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Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Portfolio Description

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Dick has written numerous publications. In addition to this Portfolio, he is the author of *Federal Income- and Transfer-Tax Consequences of Domestic Asset-Protection Trusts*, 45 Tax Mgmt. Est., Gifts & Tr. J. 75 (Mar. 12, 2020); *Minimizing or Eliminating New York Income Taxes on Nongrantor Trusts*, 45 Tax Mgmt. Est., Gifts & Tr. J. 27 (Jan. 9, 2020); *Opportunities to Save State Income Taxes on Nongrantor Trusts Expanded by U.S. Supreme Court's "Kaestner Decision,"* 44 Tax Mgmt. Est., Gifts & Tr. J. 283 (Nov. 14, 2019); *Forestalling Forties Follies*, 153 Tr. & Est. 18 (June 2019) (Coauthor Emily B. Pickering, Esq.); 867 T.M., *Choosing a Domestic Jurisdiction for a Long-Term Trust* (2018); *The Uniform Voidable Transactions Act: Why Transfers to Self-Settled Spendthrift Trusts by Settlors in Non-APT States Are Not Voidable Transfers Per Se,* 42 Tax Mgmt. Est., Gifts & Tr. J. 173 (July 14, 2017) (Coauthors George D. Karibjanian and Daniel S. Rubin); *Delaware Trusts 2017* (Wilm. Tr. Co. 2017); *A Practitioner-Friendly Guide to the Delaware Asset-Protection Trust,* 30 Prob. & Prop. 53 (Jan./Feb. 2016); *Good Directions Needed When Using Directed Trusts,* 42 Est. Plan. 12 (Dec. 2015); *Getting a Stepped-Up Income-Tax Basis and More by Springing—or Not Springing—The Delaware Tax Trap the Old-Fashioned Way,* 40 Tax Mgmt. Est., Gifts & Tr. J. 215 (Sept. 10, 2015); 869 T.M., *State Income Taxation of Trusts* (2013) and many other articles.

This Portfolio revises and supersedes 868 T.M., *Domestic Asset Protection Trusts.* Portfolio 868 T.M. should be discarded.

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Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Portfolio Description

Description

PORTFOLIO DESCRIPTION —

Tax Management Portfolio, *Domestic Asset Protection Trusts**, No. 868-2nd, discusses various aspects of the domestic asset-protection trust (APT), including the reasons for and against recognizing such trusts; the benefits of such trusts; and the attributes of the Delaware, Alaska, Nevada, and South Dakota APT statutes.

The Portfolio then covers the income and transfer-tax ramifications of domestic APTs. The ability of a creditor to reach trust assets often impacts whether a transfer to a domestic APT is a completed gift and whether a domestic APT will be included in the settlor's gross estate.

An APT is an irrevocable trust in which the settlor retains some benefits that cannot be reached by the settlor's creditors. The Portfolio gives particular attention to potential application of the fraudulent transfer rules as well as to defending APTs against creditor attacks, noting, where appropriate, matters addressed by the Uniform Trust Code and the Restatement (Second) of Conflict of Laws.

After comparing Delaware APTs to Alaska, Nevada, and South Dakota APTs and comparing domestic APTs to foreign APTs, the Portfolio describes the designing, drafting, and funding of domestic APTs and various issues related to trust distributions. To avoid misunderstandings, the Portfolio recommends, among other things, that the attorney and trustee make clear to the APT's settlor at the beginning that the settlor will receive distributions only in accordance with the trust terms.

The Portfolio concludes with a discussion of the ethical and liability concerns of attorneys involved in domestic-APT planning.

The Worksheets provide citations to pertinent state statutes together with sample forms.

This Portfolio may be cited as Nenno, 868-2nd T.M., *Domestic Asset Protection Trusts.*

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TABLE OF WORKSHEETS

A. Background

The *Second Restatement of Trusts*, the *Third Restatement of Trusts*, and the Uniform Trust Code (UTC) recognize that a client may protect interests in an irrevocable trust created for others (third-party trust) from claims by the beneficiaries' creditors by subjecting such interests to a spendthrift clause[1] or by making them discretionary.[2] But, the Restatements and the UTC do not extend creditor protection to a settlor's retained beneficial interest in an irrevocable trust (self-settled trust), even if the trust contains a spendthrift clause.[3] For example, *Restatement (Third) of Trusts* §58(2) says that:

