rose*, as part of an attorney's due diligence and fraudulent transfer analysis the attorney should review the loan documents and obtain an affidavit of solvency from the client that indicates that the client is not violating such loan documentation.

Collecting due diligence to ensure that an attorney is not assisting a client with a fraudulent transfer should not only protect the attorney by proving the planning was done under appropriate circumstances, it should also protect the client by enabling the attorney, as the client's advocate, to prove to the court that such planning should be respected and accepted by the court.

For further commentary on this case, see Gopman, Beadle & Fox, "*U.S. v. Rose*: Fraudulent Transfer of Assets to Cook Islands Asset Protection Trust," **LISI** Asset Protection Planning Newsletter #244 (May 7, 2014) at http://www.LeimbergServices.com.

17. *Branch Banking & Trust Co. v. Hamilton Greens, LLC*, 2014 WL 1603759 (S.D. Fla. Feb. 26, 2014).

In *Branch Banking & Trust Co. v. Hamilton Greens*, *LLC*, 2014 WL 1603759 (S.D. Fla. Feb. 26, 2014), the United States District Court for the Southern District of Florida denied a motion to hold defendant Richard Bellinger ("**Bellinger**") in contempt of court for failure to pay a monetary judgment entered against him. Bellinger successfully established that he was unable to pay the judgment because prior to the entry of the judgment, he irrevocably transferred his assets to a Cook Islands trust, and that he had no power to compel distributions from the trust.

On September 5, 2006, Colonial Bank issued a loan to Hamilton Greens, LLC ("**Hamilton Greens**") for $3,375,000 for the purchase of real property. Bellinger was a personal guarantor on the loan. On February 5, 2011, Hamilton Greens defaulted on the loan. On May 5, 2011, Branch Banking & Trust Co ("**BB&T**"), as successor-in-interest to Colonial Bank, filed a complaint against Bellinger seeking to enforce the guaranty.

On November 30, 2011, Bellinger created a Cook Islands trust (the "**Trust**"), funded with approximately $1.7 million in assets. BB&T filed an amended motion for final summary judgment on January 3, 2013 which the court granted. Thereafter, the court entered a final judgment against Bellinger for $4,923,797.57, plus post-judgment interest. Bellinger failed to satisfy any portion of the final judgment, and BB&T subsequently filed a motion to hold Bellinger in contempt of court. In support of its motion, BB&T alleged that Bellinger created the Trust in to shield his assets from the final judgment that was ultimately entered against him. BB&T also asserted that Bellinger could not argue it was impossible for him to comply with the final judgment because, by creating the Trust, any inability to comply was self-created.

In opposition to the motion, Bellinger argued that the Trust was lawfully created before any final judgment was entered against him. Bellinger also argued that BB&T had not pursued a fraudulent conveyance action and that BB&T improperly sought to have him held in contempt because he could not pay a civil judgment. Additionally, Bellinger argued that, because he lacked the authority to have assets released from the Trust, he could not be held in contempt as he did not have the ability to comply with the final judgment.

The court noted that *S.E.C. v. Solow*, 682 F.Supp.2d 1312 (S.D.Fla.2010), *In re Lawrence*, 279 F.3d 1294, 1300 (11th Cir.2002), and *S.E.C. v. Yun*, 208 F.Supp.2d 1279 (M.D.Fla.2002) were factually distinguishable from the instant case. Although both *Solow* and *Yun* state that inability to comply with an order is not a defense if the alleged contemnor created the inability, those two cases involved disgorgement orders arising from fraudulent conduct. The court in *Hamilton Greens* found that because federal courts have "broad equitable powers to reach assets otherwise protected by state law to satisfy a disgorgement," such courts have more power to enforce compliance with a disgorgement order than they do with a standard money judgment. *In re Lawrence* involved a turn-over order directing the debtor to

relinquish assets from an offshore trust, however, that case was distinguishable because aspects of the trust in *Lawrence* allowed the debtor to exercise control over certain trust mechanisms.

At an evidentiary hearing on the motion, Bellinger testified that (1) when he created the Trust he did not do so with an intent to evade any judgment from BB&T, (2) he transferred assets to the Trust to protect his future financial security, (3) he did not have the financial ability to pay the judgment, (4) he could not exercise control over the Trust, (5) he attempted to direct the Trust to release funds to partially satisfy the judgment, however the trustee refused, (6) he could not compel payment of the judgment from the Trust, (7) he could not replace the trustee, and (8) he could not revoke the Trust.

In accordance with the opinion of *United States v. Grant*, No. 00–08986–CIV, 2008 WL 2894826, 1 (S.D.Fla. May 27, 2008), the court concluded that Bellinger adequately demonstrated an inability to comply with the final judgment and as a result, Bellinger should not be held in contempt of court. *See also* FDIC v. Lewis, 2016 WL 589666 (D. Nev. Feb. 10, 2016) (denying creditors' motion for mandatory injunction requiring defendants to repatriate assets from off-shore trusts settled in St. Vincent and the Grenadines where the creditor failed to exhaust several available avenues of legal recourse).

18. *TrustCo Bank v. Mathews*, C.A. No. 8374-VCP (Del. Ch. Jan. 22, 2015).

In TrustCo Bank v. Mathews, C.A. No. 8374-VCP (Del. Ch. Jan. 22, 2015), the parties disputed which state's law and which state's statute of limitations applied in regards to alleged fraudulent transfers to tree purported Delaware asset protection trusts. The plaintiffs asserted that New York's six-year or two-years-from-discovery statute of limitations governed the plaintiffs's claims. The defendants argued that either Delaware or Florida law controlled, and that most of the plaintiffs' claims were barred by the identical four-year or one-year-from-notice statutes of limitations adopted by both of those states.

TrustCo Bank ("**TrustCo**") had its principal place of business in New York. TrustCo provided a construction loan to StoreSmart of North Ft. Pierce, LLC ("**StoreSmart**"), a Florida limited liability company. Plaintiff ORE Property Two, Inc. ("**ORE**," and together with TrustCo, the "**Plaintiffs**") was a Florida corporation and the assignee of TrustCo's rights, title, and interest in the StoreSmart loan and related agreements.

Defendant Susan M. Mathews ("**Mathews**") was a manager and member of StoreSmart and she personally guaranteed the loan from TrustCo to StoreSmart. Mathews created three Delaware trusts (the "**Trusts**") on December 21, 2006. Mathews and her children were the discretionary beneficiaries of the Trusts. RBC Trust Company ("**RBC**"), a Delaware corporation was the trustee of the Trusts (RBC, together with Mathews, the "**Defendants**").

TrustCo loaned $9,300,000 to StoreSmart in July 2006 for the purpose of constructing a self-storage facility in St. Lucie, Florida (the "**StoreSmart Loan**"). The StoreSmart Loan was secured by StoreSmart's real estate and other assets. Mathews also executed a personal guaranty of the StoreSmart Loan. StoreSmart defaulted on the loan in April 2011. On April 25, 2011, TrustCo filed a foreclosure action against StoreSmart and Mathews in state court in

Florida. That case resulted in a judgment on July 12, 2011, in favor of TrustCo of roughly $8.2 million plus post-judgment interest (the "**Foreclosure Judgment**").

TrustCo assigned its rights, title, and interest in the StoreSmart Loan, including the related security agreements, and the Foreclosure Judgment to ORE in August 2012. The Plaintiffs, StoreSmart, and Mathews agreed to entry of a deficiency judgment of about $2.3 million and submitted a stipulation to that effect to the Florida court in February 2013, which the court approved (the "**Deficiency Judgment**").

The Plaintiffs alleged that various transfers to the Trusts constituted fraudulent transfers. The Defendants contended that Mathews created the Trusts as part of her estate planning, which was underway before she guaranteed the StoreSmart Loan. For purposes of the pending motion for summary judgment, the court considered only the statute of limitations defense, and the court assumed, without deciding, that the challenged transfers were fraudulent.

The Plaintiffs' complaint challenged several transfers. The most important of these were the transfers of ITRAX stock. Mathews co-founded a company called Corporate Health Dimensions ("**CHD**"). Mathews retired from CHD in 1999. CHD was purchased by ITRAX in 2004. Walgreens later purchased ITRAX in 2008. In two sets of transfers that occurred on January 9 and 22, 2007, Mathews transferred her ITRAX stock to two of the Trusts (generally, the "**ITRAX Transfers**").

Mathews also held an interest in Terra Optima Ventures, LLC ("**TOV**"). TOV was an investment vehicle for a business owned by her son. Mathews sold her interest in TOV to one of the Trusts in March 2010 for $63,000 (generally, the "**TOV Transfer"**). The TOV interest had been valued at $500,000 only a year earlier, therefore, the Plaintiffs contended that the TOV sale was a fraudulent transfer. The Plaintiffs argued that they did not have legally sufficient notice of the ITRAX transfers such that the statute of limitations would begin to run until July 19, 2011. The Defendants contended that the Plaintiffs had: (1) inquiry notice in March and April of 2008; (2) inquiry notice on May 6, 2008; (3) inquiry notice on June 27, 2008; and (4) both inquiry notice and actual notice of the alleged fraudulent ITRAX Transfers in May 2010.

The Plaintiffs filed their initial complaint on March 1, 2013, along with a motion to expedite and a motion for a preliminary injunction. That complaint specifically alleged violations of Delaware's fraudulent transfer statute. On May 28, 2013, the Plaintiffs amended their complaint to remove all references to substantive Delaware law. In an effort to halt all distributions from the Trusts, the Plaintiffs renewed their motion for a preliminary injunction on July 2, 2013.

The parties framed the dispute as whether the Plaintiffs' claims were subject to the statute of limitations under Delaware law or New York law. The Defendants requested that the court treat its submissions on the preliminary injunction as the equivalent of a motion for partial summary judgment on the statute of limitations issue.

The general rule of following the forum state's relevant statute of limitations arguably may be modified by either Delaware's borrowing statute or Delaware's Qualified Dispositions in Trust Act (the "**QDTA**") (12 Del. C. §§ 3570-3576). The court concluded that the applicable statute of limitations should be determinative as to whether the Plaintiffs delayed unreasonably in filing suit more than six years after the allegedly fraudulent transfers took place.

The Defendants sought partial summary judgment that the Plaintiffs' claims for fraudulent transfer as to the ITRAX Transfers were barred by the relevant statute of limitations and laches. The ITRAX transfers occurred in January 2007. An additional disputed transfer, the TOV Transfer, occurred in March 2010. As such, regardless of which statute of limitations applied, the TOV Transfer was not barred by laches and was not subject to the Defendants' motion for partial summary judgment. The Plaintiffs initially filed suit in March 2013. The Plaintiffs also admitted that they discovered the potentially fraudulent ITRAX Transfers by July 19, 2011. Accordingly, the court relied upon the July 19, 2011 date as the date by which the Plaintiffs had discovered the fraudulent transfers under the various statutes of limitations.

The Plaintiffs argued that New York's statute of limitations applied to their fraudulent transfer claims. Under New York law, an action to avoid a fraudulent transfer must be brought within "the greater of six years from the date the cause of action accrued or two years from the time the plaintiff or the person under whom the plaintiff claims discovered the fraud, or could with reasonable diligence have discovered it." N.Y. C.P.L.R. § 213(8). The Defendants contended that Delaware's statute of limitations governed. Under Delaware law, an action to avoid a fraudulent transfer must be brought "within 4 years after the transfer was made or the obligation was incurred or, if later, within 1 year after the transfer or obligation was or could reasonably have been discovered by the claimant." 6 Del. C. § 1309.

The Plaintiffs filed their initial complaint more than six years after the January 2007 ITRAX Transfers occurred. Even under New York law, therefore, the Plaintiffs were required to file within two years of discovery of the allegedly fraudulent transfer. Assuming the undisputed July 19, 2011 discovery date, the Plaintiffs' filing of their claims to avoid the ITRAX Transfers in March 2013 would be sufficiently timely to survive summary judgment if New York law governed. If the Delaware or Florida statutes of limitations applied, the Plaintiffs' fraudulent transfer claims as to the ITRAX Transfers would be substantially outside the relevant limitations period, which would have run by July 19, 2012.

The Delaware Legislature has altered the usual rule of applying the forum state's statute of limitations through 10 Del. C. § 8121 (the "**Borrowing Statute**"), which provides:

> Where a cause of action arises outside of this State, an action cannot be brought in a court of this State to enforce such cause of action after the expiration of whichever is shorter, the time limited by the law of this State, or the time limited by the law of the state or country where the cause of action arose, for bringing an action upon such cause of action. Where the cause of action originally accrued in favor of a person who at the time of such accrual was a resident of this State, the time limited by the law of this State shall apply.

The court concluded that the Borrowing Statute presumptively applied. To determine where the causes of action arose in this case, the court looked to Delaware's conflict of law rules.

According to the court, "Delaware conflict of law rules direct that the Court determine where a plaintiff's claims arose by application of the 'most significant relationship test', as set forth in the Restatement (Second) Conflict of Laws ("**Restatement**")." *TL of Fla.,* 2014 WL 3362367, at *5 (citing *Travelers Indem. Co. v. Lake*, 594 A.2d 38, 47 (Del. 1991)). The Defendants argued that Delaware or, alternatively, Florida had the greatest connection. The Plaintiffs maintained that New York had the most significant relationship. The Restatement factors differ slightly depending on whether the alleged wrong sounds in tort or contract.

The court determined that fraudulent transfers bear some resemblance to both tort and contract claims, so the court addressed both the Restatement's tort and contract factors. The court concluded that the contract factors were either in equipoise between New York and Florida, or only weakly favored New York, and that that the tort factors from the Restatement moderately favored Florida. Delaware had the next strongest connection to the case, with New York having the weakest relationship to it. The court found that Florida had the most significant relationship to this case and that Florida's four year statute of limitations should apply.

Alternatively, the court concluded that Delaware had the next most significant relationship and had essentially an identical statute of limitations. Under either of those scenarios, the Borrowing Statute was held to be inapplicable. As a third alternative, even if New York did have the most significant relationship, the court held that its contacts were not sufficient to make this case a "special circumstance" where application of the Borrowing Statute to preclude use of New York's longer statute of limitations would be inequitable. As such, if New York did have the most significant relationship, the Borrowing Statute would be triggered and Delaware's statute of limitations nevertheless would have applied. Regardless of which of these three states had the most significant relationship with this case, the court concluded that the Plaintiffs would be subject to a statute of limitations equivalent to Delaware's of four years from the time the transfer was made or one year from when discovery of the transfer occurred or reasonably should have occurred, whichever was longer. The Plaintiffs did not file this action relating to the ITRAX Transfers until after the expiration of that period. Therefore, the court held that the Plaintiffs' claims regarding the ITRAX Transfers were barred by laches.

The Defendants further argued that Delaware's statute of limitations applied for the independent reason that the **QDTA** controlled the dispute. The QDTA limits a creditor's available remedies when attempting to avoid a "**qualified disposition**." A qualified disposition is a "disposition by or from a transferor . . . to one or more trustees, at least one of which is a qualified trustee, with or without consideration, by means of a trust instrument." 12 Del. C. § 3570(7). The Defendants contended that the case involved such qualified dispositions. In that regard, the Defendants argued that (1) Mathews was a "transferor" in that she owned property and disposed of that property, (2) that RBC satisfied the definition of a qualified trustee, and (3) the Trusts each were governed by a "trust instrument." 12 Del. C. §§ 3570 (8),(10),(11). The QDTA requires that any claim by a creditor, to avoid a qualified disposition, must be

brought pursuant to 6 Del. C. §§ 1304 or 1305, Delaware's fraudulent transfer statutes. The QDTA also specifically provides that a creditor's claim will be extinguished unless it is brought within the time constraints of 6 Del. C. § 1309, Delaware's statute of limitations for fraudulent transfers. 12 Del. C. § 3572(b)(2). Finally, the QDTA stated that "The Court of Chancery shall have exclusive jurisdiction over any action brought with respect to a qualified disposition." 12 Del. C. § 3572(a). The Defendants argued that the QDTA is a statutory command requiring both that the Plaintiffs file their suit in Delaware, specifically in the Court of Chancery, and that the court apply Delaware's statute of limitations in Section 1309 without regard to any most significant relationship analysis. The Plaintiffs contended, primarily, that the QDTA was substantive law and that, under the most significant relationship test, the court should apply New York law. However, the Court rejected the proposition that New York had the most significant relationship with the case.

The Plaintiffs further argued that the restrictions of the QDTA were inapplicable because Mathews maintained impermissible control over the property transferred to the Trusts. *See* 12 Del. C. § 3571. The court concluded that the Plaintiffs' claims relating to the ITRAX Transfers were barred because of either the most significant relationship choice of law analysis, which pointed to the use of Florida or, perhaps, Delaware law, or Delaware's Borrowing Statute, which required the application of Delaware's statute of limitations even if New York had been found to have the most significant relationship to the instant case. As a result, the court did not resolve the question of whether the QDTA required application of Delaware's fraudulent transfer statute of limitations without regard to the normal choice of law analysis or the Borrowing Statute. However, the court noted that (1) little case law interpreting the QDTA existed, and some of the issues implicated appeared to be issues of first impression, (2) the Court of Chancery had rejected the argument that the QDTA requires suits to avoid a qualified disposition to be brought exclusively in Delaware, and (3) whether or not Mathews maintained impermissible control over the assets transferred to the Trusts such that the QDTA's restrictions would not apply presented a material question of disputed fact not appropriate for summary resolution. For the foregoing reasons, the court declined to reach the question of whether the QDTA required the application of 6 Del. C. § 1309 (the Delaware statute of limitations for fraudulent transfers).

Ultimately, the court concluded that the Plaintiffs were on inquiry notice of the ITRAX Transfers by July 2010, and that the statute of limitations began running at that time. The Plaintiffs filed suit in March 2013, and thus, the Plaintiff's claims relating to the ITRAX Transfers were untimely even under New York's statute of limitations. The court therefore granted the Defendants' motion for partial summary judgment, holding that the ITRAX Transfers were brought after the expiration of the applicable statute of limitations and were barred by laches. For an excellent summary of this case, see "Alan Gassman & Travis Arango on Trustco Bank v. Mathews: Self-Settled, Spendthrift Trust Debtor Victory Involving Delaware Trusts, Allegations of Impermissible Control & Statute of Limitations Analysis," LISI Asset Protection Planning Newsletter #288 (Mar. 31, 2015) at http://www.leimbergservices.com.

XLI. CREDITOR RIGHTS ISSUES WITH CRUMMEY POWERS & OTHER WITHDRAWAL RIGHTS.

A. Crummey Power. A Crummey power (a "**Crummey Power**") is a withdrawal right granted to a beneficiary as a result of a gift to a trust. It permits a beneficiary to demand that the trustee distribute the gift (or cash or other assets of equivalent value in the trust) to the beneficiary. See *e.g.*, *Crummey v. Com'r*, 397 F.2d 82 (9th Cir. 1968); *Halsted v. Com'r*, 28 T.C. 1069 (1957), *acq*., 1958-1 CB 5; *Perkins v. Com'r*, 27 T.C. 601 (1956); *Gilmore v. Com'r*, 213 F.2d 520 (6th Cir. 1954); *Kieckhefer v. Com'r*, 189 F.2d 118 (7th Cir. 1951). Usually, a Crummey Power may be exercised for a limited period such as thirty (30) days following, or until the end of the year in which, the gift creating the Crummey Power is made to the trust. Upon the expiration of the withdrawal period, the property (or value) that was subject to the power continues to be administered and disposed of as provided in the trust agreement. The gift that qualifies for the annual exclusion is the withdrawal right. See Fiore & Ramsbacher, "IRS Takes Tougher Position on Crummey Trusts in TAM," 413 EP 23 (Nov. 1996). A Crummey Power is probably the most common withdrawal power included in trust agreements.

A 5 and 5 power typically grants a beneficiary the right to withdraw property from a trust for an entire year or on a less frequent basis, for example, for one month or one day of the year. Typically, a 5 and 5 power grants a beneficiary the right to withdraw an amount equal to the greater of $5,000 or 5% of the trust corpus valued on an annual basis. The 5 and 5 power is granted to a beneficiary based on the amounts set forth in §§ 2041(b) (2) and 2514(e). The 5 and 5 power is used to give a beneficiary greater access to trust corpus during a year without interference by a trustee and without causing adverse gift or estate tax consequences should the beneficiary elect not to exercise all or any portion of such withdrawal power.

A Crummey Power, a 5 and 5 power or any other unfettered withdrawal power granted over non-self-settled trust property is an *inter vivos* general power of appointment granted to a donee powerholder. At common law an *inter vivos* general power of appointment is considered an authorization to acquire property and not an interest in property. Thus, it is not tantamount to ownership of all or a portion of the underlying trust property. The common law rule contradicts the current transfer tax rules under §§ 2041 and 2514 of the Code for general powers created after October 21, 1942 which treat property subject to a general power of appointment as owned by the donee for estate and gift tax purposes.

1. Restatement of the Law. Section 13.2 of the Restatement of the Law Second Property 2d (Donative Transfers) provides:

> Appointive assets covered by an unexercised general power of appointment, created by a person other than the donee, can be subjected to payment of claims of creditors of the donee, or claims against the donee's estate, but only to the extent provided by statute.

Thus, the common law provides that assets subject to an unexercised general power of appointment cannot be reached by a donee's creditors or creditors of a donee's estate. Nevertheless, § 56 of the Restatement (Third) of Trusts provides a different rule according to

its commentary. Comment (b) of § 56 of the Restatement (Third) of Trusts addresses the rights of a creditor over a beneficiary's presently exercisable general power of appointment, providing in relevant part:

> Trust property subject to a presently exercisable general power of appointment (a power by which the property may be appointed to the donee, including one in the form of a power of withdrawal) because of the power's equivalence to ownership, is treated as property of the donee of the power. It therefore can be subjected to the satisfaction of the claims of the donee's creditors.

Admitted in the text of the commentary, the foregoing rule is not based on current law. Addressing this issue, the commentary goes on to provide in relevant part:

> For an earlier and more limited view of the rights of creditors of donees of general powers of appointment, see Restatement Second, Property (Donative Transfers) §§ 13.1-13.6. See also University National Bank v. Rhoadarmer, 827 P.2d 561 (Colo. App 1991) (applying no attachment rule--i.e., not "property"--to a "5 or 5" power of withdrawal). ***This may eventually prove to be a popular legislative position, but the position of this Comment seems sound as a matter of public policy and common law principle***. (Emphasis supplied).

2. ***Irwin Union Bank and Trust Company v. Long***. In *Irwin Union Bank and Trust Company v. Long*, 312 N.E.2d 908 (Ind. App. 1st Dist. 1974), the plaintiff obtained a judgment against her former husband in a divorce proceeding. The ex-husband was the beneficiary of a trust that gave him "the right to withdraw from the principal once in any calendar year . . . up to four percent (4%) of the market value of the entire trust principal on the date of such notice." The withdrawal right was not cumulative. The issue in the case was whether the assets subject to the withdrawal right could be used to satisfy the plaintiff's judgment. The ex-husband had never exercised his withdrawal right. The court considered the ex-husband's withdrawal right to be a general power of appointment and recognized a distinction between such a power and a vested property right. The court cited 62 Am. Jur. 2d, Powers, § 107, p. 206, that provides:

> Creating a general power of appointment is virtually an offer to the donee of the estate or fund that he may receive or reject at will, and *like any other offer to donate property to a person, no title can vest until he accepts the offer, nor can a court of equity compel him to accept the property or fund against his will, even for the benefit of creditors*. (Emphasis added).

The court followed the common rule in holding that the property in the trust subject to the ex-husband's withdrawal right could not be used to satisfy the claims of his creditors. See also *Quinn v. Tuttle*, 177 A.2d 391 (1962); *Shattuck v. Burrage*, 118 N.E. 889 (1918); *Gilman v. Bell*, 99 Ill. 144 (1881). Several courts have reached the opposite conclusion when considering a creditor's right to reach the assets of a trust subject to a beneficiary's power to invade corpus. See *e.g.*, *Graves v. Jasper*, 28 S.W.2d 463 (1930); *Hipple's Estate*, 30 Pa. Dist. 378 (1921); see also *Croom v. Ocala Plumbing & Electric Co.*, 57 So. 243 (Fla. 1911), providing:

> The deed . . . provides that the trustees named therein shall convey all or any part of the corpus of the property conveyed thereby to the named *cestui que* trustents or to their assigns as they may direct upon their joint request expressed in writing under their hands and seals. This provision in the deed virtually gives the *cestui que* trustents named therein such absolute dominion over the property as to vest in them or their assigns an absolute title to the property, when it vests in them the right to require the trustees, upon their bare request, to convey any part or the whole of the property either to them or to their assigns in fee simple absolute. The general rule is that when one has an interest in property which he may alien or assign, that interest, whether legal or equitable, is liable for the payment of his debts. (Citation omitted).

Notwithstanding the holding of *Croom*, at least one other Florida court appears to recognize the validity of the common law rule in Florida, that is, that assets subject to an unexercised general power of appointment cannot be reached by a donee's creditors or creditors of a donee's estate. See *Estate of Wylie*, 342 So.2d 996 (Fla. 4th DCA 1977). Additionally, *Croom* may actually be an anomaly and inapposite. It can be argued that *Croom* did not involve a trust relationship, but a conveyance of real estate.

B. Statutory Changes to the Common Law Rule. Several states have statutes reversing the common law rule. These statutory provisions typically fall into one of three categories.

1. The First Type of Statute. Section 10-7.2 (**Creditors of the donee; general power presently exercisable**) of the Estates, Powers and Trusts Act in New York provides:

> Property covered by a general power of appointment which is presently exercisable, or of a postponed power which has become exercisable, is subject to the payment of the claims of creditors of the donee, his estate and the expenses of administering his estate. It is immaterial whether the power was created in the donee by himself or by some other person, or whether the donee has or has not purported to exercise the power.

Under this type of statute property covered by a general power of appointment may be used to satisfy the claims of a donee's creditors if the power is presently exercisable regardless of whether it is exercised.

2. The Second Type of Statute. Section 556.123 (General powers; creditors' rights in appointable interests) of the Michigan Statutes provides:

> (1) If the donee has a general power of appointment, any interest which the donee has the power to appoint or has appointed is to be treated as property of the donee for the purposes of satisfying claims of his creditors, as provided in this section.
>
> (2) If the donee has an unexercised general power of appointment and he can presently exercise such a power, any creditor of the donee may by appropriate

> proceedings reach any interest which the donee could appoint, to the extent that the donee's individual assets are insufficient to satisfy the creditor's claim. If the donee has exercised the power, the creditor can reach the appointed interests to the same extent that under the law relating to fraudulent conveyances he could reach property which the donee has owned and conveyed.

See also § 1390.3 of the Cal. Civ. Code (West 1982), Minn. Stat. § 502.70 (1982), Ok. Stat. tit. 60 § 299.9 (1981), and Wisc. Stat. § 702.17 (1979-80). Under this type of statute, property covered by a general power of appointment may be used to satisfy the claims of a donee's creditors if the donee's assets are insufficient to satisfy such claims and regardless of whether the power is exercised.

3. The Third Type of Statute. Section 59-05-39 of the North Dakota Statutes provides:

> **Estates changed into fee.** When an absolute power of disposition, not accompanied by any trust, is given to the owner of a particular estate for life or years, such estate is changed into a fee, absolute in favor or creditors, purchasers, and encumbrances, but subject to any future estates limited thereon, in case the power should not be executed or the property should not be sold for the satisfaction of debts.

See also Ala. Code §§ 35-4-291 and 35-4-292 (1977), N.D. Cent. Code § 59-05-39 (1960), Tenn. Code § 66-1-106 (1982) and Dist. of Col. Code § 45-105 (1981). Under this type of statute, property covered by a general power of appointment that is an absolute power of disposition is considered ownership of the fee in the donee.

4. Analysis. The question in jurisdictions that have reversed the common law rule is the extent of a creditor's rights following the lapse of a Crummey Power or other withdrawal power. For instance, in such a jurisdiction, a powerholder may be treated as a settlor of the trust. If the jurisdiction has not reversed the common law self-settled trust doctrine, the powerholder's creditors may be able to reach all or a portion of the assets in the trust to satisfy the powerholder's debts. If a powerholder's creditors could reach the assets in the trust previously subject to a powerholder's lapsed Crummey Power rights or other withdrawal power, some of the tax benefits of using Crummey Trusts would be put into question. See Rev. Rul. 76-103, 1976-1 C.B. 293; see also *Outwin v. Com'r*, 76 T.C. 153 (1981); *Paolozzi v. Com'r*, 23 T.C. 182 (1954); *Estate of Paxton v. Com'r*, 86 T.C. 785 (1986).

C. Statutory Protection for Lapsing Crummey Powers within Annual Exclusion Limits or 5 and 5 Exemption. Arizona, Florida, Tennessee, Texas as well as other states have statutes that codify the common law self-settled trust doctrine. Nonetheless, each of these statutes contains a provision that protects a powerholder's interest related to the portion of the trust formerly subject to the powerholder's withdrawal power from the claims of a powerholder's creditors if a powerholder's Crummey Power rights or other withdrawal power rights that have lapsed are limited to not more than the greater of an amount equal to the 5 and 5 exemption or the annual exclusion. For example, § 112.035(e) of the Texas Code provides:

> A beneficiary of a trust may not be considered a settlor merely because of a lapse, waiver, or release of the beneficiary's right to withdraw a part of the trust property if the value of the property that could have been withdrawn by exercising the right of withdrawal in any calendar year does not exceed at the time of the lapse, waiver, or release the greater of the amount specified in:
>
> (1) Section 2041(b)(2) or 2514(e), Internal Revenue Code of 1986; or
>
> (2) Section 2503(b), Internal Revenue Code of 1986.

See also Az. Stat. § 14-7705; F.S. § 736.0505(2)(b) (2007); Tenn. Code Ann. 35-15-505.

This is the same rule in the UTC. Subsection (b) of Section 505 of Article 5 of the UTC (related to self-settled trusts) provides in relevant part:

> For purposes of this section: (1) during the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power; and (2) upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in Section 2041(b)(2) or 2514(e) of the Internal Revenue Code of 1986, or Section 2503(b) of the Internal Revenue Code of 1986, in each case as in effect on [the effective date of this [Code]] [, or as later amended].

Section 603(b) of the UTC also addresses the rights of a donee of a power of withdrawal over assets in a trust. It provides:

> During the period the power may be exercised, the holder of a power of withdrawal has the rights of a settlor of a revocable trust under this section to the extent of the property subject to the power.

Section 603(a) of the UTC provides:

> While a trust is revocable [and the settlor has capacity to revoke the trust], rights of the beneficiaries are subject to the control of, and the duties of the trustee are owed exclusively to, the settlor.

According to the comments to Section 603, a holder of a power of withdrawal has the same powers over the trust as a grantor of a revocable trust. Such treatment is necessary because of the holder's comparable power to control the trust.

Section 103(11) of the UTC defines the term "**power of withdrawal**." It provides that the term means a general power of appointment that is presently exercisable by the donee of the power except a power that can be exercised by a trustee and limited by an ascertainable standard or a power that may be exercised by another person only with the consent of the trustee or a person holding an adverse interest.

Section 736.0103(7) of the new Florida Trust Code defines a general power of appointment as a power "exercisable in favor of the holder of the power, the power holder's creditors, the power holder's estate, or the creditors of the power holder's estate."

Section 736.0103(12) of the FTC provides:

> "**Power of withdrawal**" ***means a presently exercisable general power of appointment other than a power***: (a) Exercisable by a trustee and limited by an ascertainable standard; or (b) ***Exercisable by another person only upon consent of the trustee or a person holding an adverse interest***.

Section 736.0505(2) of the FTC provides in relevant part:

> (a) During the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power.
>
> (b) Upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust ***only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in***:
>
> 1. Section 2041(b)(2) or s. 2514(e); or
> 2. Section 2503(b) and, if the donor is married at the time of the transfer to which the power of withdrawal applies, twice the amount specified in s. 2503(b),
>
> of the Internal Revenue Code of 1986, as amended.

Sections 736.0103(12) and 736.0505(2) of the FTC appear to open a Pandora's box containing numerous issues. Some of these issues can be addressed through careful drafting of Crummey withdrawal provisions and "five and five" withdrawal power provisions. Other issues may remain unresolved for many years if not addressed by case law or amendments to the new trust code. These issues include, but are not limited to, the following:

1. **Hanging Powers**. When a trust contains "**Hanging Power Provisions**" annual exclusion gifts may be made to the trust subject to Crummey Powers granted to one or more beneficiaries. After a limited period the portion of any transfer (or transfers) subject to a Crummey Power which may lapse within the 5 and 5 exemption under §§ 2041(b)(2) and

2514(e) is directed to lapse. That is, such portion of a beneficiary's share of the trust subject to withdrawal that does not exceed "the greater of $5,000 or 5 percent of the aggregate value of the assets out of which, or the proceeds of which, the exercise of the lapsed powers could be satisfied." The remainder of such transfer (or transfers) continues to be subject to the beneficiaries' Crummey Power rights. The trust is designed so that the "hanging" amount will lapse (in whole or in part) within the 5 and 5 exemption at a future time. In trusts that contain Hanging Power Provisions it may be critical to ascertain the portion of a withdrawal power that is permitted to lapse or has previously lapsed at a particular time to resolve a controversy involving a creditor's rights to trust assets.

A crucial question is whether §§ 2041(b)(2) and 2514(e) of the Code (which are specifically referenced in Section 505(b) of the UTC [See also F.S. §736.0505(2)]) provide a sufficient basis for a court or litigants to determine the portion of a trust that is subject to the continuing withdrawal rights of an individual possessing a withdrawal power. Surprisingly, the answer to this question may be determined by reference to Revenue Rulings, Private Letter Rulings, Technical Advice Memoranda, Chief Counsel Advice, and Field Service Advice published by the Service. Another important question is whether this is appropriate authority for a state court to rely upon to make such a determination. In other words, is it sensible to allow federal tax law and the interpretation of the Code by the Service through its published documents to have such a significant effect on state creditor's rights law?

Section 2514(e) of the Code provides that the lapse of a general power of appointment during the life of an individual possessing the power is considered a release of the power. This rule, however, is only applicable with respect to the lapse of ***powers*** during any calendar year to the extent the value of property that could have been appointed exceeds the greater of (a) $5,000 or (b) 5% of the ***aggregate value of the assets out of which, or the proceeds of which***, the exercise of the lapsed ***powers*** could be satisfied. See also Reg. § 25.2514-3(c)(4). The 5 and 5 exemption applies on an annual basis. According to the Service, each donee is granted one 5 and 5 exemption each calendar year, regardless of the number of trusts in which a donee is granted a Crummey Power or the number of annual exclusion gifts made to a trust. See Rev. Rul. 85-88, 1985-2 CB 201; and GCM 39371.

A donee may possess multiple Crummey Powers if such donee is a beneficiary of more than one trust. Additionally, successive contributions to a single trust may be made in the same calendar year. Thus, "multiple" or "successive" lapses may occur in a single year. Furthermore, multiple and successive lapses may occur under a trust or trusts created by the same or different grantors or to which different donors make gifts.

In Revenue Ruling 85-88, 1985-2 CB 201, the Service addressed the tax consequences of multiple and successive lapsing Crummey Powers in a single calendar year. The ruling provided two fact situations. In situation 1, G established an irrevocable trust in March of 1982 under which S was given all of the income for life and the remainder was given to C. S was also given a Crummey Power "to withdraw up to $5,000 from each contribution made by any donor to the trust." S had the right to exercise the Crummey Power for sixty (60) days following notice of the transfer to the trust. G transferred $5,000 to the trust on the date it was established, and S did not exercise the Crummey Power. In September of 1982, G transferred an additional $5,000 to the trust, and S also permitted that Crummey Power to lapse. In

situation 2, G established two irrevocable trusts in February 1982 with the same terms as the trust in situation 1. G transferred $5,000 to each trust at the time the trusts were established. S was notified of each transfer but failed to exercise either Crummey Power. The ruling held that S was entitled to only one 5 and 5 exemption in 1982 and providing multiple 5 and 5 exemptions "would undermine the statutory purpose to limit the exemption provided by section 2514(e)." Hence, in both situations, S was treated as the transferor of $5,000 of property to the trusts in 1982. The ruling noted that there is no indication Congress intended the holder of multiple noncumulative general powers should be granted more than one 5 and 5 exemption for any calendar year. The ruling also noted that the statute uses the term "***powers***" in the plural. In determining what the "***aggregate value of the assets out of which***" the exercise of the lapsed powers could be satisfied, the ruling explained that:

> [T]he 5 percent test . . . is stated in terms of '***the aggregate value of the assets out of which . . . the exercise of the lapsed powers could be satisfied***.'. . . The 5 percent test is based on the value of the assets subject to the power at the time of the lapse of the power. [Citation omitted]. Where the donee has more than one noncumulative withdrawal power in the same trust that lapses in a calendar year, the 5 percent test is based on the maximum amount subject to the donee's withdrawal power on the date of lapse of any such power during the calendar year. ***Where the donee has noncumulative powers to withdraw property from two or more trusts, the 5 percent test is applied by aggregating the amount determined pursuant to the preceding sentence for each such trust with respect to which the withdrawal power has lapsed during the calendar year***. (Emphasis added.)

One of the most important lessons from this ruling is to always include Crummey Power provisions in a trust since it may be possible to aggregate the value of multiple trusts for purposes of determining the amount of a 5 and 5 exemption granted to an individual possessing a withdrawal right. Such aggregation may enable an outstanding Crummey Power in a new trust to lapse within the 5 and 5 exemption, even if the trust contains a corpus of minimal value.

The ruling also provided the following important examples that illustrate the foregoing points:

> Ex. 1: B has a withdrawal power over $20,000 from Trust A which lapses on 6/1. On 6/1 the corpus of Trust A has a fair market value of $300,000. B has second withdrawal power over $20,000 from Trust A which lapses on 12/1 of the same year. On that date the corpus of Trust A has a value of $400,000.

Based on the above facts, the ruling stated "***the maximum amount of trust assets subject to B's withdrawal power at the time of any lapse during the year would be $400,000***." Thus, it held that the amount of B's 5 and 5 exemption for the year is measured by the $400,000 corpus. $400,000 is the maximum amount of Trust A assets subject to B's withdrawal power during the calendar year.

> Ex. 2: B has a withdrawal power over $20,000 from Trust A which lapses on 6/1. On 6/1 the corpus of Trust A has a fair market value of $300,000. B has a second withdrawal power over $20,000 from another trust, Trust C, which lapses on 12/1 of the same year. On that date the corpus of Trust C has a value of $400,000.

Based on the foregoing facts, the ruling stated "if B's second withdrawal power...is exercisable only with respect to a second, separate trust, B's 5-and-5 exemption for the year would be $35,000 (5% x $700,000)."

Several issues remain unanswered regarding the 5 and 5 exemption after Revenue Ruling 85-88. The facts of Revenue Ruling 85-88 involved one grantor and transfers to the same trust or to trusts with identical terms. It is still uncertain how the 5 and 5 exemption will be applied in cases involving transfers to a single trust with multiple donors, transfers to multiple trusts with the same dispositive provisions and different donors; or transfers to multiple trusts with different dispositive provisions and the same or different donors. It appears that the Service will permit a beneficiary only one 5 and 5 exemption in any calendar year regardless of the identity of the donor, the grantor or the number of trusts in which a donee is a beneficiary. See *e.g.*, Slade, 210-4th T.M., *Personal Life Insurance Trusts* at p. A-13, providing:

> Although the facts in Rev. Rul. 85-88 were limited to transfers by the same grantor to multiple trusts and the IRS appeared to be concerned about the abuse of the 5 and 5 exemption through the creation of multiple trusts by the same grantor, the language in this and other rulings suggests that the IRS may take the position that a trust beneficiary has only one '5 and 5' exemption even though he or she is the beneficiary of multiple trusts created by different donors. First, the IRS noted in GCM 39371 (June 21, 1985) that §2514(e) grants the "5 and 5" exemption, regardless of the number of withdrawal powers. Second, to allow an unlimited number of exemptions in a calendar year, the IRS stated, would invite the abuse Congress sought to avoid. Finally, the IRS noted that the allowance of multiple exemptions would frustrate congressional intent to provide a limited exemption.

Thus, prudence dictates structuring a Crummey Trust (or any other trust containing lapsing withdrawal rights) on the assumption that a donee is only permitted one 5 and 5 exemption despite the potential for receiving a number of annual exclusion gifts from multiple donors. The legislative history of the 5 and 5 exemption appears to support a narrow reading of the exemption. See S. Rep. 382, 82d Cong., 1st Sess. (1951), providing:

> The bill also provides that the failure to exercise a preexisting power shall not be deemed an exercise of the power. The House bill provided that the failure to exercise a future power which lapses during the life of the holder of the power shall not be deemed an exercise or release of the power. An amendment by your committee modifies this latter provision so as to exempt from estate and gift tax only limited amounts of property subject to lapsed powers. The committee amendment provides an annual exemption with respect to lapsed

> powers equal to $5,000 or 5 percent of the trust or fund in which the lapsed power existed, whichever is the greater. Thus, for example, if a person has a noncumulative right to withdraw $10,000 a year from the principal of a $200,000 trust fund, failure to exercise this right will not result in either estate or gift tax with respect to the power over $10,000 which lapses each year prior to the year of death. At his death there will be included in his gross estate the $10,000 which he was entitled to draw for the year in which his death occurs, less any sums which he may have taken on account thereof while he was alive during the year. However, if in the above example, the person had had a right to withdraw $15,000 annually, failure to exercise this right in any year prior to the year of death will be considered a release of a power to the extent of the excess over 5 percent of the trust fund. *Since the problem of the termination or lapse of powers of appointment during life arises primarily in the case of dispositions of moderate-sized properties where the donor is afraid the income will be insufficient for the income beneficiary and therefore gives the income beneficiary a noncumulative invasion power, it is believed that the exemption provided in the committee amendment ($5,000 or 5 percent of the principal) will be adequate to cover the usual cases without being subject to possible abuses*. (Emphasis added.)
>
> Additionally, GCM 39371, a companion document to Revenue Ruling 85-88, states:
>
> it is obvious that allowing multiple exemptions would frustrate the Congressional intent to provide a limited exemption...If we adopted the view of the proposed revenue ruling we would allow a donor, by structuring two $5,000 gifts as contributions to two identical trusts to gift his donee two 5 and 5 exemptions instead of one. Other donors could conceivably create more than two trusts and thus add potential for abuse.

Thus, GCM 39371 determined that the "5 and 5 exemption does not apply separately to each trust."

Under Section 505(b) of the UTC, beneficiaries with identical withdrawal powers over the same trust and even an identical creditor may obtain drastically different results under this provision if a creditor attempts to seize property subject to a beneficiary's withdrawal rights.

> **Example**: A and B are first cousins who share common maternal grandparents. Each is the beneficiary of a trust ("**Trust 1**") that was settled by their maternal grandparents. This trust contains Crummey withdrawal provisions granting A and B withdrawal rights over gifts to the trust by an their maternal grandparents.
>
> A's paternal grandparents have previously established a trust ("**Trust 2**") for the benefit of A and their other grandchildren that contains Crummey Power provisions.
>
> A and B were involved in an unsuccessful business venture. A and B are both personally liable on debt related to the venture. The lender obtained a judgment

against A and B relating to the debt and seeks to attach A and B's personal assets to satisfy the debt.

Trust 1 has a corpus with a fair market value of $80,000 all derived by gifts from A and B's maternal grandparents. A and B are the only living beneficiaries of Trust 1 who possess withdrawal rights over gifts from their maternal grandparents. To avoid adverse gift tax consequences, Trust 1 contains "hanging power" provisions. In February of 2007, A and B's maternal grandparents gifted $40,000 to Trust 1 and in February of 2008, they gifted $40,000 to Trust 1.

Trust 2 has a corpus with a fair market value of $10,000,000. Although A's paternal grandparents have not made any gifts to Trust 2 in several years, they decided to gift $200 to Trust 2 in January of 2007 and in January of 2008. Under the terms of Trust 2, A and his cousin C are each given the right to withdraw one-half of each $200 gift in 2007 and 2008 for a period of thirty days immediately following the gift.

Under the terms of Trust 1, a Crummey power will lapse as to a particular gift not less than thirty days following the gift and as to all outstanding withdrawal rights only at such time and in such amount as will not cause a taxable lapse under §§ 2041(b) and 2514(e) to an individual holding such a power.

Possessing a judgment against A and B, pursuant to Section 505(b) of the UTC the lender attempts to seize the assets of Trust 1 that are subject to an outstanding withdrawal right by both A and B in September of 2008.

Under Revenue Ruling 85-88, it appears that the assets of Trust 1 and Trust 2 can be aggregated when determining the amount of A's 5 and 5 exemption. Accordingly, the trustee of Trust 1 can argue that none of the $80,000 corpus is subject to withdrawal by A. In contrast, $30,000 of the corpus of Trust 1 is currently subject to withdrawal by B according to the Hanging Power Provisions. Of course, as previously mentioned, Revenue Ruling 85-88 involved a single grantor whereas the foregoing example involves multiple grantors. Thus, it is not guaranteed that a portion of Trust 1 cannot be attached by a judgment creditor of A. There may be many other examples involving Crummey Powers that will create uncertainty and potential inequity under Section 505(b) of the UTC.

2. Unintentionally Tolling Withdrawal Period. Some Crummey powers contain provisions that provide that a withdrawal period as to a particular gift will only terminate within a certain period following the time a trustee sends written notice to a beneficiary of such beneficiary's withdrawal right. In addition to the problems this can create in other areas for a trustee that neglects to send written notice to a beneficiary, such a provision can create serious concerns under Section 505(b) of the UTC, especially if the trustee neglects to send notice for several years. It is important to ensure that Crummey Power provisions are drafted to provide that the withdrawal period commences on the date the gift is made to the trust and terminates within a certain period following the gift rather than basing the termination date on the time a trustee sends written notice.