[1] *Restatement (Second) of Trusts* §152, §153(1), §157, §157 cmts. a–e (Am. Law Inst. 1959); *Restatement (Third) of Trusts* §58(1), §58 cmt. a, §59, §59 cmts. a(1)–a(2), b–d (Am. Law Inst. 2003); UTC §502–§503 (Unif. Law Comm'n 2018). To view the text of the UTC and a list of the states that have enacted it, go to www.uniformlaws.org. For analyses of state third-party spendthrift trust laws, see *In re Reynolds*, 867 F.3d 1119 (9th Cir. 2017) (California); *In re Cyr*, *2019 WL 1495137* at *11 (Bankr. W.D. Tex. Apr. 1, 2019) (Texas); *Mennen v. Fiduciary Trust Int'l of Del.*, 166 A.3d 102 (Del. 2017) (Delaware); *Matter of Testamentary Trust Under Will of King*, *2018 WL 6333710* (Or. Ct. App. Dec. 5, 2018) (Nevada). The author would like to thank John E. Sullivan, III, Esquire, Sullivan & Sullivan, Ltd., Beachwood, Ohio, for his substantial contributions to the original edition of this Portfolio. The author would also like to thank his Wilmington Trust Company colleagues Eileen M. Allen, Tammis M. Dowling, and Glenda S. Lewis for their assistance in the preparation of this Portfolio.

[2] *Restatement (Second) of Trusts* §155(1), §155 cmt. b, §187, §187 cmts. d–i (Am. Law Inst. 1959); *Restatement (Third) of Trusts* §50, §60 §50 cmts. b, d; §60 cmt. e (Am. Law Inst. 2003); UTC §504, §814(a) (Unif. Law Comm'n 2018).

[3] *Restatement (Second) of Trusts* §156(1) (1959); *Restatement (Third) of Trusts* §58(2) (2003); cmt. e; UTC §505(a)(2) (amended 2018). For summaries of the rules for self-settled spendthrift trusts, see *In re Cutter*, 398 B.R. 6 (B.A.P. 9th Cir. 2008) (California); *United States v. Martin*, *2015 WL 4496869* at *8–9 (D. Haw. May 29, 2015) (Hawaii); *Dexia Credit Local v. Rogan*, 624 F. Supp. 2d 970, 978–981 (N.D. Ill. 2009) (Illinois); *In re Rensin*, *2019 WL 2004000* at *7 (Bankr. S.D. Fla. 2019) (Florida); *In re Cyr*, *2019 WL 1495137* at *11–12 (Texas); *In re Salahi*, 2012 WL 1438213 at *3–4 (Bankr. E.D. Va. Apr. 25, 2012) (Virginia); *In re Quaid*, *2011 WL 285645* at *4 (Bankr. M.D. Fla. Jan. 26, 2011) (Florida); *In re Nichols*, 434 B.R. 906, 909 (Bankr. M.D. Fla. 2010) (Florida); *In re Potter*, No. 7-05-14071, 2008 BL 158955, 2008 WL 5157877 at *9–10 (Bankr. D.N.M. July 29, 2008) (California and New Mexico); *Kraft v. Commissioner*, 142 T.C. 259, 266–267 (2014) (District of Columbia); *Rush Univ. Med. Ctr. v. Sessions*, 980 N.E.2d 45, 58 (Ill. 2012) (Illinois); *Phillips v. Moore*, 690 S.E.2d 620 (Ga. 2010) (Georgia). For a description of a change of New York law for such rules, see *Estate of Paxton v. C.I.R.*, 86 T.C. 785, 816 (1986).

> A restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid.

Nor do those authorities give any protection to a settlor-beneficiary's interest in a self-settled discretionary trust.[4] Thus, comment f of §60 of the *Third Restatement of Trusts* provides:[5]

[4] *Restatement (Second) of Trusts* §156(2) (1959); cmt. e; *Restatement (Third) of Trusts* §60 cmt. f (2003); UTC §505(a)(2) (amended 2018). For an application of the UTC provision, see *Rensin*, *2019 WL 2004000* at *7–8.

[5] *Restatement (Third) of Trusts* §60 cmt. f (2003).

> Where the trustee of an irrevocable trust has discretionary authority to pay to the settlor or apply for the settlor's benefit as much of the income or principal as the trustee may determine appropriate, creditors of the settlor can reach the maximum amount the trustee, in the proper exercise of fiduciary discretion, could pay to or apply for the benefit of the settlor.

The 5th edition of the Scott treatise discusses the traditional rule as follows:[6]

[6] 3 Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* §15.4 at 954–955 (5th ed. 2007) (footnotes omitted). *Accord United States v. Baker*, *2014 WL 4926387* at *5 (D. Mass. Sept. 30, 2014) (“It is beyond peradventure that a ‘settlor cannot place property in trust for his own benefit and keep it beyond the reach of creditors’”). *See generally* Helene S. Shapo, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* §223 (3d ed. 2007).

> The controlling policy is clear. The settlor can properly create a trust under which someone else takes a beneficial interest, and the settlor's creditors cannot reach this interest unless the creation of the trust amounted to a fraudulent conveyance. To the extent that the settlor retains a beneficial interest, however, that interest is subject to the claims of the settlor's creditors, even in the absence of fraud. It is plainly against public policy to permit the owner of property to create for his or her own benefit an interest in the property that is beyond the reach of creditors.

As will be discussed in I.B., below, unlike the fraudulent transfer rules, which originated with the Statute of 13 Elizabeth (1571), and which are covered in VIII., below, the rule against self-settled trusts began with the even earlier Statute of 3 Henry VII (1487).

Worksheet 1, below, shows that many state statutes, like the traditional rule, provide that creditors may reach the settlor's interest in a self-settled trust. Two state statutes provide that a self-settled trust is valid even though creditors may reach the settlor's retained interest,[7] and a few state statutes provide that a transfer in trust for the use of the settlor is void against claims of existing or subsequent creditors.[8]

[7] *See* Cal. Prob. Code §15304(a); Miss. Code Ann. §91-9-509. *See Markham v. Fay*, 74 F.3d 1347, 1359 (1st Cir. 1996) (“We do not hold that the trusts are invalid—a trust in which the settlor has reserved to herself the power to alter, amend or revoke, and is also the sole trustee and one of the trusts’ beneficiaries with a right to receive income and principal in her own discretion as trustee, is not invalid”). *Accord Braunstein v. Beatrice (In re Beatrice)*, 277 B.R. 439, 447 (Bankr. D. Mass. 2002). *See also Greenwich Tr. Co. v. Tyson*, 27 A.2d 166, 173 (Conn. 1942) (“The fact that the provisions of the trust agreement are ineffective to protect the income of the trust from the claims of Tyson's creditors does not invalidate the trust as a whole”).

[8] *See, e.g.,* Wash. Rev. Code §19.36.020. *See also Waldron v. Huber (In re Huber)*, 493 B.R. 798, 809 (Bankr. W.D. Wash. 2013); *Rigby v. Mastro (In re Mastro)*, 465 B.R. 576, 611–612 (Bankr. W.D. Wash. 2011).

The traditional rule was well-entrenched in Delaware before the 1997 enactment of the legislation that is discussed in III., below.[9]

[9] *See Kulp v. Timmons*, 944 A.2d 1023 (Del. Ch. 2002); *Security Tr. Co. v. Sharp*, 77 A.2d 543 (Del. Ch. 1950); *Wilmington Tr. Co. v. Carpenter*, 75 A.2d 815 (Del. Ch. 1950); *Weymouth v. Del. Tr. Co.*, 45 A.2d 427 (Del. Ch. 1946); *Provident Tr. Co. v. Banks*, 9 A.2d 260, 261–262 (Del. Ch. 1939).

B. Origin of the Rule Against Self-Settled Trusts

The rules that allow creditors to set aside fraudulent transfers began with a statute called the Statute of Elizabeth,[10] that was enacted in England in 1571 during the reign of Queen Elizabeth I, the last Tudor monarch. But the ability of creditors to reach the assets of self-settled trusts comes from a statute[11] that was enacted almost a century earlier during the reign of Queen Elizabeth's forebear, King Henry VII, who founded the Tudor dynasty in 1485 when he and his forces defeated the infamous King Richard III (the last Plantagenet ruler) and his supporters at the battle of Bosworth Field, thus ending the War of the Roses.

[10] Statute 13 Eliz. I, c.5 (1571).

[11] Statute 3 Hen. VII, c.4 (1487). *See* VIII.E.7., below.