3. Period of Withdrawal. The question of how long an unfettered withdrawal right should remain outstanding for a gift to a Crummey trust to qualify for the annual exclusion is also an important issue to consider under Section 505(b) of the UTC. In *Cristofani v. Commissioner.*, 97 T.C. 74 (1991), the Tax Court has approved a fifteen day withdrawal period as sufficient to create a present interest. In the same year as *Cristofani*, TAM 9141008 held that twenty days was too short a withdrawal period. *Cristofani* was not the first case to rule favorably on a withdrawal period of less than thirty days. *Crummey* permitted gifts in trust to qualify as present interests based on sixteen day and twelve day withdrawal periods. In PLRs 7946007 and 8022048, a three day period was insufficient. Four days or less was insufficient in TAM 9628004, while thirty-one days was sufficient in PLR 8121069. However, four days appeared to be sufficient in PLR 7922107, and no one at the Service seemed to be concerned with only a three day withdrawal period in TAM 9532001. A thirty day period was sufficient in PLRs 200130030 (withdrawal period runs for thirty days following notice of the gift), 199912016, 9030005, 8712014, 8134135, 8024084, 8006048, and 8004172. In PLR 8103074, the Service held that gifts subject to a withdrawal period that would terminate four weeks after the date of the transfer would qualify for the annual exclusion. Eleven days was sufficient in PLR 8111123. According to this ruling, the annual exclusion would be allowed "provided that the transfer of assets to the trust is made on or before December 21 of the calendar year." (Under the Crummey Power provisions in the trust, the withdrawal right would lapse at the end of the year.) In this ruling the Service refused to express any opinion on qualification for the annual exclusion if a gift is made during the last ten days of the calendar year. Perhaps Crummey Power provisions should always ensure that the withdrawal period remains open for at least a thirty day period regardless of the day of the year a gift is made to the trust. Regardless of the withdrawal period selected, the period used in Crummey trusts must be carefully considered in light of Section 505(b) of the UTC.

There is no time requirement or controversy for that matter involving the period that a 5 and 5 power must remain outstanding. The authors have reviewed trust documents with a broad range of periods granted to a beneficiary to exercise a 5 and 5 power, some for as long as an entire year and others for as short as one day. Prudence would dictate drafting 5 and 5 powers with short withdrawal periods in light of Section 505(b) of the UTC.

4. Failure to Qualify for Annual Exclusion. If the Service holds that a gift to a trust containing Crummey Power provisions will not qualify for the annual exclusion because of a "mechanical" issue with the Crummey Power Provisions, because of a reciprocal gift issue or for another reason, how will this affect a creditor's rights? See *e.g.*, Rev. Rul. 85-24, 1985-1 C.B. 329 and PLR 8022048. There may be disparate tax treatment and creditor's rights treatment, that is, a gift might not qualify for the gift tax annual exclusion, however, a creditor may still be able to seize trust property subject to a withdrawal right under Section 505(b) of the UTC.

5. Power Exercisable Only with Consent of a Non-Adverse Party. As previously noted, Section 505(b) of the UTC does not apply to powers of withdrawal that are exercisable by a trustee and limited by an ascertainable standard or that may be exercised by another person only with the consent of the trustee or a person holding an adverse interest. Suppose a beneficiary possessing such a continuing withdrawal right can only exercise such right following the initial limited period with the consent of an independent trustee (that is, a

non-adverse party). Will the amount subject to the beneficiary's continuing withdrawal right (albeit only with the consent of the independent trustee) be subject to the potential claim of a creditor of an individual holding a power of withdrawal from the trust? The beneficiary's continuing withdrawal right no longer constitutes a "power of withdrawal" under the definition of a power of withdrawal in Section 103(11) of the UTC. Equally important, however, the lapse of the beneficiary's unfettered withdrawal right will not constitute a taxable lapse under §§ 2041(b)(2) and 2514(e). § 2514 and Regs. § 25.2514-3(b)(2) and (3). The comments to Section 505 of the UTC provide "If the power is unlimited, the property subject to the power will be fully subject to the claims of the power holder's creditors, the same as the power holder's other assets." In this particular instance, however, the power is no longer "unlimited" and appears subject to argument that the power has "lapsed" for creditor's rights purposes within the parameters of the statute.

6. Fraudulent Transfers. Does an applicable fraudulent transfer statute apply to the lapse of a Crummey withdrawal right? The comments to Section 505 of Article of the UTC provide:

> For powers limited either in time or amount, such as a right to withdraw a $10,000 annual exclusion contribution within 30 days, this subsection would limit the creditor to the $10,000 contribution ***and require the creditor to take action prior to the expiration of the 30-day period***. (Emphasis added.)

While the comments appear to take the position that the lapse of a limited withdrawal power held by a beneficiary will not be subject to avoidance under an applicable fraudulent transfer, there is no specific language in Section 505(b) negating the application of the fraudulent transfer rule in such circumstances. Thus, an ambiguity exists as to how an applicable fraudulent transfer rule will apply to a portion of a trust previously subject to a beneficiary's withdrawal right. Will the application of the fraudulent transfer rule apply differently where a lapse occurs, that is, a beneficiary's withdrawal power lapses as provided under the terms of the trust agreement as opposed to a situation where a beneficiary affirmatively waives his or her withdrawal right? The language in Section 505(b) appears to treat both situations in the same manner. Perhaps the best argument that a fraudulent transfer statute should not apply is found in the language of the statute providing that "the holder is treated as the settlor of the trust *only to the extent*…" Nevertheless, without language in the statute expressly negating an applicable fraudulent transfer statute, a creditor may prevail on this theory.

7. Income Tax Consequences. What are the income tax consequences related to Section 505(b) of the UTC? In several private letter rulings the Service takes the position under §§ 678(a)(1) and (a)(2) that a powerholder is treated as the owner for income tax purposes of all or a portion of a trust since the powerholder possesses or possessed a Crummey Power over such property. See *e.g.*, PLRs 201216034, 201039010, 200747002, 200238012, 200238011, 200238010, 200238009, 200238008, 200238007, 200238006, 200238005, 200238004, 200235009, 200235008, 200235007, 200147044, 200022035, 200011054, 200011055, 200011056, 200011058, 9812006, 9810008, 9810007, 9810006, 9809004, 9809005, 9809006, 9809007, 9809008, 9801025, 9745010, 9739026, 9625031, 9541029, 8142061, 8521060, 8545076, 8809043, 8805032, 8701007, 9034004, 9320018 and

9311021. See also Rev. Rul. 67-241, 1967-2 CB 225.

Under § 678(a), an individual who is not the grantor is treated as the owner of any portion of a trust if such individual has a power exercisable solely by the individual to withdraw trust corpus or the income therefrom. Additionally, if that person previously released or modified his or her withdrawal power and thereafter retains such control over the trust which would otherwise make the grantor the owner under §§ 671 to 677 of the grantor trust rules, § 678(a) will continue to treat the Powerholder as the owner. Use of the term "control" in § 678 should be read in light of the grantor trust rules and viewed with an expansive meaning (*i.e.*, "within the principles of sections 671 to 677").

Section 678(a)(2) uses the terms "release" and "modify" which seem to indicate the need for an overt act on the part of the powerholder for the statute to apply. Conversely, most Crummey Powers generally lapse by operation of the terms of the trust instrument. Compare also, §§ 2041(b)(2) and 2514(e), provisions which specifically use the term "lapse." Under these provisions it would seem **inaction** may be necessary to claim the desired tax benefits.

Section 678(b) provides that the general rule of § 678(a) shall not apply with respect to a power over income if the grantor of the trust is otherwise treated as the owner under any other provision in the grantor trust rules. Consequently, § 678(b) resolves any potential overlap in favor of treating the grantor, rather than a beneficiary, as owner of the trust income. Thus, assuming any other provision of the grantor trust rules initially causes the grantor to be treated as the owner of a trust, the existence of a Crummey Power or a 5 and 5 power in one or more beneficiaries should not change this treatment due to the ordering rule of § 678(b). See *e.g.*, PLRs 200729005, 200729007, 200729008, 200729009, 200729010, 200729011, 200729013, 200729014, 200729015, 200729016, 200730011, 200606006, 200603040, 9321050, 9309023, 9141027, 8308033, 8326074, 8142061, 8103074, and 7909031. For a more detailed analysis of this subject see Gopman & Rizzo, "PLRs 200730011, 200729005, 200729007, 200729008, 200729009, 200729010, 200729011, 200729013, 200729014, 200729015, 200729016 – Grantor Treated as Owner of Entire Trust," Steve Leimberg's Estate Planning Newsletter # 1157 (August 1, 2007) and "PLR 200730011- Grantor Trust Ruling," Steve Leimberg's Estate Planning Newsletter # 1156 (July 31, 2007). See also e.g., PLR 201235006 ("Under § 678(a), the withdrawal rights granted to the beneficiaries result in the treatment of the beneficiaries as owners of the portions of [the trust] subject to their respective withdrawal powers, unless as provided in § 678(b), the grantor is treated as the owner. If it is determined that [the trust] is a grantor trust under §675(4) with respect to Taxpayer, then it is a grantor trust in its entirety with respect to Taxpayer notwithstanding the withdrawal rights held by the beneficiaries that would otherwise make them owners under § 678(a)").

However, the holding of two earlier private letter rulings, 8142061 and 8545076, may be based on a different theory from the rulings cited above. Some commentators believe these earlier rulings could be read to hold that a powerholder who allows a Crummey Power to lapse is treated as having withdrawn the assets subject to the withdrawal right and to have recontributed such assets to the trust. See Early, "Income Taxation of Lapsed Powers of Withdrawal: Analyzing their Current Status." 62 J.Tax'n 198 (April 1985); Mulligan, "Defective Grantor Trusts Offer Many Tax Advantages," 19 E.P. 131 (May/June 1992). Under this theory, a Powerholder is treated as the new grantor of the trust upon the lapse of the

Crummey Power. Furthermore, the original grantor cannot be taxed on the income earned by a grantor trust after the lapse because he is no longer considered the grantor of the trust. This "recontribution" theory has merit under Section 505(b)(1) of the UTC where the beneficiary possessing the withdrawal power "is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power." Perhaps the counter argument to this theory is that Section 505(b)(2) of the UTC provides "upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust ***only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in Section 2041(b)(2) or 2514(e)…or Section 2503(b).***" Nevertheless, this argument may be weak because Section 505 clearly changes the common law rule that was fundamental to the manner in which general powers of appointment have been treated for creditor rights purposes. Both Crummey Powers and 5 and 5 powers are *inter vivos* general powers of appointment granted to a beneficiary of a trust. At common law an *inter vivos* general power of appointment is considered an authorization to acquire property and not an interest in property. It is not considered the same as ownership. See *e.g.*, *Irwin Union Bank and Trust Company v. Long*, 312 N.E.2d 908 (Ind. App. 1st Dist., 1974). Section 13.2 of the Restatement of the Law Second Property 2d (Donative Transfers) reflects this common law rule. It provides:

> Appointive assets covered by an unexercised general power of appointment, created by a person other than the donee, can be subjected to payment of claims of creditors of the donee, or claims against the donee's estate, but only to the extent provided by statute.

Thus, the common law provides that assets subject to an unexercised general power of appointment cannot be reached by a donee's creditors or creditors of a donee's estate. But see § 56 Restatement 3rd of Trusts. See also *In re Estate of Wylie,* 342 So 2d 996 (Fla. 4th DCA 1977). This case involves a general power of appointment given a wife by her husband's will over a testamentary trust created in favor of the wife. The Court held that the wife's power of appointment was an authority to dispose of property and not an interest in property. As authority it cites the relation back doctrine from the Restatement of Property. It provides "[t]he donee of the power of appointment likewise has the power to create interest in other persons; but it is the underlying dogma of the law of powers of appointment that such interest constitute transfers from the donor of the power, not from the donee." The common law rule contradicts the current transfer tax rules under §§ 2041 and 2514 for general powers created after October 21, 1942 which treat property subject to a general power of appointment as owned by the beneficiary possessing such power. Thus, estate planners must carefully consider the income tax consequences of Section 505(b) on the use of Crummey Powers and 5 and 5 withdrawal powers.

8. How Much Does Reference to Section 2503(b) Include? Florida recently amended F.S. § 736.0505(2)(b)2 by adding the following language:

> Section 2503(b) **and, if the donor is married at the time of the transfer to which the power of withdrawal applies, twice the amount specified in s. 2503(b)**.

This amendment was made to clarify that the reference to § 2503(b) includes amount that ***could*** be subject to gift splitting under § 2513. It is now purportedly clarified the operation of the section is based on marital status rather than marital status ***coupled*** with a subsequent election/consent by the donor's spouse to permit the donor to split the donor's gifts with the donor's spouse.

After identifying the issues created by Section 505(b) of the UTC one can see that there are a number of ways to ameliorate such problems. These techniques may include:

a. Recommend certain clients establish trusts in non-UTC jurisdictions such as Alaska, Delaware, or Nevada. These jurisdictions have favorable trust law and are unlikely to adopt the UTC.

b. Utilize a flee clause in trust documents or upgrade an existing flee clause. Many trusts already include such a clause as part of the standard boilerplate provisions in such documents. A flee clause permits a trustee to move the situs and administration of a trust and change the governing law of a trust to another jurisdiction. This authority can often be exercised by a trustee or a protector without the approval of a court or any beneficiary. For convenience and economic reasons many clients will choose to establish trusts in jurisdictions that have or will adopt a version of the UTC. When drafting these trusts, the attorney must ensure that the trust agreement includes provisions to change both the governing law and the principal place of administration without court approval and without notice to a beneficiary. The UTC defines choice of law and place of administration separately in Sections 107 and 108. Many existing irrevocable trusts that permit a trustee to change the governing law of the trust refer only to choice of law. As a default provision the UTC requires notice of a sixty days and the consent of all qualified beneficiaries to change the place of trust administration. To change both the place of the administration of a trust and the choice of law of the trust without the default rule applying, separate trust provisions regarding each issue would need to be included in a trust.

c. Give a an independent trustee the authority to exclude a beneficiary from exercising a withdrawal power. When drafting trusts with power of withdrawal provisions consider including a provision granting authority to the trustees or the grantor, prior to or contemporaneously with a contribution to a trust, to exclude a beneficiary from having powers of withdrawal. This may address problems with a beneficiary who has a creditor issue or an estranged or hostile beneficiary.

d. If drafted properly, a donor should be able to retain the right to turn Crummey Power rights on and off, to exclude a Powerholder from being able to exercise a Crummey Power as to a particular gift, and perhaps to change the period in which a Crummey Power may be exercised. For example, the Crummey Trust could provide a procedure for a donor to give the trustee written instructions regarding these matters prior to or contemporaneously with the gift but not at any time following the gift. In PLR 9030005, the terms of a Crummey Trust provided that a donor could declare in writing that no beneficiary is entitled to withdraw all or any portion of the donor's gift to the trust. The ruling held that such a power would not cause the trust to be included in the donor's estate. In PLR 8103069, however, the IRS refused to rule on the estate tax consequences of a similar retained power. In

PLR 9030005, the trust provided that a donor could declare in writing that no beneficiary is entitled to exercise a Crummey Power over the donor's gift or any portion of it. The IRS had no estate tax concerns with this power in this ruling. The IRS had no transfer tax concerns with a similar retained power in TAM 9532001. Additionally, such a power should not cause the trust to be a grantor trust for income tax purposes. TAM 8901004. In TAM 8901004, the terms of the trust provided:

> The donor of any property added to the trust has the right by giving written notice to the Trustee, to exclude any person who has been given a power of withdrawal from exercising the power, but only as to property added after the date the notice is received by the Trustee.

The TAM held that the power would not cause a donor to be treated as the owner of any portion of the trust because a donor must decide whether to exercise the power **before** the donor makes the gift. Thus, a donor has no power to affect the beneficial enjoyment of any trust property after his or her gift. (See also PLR 8103074 for another ruling which involves a trust with a similar retained power provision.) It should also be clear that the retained power can only be exercised prior to or contemporaneously with the gift, otherwise the IRS could argue that the power should cause a loss of any claimed annual exclusion(s).

e. Limit the withdrawal period of a Crummey Power to bare minimum. Based on existing authority even a thirty day withdrawal period appears to be too long.

f. Give an independent trustee the authority to amend or modify Crummey Power provisions and 5 and 5 power provisions.

D. Reversion to Common Law Rule & More (Alaska & Delaware). In an effort to provide the most significant wealth protection benefits to trusts established in and governed by the law of their states, Alaska and Delaware have each enacted statutes that revert to the common law rule regarding the ability of a creditor to reach the assets of a trust subject to a general power of appointment in a beneficiary.

1. Section 3536(d)(1) and (2) of Title 12 of the Delaware Code provides in relevant part:

> a creditor shall have no right against the interest of a beneficiary of a trust or against the beneficiary or trustee of the trust with respect to such interest unless: (1) The beneficiary has a power to appoint all or part of the trust property to the beneficiary, the beneficiary's estate, the beneficiary's creditors, or the creditors of the beneficiary's estate by will or other instrument such that the appointment would take effect only upon the beneficiary's death ***unless the beneficiary actually exercises such power in favor of the beneficiary, the beneficiary's creditors, the beneficiary's estate, or the creditors of the beneficiary's estate but then only to the extent of such exercise***. (2) The beneficiary has a power to appoint all or part of the trust property to the beneficiary, the beneficiary's creditors, the beneficiary's estate, or the creditors of the beneficiary's estate

during the beneficiary's lifetime ***unless the beneficiary actually exercises such power in favor of the beneficiary, the beneficiary's creditors, the beneficiary's estate, or the creditors of the beneficiary's estate but then only to the extent of such exercise***. (Emphasis supplied.)

2. Alaska Statutes § 34.40.115 provides:

The property that a donee of a power of appointment is authorized to appoint is not subject to the claims of the creditors of the donee except to the extent that a donee of an inter vivos or testamentary power of appointment (1) is permitted by the donor of the power to appoint the property to the donee, the creditors of the donee, the donee's estate, or the creditors of the donee's estate; ***and (2) effectively exercises the power of appointment in favor of the donee, the creditors of the donee, the donee's estate, or the creditors of the donee's estate***. (Emphasis supplied.)

E. Bankruptcy. Property subject to an outstanding Crummey Power or other withdrawal power will be considered property included in the bankrupt's estate because a bankruptcy trustee succeeds to the rights of the debtor. 1 U.S.C. § 541. This should be the result regardless of the situs of the trust or applicable law. Section 13.6 of the Restatement of the Law Second Property 2d (Donative Transfers) provides:

(1) Creditors of donee of a power of appointment cannot acquire the power or compel its exercise except as provided by statute.

(2) Section 541(b)(1) of the Bankruptcy Code of 1978 (11 U.S.C. § 541) provides that "Property of the estate does not include any power that the debtor may only exercise solely for the benefit of an entity other than the debtor."

The previous discussion focused on the ability of creditors outside of bankruptcy to reach the assets subject to a general power of appointment. Under bankruptcy law, the trustee acquires a debtor's right to exercise a general power or compel its exercise. Therefore, property subject to a presently exercisable general power of appointment is considered part of the bankrupt estate. See *e.g.*, *In re May*, 83 B.R. 812 (1988).

XLII. BUSINESS AND TAX PLANNING.

A. Liability and Tax Considerations.

1. Choice of Entity. The choice of a limited liability entity will depend on several factors, including the level of liability protection and the tax consequences associated with the creation, operation and possible dissolution of the entity.

a. Corporations.

i. **Liability**. The shareholder of a corporation should have limited liability for the debts of the corporation in that the shareholder's personal liability for corporate obligations cannot exceed the amount of the shareholder's capital contribution. See

F.S. §607.0622 (shareholder is personally liable only for the consideration for which shares were issued). See also *Stock v. Stock*, 693 So.2d 1080 (Fla. App. 2 Dist. 1997) (shareholder is insulated from liability for the corporation's debts). A shareholder could be liable, however, to the extent of any distributions received during a period of corporate insolvency. F.S. §§607.06401(3) (no distribution to the shareholders may be made if, after giving it effect, the corporation would not be able to pay its debts as such debts become due in the usual course of business) and 607.0834 (director and shareholder liability with respect to certain distributions if corporation was insolvent). See, *e.g.*, *Alliegro v. Pan Am. Bank of Miami***,** 136 So.2d 656 (Fla .App. 3 Distr. 1962) (shareholder required to return improperly paid dividends). Further, where a shareholder is also a director, officer or employee of a corporation, that person could be personally liable to the corporation or to third parties for misconduct or torts he or she commits in the course of carrying out his or her duties. See, *e.g.*, F.S. §607.0831 (director liability).

In certain limited circumstances, however, creditors of a corporation may "pierce the corporate veil" to hold shareholders liable for corporate debts. Under Florida law, the corporate veil may be pierced where the corporation is a "**mere instrumentality**" or "**alter ego**" of a shareholder, and that the shareholder engaged in fraud or other improper conduct in the formation or use of the corporation. See *Danai Jai-Alai Palace, Inc. v. Sykes*, 450 So. 2d 1114 (Fla. 1984); *XL Vision, LLC. v. Holloway*, 856 So.2d 1063 (Fla. App. 5 Dist. 2003). Following corporate formalities, such as maintaining corporate minutes and consents and holding annual and other meetings, tends to establish that a corporation is not a mere instrumentality. See, *e.g.*, *Advertects, Inc. v. Sawyer Industries*, 84 So.2d 21 (Fla. 1955) (improper handling of business affairs, alone, insufficient grounds to pierce the corporate veil). Conversely, the failure to observe corporate formalities coupled with improper conduct can justify piercing the corporate veil such as when a shareholder fails to segregate business activities and expenses from personal activities and expenses by commingling corporate assets with personal funds. See, *e.g.*, *Futch v. Head*, 511 So.2d 314 (Fla. App. 1 Dist. 1987).

Although a corporation may offer its shareholders limited liability for corporate debt and other obligations, establishing a corporation offers little asset protection to a shareholder for the shareholder's personal debts. A shareholder's stock in a corporation is an asset available to satisfy the claims of the shareholder's creditors and is subject to attachment and execution. See F.S. §76.02 (stock subject to attachment). See F.S. §56.011 *et seq*. (execution proceedings). Further, in many closely-held corporations, the debtor shareholder's stock may be subject to a buy-sell agreement pursuant to which the other shareholders and/or the company could purchase the debtor shareholder's stock with the sale proceeds being available to satisfy the claims of such shareholder's creditors.

With respect to professionals such as physicians, architects, attorneys, and public accountants, Florida law authorizes such professionals to form a "professional corporation" through which each professional can render services without being liable for the acts of the other professionals. See F.S. §§621.05, 621.07. The professional has limited liability similar to that of the shareholder of a regular corporation, however, the professional remains personally liable for his or her own negligent or wrongful acts and those of any person under his or her direct supervision and control. See F.S. §621.07.

ii. **Taxation**. A corporation is subject to Federal and Florida income tax. See I.R.C. §11; F.S. §§220.03, 220.11. Its shareholders are subject to Federal income tax on corporate distributions. See, generally, I.R.C. §301. Shares of stock in a corporation are also subject to the Florida intangible personal property tax. See F.S. §199.023.

There are also special tax rules governing certain contributions to and distributions from a corporation. In general, the contribution of appreciated assets by a shareholder to a corporation is generally taxable, unless the contributing shareholder or shareholders own at least eighty percent (80%) of the corporation's voting power and at least eighty percent (80%) of the corporation's other stock. See I.R.C. §351. Thus, initial capitalization of a corporation may be tax-free, however, later contributions by existing or new shareholders may trigger gain recognition by the contributing parties. Further, a shareholder must recognize gain if liabilities assumed by the corporation exceed the basis of the contributed assets. See I.R.C. §357(c). Additionally, with contributions of investment portfolios, a shareholder may be subject to tax under certain investment company rules related to diversification. See I.R.C. §§ 351(e); Treas. Reg. § 1.351-1(c).

When a corporation distributes appreciated assets to its shareholders, both the corporation and the shareholders may be required to recognize gain. With most distributions, the corporation is taxed on the deemed gain from a hypothetical sale of the appreciated assets. See I.R.C. §§311, 336. The corporation is not taxed on a distribution in complete liquidation to a corporate shareholder that owns at least 80% of the distributing corporation's voting power and value. See I.R.C. §337. With most distributions the shareholders will recognize ordinary income if the distribution is treated as a dividend, or capital gain to the extent the distribution exceeds their respective stock basis in the case of a redemption that is treated as a sale or exchange. See I.R.C. §§301(c), 302. Shareholders generally recognize gain with respect to a liquidating distribution. See I.R.C. §331. However, a corporate shareholder is not taxed on a liquidating distribution if the shareholder owns at least 80% of the distributing corporation's voting power and value. See I.R.C. §332.

A corporation and its shareholders also may elect to have the corporation treated as an "S Corporation" rather than a "C Corporation." See I.R.C. §1362. There are several eligibility requirements including the number and type of eligible shareholders. See I.R.C. §1361. In general, the S Corporation is not subject to a corporate-level tax and each of the shareholders is taxed on the shareholder's *pro rata* share of the S Corporation's earnings, whether or not such earnings are distributed. See I.R.C. §§1366, 1368. Under special rules related to a corporation's prior status as a C Corporation, the S Corporation may be subject to a tax on built-in gains or passive investments. See I.R.C. §§1374, 1375. Earnings and profits from prior C Corporation years also may trigger special tax rules. See I.R.C. §1368.

Under special rules applicable to "**personal service corporations**," a professional corporation is subject to Federal income tax at a flat thirty-five percent (35%) rate. See I.R.C. §§11(b)(2), 448(d)(2).

b. Limited Partnerships.

i. **Liability**. Unlike a general partnership (a "**GP**") in which each of the partners is jointly and severally liable for the debts of the partnership (see F.S. § 620.8306), a limited partnership (an "**LP**") offers its limited partners protection from partnership-level obligations. See F.S. § 620.1303. Similar to a corporate shareholder, a limited partner's personal liability for LP obligations cannot exceed the amount of the limited partner's capital commitment to the LP. See F.S. §§ 620.1303, 620.1502; see also F.S. §§ 620.1508, 1509 (liability for certain distributions received during a period of partnership insolvency). The general partner of the LP, however, is liable for the LP's debts and other obligations. See F.S. § 620.1404. The general partner is often formed as a limited liability entity because of such liability.

From a wealth preservation perspective the primary benefit of an LP compared to a corporation is the type of remedy available to a limited partner's creditors. In general, the creditor of a limited partner cannot attach an LP's assets to satisfy a claim against a limited partner. The creditor generally is limited to obtaining a "**charging order**" against the limited partner's economic interest in the partnership (*i.e.*, the right to receive an income distribution), and cannot obtain any other rights of a partner, including the right to force a partnership distribution or dissolution. The creditor is treated as a mere assignee and is not entitled to exercise any voting rights or other rights that the partner possesses. See F.S. § 620.1703.

A GP may elect to be treated as a limited liability partnership (an "**LLP**"). See F.S. §§620.8101(6), 620,9001. The effect of such election is that each of the general partners is granted limited liability with respect to the debts of the partnership. See F.S. §620.8306(3). In all other respects an LLP is identical to a GP.

An LP may elect to be treated as a limited liability limited partnership (an "**LLLP**"). The effect of such election is that the LP's general partner or general partners are granted limited liability with respect to the debts of the partnership. See F.S. §620.1404(3). In all other respects an LLLP is identical to an LP.

ii. **Taxation**. A partnership, whether a GP, LP, LLP or LLLP, is not subject to Federal or Florida income tax. See I.R.C. §11; F.S. §§220.03, 220.11. The partners are subject to tax on their distributive shares of partnership income, whether or not distributed to the partners. See I.R.C. §§701, 702. Partnership interests are not subject to the Florida intangible personal property tax unless the partnership is publicly traded. See F.S. §199.185(1)(c).

There are also special tax rules governing certain contributions to and distributions from a corporation. In general, the contribution of appreciated assets to a partnership is tax-free. See I.R.C. §721. However, there are several exceptions to the general rule that may cause the recognition of income to the contributing partner, either at the time of the contribution, at a later distribution of the contributed property to another partner, or at a later distribution of other property to the contributing partner. See I.R.C. §§ 704(c)(1)(B), 707(a), 737. Further, a partner must recognize gain if liabilities assumed by the partnership

exceed the basis of the contributed assets. See I.R.C. §752(c). In addition, with contributions of investment portfolios, a partner may be subject to tax under certain "**investment company**" rules related to diversification. See I.R.C. §721(b).

When a partnership distributes appreciated assets to its partners the distributions are generally tax-free to the partners. See I.R.C. §731. There are exceptions to the general rule for certain distributions of marketable securities and the unrealized receivables or inventory items of the partnership. See I.R.C. §§731(c)-(d), 751(a). Additionally, with respect to contributions of appreciated property, where a partner contributes appreciated property to a partnership and, within seven (7) years of the contribution date, the partnership distributes the property to another partner or distributes some other property to the contributing partner, the contributing partner must recognize the pre-contribution gain inherent in the contributed property. See I.R.C. §§704(c), 737.

Unlike corporations, including S Corporations, a partnership has considerable flexibility in making special allocations (allocations other than in accordance with a partner's interest in the partnership), as well as distributions of profits or liquidating proceeds, to its partners, so long as the special allocations have substantial economic effect. See I.R.C. § 704(b).

c. Limited Liability Companies.

i. **Liability**. The member or members of a limited liability company (an "**LLC**") do not have personal liability for the debts, obligations or other liabilities of the LLC. See F.S. §608.4227. The managers or managing-members have similar limited liability, except for misconduct or torts they commit in the course of carrying out their duties. See F.S. §608.4228. Each member's liability is limited to the member's capital commitment to the LLC. See F.S. §608.4211. See also F.S. §608.428 (liability for distributions received during a period of insolvency). In any case where a creditor of an LLC seeks to "pierce the veil" of an LLC to hold the members liable for an LLC debt, a court must apply the common law principals applicable to a corporation and its shareholders discussed above. See F.S. §608.701.

As with an LP, the assets of an LLC generally are not subject to attachment by the creditor of a member of the LLC. Rather, the creditor is generally limited to obtaining a charging order against the member's economic interest in the LLC, and cannot obtain any membership rights, other than the ability to receive a distribution if and when the LLC ever makes such a distribution. See F.S. §608.433(4).

Similar to a professional corporation, a "**professional limited liability company**" may be formed by certain professionals. See F.S. §621.051. Each professional would have limited liability similar to that of the shareholder of a regular corporation, except for personal liability for his or her own negligent or wrongful acts and those of any person under his or her direct supervision and control. See F.S. §621.07.

ii. **Taxation**. Under the "**Check-the-Box**" Regulations, an LLC can be classified as a disregarded entity if it has one member or as a corporation or

partnership if it has two or more members. See Treas. Reg. § 301-7701-3(a). If an LLC desires to be classified other than under applicable default classification rules, the LLC must file a Form 8832, electing its desired classification. Treas. Reg. § 301-7701-3(c)(1). As a disregarded entity, an LLC is not subject to tax and its income is taxed to its sole member. See Treas. Reg. § 301-7701-2(a). Otherwise, an LLC is subject to taxation as either a corporation or partnership, as discussed above.

d. Operating Agreement and Partnership Agreement Terms.

In ***In re Baldwin***, 593 F.3d 1155 (10th Cir Ct. App. 2010), Carolyn S. Baldwin ("**W**") and her husband, Trenton (collectively the "**Debtors**"), filed a voluntary bankruptcy petition in 2004. In 1994, W's father created a limited partnership under Oklahoma law called the Bill and Carolyn Limited Partnership (the "**Partnership**"). The Partnership was created by W's father as an "estate planning tool." The sole general partner of the Partnership was a trust (the "**Trust**") and W's parents were the sole trustees of the Trust. Initially, W owned a 7.73993% in the Partnership as a limited partner and the Trust owned a 91.26007% as a limited partner and a 1% interest as a general partner. Sometime thereafter, the Trust assigned its entire limited partnership interest to W and W became the sole limited partner in the Partnership owning a 99% interest. The Partnership owned 200 acres of undeveloped land and a house that the Partnership constructed on the land. The Debtors used the house as their primary residence.

The bankruptcy trustee brought an adversary proceeding against the Partnership and the general partner seeking a declaration that W's interest in the Partnership was property of the bankruptcy estate and the Partnership should be dissolved because the general partner failed to recognize the interest of the bankruptcy estate. To support its position the trustee cited Oklahoma law which provides "[o]n application by or for a partner, the district court may decree dissolution of a limited partnership whenever it is not reasonably practicable to carry on business in conformity with the partnership agreement." Okla. Stat. tit. 54, § 346. The trustee argued that he was entitled to judicial dissolution under the statute because the Partnership could not carry out its purpose of estate planning because W's limited partnership interest was now part of her bankruptcy estate. The Debtors correctly argued, however, that the partnership agreement provided that the purpose of the Partnership was "to engage in general business activities including but not limited to the purchasing, holding, construction, owning, operating, improving, managing, mortgaging, leasing and selling of and dealing in and with real property." The Debtors pointed out that the Partnership engaged in various profit-seeking activities and the profits had been retained in the partnership to continue to reinvest in real estate projects. The court agreed with the Debtors that the Partnership continued to carry out its business in accordance with the partnership agreement and nothing under Oklahoma law provided for the judicial dissolution of the Partnership under such circumstances.

Failing to convince the court to order the dissolution of the Partnership under Okla. Stat. tit. 54, § 346, the trustee submitted a withdrawal notice and buy-sell offer in accordance with the terms of the partnership agreement. Pursuant to the notice the trustee offered to sell its 99% interest in the Partnership to the general partner for $297,000 or alternatively to purchase the general partner's 1% interest for $3,000. The trustee's offer was based on a price per unit in the Partnership (assuming 100 units outstanding) of $3,000. The Debtors countered that the court ruled that the trustee was not entitled to dissolve the Partnership and permitting the

trustee to exercise the buy-sell right would cause a dissolution. Therefore, the Debtors argued that the trustee was not permitted to withdraw from the Partnership in this manner. The Debtors also argued that the trustee's buy-sell offer violated the requirement in the partnership agreement that the sale and purchase offers be on "identical terms." In this regard paragraph 16 of the partnership agreement provided:

> A Partner may withdraw from the Partnership after delivering written notice of his intention to withdraw to the other Partner at least thirty (30) days prior to the proposed date of withdrawal.... Such notice of withdrawal shall include an offer by the Withdrawing Partner to purchase the interest of the Remaining Partner (the "purchase offer") on stated terms and for a stated amount and, in the alternative, to sell the Withdrawing Partner's interest (the "sale offer") on identical terms.
>
> For thirty (30) days after the delivery of such notice of withdrawal, the Remaining Partner shall have the option to accept the purchase offer o[r] the sale offer, or serve notice that the Partnership be terminated and liquidated in accordance with Section 15.3 herein.

The trustee noted that the court had merely held that neither the partnership agreement nor Oklahoma law permitted the trustee to dissolve the Limited Partnership. The court held that the terms of the partnership agreement permitted the limited partner to withdraw by making a buy-sell offer in accordance with the provisions of paragraph 16. Such provisions were part of an enforceable contract (that is, the partnership agreement) under applicable state law.

As previously mentioned, the Debtors also argued that the trustee's buy-sell offer was invalid under paragraph 16 of the partnership agreement because it required that the sell offer be "on identical terms" with the purchase offer. According to the Debtors, "identical terms" meant the limited partner must be willing to buy or sell it interest for an identical amount (*e.g.*, if offering its 99% interest for $297,000, the trustee could only purchase the Trust's 1% interest for $297,000 and not $3,000). The trustee countered that "identical terms" meant that the buy and sell offers must be based on the same *pro rata* price per unit and the same proposed payment terms. The court agreed with the trustee and held that the trustee's buy-sell offer satisfied the requirements of the partnership agreement because it was based on the same $3,000 per unit value and the same terms that the price be paid immediately in cash.

Finally, the Debtors argued that the buy-sell offer was invalid because it was intrinsically inequitable and did not account for the management and control difference between the general and limited partnership interests. The trustee countered that the buy-sell offer did not distinguish between the management and control rights because there was no such requirement in the partnership agreement or under Oklahoma law. The trustee emphasized that in Oklahoma voluntary contracts must be enforced as written and "[t]he fairness or unfairness, folly or wisdom or inequality of contracts are questions exclusively within the rights of the parties" to the contact. The court agreed with the trustee that the potential inequity of the partnership agreement failing to account for the value of the management and control rights

associated with the general partnership interest is not sufficient to prevent its enforcement under Oklahoma law.

It should be noted that the parties stipulated that the trustee "stepped into the shoes of the debtor" in regards to W's interest in the Partnership. Therefore, the parties agreed that the trustee could exercise "whatever rights the limited partner had under the partnership agreement." In an earlier unpublished opinion regarding the same case (see 2006 WL 2034217 (10th Cir. BAP (Okla.))), the Debtors unsuccessfully argued that the only remedy available to the trustee under applicable law was a charging order. The court quickly disposed of this argument affirming the lower court's holding providing:

> although state law determines the nature of [W]'s partnership interest, federal law determines the extent to which that partnership interest becomes a part of the [bankruptcy] estate. *Bailey v. Big Sky Motors, Ltd.* (*In re Ogden*), 314 F.3d 1190, 1197 (10th Cir. 2002). At least two factually similar cases have held that a debtor's rights pursuant to a family partnership or limited liability company become property of the bankruptcy estate and may be exercised by the trustee. In *Samson v. Prokopf*, (*In re Smith*), 185 B.R. 285 (Bankr. S.D. Ill. 1995), the court held that a limited partner "has contractual rights arising from the partnership" that are "legal or equitable interests of the debtor within the ambit of 11 U.S.C. § 541(a)(1) and become property of the bankruptcy estate…Similarly, in *Movitz v. Fiesta Invs*. (*In re Ehmann*), 319 B.R. 200, 204 (Bankr. D. Ariz. 2005), the court considered the estate's interest in a limited liability company that was set up by the debtor's parents in order "to remove assets from the parents' estates for estate tax purposes, and to accumulate investments for the benefit of their children after their deaths." The court concluded that the "[t]rustee has all of the rights and powers with respect to [the company] that the [d]ebtor held as of the commencement of the case[,]" including the right to seek dissolution.

In reaching its conclusion on this issue that the court noted that this partnership agreement did not create an executory contract that was governed by 11 U.S.C. § 365. Instead, it noted that W did not owe "such a material obligation to the partnership that failure to perform it would relieve the partnership of its obligations to debtor." Thus, W's limited partnership interest was a "property interest" governed by 11 U.S.C. § 541 and not § 365.

The lessons of *Baldwin*:

1. Carefully consider the terms used in a partnership agreement and limited liability company operating agreement. As *Baldwin* illustrates, these terms can be enforced against the parties to the agreement. Such is the case even when the only parties to the agreement are close relatives. Even though the terms of a partnership agreement or operating agreement may contain undesirable provisions, it may still be possible for the parties to modify such agreements even during the course of litigation against a partner or member. Modifying such an agreement should not be an act that can be avoided under a fraudulent transfer statute. Nonetheless, it would be wise for the parties to act in good faith when making any such modification and ensure the modification has a sound business purpose.

2. Carefully consider the structure of a gift. If W's parents made this gift using a properly drafted discretionary trust that included a spendthrift provision, this case would have never happened. See *e.g.*, *Wachovia Bank, NA v. Levin*, E.D. N.C., No. 4:09-CV-87-BO, 11/4/09 and *In re: Coumbe*, 304 B.R. 378 (2004).

3. Understand your local exemption laws. In this case the Partnership owned the home that W and her husband were using as their primary residence. Oklahoma law provides a homestead exemption that protects an unlimited amount of equity from forced sale. See Okla. Const. § XII-2; Okla. Stat. § 31-1. It seems doubtful that W and her husband could claim the benefit of her local homestead exemption because she did not own the home directly, it was owned by the Partnership.

e. A Closer Examination of the Charging Order.

Florida, South Dakota Alaska and Delaware charging order statutes:

i. Section 608.433(4) of the Florida Statutes provides as to an interest in a limited liability company:

> On application to a court of competent jurisdiction by any judgment creditor of a member, the court may charge the limited liability company membership interest of the member with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor **has only** the rights of an assignee of such interest. This chapter does not deprive any member of the benefit of any exemption laws applicable to the member's interest.

ii. Section 620.1703 of the Florida Revised Uniform Limited Partnership Act of 2005 provides:

> (1) On application to a court of competent jurisdiction by any judgment creditor of a partner or transferee, the court may charge the partnership interest of the partner or transferable interest of a transferee with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of a transferee of the partnership interest.
>
> (2) This act shall not deprive any partner or transferee of the benefit of an exemption law applicable to the partner's partnership or transferee's transferable interest.
>
> (3) ***This section provides the exclusive remedy which a judgment creditor of a partner or transferee may use to satisfy a judgment out of the judgment debtor's interest in the limited partnership or transferable interest***. ***Other remedies, including foreclosure on the partner's interest in the limited partnership or a transferee's transferable interest and a court order for directions, accounts, and inquiries that the debtor general or limited partner might have made, are not available to the judgment creditor attempting to***

satisfy the judgment out of the judgment debtor's interest in the limited partnership and may not be ordered by a court. Emphasis supplied.

iii. Section 620.8504 of the Florida Revised Uniform Partnership Act of 2005 provides that a partner's transferable interest in a general partnership is subject to charging order:

> (1) Upon application by a judgment creditor of a partner or of a partner's transferee, a court having jurisdiction may charge the transferable interest of the judgment debtor to satisfy the judgment. The court may appoint a receiver of the share of the distributions due or to become due to the judgment debtor in respect of the partnership and make all other orders, directions, accounts, and inquiries the judgment debtor might have made or which the circumstances of the case may require.
>
> (2) A charging order constitutes a lien on the judgment debtor's transferable interest in the partnership. The court may order a foreclosure of the interest subject to the charging order at any time. The purchaser at the foreclosure sale has the rights of a transferee.
>
> (3) At any time before foreclosure, an interest charged may be redeemed:
>
> (a) By the judgment debtor;
>
> (b) With property other than partnership property, by one or more of the other partners; or
>
> (c) With partnership property, by one or more of the other partners with the consent of all of the partners whose interests are not so charged.
>
> (4) This act does not deprive a partner of a right under exemption laws with respect to the partner's interest in the partnership.
>
> (5) This section provides the exclusive remedy by which a judgment creditor of a partner or partner's transferee may satisfy a judgment out of the judgment debtor's transferable interest in the partnership.

iv. Section 10.50.380 of the Alaska Revised Limited Liability Company Act provides in relevant part:

> Rights of judgment creditors.
>
> (a) If a judgment creditor of a limited liability company member applies to a court of competent jurisdiction, the court may charge the member's limited liability company interest for payment of the unsatisfied amount of the judgment.
>
> (b) To the extent a limited liability company interest is charged under (a) of this section, the judgment creditor has only the rights of an assignee of the member's interest.

(c) This section provides the ***exclusive remedy that a judgment creditor of a member or a member's assignee may use to satisfy a judgment out of the judgment debtor's interest in the limited liability company***. ***Other remedies, including foreclosure on the member's limited liability company interest and a court order for directions, accounts, and inquiries that the debtor member might have made, are not available to the judgment creditor attempting to satisfy a judgment out of the judgment debtor's interest in the limited liability company and may not be ordered by a court***.

Emphasis supplied.

v. Section 504 of the South Dakota Limited Liability Company Act provides:

(a) On application by a judgment creditor of a member of a limited liability or of a member's transferee, a court having jurisdiction may charge the distributional interest of the judgment debtor to satisfy the judgment.

(b) A charging order constitutes a lien on the judgment debtor's distributional interest.

(c) A distributional interest in a limited liability company which is charged may be redeemed:

(1) By the judgment debtor;

(2) With property other than the company's property, by one or more of the other members; or

(3) With the company's property, but only if permitted by the operating agreement.

(d) This chapter does not affect a member's right under exemption laws with respect to the member's distributional interest in a limited liability company.

(e) **This section provides the exclusive remedy that a judgment creditor of a member's distributional interest or a member's assignee may use to satisfy a judgment out of the judgment debtor's interest in a limited liability company. No other remedy, including foreclosure on the member's distributional interest or a court order for directions, accounts, and inquiries that the debtor, member might have made, is available to the judgment creditor attempting to satisfy the judgment out of the judgment debtor's interest in the limited liability company**.

(f) No creditor of a member or a member's assignee has any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the company.

vi. Section 32.11.340 of the Alaska Revised Partnership Act provides in relevant part:

> Rights of creditor.
>
> (a) On application to a court of competent jurisdiction by a judgment creditor of a partner, the court may charge the partnership interest of the partner with payment of the unsatisfied amount of the judgment with interest. To the extent charged, the judgment creditor has only the rights of an assignee of the partnership interest. This chapter does not deprive a partner of the benefit of an exemption law applicable to the partner's partnership interest.
>
> (b) ***This section provides the exclusive remedy that a judgment creditor of a general or limited partner or of the general or limited partner's assignee may use to satisfy a judgment out of the judgment debtor's interest in the partnership***. ***Other remedies, including foreclosure on the general or limited partner's partnership interest and a court order for directions, accounts, and inquiries that the debtor general or limited partner might have made, are not available to the judgment creditor attempting to satisfy the judgment out of the judgment debtor's interest in the limited partnership and may not be ordered by a court***.