Dean Griswold explained this distinction in 1947:[12]

[12] Erwin N. Griswold, *Spendthrift Trusts* §473 at 539–540 (2d ed. 1947) (footnotes omitted).

> Many states have expressly reenacted the substance of a statute which was first passed in England in 1487. This statute provided that “All 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.” In its original form the statute applies in terms only to gifts of goods and chattels, and it has been held that it applies only to gifts made for the sole benefit of the settlor. It was not directed against trusts made with fraudulent intent, but was a prohibition of trusts for the benefit of the settlor on the ground that such a trust was against public policy. All trusts to which a statute of this type applies are invalid against the claims of any creditor, whether the trusts are spendthrift trusts or not.

Hence, there was no need for the later enacted Statute of Elizabeth to cover the potential abuses of self-settled trusts because that issue already had been addressed almost a century earlier!

The *Restatements of Trusts* incorporate this historic rule against self-settled trusts (the historic Self-Settled Trust Rule). Thus, the pertinent provision of the *Second Restatement of Trusts* says that “[w]here 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.”[13]

[13] *Restatement (Second) of Trusts* §156 (Am. Law Inst. 1959).

The relevant section of the *Third Restatement* similarly provides that “a restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid.”[14]

[14] *Restatement (Third) of Trusts* §58(2) (Am. Law Inst. 2003). *See* 3 Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* §15.4–§15.4.4 at 951–989 (5th ed. 2007); Helene S. Shapo, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* §223 (3d ed. 2007).

The comparable rule in the UTC provides that “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.”[15]

[15] UTC §505(a)(2) (Unif. Law Comm'n 2018).

Accordingly, the historic Self-Settled Trust Rule continues to be applicable, generally, under modern trust law. However, one looks in vain for a section of the Uniform Fraudulent Conveyance Act (UFCA), the Uniform Fraudulent Transfer Act (UFTA), or the Uniform Voidable Transactions Act (UVTA)[16] that provides that a transfer to a self-settled trust will be voidable per se—because such a section is simply not there. To be clear, the author is not aware of a single state statute that would declare a transfer to a self-settled trust to be a voidable transfer per se. Instead, creditors' rights vis-à-vis self-settled trusts are governed by trust law—not fraudulent transfer law.

[16] To view the texts of the 1918 UFCA, the 1984 UFTA, and the 2014 UVTA and compilations of the states that have enacted them, go to www.uniformlaws.org.

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C. What Is a Self-Settled Trust?

Black's Law Dictionary defines “self-settled trust” as “[a] trust in which the settlor is also the person who is to receive the benefits from the trust, usu. set up in an attempt to protect the trust assets from creditors.”[17]

[17] *Black's Law Dictionary* 1824 (11th ed. 2019). *See In re Glick*, 568 B.R. 634, 668 (Bankr. N.D. Ill. 2017) (“Because Glick is both trustee [sic] and a beneficiary of the JCG 1999 Trust, any interests he held in the trust became property of his bankruptcy estate on the petition date”).

The above definition seems straight-forward, but nuances exist. Because, as noted above, greater protection from creditor claims is available through third-party trusts than through self-settled trusts, the attorney should not concede that a trust is self-settled without careful inquiry.

For example, if a settlor funds a trust with assets provided by another, a court might classify the trust as a third-party trust. Hence, whereas a federal bankruptcy judge in Alaska concluded that an Alaska trust created by a settlor with funds that he received from his mother was self-settled,[18] an intermediate appellate court in Illinois came to a different conclusion in similar circumstances.[19] The latter court reasoned that “The trust assets proceeded from someone other than the judgment debtor and were protected from Lange's creditors under Section 2-1403 of the Code.”[20]

[18] *In re Mortensen*, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 at *6 (Bankr. D. Alaska May 26, 2011).

[19] *Hickory Point Bank & Tr., FSB v. Natural Concepts, Inc.*, 2017 IL App (3d) 160260-U, 2017 BL 123234, 2017 WL 1392860 (Ill. App. Ct. Apr. 11, 2017).

[20] *Hickory Point Bank & Tr., FSB v. Natural Concepts, Inc.*, 2017 IL App (3d) 160260-U, 2017 BL 123234, 2017 WL 1392860 at *3 (Ill. App. Ct. Apr. 11, 2017).

Similarly, courts have found trusts established through the exercise of a decanting power not to be self-settled.