Emphasis supplied.

vii. Section 18-703 of the Delware Limited Liability Company Act provides:

> (a) On application by a judgment creditor of a member or of a member's assignee, a court having jurisdiction may charge the limited liability company interest of the judgment debtor to satisfy the judgment. To the extent so charged, the judgment creditor has only the right to receive any distribution or distributions to which the judgment debtor would otherwise have been entitled in respect of such limited liability company interest.
>
> (b) A charging order constitutes a lien on the judgment debtor's limited liability company interest.
>
> (c) This chapter does not deprive a member or member's assignee of a right under exemption laws with respect to the judgment debtor's limited liability company interest.
>
> (d) ***The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or a member's assignee may satisfy a judgment out of the judgment debtor's limited liability company interest and attachment, garnishment, foreclosure or other legal or equitable remedies are not available to the judgment creditor, whether the limited liability company has 1 member or more than 1 member.***

> (e) No creditor of a member or of a member's assignee shall have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited liability company.
>
> (f) The Court of Chancery shall have jurisdiction to hear and determine any matter relating to any such charging order.

viii. Section 608.505(3) of the Florida Limited Liability Company Act provides in relevant part:

> This chapter does not authorize this state to regulate the organization or internal affairs of a foreign limited liability company authorized to transact business in this state. ***The laws of the state or other jurisdiction under which a foreign limited liability company is organized govern the foreign limited liability company's organization, internal affairs, and the liability of its managers, members, and their transferees***.

Emphasis supplied.

ix. Section 620.1901 of the Florida Revised Uniform Limited Partnership Act of 2005 provides in relevant part:

> (1) The laws of the state or other jurisdiction under which a foreign limited partnership is organized govern relations among the partners of the foreign limited partnership and between the partners and the foreign limited partnership and the liability of partners as partners for an obligation of the foreign limited partnership.
>
> (2) A foreign limited partnership may not be denied a certificate of authority by reason of any difference between the laws of the jurisdiction under which the foreign limited partnership is organized and the laws of this state.

x. Florida Statutes § 620.1107(1) provides, "Unless displaced by particular provisions in this act, the principles of law and equity supplement this act."

Does the Income Tax Liability Shift to a Creditor Who is Awarded a Charging Order?:

(A) This may constitute one of the greatest legal myths of our time. The authors have heard this proposition stated numerous times at legal presentations throughout the country and by numerous lawyers and accountants and have read many articles stating that upon obtaining a charging order a creditor will be forced to incur its debtor's income tax liability. Nevertheless, to date none of the authors of this outline have ever reviewed one case or heard of an actual case where a creditor that obtained a charging order was forced to incur and purportedly pay a debtor's income tax liability. **NOT ONE CASE!!!!**

(B) Examining the authority for and against the myth:

(1) Is there any provision in the Internal Revenue Code that permits or directs this tax result? To date the authors have been unable to find any such provision to support this result.

(2) Does the notion of shifting income tax liability in this context make economic sense? Would your creditor be forced by the Service to recognize income that may or may not be used to satisfy the debtor-partner or member's legal obligation to the creditor? Satisfaction of the debt reduces the debtor-partner's liability to the creditor possessing the charging order resulting in an economic benefit to the debtor-partner. Thus, such income should be taxable to the debtor-partner. See *Rutkin v. U.S.*, 343 U.S. 130 (1952).

(3) What is a charging order? A charging order is a *lien* on a partner's "**transferable interest**" in a partnership. See *Schiller v. Schiller*, 625 So.2d 856 (Fla. 5th Dist. 1993). See also *e.g.*, F.S. § 620.1703 and F.S. § 620.8504(2). A lien does not constitute a sale of the partnership interest to the creditor. Instead, it merely provides the creditor "with payment of the unsatisfied amount of the judgment with interest." F.S. § 620.1703(1). The debtor-partner remains the owner of the interest and it is the owner of the economic interest that must report the income attributable to such interest. See *Blair v. Com'r.*, 300 U.S. 5 (1937) and *Evans v. Com'r.*, 447 F.2d 547 (CA 7, 1971).

(4) Has the creditor that obtains a charging order acquired property in a taxable exchange or some other right? The best answer is the creditor has acquired some other right, that is, a lien. The debtor partner or member continues to maintain ownership of the interest that is charged. It is the debtor's legal obligation that the charging order is designed to ensure will be satisfied for the debtor.

(5) Many commentators and lawyers cite Revenue Ruling 77-137, 1977-1 C.B. 178 as authority to support the proposition that the income tax liability inherent in the income generated by a partnership or limited liability company and allocable to a partner or member's interest should shift to the creditor who obtains a charging order against this interest. The facts of this Revenue Ruling do not support this result.

In Revenue Ruling 77-137, a limited partner ("**LP**") in a limited partnership assigned such partner's interest to another person ("**A**"). The agreement governing the partnership provided in relevant part that an assignee of a limited partner could not become substituted limited partner in the partnership without obtaining the written consent of the general partners. The partnership agreement also provided, however, that a limited partner could assign such partner's right to share in the profits and losses of the partnership and receive distributions from the partnership to another person without obtaining the consent of the general partners. As a result of the assignment, LP was still considered a nominal limited partner under applicable law. Under the assignment LP had agreed to exercise any powers he continued to hold as a limited partner in the partnership for the benefit of A. The ruling held that because A acquired substantially all dominion and control of the limited partnership interest assigned to

him by LP, for Federal income tax purposes A would be treated as a substituted limited partner. (This result was deemed to occur despite the general partners not providing their consent to the assignment.) As a result, the ruling held that A had to report his distributive share of partnership items of income, gain, loss, deduction, and credit attributable to the interest that LP assigned to him on his Federal income tax return. This result was deemed to mirror the result that would occur had A been admitted as a substitute limited partner in the partnership.

Thus, Revenue Ruling 77-137 involved *a transfer or assignment* of the ownership rights of the partner in the partnership to the assignee. It did not involve a charging order or any other lien on an interest in the partnership.

(6) Would the debtor have the nerve to send the debtor's creditor a Form K-1? Would the debtor risk the audit and the adverse consequences of taking the position that the creditor is liable for the tax liability? The creditor may inform the Service of the debtor's action. Also, the creditor receiving the K-1 may be obligated to file a Form 8082 with the creditor's income tax return. Form 8082 alerts the Service of the discrepancy between the income the creditor has reported and the income that another party is taking the position should be reported by the creditor, however, is not so reported. This may generate an immediate inquiry from by Service.

(7) A random sampling of accountants who prepare Form 1065 partnership tax returns finds no one who would send (or propose sending) a Form K-1 to a debtor possessing a charging order over a partner or member's interest in a partnership or limited liability company.

xi. **Florida and Single Member LLCs**. In *Olmstead v. FTC*, 2010 WL 2518106 (June 24, 2010), Shaun Olmstead ("**Shaun**") and Julie Connell (**Julie**") (collectively referred to as the "**Defendants**") operated what the court referred to as an advance-fee credit card scam through various corporate entities. As a result, the Federal Trade Commission ("**FTC**") sued the Defendants and their various corporate entities for unfair or deceptive trade practices. The assets of the Defendants were frozen and placed in receivership. Several single-member Florida limited liability companies ("**LLCs**") were included in the assets that were frozen and placed in receivership. Some of the LLCs were wholly-owned by Shaun and some were wholly-owned by Julie. The FTC also obtained a judgment for injunctive relief and for restitution in the amount of $10 million. The FTC obtained an order compelling the Defendants to endorse and surrender to the receiver all of their right, title and interest in the LLCs.

The Defendants appealed the order compelling them to endorse and surrender all their right, title and interest in the LLCs and the Eleventh Circuit Court of Appeal certified the following question to the Supreme Court of Florida:

> Whether, pursuant to Fla. Stat. § 608.433(4), a court may order a judgment-debtor to surrender all 'right, title and interest' in the debtor's single-member limited liability company to satisfy an outstanding judgment.

The Supreme Court of Florida rephrased the certified question as follows:

> Whether Florida law permits a court to order a judgment debtor to surrender all right, title, and interest in the debtor's single-member limited liability company to satisfy an outstanding judgment.

The Defendants argued that the only remedy available against their ownership interests in the LLCs is a charging order, which is the sole remedy authorized by Florida Statutes § 608.433(4). The FTC countered that a charging order is not the sole remedy available to a judgment creditor of the owner of a single-member limited liability company.

Fla. Stat. § 56.061 provides that various categories of real and personal property, including "stock in corporations shall be subject to levy and sale under execution."

Florida Statutes § 608.433(4) provides:

> On application to a court of competent jurisdiction by any judgment creditor of a member, the court may charge the limited liability company membership interest of the member with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of such interest. This chapter does not deprive any member of the benefit of any exemption laws applicable to the member's interest.

The court recognized that the sole member in a single-member LLC may freely transfer his or her interest in the company. The court reasoned that since Florida Statutes § 608.433(4) provides that a "judgment creditor has only the rights of an assignee of [an LLC] interest" it acknowledges that a judgment creditor cannot defeat the rights of nondebtor members of a LLC to withhold consent to the transfer of management rights. The FTC argued that this provision does not support an interpretation which gives a judgment creditor of the sole owner of an LLC less extensive rights than the rights that are freely assignable by the judgment debtor.

The FTC also argued that on its face Florida Statutes § 608.433(4) establishes a nonexclusive remedy because there is no express provision in the statutory text providing that the charging order remedy is the only remedy available for a judgment debtor's membership interest in an LLC. Furthermore, the FTC emphasized that the LLC statute stands in stark contrast to the charging order provisions in both the Florida Revised Uniform Partnership Act and the Florida Revised Uniform Limited Partnership Act. The FTC argued that each of these statutes includes language in the statutory text providing that the charging order is the exclusive remedy.

The FTC further argued that "when the legislature has inserted a provision in only one of two statutes that deal with closely related subject matter, it is reasonable to infer that the failure to include that provision in the other statute was deliberate rather than inadvertent." Thus, the FTC argued that the Florida legislature demonstrated in both the partnership statute and the limited partnership statute that it knows how to provide that a charging order remedy is an exclusive remedy in a statute. Therefore, the existence of the express exclusive remedy

language in the partnership and limited partnership statutes undermines the Defendants' argument that the charging order is the exclusive remedy under the LLC statute because that statute omits the exclusive remedy language. Furthermore, the FTC emphasized that the Defendants' position is further vitiated by the general rule that "repeal of a statute by implication is not favored and will be upheld only where irreconcilable conflict between the later statute and earlier statute shows legislative intent to repeal" and the specific presumption against the "[s]tatutory abrogation by implication of an existing common law remedy, particularly if the remedy is long established."

The court concluded that there was no reasonable basis for inferring that the provision authorizing the use of charging orders under Florida Statutes § 608.433(4) establishes the sole remedy for a judgment creditor against a judgment debtor's interest in a single-member LLC. **The court answered the certified question (as rephrased) in the affirmative and ruled that a court may order a judgment debtor to surrender all right, title, and interest in an LLC to satisfy an outstanding judgment**.

There was also an extensive dissenting opinion in *Olmstead*. It noted the majority opinion did not answer the certified question proffered by the Eleventh Circuit.

Judge Lewis wrote:

> when the Legislature amended the LLC requirements for formation to allow single-member LLCs, it did not enact other changes to the provisions in the LLC Act relating to an involuntary assignment or transfer of a membership interest to a judgment creditor of a member or to the remedies afforded to a judgment creditor. Moreover, no other amendments were made to the statute to demonstrate any different application of the provisions of the LLC Act to single-member and multi-member LLCs. For example, the LLC Act generally does not refer to the number of members in an LLC within the separate statutory provisions. The Legislature is presumed to have known of the charging order statute and other remedies when it introduced the single-member LLC statute. Accordingly, by choosing not to make any further changes to the statute in response to this addition, the Legislature indicated its intent for the charging order provision and other statutory remedies to apply uniformly to all LLCs. This Court should not disregard the clear and plain language of the statute.

The dissent also noted that the majority in *Olmstead* may have now provided an opportunity for a creditor to argue that a charging order is also not an exclusive remedy in the context of multi-member LLCs.

In response to *Olmstead*, various Florida bar committees worked to create an amendment to Florida Statute Section 608.433. On May 31, 2011, Governor Scott signed CS/SB 1152. The note to this bill provided that the amendment to Florida Statutes § 608.433 "is intended by the Legislature to be clarifying and remedial in nature and shall apply retroactively."

This amendment (also referred to as the "**Olmstead patch**") clarifies the existing statute by explicitly making it applicable to multi-member LLCs. Thus, the sole and exclusive remedy for a judgment creditor of a multi-member LLC member is a charging order. See also, *Young v. Levy,* 39 Fla. L. Weekly D1268b (Fla. 4th DCA 2014). The amendment goes on to provide details of how a single member LLC interest may be foreclosed upon by a judgment creditor.

Florida Statutes § 608.433 now provides:

> (1) Unless otherwise provided in the articles of organization or operating agreement, an assignee of a limited liability company interest may become a member only if all members other than the member assigning the interest consent.
> (2) An assignee who has become a member has, to the extent assigned, the rights and powers, and is subject to the restrictions and liabilities, of the assigning member under the articles of organization, the operating agreement, and this chapter. An assignee who becomes a member also is liable for the obligations of the assignee's assignor to make and return contributions as provided in s. 608.4211 and wrongful distributions as provided in s. 608.428. However, the assignee is not obligated for liabilities which are unknown to the assignee at the time the assignee became a member and which could not be ascertained from the articles of organization or the operating agreement.
> (3) If an assignee of a limited liability company interest becomes a member, the assignor is not released from liability to the limited liability company under s. 608.4211, s. 608.4228, or s. 608.426.
> (4)(a) On application to a court of competent jurisdiction by any judgment creditor of a member or a member's assignee, the court may enter a charging order against the limited liability company interest of the judgment debtor or assignee rights for the unsatisfied amount of the judgment plus interest.
>
> (b) A charging order constitutes a lien on the judgment debtor's limited liability company interest or assignee rights. Under a charging order, the judgment creditor has only the rights of an assignee of a limited liability company interest to receive any distribution or distributions to which the judgment debtor would otherwise have been entitled from the limited liability company, to the extent of the judgment, including interest.
>
> (c) This chapter does not deprive any member or member's assignee of the benefit of any exemption law applicable to the member's limited liability company interest or the assignee's rights to distributions from the limited liability company.
> (5) Except as provided in subsections (6) and (7), a charging order is the sole and exclusive remedy by which a judgment creditor of a member or member's assignee may satisfy a judgment from the judgment debtor's interest in a limited liability company or rights to distributions from the limited liability company.
> (6) In the case of a limited liability company having only one member, if a judgment creditor of a member or member's assignee establishes to the satisfaction of a court of competent jurisdiction that distributions under a charging order will not satisfy the judgment within a reasonable time, a

charging order is not the sole and exclusive remedy by which the judgment creditor may satisfy the judgment against a judgment debtor who is the sole member of a limited liability company or the assignee of the sole member, and upon such showing, the court may order the sale of that interest in the limited liability company pursuant to a foreclosure sale. A judgment creditor may make a showing to the court that distributions under a charging order will not satisfy the judgment within a reasonable time at any time after the entry of the judgment and may do so at the same time that the judgment creditor applies for the entry of a charging order.

(7) In the case of a limited liability company having only one member, if the court orders foreclosure sale of a judgment debtor's interest in the limited liability company or of a charging order lien against the sole member of the limited liability company pursuant to subsection (6):

(a) The purchaser at the court-ordered foreclosure sale obtains the member's entire limited liability company interest, not merely the rights of an assignee;

(b) The purchaser at the sale becomes the member of the limited liability company; and

(c) The person whose limited liability company interest is sold pursuant to the foreclosure sale or is the subject of the foreclosed charging order ceases to be a member of the limited liability company.

(8) In the case of a limited liability company having more than one member, the remedy of foreclosure on a judgment debtor's interest in such limited liability company or against rights to distribution from such limited liability company is not available to a judgment creditor attempting to satisfy the judgment and may not be ordered by a court.

(9) Nothing in this section shall limit:

(a) The rights of a creditor that has been granted a consensual security interest in a limited liability company interest to pursue the remedies available to such secured creditor under other law applicable to secured creditors;

(b) The principles of law and equity which affect fraudulent transfers;

(c) The availability of the equitable principles of alter ego, equitable lien, or constructive trust, or other equitable principles not inconsistent with this section; or

(d) The continuing jurisdiction of the court to enforce its charging order in a manner consistent with this section.

xii. **Bankruptcy & Charging Orders**.

(A) **Single Member LLCs**: *In re Albright*, 291 B.R. 538 (2003), involved a single member limited liability company known as Western Blue Sky LLC (the "**LLC**") owned by a debtor, Ashley Albright ("**D**"). The LLC was formed under Colorado law. D was also the sole acting manager of the LLC. The LLC owned certain real estate located in Colorado. The bankruptcy trustee ("**T**") asserted that T owned and controlled the LLC and therefore could cause it to sell its real estate and distribute the proceeds of such sale to the bankruptcy estate because D was the sole member and manager of the LLC. Alternatively, if T controlled the LLC, he could liquidate the LLC in favor of the bankruptcy

estate. D, however, argued that T was only entitled to a charging order over her one hundred percent (100%) interest in the LLC.

In regards to D's argument that a charging was the only appropriate remedy the court noted that a charging order:

> exists to protect other members of an LLC from having involuntarily to share governance responsibilities with someone they did not choose, or from having to accept a creditor of another member as a co-manager. A charging order protects autonomy of the original members, and their ability to manage their own enterprise. In a single member entity, there are no non-debtor members to protect. The charging order limitation serves no purpose in a single member limited liability company, because there are not other parties' interests affected.

The court held that when D filed bankruptcy she assigned her membership interest in the LLC to the bankruptcy estate and T obtained all of her rights, including control over the management of the company. Thus, the court held that T, as the sole member of the LLC, could cause the LLC to sell all of its property and distribute the net proceeds of such sale to the bankruptcy estate. Alternatively, the court held that T could merely liquidate the LLC and distribute its assets to bankruptcy estate.

In a footnote [see Footnote 7 of the case] the court mentioned that the result in this case would be different under Colorado law if there were other non-debtor members in the LLC. The court mentioned:

> Where a single member files bankruptcy while the other members of a multi-member LLC do not, and where the non-debtor members do not consent to a substitute member status for a member interest transferee, the bankruptcy estate is only entitled to receive a share of profits or other compensation by way of income and the return of the contributions to which that member would otherwise be entitled.

In another footnote [see Footnote 9] the court noted:

> The harder question would involve an LLC where one member effectively controls and dominates the membership and management of an LLC that also involves a passive member with a minimal interest. If the dominant member files bankruptcy, would a trustee obtain the right to govern the LLC? Pursuant to Colo. Rev. Stat. § 7-80--702, if the non-debtor member did not consent, even if she held only an infinitesimal interest, the answer would be no. The Trustee would only be entitled to a share of distributions and would have no role in the voting or governance of the company. Notwithstanding this limitation, 7-80-702 does not create an asset shelter for clever debtors. To the extent a debtor intends to hinder, delay or defraud creditors through a multi-member LLC with "peppercorn" co-members, bankruptcy avoidance provisions and fraudulent transfer law would provide creditors or a bankruptcy trustee with recourse. 11 U.S.C. §§ 544(b)(1) and 548(a).

See also *In re Modanlo*, 2007 WL 2609470 (Bankr. D. Md. 2006); *Olmstead v. FTC*, 2010 WL 2518106 (June 24, 2010); *In re First Protection, Inc.*, 440 B.R. 821; 2010 WL 5059589 (B.A.P. 9th Cir. 2010 (Arizona); *In re B & M Land & Livestock, LLC*, 498 B.R. 262, 267 (Bankr.D.Nev.2013); and *In re Cleveland*, 2014 WL 4809924 (D. Nev. Sept. 29, 2014). See also, Riser & Adkisson "*In re Cleveland*: US District Court for District of Nevada Allows Chapter 7 Bankruptcy Trustee to Sell Assets Two Single-Member LLCs," LISI Asset Protection Planning Newsletter #264, (October 15, 2014) at http://www.LeimbergServices.com.

xii. **Other SMLLC Cases**.

See *Voll v. Dunn*, 2014 WL 7461644 (Unpublished Opinion, Superior Court of Connecticut) (Nov. 10, 2014) (court held SMLLC interest not protected by charging order in Connecticut); and *Greenhunter Energy, Inc. v. Western Ecosystems Tech., Inc.*, 2014 WY 144, 2014 WL 5794332 (Wyo., Nov. 7, 2014) (Wyoming Supreme Court permitted piercing of the viel of a SMLLC to collect debt owed by LLC.). For a discussion of the *Greenhunter* case see, Riser & Adkisson, "*Greenhunter*: Wyoming Supreme Court Allows Piercing of Limited Liability Veil of a Wyoming LLC," LISI Asset Protection Planning Newsletter #278 (January 8, 2015) at http://www.LeimbergServices.com.

(B) **Passive Interests**: In *In re Ehmann*, 319 B.R. 200 (2005), the bankruptcy trustee sued Fiesta Investments, LLC ("**FI**"), an Arizona limited liability company, seeking a declaration from the court that the trustee had the status of a member in FI and that the assets of FI were being wasted, misapplied or diverted for improper purposes, and an order for dissolution and liquidation of the company or an appointment of a receiver for the company. FI was formed in 1998 by the debtor's ("**D**") parents. At the time FI was formed it owned two (2) assets, a seventeen percent (17%) interest in City Leasing Co. Ltd. and a twenty-five percent (25%) interest in Desert Farms LLC. Shortly after D filed bankruptcy, however, City Leasing Co. Ltd. was liquidated resulting in FI receiving about $837,000. FI also receives regular distributions of cash from FI.

No formal profit distributions were declared or made to the members of FI after D filed for bankruptcy. Nonetheless, the court noted:

> substantial amounts of cash have flowed out of Fiesta to or for the benefit of other members, including $374,500 in loans to members or to corporations owned or controlled by members, a $42,000 payment to one member, and $124,000 paid to another member to redeem his interest. In response to the Trustee's demand for information and distributions, the managing member of Fiesta, the Debtor's father, responded that he had created "Fiesta a few years ago to remove assets from our estate for estate tax purposes, and to accumulate investments for the benefit of our children after our deaths…. [W]e see no reason to accede to the wishes of any member or assignee of any member which runs contrary to our original goals." Yet the outflow of over half a million dollars does seem to be inconsistent with the original goal "to accumulate investments for the benefit of our children after our deaths."

The court noted that the outcome of the case was governed by §§ 365(e)(2) and 541(c)(1) of the Bankruptcy Code. Generally, if § 541(c)(1) is applicable, it would permit the enforcement of restrictions on the trustee's rights and powers under state law and in contractual arrangements. On the other hand, if § 365(e)(2) is applicable, any such restrictions would be unenforceable against the trustee.

Section 365(c) of the Bankruptcy Code provides:

> The trustee may not assume or assign any executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if-
> (1) (A) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to an entity other than the debtor or the debtor in possession, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and (B) such party does not consent to such assumption or assignment; or
>
> (2) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor;
>
> (3) such lease is of nonresidential real property and has been terminated under applicable nonbankruptcy law prior to the order for relief; or
>
> (4) such lease is of nonresidential real property under which the debtor is the lessee of an aircraft terminal or aircraft gate at an airport at which the debtor is the lessee under one or more additional nonresidential leases of an aircraft terminal or aircraft gate and the trustee, in connection with such assumption or assignment, does not assume all such leases or does not assume and assign all of such leases to the same person, except that the trustee may assume or assign less than all of such leases with the airport operator's written consent.

Section 365(e) of the Bankruptcy Code provides:

> (1) Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on-
>
> (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
>
> (B) the commencement of a case under this title; or
>
> (C) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.

(2) Paragraph (1) of this subsection does not apply to an executory contract or unexpired lease of the debtor, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties, if-

(A)

(i) applicable law excuses a party, other than the debtor, to such contract or lease from accepting performance from or rendering performance to the trustee or to an assignee of such contract or lease, whether or not such contract or lease prohibits or restricts assignment of rights or delegation of duties; and

(ii) such party does not consent to such assumption or assignment; or

(B) such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor, or to issue a security of the debtor.

Section 541(c) of the Bankruptcy Code provides:

(1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law-

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

(2) A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

FI argued that its operating agreement provided that if "a trustee acquires a member's interests, such action shall not dissolve the company or entitle "any such assignee to participate in the management of the business and affairs of the company or to exercise the right of a Member unless such assignee is admitted as a Member…." FI also argued that the operating agreement provided that "an assignee that has not become a Member is only entitled to receive to the extent assigned the share of distributions…. to which such Member would otherwise be entitled with respect to the assigned interest." Finally, FI asserted that the foregoing limitations were specifically authorized by Arizona law and that the trustee was a judgment creditor which was only entitled to a charging order. (Under Arizona law a charging order is the exclusive remedy available to a creditor seeking to satisfy a judgment against a member of an LLC. See A.R.S. § 29-655(c).) Notwithstanding the foregoing, FI did not argue that its operating agreement created an executory contract between its members and the LLC.

According to the court, a contract is executory when the obligations of both parties are so far unperformed that the failure of either party to complete performance would be a material breach and therefore excuse performance of the other party.

The court noted:

> While Fiesta undoubtedly owes many obligations to its members pursuant to the Operating Agreement, for the contract to be executory there would also have to be some material obligation owing to the company by the member. Moreover, such member's obligations must be so material that if the member did not perform it, Fiesta would owe no further obligations to that member.

For those who have counseled clients to create LLCs and limited partnerships for estate planning benefits and have espoused the benefits of the charging order for such entities for creditor protection purposes, such practitioners should be aware that the court noted:

> Moreover, the founding member's statement of the purposes for which the company was formed suggests that it is very likely there are no such obligations. The purpose was twofold: to remove assets from the parents' estates for estate tax purposes, and to accumulate investments for the benefit of their children after their deaths. One would certainly not expect the children-members to have any obligations with respect to satisfaction of that first goal, which was a unilateral act by the parents, and it is highly unlikely the children-members undertook any obligations with respect to the second goal any more than would an ordinary prospective heir.

The court held that the operating agreement for FI imposed no obligations on the members to the company. The court stated:

> it is facile to assume that all partnership agreements are executory contracts. Closer analysis reveals that if there are no material obligations that must be performed by the members of a limited liability company or the limited partners in a limited partnership, then the contract is not executory and is not governed by Code § 365. This case is therefore unlike others that have expressly found "an obligation to contribute capital" and other "continuing fiduciary obligations among the partners that make this [Partnership] Agreement an executory contract."

The operating agreement was not an executory contract. Thus, the trustee was held to receive all of the rights that the debtor possessed over the debtor's membership interest in FI and any restrictions in the operating agreement or under Arizona law (such as the charging order restriction) were held not to apply. As a result, the court noted:

> It therefore appears that the Trustee may be able to prove a set of facts that would entitle the Trustee to some remedy. The appropriate remedy might include a declaration of the Trustee's rights, redemption of the Debtor's interest, appointment of a receiver to operate the partnership in accordance with its purposes and the members' rights, or dissolution, wind up and liquidation.

As an epitaph to this case the bankruptcy court granted an order withdrawing its original opinion and order dated December 7, 2005 on January 25, 2006. The LLC settled all of the creditor's claims against it in this matter for eighty-five thousand dollars ($85,000). The settlement was made conditioned on the court withdrawing its original opinion. According to the court:

> Here, it is essentially conceded that the general manager of Defendant Fiesta Investments is particularly interested in eliminating any precedential effect this Court's December 7th Opinion might have, because his principal occupation is as a tax lawyer who frequently advises clients in the use of limited liability companies for estate planning purposes.

The court agreed to withdraw its original opinion in the interest of the creditors having their claims settled in a timely manner.

For additional cases in Banrkruptcy Court involving membership interests in partnerships and limited liability companies and executory contacts see *In re Denman*, 513 B.R. 720, 59 Bankr. Ct. Dec. 219 (2014) (operating agreement for a Tennessee limited liability company cannot constitute an executory contact because of the distinct characteristics of the law related to limited liability companies); *In re Garrison-Ashburn*, L.C., 253 B.R. 700 (Bankr. E.D. Va. 2000); *In re Capital Acquisitions & Management Corp.*, 341 B.R. 632 (Bankr. N.D. Ill. 2006); *In re Tsiaoushis*, 383 B.R. 616 (Bankr. E.D. Va. 2007); *In re Warner*, 480 B.R. 641 (Bankr. N.D. W. Va. 2012); *In re Prebul*, 2011 WL 2947045 (Bankr. E.D. Tenn. 2011); and *In re Alameda Investments, LLC*, 2013 WL 3216129 (Bankr. C.D. Cal. 2013). But see *contra*, *In re Tsiaoushis*, 383 B.R. 616 (Bankr. E.D. Va. 2007) (no "per se" rule for determining whether an operating agreement for an LLC constitutes an executory contract); *In re Daugherty Construction, Inc.*, 188 B.R. 607 (Bankr. D. Neb. 1995); *In re Deluca*, 194 B.R. 65 (Bankr. E.D. Va. 1996); and *In re Allentown Ambassadors, Inc.*, 361 B.R. 422 (Bankr. E.D. Pa. 2007).

(C) **Situs of Membership Interest**. In *Koh v. Inno-Pacific Holdings*, Ltd., 54 P.3d 1270 (Wash. App. Div. 1 2002), Inno-Pacific Holdings, Ltd. ("**Inno-Pacific**") was a publicly traded corporation located in Singapore. Its principal place of business was in Singapore. Inno-Pacific employed Kay Yew Koh ("**Koh**") to conduct business activities on its behalf in California. Koh sued Inno-Pacific for wrongful termination in California and obtained a $240,000 (Singapore dollars) money judgment against Inno-Pacific. In post-judgment discovery Koh discovered that Inno-Pacific owned a 50% interest in Sawyer Falls, a Washington limited liability company ("**SF**"). SF had an agent in Washington state and owned 478 acres of undeveloped real property there for a long-term development project. SF's principal place of business was registered as Malaysia. SF also represented that its main office, officers, employees, books and records were all located in Malaysia.

Koh obtained a charging order in King County Superior Court (in Washington) against Inno-Pacific's interest in SF. Inno-Pacific filed a motion to quash the charging order based on lack of personal jurisdiction and lack of *in rem* jurisdiction. The trial court in Washington quashed the charging order holding that the court lacked jurisdiction over Inno-Pacific's membership interest in SF because the membership interest was personal property and therefore should be deemed located outside Washington where the owner-member is located.

On appeal, Inno-Pacific argued that an entity's interest in an LLC exists where the entity resides, that is, Singapore. Koh countered an entity's interest in an LLC is located where that company is formed. Inno-Pacific argued that "personal property is located where the owner is domiciled." However, Koh argued that the language of the LLC statute appears to reflect that a partnership interest is located where the partnership is formally organized. It provides:

> On application to a court of competent jurisdiction by any judgment creditor of a member, the court may charge the limited liability company interest of the member with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of the limited liability company interest. This chapter does not deprive any member of the benefit of any exemption laws.

Further, Koh cited the Pennsylvania case of *Rankin v. Culver*, 154 A. 701(1931), to support the proposition that an LLC is subject to a charging order in the state it is formed. In *Rankin*, the Supreme Court of Pennsylvania analyzed whether a creditor could attach the partnership interest of a nonresident debtor when the partnership was organized and doing business in Pennsylvania. *Rankin* held that an interest of a partner in firm assets is personalty and subject to foreign attachment and further held that a partnership doing business in Pennsylvania constituted a property interest in Pennsylvania to those who owned an interest in the partnership.

Koh also cited *Federal Deposit Insurance Corporation v. Birchwood Builders, Inc.*, 573 A.2d 182 (1990), in which a plaintiff obtained a judgment in New York and discovered that the debtor, a resident of New York, owned 40% of a New Jersey partnership. The partnership owned a tract of vacant land in New Jersey. The court held that even though the owner of the partnership interest resided in New York, the partnership was incorporated in New Jersey and therefore the interest was subject to attachment in New Jersey.

The court reasoned that the cases cited by Koh illustrate that where an LLC organizes under the laws of a state, the LLC is located within that state. Thus, the court held that since SF was formed in Washington, maintained an office and registered agent in Washington and owned a parcel of real property in Washington, the LLC interest was located in Washington and was subject to the charging order in Washington.

In *Wells Fargo Bank v. Barber,* Wells Fargo Bank and Regions Bank (collectively, the "**Plaintiffs**"), sought to enforce a state court judgment against Sabrina Barber ("**Barber**") and Blaker Enterprises, LLC ("**Blaker**") (collectively, the "**Defendants**"). The Plaintiffs held a deficiency judgment against Barber in the amount of $62,491,162.98, entered by a Florida state court on October 3, 2013 (the "**Deficiency Judgment**"). On June 6, 2014, counsel for the Plaintiffs deposed Barber in aid of execution of the Deficiency Judgment. As a result of Barber's deposition, the Plaintiffs discovered certain transfers of money by Barber which gave rise to the claims the Plaintiffs alleged in their complaint.

Prior to April 13, 2009, Barber received $1,000,000 from the sale of her former marital home through the dissolution of her marriage. Barber deposited these funds into an account

with American Momentum Bank. Barber then used these funds to purchase a certificate of deposit with American Momentum Bank. On February 17, 2010, Barber then transferred the certificate of deposit to an account with AIG Bank. Barber testified at her deposition that she intended to use these funds to purchase a home. Barber withdrew $227,026.20 from the AIG Bank account on April 15, 2010 and used the money to purchase a home in Winter Garden, Florida.

On January 10, 2011, Barber formed Blaker. On February 28, 2011, Barber withdrew $641,350.00 from the AIG Bank account and withdrew $228,650.49 from a second AIG account, for a total withdrawal of $870,000.49. Barber then deposited these funds into a brokerage account with TD Ameritrade established in Blaker's name.

In September 2011, Blaker transferred $275,000.00 from the TD Ameritrade account back to the AIG Bank account. On February 9, 2012, Barber transferred $220,000.00 out of the AIG account. On April 2, 2012, Blaker transferred $110,000.00 from the TD Ameritrade account into a new account with TD Ameritrade.

On June 10, 2014, the Plaintiffs filed a complaint in which they alleged four claims for relief. Count 1 alleged a claim for injunctive relief; Count 2 alleged a claim to foreclose Barber's membership interest in Blaker or, in the alternative, for a charging order against that interest; Count 3 sought to avoid the fraudulent transfers of Barber and Blaker based on actual fraud; Count 4 sought to avoid the fraudulent transfers of Barber and Blaker based on constructive fraud. The Defendants moved to dismiss the complaint for lack of subject matter jurisdiction and for failing to state claims upon which relief could be granted.

Upon filing the Complaint, the Plaintiffs additionally filed an Emergency Motion for Temporary Restraining Order and Preliminary Injunction. On June 13, 2014, the court denied the Plaintiffs' request for an emergency temporary restraining order and set the matter for a hearing on the issuance of a preliminary injunction. After conducting a hearing on the matter, the court denied the Plaintiffs' request for a preliminary injunction on July 17, 2014.

The Defendants moved to dismiss Count 1 of the complaint on the basis that injunctive relief was not a cognizable claim, but rather a remedy that may be issued upon a finding of liability. The Defendants' motion to dismiss was granted as to Count 1.

With respect to Count 2 of the complaint, the Florida Limited Liability Company Act (the "**Florida LLC Act**"), Fla. Stat. §§ 608.401–.705, provides that a judgment creditor to any member of a limited liability company may obtain a charging order against the member's interest in the company or foreclose that interest in the company under certain circumstances. As to a charging order, the Florida LLC Act provides:

> On application to a court of competent jurisdiction by any judgment creditor of a member or a member's assignee, the court may enter a charging order against the limited liability company interest of the judgment debtor or assignee rights for the unsatisfied amount of the judgment plus interest. Fla. Stat. § 608.433(4)(a).

A charging order issued under Fla. Stat. § 608.433(4)(a) acts as a lien on the member's interest in the limited liability company and grants the judgment creditor the right to receive distributions from the company which the member would have otherwise been entitled to receive.

Generally, a charging order is the sole and exclusive remedy by which a judgment creditor may satisfy a judgment from a member's interest in a limited liability company or distributions therefrom. See Fla. Stat. § 608.433(5). However, where the limited liability company has only one member, the Florida LLC Act allows a judgment creditor to foreclose the member's interest in the company as follows:

> [I]f a judgment creditor of a member ... establishes to the satisfaction of a court of competent jurisdiction that distributions under a charging order will not satisfy the judgment within a reasonable time, a charging order is not the sole and exclusive remedy by which the judgment creditor may satisfy the judgment against a judgment debtor who is the sole member of a limited liability company ..., and upon such showing, the court may order the sale of that interest in the limited liability company pursuant to a foreclosure sale. A judgment creditor may make a showing to the court that distributions under a charging order will not satisfy the judgment within a reasonable time at any time after the entry of the judgment and may do so at the same time that the judgment creditor applies for the entry of a charging order. Fla. Stat. § 608.433(6).

The purchaser of the member's interest at a foreclosure sale steps into the shoes of the member for all purposes and the member loses all interests and rights in the company. Fla. Stat. §608.433(7).

The Defendants challenged Count 2 of the complaint on the grounds that the court lacked jurisdiction to either foreclose Barber's interest in Blaker or to enter a charging order against that interest. The Defendants' argued that because Blaker was organized under the laws of Nevis, Blaker was a foreign limited liability company beyond the *in rem* or *quasi in rem* jurisdiction of the court.

The Defendants relied on *Sargeant v. Al–Saleh*, 137 So.3d 432 (Fla.Dist.Ct.App.2014). In *Sargeant*, the trial court ordered debtors to turn over their stock certificates in a foreign corporation in order to help satisfy a creditor's judgment. *Sargeant*, 137 So.3d at 433. The debtors in *Sargeant* asserted that the trial court lacked the authority to compel the turnover because the stock certificates were located outside the court's *in rem* jurisdiction. *Id.* at 433–34. Upon review, the Fourth District Court of Appeal agreed, holding that courts may only exercise jurisdiction over property of a debtor located within the court's jurisdictional territory. *Id*. at 435. Because the stock certificates in *Sargeant* were located in the Bahamas, the Netherlands, Jordan, the Isle of Man, and the Dominican Republic, the Florida trial court erred in compelling their turnover. *Id*.

The *Barber* court held that unlike stock certificates in a corporation, a membership interest in a limited liability company was intangible personal property, which "accompanies the person of the owner." *Beverly Beach Props. v. Nelson*, 68 So.2d 604, 611 (Fla.1953), cert. denied 348 U.S. 816 (1954); cf. Restatement (Second) of Conflict of Laws sec. 65 and cmt. a (describing corporate shares not embodied by a document as intangible property). Therefore, because Barber resided in Florida, Barber's membership interest in Blaker was found to be located with Barber in Florida, and the interest was subject to the court's *in rem* jurisdiction.

The Defendants challenged Count 2 for failing to state a claim. Specifically, the Defendants contended that any charging order against or foreclosure of a membership interest in Blaker should be made pursuant to Nevis law. The court was confronted with a conflict-of-laws issue as to whether it should apply the Florida LLC Act or whether it should apply Nevis law—in this case, the Nevis Limited Liability Company Ordinance of 1995 (hereinafter referred to and cited as the "**Nevis LLC Ordinance**").

The Florida LLC Act provides two avenues for a judgment creditor to recover from a judgment debtor's membership interest in a limited liability company. First, the judgment creditor may apply to a court for a charging order to receive distributions from the company to which the judgment debtor would otherwise be entitled. Fla. Stat. § 608.433(4). Second, in cases where the judgment debtor is the sole member of the limited liability company, the judgment creditor may apply to a court to foreclose the judgment debtor's interest in the company upon the proper showing. Fla. Stat. § 608.433(6).

The Nevis LLC Ordinance also allows for the entry of a charging order against a judgment debtor's membership interest in a limited liability company:

> On application to a court of competent jurisdiction by any judgment creditor of a member of a limited liability company, the court may charge the member's interest with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of the member's interest. Nevis LLC Ordinance sec. 43(1).

Nevis law is clear that such a charging order "shall be the sole remed[y] available to any creditor of a member's interest," thus excluding foreclosure of the membership interest regardless of the circumstances. *Id.* § 43(3). Moreover, Nevis law allows the non-charged members of the limited liability company to redeem a charged member's interest, while the Florida LLC Act does not. *Id*. § 43(2). Based on these distinctions, the court concluded that the remedies afforded to judgment creditors under the Florida LLC Act and the Nevis LLC Ordinance were not substantially similar and completed a traditional conflicts-of-law analysis.

When confronted with a "true" conflict-of-laws question, a federal court sitting in diversity must apply the forum state's choice of law rules. *Klaxon Co. v. Stentor Elec. Mfg*. Co., 313 U .S. 487, 496 (1941). "As a preliminary matter, the court must characterize the legal issue and determine whether it sounds in torts, contracts, property law, etc." *Grupo Televisa, S.A. v. Telemundo Commc'ns Grp., Inc.,* 485 F.3d 1233, 1240 (11th Cir.2007). Once the legal

issue has been characterized, the court applies the choice of law rules that the forum state applies to that category. *Id.*

Both the Florida LLC Act and the Nevis LLC Ordinance characterize membership interests in limited liability companies as personal property. Fla. Stat. § 608.431; Nevis LLC Ordinance § 38. Therefore, the court determined that the legal issue in this case sounded in property, and in Florida, the law of the situs of the property controls. W*ells Fargo Bank, N.A. v. Scalercio*, No. 11–60498–CIV., 2011 WL 6840583, (S.D.Fla. July 1, 2011) (citing *Quintana v. Ordono*, 195 So.2d 577, 579 (Fla.Dist.Ct.App.1967)); In re *Hillsborough Holdings Corp*., 207 B.R. 299, 302 (Bankr.M.D.Fla.1997). Since Barber resided in Florida the court held that Barber's membership interest in Blaker also resided in Florida. See *Nelson*, 68 So.2d at 611; cf. Restatement (Second) of Conflict of Laws sec. 65 and cmt. a. Therefore, court held that the situs of the property at issue in this case was Florida, and that Florida law applied. See *Scalercio*, 2011 WL 6840583. As a result, the Court analyzed Count 2 under the Florida LLC Act.

The court was satisfied that the Plaintiffs were plausibly entitled to enforce the Deficiency Judgment by foreclosing Barber's interest in Blaker, or in the alternative, by charging Barber's membership interest in Blaker. Further, the Court inferred that a charging order would not satisfy the Deficiency Judgment within a reasonable time, even considering any amounts the Plaintiffs could recover from the Defendants' other various bank accounts. Finally, there was no dispute that Barber was the sole member of Blaker, thus permitting foreclosure as a possible remedy (under the Florida LLC Act). For these reasons, the Plaintiffs sufficiently alleged a claim for foreclosure of interest, or in the alternative, for a charging order, and thus the court denied the Defendants' motion to dismiss as to Count 2.

The Florida Uniform Fraudulent Transfer Act ("**FUFTA**"), Fla. Stat. §§ 726.101–.201, provides creditors with various forms of relief to avoid a debtor's fraudulent transfer of assets or funds. A creditor may avoid a debtor's transfer where the creditor shows that the transfer was made "[w]ith actual intent to hinder, delay, or defraud." Fla. Stat. §§ 726.105(1)(a). FUFTA provides a non-exhaustive litany of factors—referred to as "badges of fraud"—to consider when determining whether a debtor's transfer is fraudulent as to her creditor:

> (a) The transfer or obligation was to an insider.
> (b) The debtor retained possession or control of the property transferred after the transfer.
> (c) The transfer or obligation was disclosed or concealed.
> (d) Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit.
> (e) The transfer was of substantially all the debtor's assets.
> (f) The debtor absconded.
> (g) The debtor removed or concealed assets.
> (h) The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred.

(i) The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation incurred.
(j) The transfer occurred shortly before or shortly after a substantial debt was incurred.
(k) The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

See Fla. Stat. § 726.105(2)(a)-(k).

A court may additionally consider any other factor it deems relevant and should look to the totality of the circumstances in determining actual fraud. *Gen. Trading Inc. v. Yale Materials Handling Corp*., 119 F.3d 1485, 1498 (11th Cir.1997). "The existence of badges of fraud creates a prima facie case and raises a rebuttable presumption that the transaction is void." *Wiand v. Lee*, 753 F.3d 1194, 2000 (11th Cir.2014) (quoting *Gen. Elec. Co. v. Chuly Int'l, LLC*, 118 So.3d 325, 327 (Fla.Dist.Ct.App.2013)) (internal quotation marks omitted).

FUFTA also allows a creditor to avoid a debtor's transfer that is constructively fraudulent. In order to establish a *prima facie* case for avoidance based on constructive fraud, the creditor must show that the debtor did not receive reasonable value for the transfer and either (1) the debtor was engaged or was about to engage in a business or transaction for which the debtor's remaining assets were unreasonably small in relation, (2) the debtor intended to, believed, or reasonably should have believed that she would incur debt beyond what she could pay as the debt became due, or (3) the debtor was insolvent at the time of the transfer. *Wiand v. Morgan*, 919 F.Supp.2d, 1342, 1355 and n. 14 (M.D.Fla. Jan. 23, 2013); see also Fla. Stat. §§ 726.105(1)(b), 726.106(1).

The Defendants argued that the Plaintiffs' factual allegations were insufficient to plead either actual or constructive theories of fraud. (Doc. 32, pp. 9–12). Specifically, the Defendants asserted that although the Plaintiffs alleged some badges of fraud, they ignored others that weighed against the Plaintiffs' case. For example, Barber had not absconded, she had not concealed or removed assets, and she voluntarily disclosed the status of her assets at her deposition. As to her transfers to Blaker, Barber stated that these transfers were made for legitimate investment purposes.

The court found that the complaint and the exhibits attached thereto showed numerous badges of fraud under FUFTA, including the following:

1. Barber's transfers to Blaker were transfers to an insider, as Barber was the sole member of Blaker;
2. Barber retained possession or control of the funds transferred to Blaker because Barber was the sole member of Blaker;
3. Barber transferred the funds shortly after the state court entered summary judgment against her and shortly before the Plaintiffs sued Barber for a deficiency judgment;
4. Barber's transfers to Blaker appear to constitute substantially all of Barber's assets; Barber did not receive any consideration from Blaker for the funds transferred; and
5. Barber was insolvent at the time she made the transfers to Blaker.