In one instance, a New York intermediate appellate court analyzed a special needs trust that trustees created by exercising a decanting power.[21] The court concluded:[22]

[21] *Kroll v. N.Y. State Dep't of Health*, 39 N.Y.S.3d 183 (App. Div. 2016).

[22] *Kroll v. N.Y. State Dep't of Health,* 39 N.Y.S.3d 183, 186 (citations omitted).

> Contrary to the State's contention, at the time that the trustees exercised their power of appointment, the principal contained in the original trust did not constitute a “resource” or “income” of the grandson as those terms are defined under state and federal law. It is undisputed that the original trust was funded by Ratowsky and that none of the grandson's assets was transferred to the original trust. Since the grandson did not establish the original trust by contributing his own assets to it, the principal of the original trust was not a resource or income of the grandson. Inasmuch as the principal of the original trust was not the grandson's asset at the time that it was decanted into the new supplemental needs trust, it cannot be said that the grandson “created” the new trust. As the grandson was not the “creator” of the new trust, a payback provision was not required.

The Supreme Court of Connecticut considered the status of a trust created by trustees’ exercise of a decanting power to remove the beneficiary's powers to withdraw assets in connection with a divorce proceeding.[23] The court held:[24]

[23] *Ferri v. Powell-Ferri*, 165 A.3d 1137 (Conn. 2017).

[24] *Ferri v. Powell-Ferri*, 165 A.3d 1137, 1148.

> In light of the trial court's finding that Ferri took no active role in planning, funding, or creating the 2011 trust, we can find no authority for the proposition that it should be considered self-settled.

The issue in *Calhoun v. Rawlins* [25] was as follows:[26]

[25] *Calhoun v. Rawlins*, 106 N.E.3d 684 (Mass. App. Ct. 2018).

[26] *Calhoun v. Rawlins*, 106 N.E.3d 684, 686.

> At issue in this case is whether the assets of an irrevocable spendthrift trust, established in 2007 on behalf of a disabled husband upon divorce from his wife, are available to satisfy any damages awarded in a subsequent personal injury action against the former husband. Resolution of the issue requires us to consider whether the trust was self-settled. We conclude that successful plaintiffs in this action may recover damages from the trust.

After reviewing the rules for third-party trusts in Massachusetts, the rules for self-settled trusts in the Commonwealth,[27] and the rules for determining whether or not a trust is self-settled,[28] a Massachusetts intermediate appellate court concluded:[29]

[27] *Calhoun v. Rawlins*, 106 N.E.3d 684, 688–689.

[28] *Calhoun v. Rawlins*, 106 N.E.3d 684, 689–690.

[29] *Calhoun v. Rawlins*, 106 N.E.3d 684, 693 (citation omitted).

> We conclude that the trust was self-settled. The funds transferred to the trust by Stone were transferred for the purpose of satisfying her obligations to McInerney related to the dissolution of the marriage. The principal and the interest of the trust were available to McInerney during his lifetime and the same amounts are available to the plaintiffs to satisfy any judgment in their personal injury action. The judgment is reversed and a new judgment is to enter declaring that the plaintiffs may reach the assets of the Brian K. McInerney Irrevocable Trust.

D. Effect of Traditional Rule

As noted in I.A., above, a few state statutes provide that a self-settled trust is void as to claims of existing and subsequent creditors. In those states, creditors might be able to reach all of the assets of a self-settled trust, regardless of the interest or interests retained by the settlor. If, as usually is the case, the pertinent statute provides that creditors may reach only the settlor's interest, however, the result is quite different.

Thus, if the settlor creates a spendthrift trust to pay the income to the settlor for life, with remainder to the settlor's issue, creditors may only reach the retained income interest and not the principal of the trust.[30] A 2002 case illustrates this point.

[30] *Restatement (Second) of Trusts* §156 cmt. a, illus. 1 (Am. Law Inst. 1959); *Restatement (Third) of Trusts* §58 cmt. e (Am. Law Inst. 2003). *See Markham v. Fay*, 74 F.3d 1347, 1359 (1st Cir. 1996).

In *Mennotte v. Brown*,[31] the Eleventh Circuit held that the debtor's retained interest in a 7% charitable-remainder unitrust ("CRUT") was includible in her bankruptcy estate. The court described the impact of its holding as follows:[32]

[31] *Mennotte v. Brown*, 303 F.3d 1261 (11th Cir. 2002). *Accord In re Nichols*, 434 B.R. 906, 909 (Bankr. M.D. Fla. 2010).