Due to the badges of fraud demonstrated by the complaint and the totality of the circumstances relating to Barber's transfers to Blaker, the court held that the Plaintiffs plausibly alleged a *prima facie* claim for avoidance based on actual fraud. For the same reasons, the court held that the Plaintiffs demonstrated that Barber did not receive sufficient consideration from Blaker for the transfers and that Barber was insolvent at the time of the transfers, thus alleging a *prima facie* claim for avoidance based on constructive fraud. Accordingly, the Defendants' motion to dismiss was denied as to Counts 3 and 4.

For an excellent discussion of *Barber*, see Riser & Adkison, LISI Asset Protection Planning Newsletter #286 (March 17, 2015) at http://www.leimbergservices.com; See also Gassman & Arango, LISI Asset Protection Planning Newsletter #287 (March 24, 2015) at http://www.leimbergservices.com.

See also *In re Blixseth*, 484 B.R. 360, (9th Cir. BAP (Nev.)) ("The sole issue in this appeal is whether, for venue purposes under 28 U.S.C. § 1408(1), Blixseth's principal assets, consisting of his intangible equity interests in Desert Ranch and Desert Management, were located in Nevada.") At common law, an intangible asset is deemed to be located where a person is domiciled (*mobilia sequuntur personam*). See *e.g.*, *Delaware v. New York,* 507 U.S. 490, 503 (1993).

In *Blixseth*, On April 5, 2011, the Montana Department of Revenue ("**C**") filed an involuntary bankruptcy petition under Chapter 7 against Timothy L. Blixseth ("**D**") in the bankruptcy court for the District of Nevada. (Two other creditors joined C's petition, however, they settled with D soon after filing and were not relevant to this case.) C's petition listed D's residence and mailing address as located in the state of Washington, and D's "county of residence or principal place of business" as located in the state of Nevada. C asserted a claim against D in the amount of $219,258.

Section 1408(1) of Title 28 of the United States Code provides that venue for a bankruptcy case may be based upon the debtor's (1) domicile, (2) residence, (3) principal place of business in the United States, or (4) principal place of assets in the United States (the "**principal assets test**"). Proper venue is determined by reference to the facts existing within the 180–day period prior to the filing of the petition. 28 U.S.C. § 1408(1). Any of these four factors is sufficient to support proper venue.

On April 8, 2011, the bankruptcy court, acting *sua sponte*, entered an order to show cause why venue was proper in Nevada, noting that D's Washington street and mailing address were listed in C's petition. The bankruptcy court expressed concern that venue in Nevada was not proper "because of the paucity of the connection between D and [Nevada]."

C responded that the only indicator as to proper venue for the involuntary bankruptcy case under 28 U.S.C. § 1408(1) was that D "had transferred most of his assets out of his personal name and into two Nevada corporate entities." C asserted that D's principal assets consisted of his 98% interest in Desert Ranch LLLP, a Nevada limited liability limited partnership ("**Desert Ranch**"), and his 40% interest in Desert Ranch Management LLC, a Nevada limited liability company ("**Desert Management**"). (Desert Ranch and Desert

Management are collectively referred to as the "**Entities**" and D's interests in the Entities is collectively referred to as the "**Interests**.") Desert Ranch was a holding company for several non-Nevada entities, whose principal assets are real estate located in Idaho, Washington, California, Mexico and the Turks & Caicos. D's interest in Desert Management comprised the rest of his principal assets. Desert Management was the general partner of Desert Ranch, holding a 2% interest in Desert Ranch.

C asserted that the principal assets test provided the proper basis for venue. First, C explained that it was unclear whether D resided or was domiciled in Washington because the public real property records indicated his residence there was owned by a corporation. Second, C asserted that D transferred all of his valuable assets into Desert Ranch, which was co-managed by D and his son through Desert Management, both of which were Nevada entities. Therefore, C argued that D's principal assets were located in Nevada.

C also asserted that D had a statutory connection with Nevada regarding the governance and operation of the Entities. C argued that, based on Nevada's charging order statutes for LLCs and LLLPs, and a decision by a Washington appellate court interpreting a statute similar to those Nevada statutes for venue purposes the location of a debtor's uncertificated interest in an LLC or LLLP was the entity's state of registration. C also argued that because Nevada law could apply to unwind transfers to the Entities, Nevada had a greater interest in the case than Washington. Therefore, in the interests of justice, venue should be in Nevada, not Washington.

D asserted that there was no basis for venue in Nevada. D and his son co-managed Desert Management, however, Desert Management had no offices or place of business, and did not conduct business, in Nevada. Also, D argued that under case law and the UCC, intangible assets are located at a person's domicile (the "**common law principle**"). D affirmed that he had resided in Washington since 2007. Therefore, D argued that proper venue was in Washington.

The bankruptcy court concluded that intangible ownership interests have no physical location (an argument neither party had made). Therefore, the bankruptcy court determined that, in this case, venue based on the principal assets test was unavailable, and that venue must be based on one of the other factors under 28 U.S.C. § 1408(1). It was undisputed that D did not reside, was not domiciled, and did not have a principal place of business in Nevada. Therefore, there was no other basis for venue in Nevada. Alternatively, the bankruptcy court noted that courts have applied the common law principle for various non-venue purposes. It was undisputed that D did not reside in Nevada at any time relevant to this case. Therefore, the bankruptcy court reasoned that, if the principal assets test applied, under the common law principle the Interests were not located in Nevada.

The main question on appeal was whether D's principal assets, consisting of the Interests, were located in Nevada for purpose of venue of the bankruptcy case. It was undisputed that the Entities were established under and existed pursuant to Nevada law. D also did not contest that the Interests constituted his "principal assets."

The Bankruptcy Appellate Court for the Ninth Circuit (the "**Court**") agreed with the trial court that intangible property has no physical location and that the situs of intangible

property is a "legal fiction." See *e.g.*, *Delaware v. New York,* 507 U.S. 490, 503 (1993). The Court noted that it was "tempted" to agree with the trial court's primary holding that because intangible property has no physical location venue based on the principal assets test was inapplicable and therefore, bankruptcy venue must be based on one of the other three alternatives in 28 U.S.C. § 1408(1).

However, the Court reasoned that even though intangible property has no physical location courts have frequently ascribed a location to intangible assets for various purposes. The Ninth Circuit had held in a case involving internet domain names that in determining the location of intangible property for venue purposes a trial court must adopt a "context-specific" analysis that employs a "common sense appraisal of the requirements of justice and convenience in particular conditions." *Office Depot, Inc. v. Zuccarini*, 596 F.3d 696, 702 (9th Cir. 2010). The Court argued that the "principal place of assets" should "be construed in a way most resonant with the functional concerns of the administration of the bankruptcy estate [since] all assets in question will be administered by a trustee serving under the jurisdiction of the forum court." *In re Murrin*, 461 B.R. 763, 788 (Bankr. D. Minn. 2010).

To apply a context-specific analysis the Court noted that the venue issue arose in C's action to place D into involuntary bankruptcy so that his available assets may be liquidated for the benefit of C. In the Court's view an involuntary bankruptcy case is mainly a creditor collection device. If C were successful in prosecuting its petition, C, acting through a bankruptcy trustee, would seize and liquidate the Interests to satisfy its claim. Therefore, the Court should consider what rights a bankruptcy trustee would have to seize and liquidate the Interests. The Court stated:

> The Nevada legislature has made it clear that, to sell [the Interests], a bankruptcy trustee must resort to the Nevada courts either to obtain a charging order against [the Interests], or to dissolve [the Entities]. Through these restrictions, in our opinion, the statutes implicitly reflect the legislature's assumption that a member's or partner's interests are "located" in Nevada. Consistent with that assumption, in the context of this case, we believe Nevada should be deemed the location of [the Interests].

The Court also argued that the interests of justice and convenience supported its ruling. The Court stated that D presumably desired to take advantage of Nevada law in his future dealings with business associates and personal creditors. Given D's strategy in dealing with his assets, the Court found it "disingenuous" to argue that Nevada was not a proper venue for his creditors to pursue their efforts to seize and liquidate those assets. Also, the Court reasoned that if D were eventually adjudicated an involuntary debtor, it would be "obviously" more convenient for a Nevada trustee to administer the bankruptcy case. Therefore, the Court held that Nevada was the principal place of D's assets and that proper venue for this case was in Nevada.

(D) **Kenrob**. *In re Kenrob Information Technology Solutions, Inc*., 474 B.R. 799 (Bankr.E.D.Va. July 10, 2012), is a case involving an S corporation in an involuntary Chapter 7 bankruptcy proceeding. Pursuant to an undocumented shareholders' agreement the corporation paid its shareholders' tax liability directly to the Internal Revenue Service on a

proportionate basis. The trustee in bankruptcy attempted to avoid the payment of such tax liability as a fraudulent transfer, however, the court held that such payments were made for adequate and full consideration. Reading between the lines, this short decision may provide the foundation for a significant planning opportunity for equity holders of pass through entities.

Kenrob Information Technology Solutions, Inc. ("**Kenrob**") was a Virginia corporation taxed under subchapter S of the Internal Revenue Code (the "**Code**"). Kenrob experienced financial difficulty and was taken into involuntary bankruptcy proceeding on November 23, 2009. Several months later the Bankruptcy Court entered an order for relief under Chapter 7.

Interestingly, in 2007 Kenrob paid its shareholders' personal income taxes attributable to the pass-through tax liability directly to the Internal Revenue Service (the "**IRS**"). Although Kenrob reimbursed its shareholders for their income tax liability dating back to 1998, the bankruptcy trustee ("**T**") was contesting transfers on or within two years of the filing of the involuntary petition pursuant to Bankruptcy Code Section. The tax payments were applied by the IRS to the shareholder's personal income tax returns. Kenrob paid its shareholders' income taxes again in April of 2008. The Department of Justice (the "**DOJ**"), on behalf of the IRS, denied T's request for admission that the IRS was paid directly by Kenrob. The DOJ's response to T's request for admission on this point was that "it was the [shareholders] who received the payment as [Kenrob's] initial transferee. The [shareholders] then forwarded this payment to the US by using a payment voucher form (Form 1040-V) to apply the check to their personal tax liability."

The tax payments were made pursuant to an established course of dealing between the shareholders and Kenrob and pursuant to a shareholders' agreement entered into some time in 2005. The shareholders' agreement required Kenrob to reimburse each shareholder with sufficient cash to fund the payment of federal and state income tax liabilities attributable to such shareholder's interest in Kenrob. According to the unexecuted redline version of the shareholders' agreement dated November 16, 2005, if an S election was made, "the Corporation shall distribute sufficient Cash to the Stockholders to provide each Stockholder with sufficient cash to fund the payment of federal and state income tax liabilities attributable to his or her interest in the Corporation." The absence of an executed copy of the shareholders' agreement was not enough to overcome the evidence that supported a course of dealing that existed since the original S election was made in 1998.

In December of 2011, T filed a complaint against the United States (the "**US**") seeking to avoid the tax payments made to the IRS as constructive fraudulent transfers under Section 548(a) of the Bankruptcy Code. Under Bankruptcy Code Section 548(a)(1)(B), the bankruptcy trustee may avoid transfers as constructively fraudulent if the trustee proves (1) the transfers were an interest of the debtor in property made within two years before the petition date; (2) the debtor received less than reasonably equivalent value in exchange for the transfers; and (3) the transfers rendered the debtor insolvent, left it with unreasonably small capital or the debtor believed it would be unable to pay its debts after making the transfers. T argued that the US (as the transferee of the tax payments) did not provide reasonably equivalent value to Kenrob for the tax payments. As a result, T argued that the US should be liable for the fraudulently transferred tax payments.

T and the DOJ, on behalf of the US, both filed motions for summary judgment on June 4, 2012. The DOJ argued that Kenrob did receive reasonably equivalent value for the tax reimbursements made pursuant to the shareholders' agreement. According to the DOJ, the standard for reasonably equivalent value "looks to the consideration actually received by the debtor, not the value given by the transferee."

T argued that the shareholders' agreement did not exist since the only documentation of the agreement introduced into evidence was an unexecuted redline version. The court held that mere denial of a fact is not enough to deny an agreement existed and relied on evidence that the shareholders acted in accordance with the agreement.

The court agreed with the DOJ that the "consideration need not come directly from the party to whom the payment is made." It then examined the nature of the consideration stating:

> *The consideration was the election by the shareholders of the corporation to be taxed as a chapter S corporation as long as the corporation paid their additional personal taxes*. There was a continuing benefit to the corporation over the years and a continuing obligation on the part of the corporation to reimburse the shareholders. (Emphasis added.)

To establish consideration, the IRS examined what would have happened if the tax reimbursement obligation was not included in the shareholders' agreement. First, the shareholders testified that they would not have made the S-election without the corresponding reimbursement provision. Second, if no S-election was made, the IRS calculated that in 2007 Kenrob's tax liability would have been $518,634. On the other hand, the tax liability on Kenrob's income in 2007 with an S election in effect was only $352,843. Thus, the failure to make an S election would have resulted in approximately $165,000 of additional taxes due to Kenrob being taxed under subchapter C of the Code.

Furthermore, Kenrob did not distribute the income which was taxed to its shareholders. This resulted in approximately $1.2 million of operating capital that otherwise would have been distributed to the shareholders in the absence of the reimbursement agreement.

T also argued that the calculation of the tax savings was incorrect because Kenrob presumably would have engaged in tax planning to reduce its tax liability if no S election was made by the shareholders. The court found this argument to be of no consequence or "no moment." The standard for summary judgment is for a court to examine the evidence before it. Mere speculation of alternative tax planning did not create a genuine dispute as to a material fact.

Although no more than a brief case in the reporter, *Kenrob* can potentially significantly effect the manner in which shareholders agreements, partnership agreements and operating agreements are drafted when dealing with corporations, partnerships and limited liability companies. Based on the reasoning in *Kenrob* it would seem prudent for practitioners to include appropriate tax payment provisions in all shareholders' agreements for corporations that will be taxed under subchapter S. Care should be taken to comply with the S corporation single class of stock requirement by avoiding disproportionate distributions. Equal

shareholders may owe different amounts of tax on equal amounts because of differences in tax brackets. Therefore, when using this provision a make-up or equalizing clause should be included requiring an additional distribution if necessary, to make the total of tax payments and make-up distributions to be in proportion to stockholdings. It may also be prudent to the include a similar provision in partnership agreements and operating agreements for partnerships and limited liability companies as the same reasoning may apply regarding the pass through tax consequences. Furthermore, there are such significant similarities between these entities since the Check the Box Regulations were first promulgated that many limited liability companies are currently taxed as S corporations.

Kenrob can also be analyzed in the "**outside creditor**" context as well. *Kenrob* involved a corporation in a bankruptcy (dealing with "**inside creditors**") and the efficacy of the corporation's payments directly to the IRS on behalf of its shareholders. Nonetheless, the situation could be reversed where an equity holder is the party in bankruptcy and not the entity. It is quite possible, however, that the reasoning in *Kenrob* could prove as helpful when the roles are reversed, particularly with regard to partnerships and limited liability companies where equity holders may receive the benefit of charging order protection.

Regarding partnerships and limited liability companies, in most jurisdictions the owners of those entities receive the benefit of charging order protection whereas ownership of stock in a corporation does not receive the benefit of charging order protection. But see Nevada Revised Statutes Sections 21.090 and 78.746. For a discussion of the protection afforded to corporate stock under Nevada law, see *Steve Oshins: Nevada Passes New Charging Order Laws*, LISI Asset Protection Planning Newsletter #180 (June 20, 2011).

Although it can differ in scope significantly between jurisdictions, in general a charging order is a lien that gives a creditor the right pursuant to a court order to receive distributions (if any) from a partnership or limited liability company that would otherwise be payable to the partner or member. The lien can continue until the creditor receives full payment on the creditor's judgment plus statutory interest. Highly protective of the judgment debtor's economic rights, the rights of the partnership or the limited liability company and the rights and interests of the other partners or members, the charging order does not (at least initially) permit a creditor to seize a debtor's interest in the partnership or limited liability company. This protection can be rather frustrating to creditors, however, it does have its limitations.

Assume one of Kenrob's shareholders was a debtor rather than Kenrob. Of course, if the corporation was a state law corporation in most states that debtor's creditor could simply seize the debtor's interest in the corporation. (See prior discussion *supra*.) However, assume further that Kenrob was structured as a state law limited liability company rather than a corporation. In such a case the debtor may receive the full protection of a charging order statute. Nevertheless, despite some practitioners arguing to the contrary, although the debtor's economic interest is protected, the income tax liability should not necessarily shift to the creditor who possesses the charging lien. Instead, in most instances it should remain with the debtor. Although the assets and business inside of the company may be protected, the tax liability that continues to burden the debtor may produce an economic hardship that forces the debtor into a dire situation. The ability of the entity to pay such tax liability directly to the IRS or other taxing authority, however, can drastically change the debtor's position in the

sophisticated chess game of creditor protection. Section 13.1-1041.1 of the Code of Virginia provides:

> Member's transferable interest subject to charging order.
> A. On application by a judgment creditor of a member or of a member's assignee, a court having jurisdiction may charge the transferable interest of the judgment debtor to satisfy the judgment. To the extent so charged, the judgment creditor has only the right to receive any distribution or distributions to which the judgment debtor would otherwise have been entitled in respect of the interest.
> B. A charging order constitutes a lien on the judgment debtor's transferable interest in the limited liability company.
> C. This chapter does not deprive a member or a member's assignee of a right under exemption laws with respect to the judgment debtor's interest in the limited liability company.
> D. ***The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or of a member's assignee may satisfy a judgment out of the judgment debtor's transferable interest in the limited liability company***.
> E. No creditor of a member or of a member's assignee shall have any right to obtain possession.

The foregoing assumes the debtor retains the income tax liability associated with entity ownership. Many practitioners have claimed that a charging order has the benefit of shifting the income tax liability on a debtor's interest in a partnership or limited liability company to the creditor possessing the charging order. Observation based on random sampling of websites. See *e.g.*, the hypothetical posed on http://www.assetlawyer.com/asset_protection_FLP.htm which suggests a "K.O. With A K-1" for a judgment creditor. However, this proposition is more likely myth than reality. To date there does not appear to be any published decision or an actual case where a creditor that obtained a charging order was forced to incur and purportedly pay a debtor's income tax liability. There does not appear to be any provision in the Code that permits or directs this shifting tax result. The notion of shifting the income tax liability to a creditor possessing a charging order does not appear to make economic sense. Forcing a creditor to recognize income that may or may not be used to satisfy the debtor-partner or member's legal obligation to the creditor seems completely inappropriate. Satisfaction of the debt reduces the debtor-partner/member's liability to the creditor possessing the charging order resulting in an economic benefit to the debtor-partner. Thus, such income should be taxable to the debtor-partner. See *e.g.*, *Rutkin v. U.S.*, 343 U.S. 130 (1952). Moreover, a charging order is a *lien* on a partner's (or member's) "**transferable interest**" in a partnership or limited liability company. See *e.g.*, F.S. § 620.1703, F.S. § 620.8504(2) and F.S. § 608.433(4)(b); *Schiller v. Schiller*, 625 So.2d 856 (Fla. 5th Dist. 1993). A lien does not constitute a sale of a partnership or membership interest to the creditor. Instead, it merely provides the creditor "with payment of the unsatisfied amount of the judgment with interest." See *Blair v. Com'r.*, 300 U.S. 5 (1937) and *Evans v. Com'r.*, 447 F.2d 547 (CA 7, 1971). The creditor who obtains a charging order has not acquired property in a taxable exchange or some other economic right. The creditor has acquired a statutory lien on an asset. It is the debtor partner or member who continues to maintain ownership of the interest that is charged. Therefore, it should be the

debtor's legal obligation that the charging order is designed to ensure will be satisfied for the debtor.

Some commentators and lawyers cite Revenue Ruling 77-137, 1977-1 C.B. 178 as authority to support the proposition that the income tax liability inherent in the income generated by a partnership or limited liability company and allocable to a partner or member's interest should shift to the creditor who possesses a charging order against this interest. See *e.g.*, the hypothetical posed on http://www.assetlawyer.com/asset_protection_FLP.htm which cites Revenue Ruling 77-137. Nonetheless, the facts of this Revenue Ruling 77-137 do not appear to support this result. In Revenue Ruling 77-137, a limited partner ("**LP**") in a limited partnership assigned such partner's interest to another person ("**A**"). The agreement governing the partnership provided in relevant part that an assignee of a limited partner could not become substituted limited partner in the partnership without obtaining the written consent of the general partners. The partnership agreement also provided, however, that a limited partner could assign such partner's right to share in the profits and losses of the partnership and receive distributions from the partnership to another person without obtaining the consent of the general partners. As a result of the assignment, LP was still considered a nominal limited partner under applicable law. Under the assignment LP had agreed to exercise any powers he continued to hold as a limited partner in the partnership for the benefit of A. The ruling held that because A acquired substantially all dominion and control of the limited partnership interest assigned to him by LP, for Federal income tax purposes A would be treated as a substituted limited partner. (This result was deemed to occur despite the general partners not having provided their consent to the assignment.) As a result, the ruling held that A had to report his distributive share of partnership items of income, gain, loss, deduction, and credit attributable to the interest that LP assigned to him on A's Federal income tax return. This result was deemed to mirror the result that would occur had A been admitted as a substitute limited partner in the partnership. Thus, Revenue Ruling 77-137 involved *a transfer or assignment* of the ownership rights of the partner in the partnership to the assignee. It did not involve a charging order or any other lien on an interest in the partnership.

A final issue to consider regarding shifting of the income tax liability is whether a debtor and the debtor's lawyers and accountants would actually have the chutzpah to send the debtor's creditor a Schedule K-1. Such a debtor might face an increased risk of an audit and adverse consequences by taking the position that the creditor is liable for the tax liability. The creditor who receives a Schedule K-1 for the debtor's share of taxable income and not reporting that income on his tax return would file a Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR), as an attachment to his tax return explaining why that income is not being included. If the Schedule K-1 recipient does not include Schedule K-1 income on his tax return and does not notify the IRS of the inconsistency by attaching a Form 8082, then any differences in tax resulting from such omission may be assessed immediately, without any Notice of Deficiency, thus depriving the K-1 recipient of access to the US Tax Court. A random sampling of accountants who prepare Form 1065 partnership tax returns and Form 1120S tax returns finds no one who would send (or propose sending) a Form K-1 to a debtor possessing a charging order over a partner or member's interest in a partnership or limited liability company (whether such company is taxed as a partnership or as an S corporation).

If the provision and/or action of the entity is respected as it was in *Kenrob*, including a direct tax payment provision in a partnership agreement or operating agreement would appear highly beneficial based on the foregoing analysis.

Although *Kenrob* provides authority for the proposition that tax payment provisions included in a partnership or operating agreement should be respected by a court, the authors recognize that payment of such tax liability directly to the IRS by the entity presents a risk that a court reviewing the issue will hold that such payment is a constructive distribution to the debtor and therefore was properly distributable to the creditor possessing the charging order rather than the taxing authority. Perhaps to substantially reduce this risk the authors invite various states and foreign countries with partnership and limited liability company acts to consider amending their charging order statutes to permit such direct payment of tax liability directly to a taxing authority. This would greatly enhance the value of charging order protection and further promote the fundamental policy reasons for such acts providing for charging order protection. It is also supported by the reasoning in *Kenrob*.

Kenrob teaches practitioners important lessons. First, always consider including language in shareholders' agreements, partnership agreements and operating agreements that requires the entity to pay its equity holders' tax liability on a proportionate basis directly to the appropriate taxing authorities The agreement should recite the consideration received by the entity, such as the consent of each shareholder to an S corporation election or a partner's agreement to join the partnership and consent to the formation of an entity that is taxed on a pass through basis. Second, when defending against a fraudulent transfer claim, consideration for a transfer may be present, albeit hidden and need not always be present in the traditional sense.

See also, *In re Northlake Foods, Inc.*, 483 B.R. 247 (2012) (*aff'd*, 24 Fla. L. Weekly Fed. C259a (Fla. 11th Cir. May 6, 2013), providing in the West Headnotes:

> Dividend that corporate debtor paid to its shareholder, in exact amount of shareholder's proportionate share of "pass through" income tax liability that shareholders incurred as result of corporation's status as subchapter S corporation, pursuant to agreement that corporation made with its shareholders at time of their election for subchapter S status that it would reimburse them for any resulting tax liability, was not avoidable as constructively fraudulent transfer; tax benefit to debtor as result of its subchapter S status was "reasonably equivalent value" for its corresponding obligation to pay dividend, of kind sufficient to preclude constructive fraudulent transfer claim.

Northlake cited *Kenrob* to support its holding under similar facts.

Does A Charging Order Lien Survive The Expiration Of The Judgment? *Delaware Acceptance Corporation v. Estate of Metzner*, Not Reported in A.3d (2016) 2016 WL 632893

The current litigation arose after Plaintiffs Delaware Acceptance Corp. CACV of Colorado, LLC and 202 Investment, Inc. (hereinafter "the Creditor") filed a claim in the Sussex

County Register of Wills Office for $41,002.59 against the Estate of Frank C. **Metzner**, Sr. based on a Charging Order against the late Mr. **Metzner's** interest in the **Metzner** Family, LLC. The Estate denied the claim by letter dated June 3, 2013, and the Creditor thereafter filed a timely complaint in this Court on September 3, 2013, alleging that the **Metzner** Family, LLC had dissolved following the death of Mr. **Metzner** on October 26, 2012, and that Mr. **Metzner's** 49% interest in the **Metzner** Family, LLC had passed to the Estate and was subject to creditors' claims. The Creditor now seeks the removal of the executrix for cause and the appointment of a new executor with an order to (a) dissolve the **Metzner** Family, LLC, (b) liquidate the assets of the LLC, and (c) make disbursements to the Creditor as required by the Charging Order. In their Answer, Defendants deny that the **Metzner** Family, LLC has dissolved, and attach a copy of a letter purportedly executed on November 30, 2012, by the surviving members of the **Metzner** Family, LLC, i.e., Lona C. **Metzner** and Frank C. **Metzner**, Jr., electing to continue the LLC as required by Article I section 1.5 of the **Metzner** Family, LLC Operating Agreement.

The Charging Order was issued upon a complaint filed by the Creditor against Mr. and Mrs. **Metzner**, and the **Metzner** Family, LLC in 2007. As alleged in this complaint, on September 16, 2002, the couple deeded their home in Lewes, Delaware, to the **Metzner** Family, LLC and sold their household goods to their son, Frank Jr. In 2003, the couple stopped paying on all of their credit cards, whose outstanding balances totaled approximately $55,000, and Mr. **Metzner** surrendered his car to the finance company holding a lien on it. After that time, Mr. **Metzner** drove a truck owned by his son. According to the complaint, the documents produced in discovery showed that Mr. and Mrs. **Metzner** were the only two members of the **Metzner** Family, LLC, but Mr. **Metzner** testified that he and his wife together owned 98 percent and their son owned two (2) percent. The Creditor sought a charging order and the appointment of a receiver to rent or sell the real estate and to use the proceeds to pay the Creditor.

On June 2, 2009, the Creditor moved to amend its complaint to add a claim for relief under the theory of reverse veil piercing, alleging that the LLC had no other purpose than to improperly shield the couple's assets from creditors. In his Final Report, the Master denied the motion to amend because the Creditor had not availed itself of the statutory right to set aside the transfer of property within one year of its discovery. The Master found any action under this theory would be barred by *laches* and, therefore, an amendment would be futile. The Master then signed an order to issue a Charging Order on December 6, 2010, and the Charging Order was subsequently served on the **Metzner** Family LLC to attach any distributions owing to either Frank C. **Metzner** or Lona C. **Metzner** related to their respective interests in the LLC, to satisfy the debts owed by the couple, individually and jointly, to the Creditor.

Now, Defendants argue that they are entitled to summary judgment because the Charging Order had expired by operation of law as of June 23, 2011. According to Defendants, the Court of Common Pleas judgments, on which the Charging Order was based, were all entered before 2006, and under 10 *Del. C.* § 5073, the judgments expired after five years. Defendants argue that the only mechanism by which a Court of Common Pleas judgment can be revived is by writ of *scire facias*. Since the Creditor has never obtained a writ of *scire facias,* both the judgments and the Charging Order had lapsed by the time of Mr. **Metzner's** death. Thus, according to Defendants, the Estate properly denied the Creditor's claim.

In response, the Creditor simply quotes from *Gamles Corp. v. Gibson*, 939 A.2d 1269, 1272 (Del.2007) as follows: "Delaware has no statute of limitations governing judgments or actions on judgments. There is only a rebuttable presumption of payment after twenty years."

10 *Del. C.* § 5073 states in pertinent part:

An execution may be issued upon a judgment recovered before the Court of Common Pleas or a justice of the peace, and of which a transcript has been filed and entered in the Superior Court, or on a judgment upon an appeal from the Court of Common Pleas or a justice of the peace, ***at any time within 5 years*** from entering the transcript, or giving the judgment on appeal, ***without scire facias*** .....

The Creditor correctly observes that there is no statute of limitations on judgments. A charging order is "a form of execution permitting a judgment creditor to divert a flow of payments from the judgment debtor to the party obtaining the charging order." In this case, an execution, i.e., the Charging Order, was issued on December 6, 2010, within the five-year period under § 5073 when an execution may be issued without *scire facias*. The fact that the Creditor never obtained a writ of *scire facias* is irrelevant since the Creditor did not wait more than five years to execute upon its judgments and, therefore, did not need to ask permission of the Superior Court before filing its claim against the Estate. Therefore, I recommend that the Court deny the Defendants' motion for summary judgment.

Although execution issued in 2010, so far the Creditor has been unable to satisfy its judgments. Under the Charging Order, the Creditor is only entitled to divert a flow of payments from the LLC to its members who are the judgment debtors, and there have never been any payments or distributions from the **Metzner** Family, LLC to Mr. and/or Mrs. **Metzner**. The only asset of the LLC is the **Metzners**' house and, until Mr. **Metzner's** death, the couple resided in their house, and Mrs. **Metzner** continues to reside there. Under the terms of the **Metzner** Family, LLC Operating Agreement, however, the death of a member is considered a withdrawal, resulting in the dissolution of the LLC unless the surviving members elect to continue the LLC within 90 days of the death of the member. After Mr. **Metzner's** death, the Creditor filed a claim against the Estate in the belief that the **Metzner** Family, LLC had dissolved and Mr. **Metzner's** 49% interest in the assets of the LLC had passed to his Estate. The subsequent appearance of a document purporting to be an Election to Continue the **Metzner** Family, LLC (hereinafter "the Election") signed by Mrs. **Metzner** and Frank, Jr. within the 90–period following Mr. **Metzner's** death led to the discovery issue that I will now address.

On March 24, 2015, the Creditor moved to compel Defendants' responses to its third request for production. The Creditor was seeking the production of documents from the file of Harold W.T. Purnell II, Esquire, an attorney who had drafted the Election, in order to determine the date the Election was drafted or, if the file was not sufficient to establish the date, then the Creditor wanted access to the metadata on the computer used by Mr. Purnell. The Defendants objected to the production request, asserting attorney-client privilege, but the Creditor expressed a reasonable belief that the Election had been backdated to appear as if the

document had been executed within the 90–day period. After the Defendants failed to respond to the Creditor's motion to compel, on April 21, 2015, I issued an order directing the Defendants to produce their attorney's file "limited to evidence which would establish the date on which Mr. Purnell created the Election and/or the metadata on the computer used by Mr. Purnell limited to establishing the date the Election was created or to produce the same above for an *in camera* review by the Court."

On April 22, 2015, the Defendants filed their current motions, arguing that the Court should vacate or revise its order because it is impossible for Defendants to perform since the metadata is located outside of the State of Delaware in the possession of Mr. Purnell's previous law firm, which is based in New Jersey. On May 1, 2015, I nevertheless received a letter with several attachments from the Defendants for *in camera* review. None of these documents establish the date of the creation of the Election. Furthermore, in a supplemental affidavit—attached as Exhibit D –Mr. Purnell averred that the document in question may not have been saved on Archer & Greiner's network server because the Election lacks a document location number in the lower left corner.

Assuming the document was saved on the law firm's network server when it was created, metadata may be helpful in establishing whether the document which purports to be a timely-executed election to continue the entity by the surviving members of the **Metzner** Family, LLC was, in fact, executed within 90 days following the death of Mr. **Metzner**. If the metadata were to show that the document had been created after the 90–day period had expired, i.e., after January 23, 2014, such evidence would support the Creditor's position that the Estate wrongfully denied its claim. Therefore, I conclude that the Creditor has made a particularized showing of need for the metadata entitling the Creditor to discovery of electronically stored data. In a letter to the Court dated May 5, 2015, counsel for the Creditor stated that the Creditor has retained an expert on metadata and is prepared to shoulder the costs of this discovery. Therefore, I recommend that the Court approve the motion for clarification to the extent that I am clarifying the April 21, 2015 Order to allow the Creditor to compel the production of the metadata from Archer & Greiner, with the understanding that the Creditor has volunteered to bear the cost of the production and analysis. If I have misunderstood the Creditor's offer, then the Creditor should not hesitate to contact the Court accordingly.

For the reasons stated above, I recommend that the Court deny Defendants' motions for summary judgment, re-argument and relief from judgment, but grant their motion for clarification.

The Master appointed by the Court of Chancery ruled that the Charging Order was still valid because it was issued within five years of the Judgment, and Summary Judgment was denied on that issue. The Master then instructed the parties to get on with discovery of the alleged backdating issue.

While this opinion does not get to this issue, it does bring up the novel question of whether a Charging Order would survive an expired judgment. The so-called Harmonized Acts (the Uniform Partnership Act, the Uniform Limited Partnership Act, and the Uniform Limited Liability Company Act, and all their revisions) do not speak to the issue, and thus we are left to

look to local Enforcement of Judgment Laws (EJLs) for guidance. This of course means that the outcome may vary from state-to-state.

B. Business Operations.

In operating and professional service businesses there are several important classes of assets, *i.e.*, cash, human capital, equipment, real estate, intellectual property and accounts receivable. Prudent wealth preservation planning involves minimizing the amount of business assets exposed to creditors of a business and to creditors of the business' owner(s). By properly structuring the business operations, the value of the business to potential creditors can be minimized and such creditors can be persuaded to settle claims on favorable terms to the business and its owner(s).

1. Cash. It is recommended that a business maintain only a sufficient level of cash to cover short term operating expenses. As accounts receivable are collected, the business can periodically adjust the level of its cash reserves to provide for future business needs. Any surplus cash held by the business should be distributed in the form of salary payments, deferred compensation payments or other kinds of distributions. While wages and retirement accounts can be protected from creditor claims under Florida law, see F.S. §§ 222.11 (wages) and 222.21 (retirement accounts), and are valid liabilities of the business, a business' surplus cash is merely a tempting target for creditors. See II.C. & D. for a detailed discussion of the Florida exemptions for wages and retirement accounts.

2. Human Capital. With operating businesses the essential human capital is represented by the officers and other key employees of the business. By implementing "change in control" or other anti-take-over provisions in employment agreements, officers (including the owners) and other key employees may be entitled to receive preferential, lump-sum "golden parachute" distributions from the business if creditors seize control. The combination of such payments with the loss of such human capital could cripple the business' operations, thereby lessening the value of the business to creditors of the business and its owners.

Further, with most professional service businesses, the value of the business is attributable, almost entirely, to the continued performance of services by the individual professionals. As an individual's capacity and ability as a professional is not an asset that is subject to seizure to satisfy a debt, creditors cannot rely on, or force, such continued performance of services and thus the value of the business may be negligible to creditors. However, in Florida, a physician's failure to satisfy a judgment of up to $300,000 could result in the revocation of the a physician's medical license. See F.S. § 458.320(8). Further, under Florida law, three (3) malpractice judgments against a physician could result in revocation of the physician's medical license. See Florida Constitution, Article X, Section 26.

It is important to consider documenting the terms and conditions of an owner's employment agreement with the business. This employment agreement should set the terms of compensation (*i.e.*, a fixed pay period with a fixed amount to be paid to you as wage income), including any "**golden parachute**" pay-out. Although general profits distributions from a business are not protected by the Florida wage exemption, a properly drafted employment

agreement may strengthen an argument that the portion of business income paid as compensation is protected by such wage exemption. See F.S. § 222.11(a) (the Florida wage exemption encompasses compensation paid as wages, salary, commission, or bonus). See *In re Manning*, 163 B.R. 380 (Bkrtcy. S.D. Fla. 1994) (for the Florida wage exemption to apply, the employee must receive regular compensation dictated by the terms of an arms-length employment agreement); *Kane v. Steweart Tilghman Fox & Bianchi, P.A.*, 41 Fla. L. Weekly D1742a, (Fla. 4th DCA, 2016) (Florida wage exemption did not apply where appellant shareholders of a law firm were paid in what were akin to shareholder distributions rather than regular predictable wages). But see *U.S. v. Alexander*, 2016 WL 2893406 (D.Ariz., May 18, 2016) (using a substance over form approach to find that an LLC's distributions to a debtor were properly classified as wage income instead of distributions since the debtor's personal services to the business were the source of the funds). A valid and enforceable employment agreement also establishes liabilities for the business that can reduce its cash reserves and accounts receivable, thereby reducing the amount of business assets subject to potential seizure by a creditor.

As discussed below, establishing an employee-leasing company with which the business contracts for some or all of its employees, could establish another stream of payments from the business to entity directly or indirectly controlled by the owner or the owner's family (or a trust for their benefit). The liability for such lease payments could further reduce the amount of business assets available to satisfy any creditor judgment.

3. Equipment. Restructuring the ownership of the equipment used in the operation of a business is another planning option for reducing the value of the business to potential creditors. By vesting ownership of equipment in one or more limited liability entities, which would lease such equipment back to the business, the resulting liability for lease payments will reduce the amount of business assets that could be subject to claims of a creditor. See F.S. § 212.01 *et seq*. and Florida Administrative Code Rule 12A-1.071 concerning sales tax liability. Ownership of the equipment-leasing entity would be vested in the owner or the owner's family (or a trust for their benefit). Ownership would be tailored to fit with the parameters of the owner's overall wealth preservation plan.

4. Intellectual Property. If intellectual property, such as goodwill, trademarks and patents, is associated with the business, such intellectual property should not be owned by the operating business. Instead, a separate limited liability entity should be established to own such assets. As with equipment, the intellectual property could be leased back to the operating business (or other persons), thereby creating additional liabilities that can further reduce the overall value of the business, and deplete cash and offset future collections of accounts receivable. Although beyond the scope of this outline and subject to detailed tax rules, the properly structured migration of intellectual property to an offshore limited liability entity can secure additional tax savings and efficiencies. See generally I.R.C. § 367. Further, such entity could be owned by a wealth preservation trust.

5. Real Estate. Commonly, the owner or the business will own the real estate where the business is located. As with the leasing structures discussed above, a separate limited liability entity should own and lease the real estate. Real estate is also an asset in which the value can readily be "stripped" through a mortgage or other financing vehicle (with

the funds invested in exempt assets or tax-advantaged structures). In addition to facilitating the overall wealth preservation plan, separate ownership of real estate should serve to insulate the rest of the business from environmental and other liability risks associated with real estate. Ownership of any hazardous equipment or business activity should be similarly structured.

6. Accounts Receivable. Protecting accounts receivable is one of the more challenging aspects of business planning. There are numerous "strategies" being promoted in the marketplace for receivables financing transactions. However, most of these strategies have relatively little value and the purported asset protection benefits rest on dubious grounds.

As an alternative to a receivables financing transaction, the business owners could establish one or more collateral companies such as equipment leasing companies discussed above and perhaps a captive insurance fund. The legal obligations incurred by the business to these collateral companies can serve as a valid liability that reduces the value of outstanding accounts receivable otherwise subject to seizure to a relatively nominal amount.

It is important to realize that, although accounts receivable generate a large portion of the ultimate financial return of a business, accounts receivable are not protected by the Florida wage exemption statute. See, *e.g.*, *In re Zamora*, 187 B.R. 783 (Bkrtcy. S.D. Fla. 1995). Only when accounts receivable are collected and distributed as wage income would such amounts be potentially protected under applicable wage exemption law.

©Jonathan E. Gopman 2016

Fact Patterns for Discussion in: I Ain't Afraid of No Laws

Good Doctor

The Odd Story of a Wealthy Doctor with a Big Gas Problem

Doctor Benedict Odd ("Dr. Odd") is a medical researcher who has developed several valuable medical devices over his career. In 2015, after suffering massive losses in the natural gas markets, he sought legal advice about transferring $75,000,000 (75% of his total liquid assets) to "debtor friendly," off shore investments in the Caribbean. He comes to you, as his lawyer, to help him set up one of the "off-shore trust" he has heard so much about.

In addition to the $75,000,000 he wants to put in an off-shore trust, Dr. Odd also has the following significant assets: $5,000,000 in his 401K, $10,000,000 in his brokerage account, and $10,000,000 in other personal property (primarily an extensive comic book collection). He also owns a $2,000,000 Florida home with his wife Cleo Odd ("Cleo") as tenants by the entities and 100% of his medical products company, Marvel Medical Materials, LLC ("MMM"), which supplies a revolutionary material called "Comix") to various manufacturers to be used in various surgical implants and is valued at $25,000,000.

Dr. Odd's only known debts are a $1,000,000 mortgage on his home and his guarantee of a $20,000,000 line of credit on MMM. His financial statements have been audited by reputable CPA firm [as a requirement of MMM's lender], and shows he has a net worth of over $100,000,000. Dr. Odd informs you that there are no lawsuits pending against him or MMM.

Questions

1. Are there any ethical or professional issues related to planning and establishment of an off-shore asset protection trust or other device for Dr. Odd – other than making sure his retainer check clears?

2. Discuss various strategies that should be followed in creating a wealth protection program for such a client, including the appropriateness of using off-shore trusts.

3. Are there any other steps that you, in order to meet your ethical obligations, should be taking in establishing Dr. Odd's solvency and/or good faith in transfers to off-shore trusts?

4. Should Cleo, Dr. Odd's wife, be a client along with Dr. Odd or have separate counsel? Would the answer be different if Dr. Odd's assets were held in an LLC in which Cleo had an interest?

5. Assume that 8 years after you set up an otherwise valid off-shore trust for Dr. Odd, it is discovered that Comix causes uncontrollable flatulence in 90% of people who use medical appliances containing Comix. Further, it is discovered that Dr. Odd knew of this problem and improperly covered it up. As a result of his actions, Dr. Odd has over $200,000,000 in judgments against him. Do you, as a professional, have any issues related to your work? Given Dr. Odd's fraud, can his otherwise valid attorney-client privilege be breached?

Bad Doctors

Dr. Odd from Another Reality: He Has a Different Gas Problem

Assume all the facts above except that Dr. Odd comes to you: (1) after the FDA discovered that Comix causes the above-described "adverse" reactions; (2) the U.S. Attorney's office has announced a criminal investigation of the conduct of Dr. Odd concerning the testing of Comix; and (3) $300,000,000 of law suits have been filed against Dr. Odd, although no judgments have been entered against him yet.

Question

1. What are the legal issues that face attorneys or other professionals in advising obviously financially distressed client in making transfers to an off-shore trust under these facts? Further, assuming you create a valid and enforceable off-short trust for Dr. Odd:

(a) Can you be sued for aiding and abetting Dr. Odd in making a fraudulent transfer?

(b) Can you be sued for conspiracy to defraud a creditor of Dr. Odd?

(c) Can other actions be taken against you related to the establishment of an off-shore trust?

2. What steps should you take to ensure that you do not become involved in an improper conspiracy to defraud your client's creditors?

Short Fact Patterns Concerning Settlors, Beneficiaries, Foreign Individuals and Entities in Avoidance and Clawback Litigation

They Won't Send in the Marines . . . Will They?

1. You are contacted by a Nevis LLC which acts as trustee for a self-settled trust ("Sword Trust") for Bob "Iron" Throne who recently had a $20,000,000 judgment entered against him for counterfeiting tickets to numerous "hot" Broadway shows in New York City. Bob also was placed in an involuntary Chapter 7 bankruptcy. The Sword Trust assets consists of: (a) $5,000,000 in stocks held by a U.S.-based brokerage company; and (b) $500,000 of artwork stored at a Nevis bank. The Nevis LLC has been contacted by Bob Throne's bankruptcy trustee concerning service of a complaint which he filed against it, as trustee of the Sword Trust, seeking turnover or recovery of all assets of the Sword Trust under numerous theories.

The Nevis LLC Has Several Questions

(a) Should the Nevis LLC agree to service or otherwise appear in bankruptcy court to contest the litigation? Would your answer change if some of the Nevis LLC's managers were U.S. Citizens or had vacation homes in the U.S.? Would your answer change if the Nevis LLC owned assets in its own name in the United States?

(b) Assuming the brokerage company holding the stock owned by the Sword Trust has been named as a defendant in the same complaint and the complaint seeks to have the brokerage turn over the $5,000,000 in stock to the bankruptcy trustee. The brokerage informs the Nevis LLC that it will not defend the Sword Trust's ownership of the stock held by them and will obey any lawful order of the federal bankruptcy court. Should the Nevis LLC take any action due to this threat?

2. You are representing Terry and Cici Lancaster ("T&C"), who have been involved in 10 years of bitter litigation with their neighbor, Johnny Snow ("Snow") over ownership of their business Red Weddings RS LLC. Three years ago, Snow won a $5,000,000 judgment against T&C, which was finally affirmed on appeal. Unknown to you, T&C transferred all of their assets to an irrevocable off-shore trust ("Mountain Trust") shortly after the judgment was entered against them. T&C and their children are beneficiaries of Mountain Trust. The Mountain Trust has provisions for a trust protector and "events of duress" provisions which prevent involuntary transfers of assets from the Mountain Trust to any of the beneficiaries' creditors.

(a) Assume a federal district court orders T&C to return all assets of the Mountain Trust to the United States. What steps should T&C take to comply with this order?

(b) Assume the trust protector refuses to return the money and the court sets a hearing on contempt of T&C. What defenses can you raise to a contempt action under these circumstances?

17948421_1.docx