[32] *Mennotte v. Brown*, 303 F.3d 1261, 1271.

> When establishing the ICRUA, Appellee made an irrevocable charitable gift of the trust corpus. By including the right to receive income payments for life, Appellee retained a portion of the assets for herself. Whatever interest Appellee retained is her own property, subject to the claims of her creditors. Accordingly, Appellee's right to an income stream is not exempt from her bankruptcy estate and may be reached by her creditors. The corpus of the trust, however, may not be reached by Appellee's creditors.

A trust is self-settled with respect to an individual only to the extent that such individual contributes funds.[33]

[33] *See In re Salahi,* 2012 WL 1438213 at *4–6 (E.D. Va. Apr. 25, 2012); *In re Quaid*, *2011 WL 285645* at *4–5 (Bankr. M.D. Fla. Jan. 26, 2011).

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E. Domestic APT Option

As society became increasingly litigious, Americans became interested in the asset protection trust (APT)—a trust in which the settlor may retain some potential benefits that cannot be reached by creditors. Until 1997, this interest was satisfied only by trusts created in foreign jurisdictions. For many Americans, however, a foreign APT is not an attractive option for the reasons set forth in XI.C., below (e.g., risk of fine or imprisonment, possible application of the foreign-trust rules for income-tax purposes, denial of bankruptcy discharge, and financial risk if the jurisdiction experiences political change).

As of January 1, 2020, a client may create a domestic APT, i.e., an irrevocable self-settled trust that generally is effective against claims by creditors in as many as 19 states—Alaska, Connecticut, Delaware, Hawaii, Indiana, Michigan, Mississippi, Missouri,[34] Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming.[35] In 2017, a commentator noted that "most of these laws are transparent variations of the law enacted by Delaware."[36] For a time, some Colorado practitioners contended that an old Colorado statute[37] made domestic APTs available there, but the consensus is that this is not the case.[38]

[34] The validity of Missouri's statute was confirmed in *Olsen v. Reuter (In re Reuter)*, 499 B.R. 655, 675–678, 682–683 (Bankr. W.D. Mo. 2013).

[35] *See* Worksheet 1, below.

[36] Peter Spero, *Recent Cases Show Need for Strict Compliance with DAPT Statutes*, 44 Est. Plan. 8, 8 (May 2017).

[37] Colo. Rev. Stat. §38-10-111.

[38] David G. Shaftel, *Twelfth ACTEC Comparison of the Domestic Asset Protection Trust Statutes* (Aug. 2019), www.actec.org.

Domestic APTs warrant consideration along with other strategies for protecting assets,[39] particularly because the effectiveness of some long-standing asset-protection techniques has been called into question. For example, reversing decades of judicial precedent, the United States Supreme Court held in 2002 that one spouse's interest in tenancy-by-the-entireties property was subject to the federal tax lien under §6321.[40] Moreover, 2005 federal legislation affects the United States bankruptcy law-treatment of a retirement plan, a homestead, an individual retirement account (IRA), and an APT.[41] Furthermore, in some notorious cases, settlors of foreign APTs have been fined or jailed for failure to produce documents or to repatriate assets when ordered to do so by United States courts.[42]

[39] *See* Barry A. Nelson, *State Survey of Asset Protection Techniques* (Apr. 2018), www.actec.org. For a description of the Special Power of Appointment Trust as an alternative to the domestic APT, see Abigail O'Connor, Mitchell M. Gans & Jonathan G. Blattmachr, *SPATs: A Flexible Asset Protection Alternative to DAPTs*, 45 Est. Plan. 3 (Feb. 2019).

[40] *United States v. Craft*, 535 U.S. 274 (2002). *See* I.F.3.a., below. All section references herein are to the Internal Revenue Code of 1986, as amended, and the regulations thereunder, unless otherwise specified.

[41] *See* IX.I.4., below.

[42] *See* XI.C.5., below.

The "best candidates" for domestic APTs are clients who have surplus assets after they perform realistic assessments of their existing and foreseeable assets and liabilities. The "worst candidates" for such trusts are clients who have (or are about to incur) large obligations and wants to hide assets to avoid paying them. Nevertheless, if clients must satisfy specific debts or claims, they may fund domestic APTs with assets that are not needed to satisfy those obligations.

Practitioners should beware of "rankings" of domestic APT states. Not surprisingly, such rankings use a framework under which the creators' jurisdictions come out first. The author does refer readers to the comparison of domestic APT states available on the website of the American College of Trust and Estate Counsel (ACTEC).[43] There, one or more practitioners from each domestic APT state were given the opportunity to provide input.

[43] David G. Shaftel, *Twelfth ACTEC Comparison of the Domestic Asset Protection Trust Statutes* (Aug. 2019), www.actec.org.

F. Limitations of Creditor Protection Provided by State Exemptions and Other Vehicles

1. **Introduction** —

Under the Supremacy Clause of the United States Constitution,[44] state-law exemptions from creditor claims, such as domestic APT statutes, homestead exemptions, and tenancies by the entireties, must yield to certain "supercreditors" created by federal law. Supercreditors, which include, but are not limited to, the Internal Revenue Service ("IRS"),[45] the Securities and Exchange Commission (SEC),[46] the Federal Trade Commission (FTC),[47] and persons claiming child support for minors[48] may disregard state-law protections through disgorgement and other remedies. Hence, at the request of supercreditors, courts have ordered foreclosure and sale of property notwithstanding the Texas homestead exemption,[49] the Florida homestead exemption,[50] and the tenancy-by-the-entireties laws of various states.[51] The IRS also may sell tenancy-by-the-entireties property without court involvement by administrative levy under §6331.[52] When supercreditors have encountered difficulty reaching assets of foreign APTs, courts have not been reluctant to employ civil-contempt sanctions to reach those assets.[53] Planning with a domestic APT (Alaska, Delaware, Nevada, South Dakota, or otherwise) should proceed with this in mind.

[44] U.S. Const. Art. VI.

[45] *See United States v. Grant*, *96 AFTR 2d 6270*, 2013 WL 1729380 (S.D. Fla. 2013); *Eulich v. United States*, 2004 WL 1844821 (N.D. Tex. Aug. 18, 2004).

[46] *See SEC v. Solow*, 682 F. Supp. 2d 1312 (S.D. Fla. 2010), *aff'd*, 396 Fed. App'x 635 (11th Cir. 2010); *SEC v. Bilzerian*, 131 F. Supp. 2d 10 (D.D.C. 2001).

[47] *See FTC v. Affordable Media, LLC*, 179 F.3d 1228 (9th Cir. 1999); *FTC v. Ameridebt, Inc.*, 373 F. Supp. 2d 558 (D. Md. 2005).

[48] *See* 28 U.S.C. §1738B.

[49] *See United States v. Rodgers*, 461 U.S. 677, 680 (1983) (federal law "empowers a federal district court to order the sale of a family home in which a delinquent taxpayer had an interest at the time he incurred his indebtedness, but in which the taxpayer's spouse, who does not owe any of that indebtedness, also has a separate 'homestead' right as defined by Texas law").

[50] *See Rubenstein v. Commissioner*, 134 T.C. 266, 275 (2010) ("[T]he United States could have enforced its lien on Jerry Rubenstein's condominium by filing suit in Federal District Court, which would have been empowered to order the condominium's sale, notwithstanding any homestead protections").

[51] *See* I.F.3.a., below.

[52] *See, e.g., Hatchett v. United States*, 330 F.3d 875, 884 (6th Cir. 2003).

[53] *See* XI.C.5., below.

2. **Disclaimers** —

In *Drye v. United States* (1999),[54] the U.S. Supreme Court considered whether a taxpayer could defeat the federal tax lien through the use of a disclaimer. At the outset, Justice Ginsburg summarized the controversy as follows: [55]

[54] *Drye v. United States*, 528 U.S. 49, 53 (1999) (under Arkansas law “[t]he disavowing heir's creditors … may not reach property thus disclaimed.”).

[55] *Drye v. United States*, 528 U.S. 49, 52.

> This case concerns the respective provinces of state and federal law in determining what is property for purposes of federal tax lien legislation. At the time of his mother's death, petitioner Rohn F. Drye, Jr., was insolvent and owed the Federal Government some $325,000 on unpaid tax assessments for which notices of federal tax liens had been filed. His mother died intestate, leaving an estate with a total value of approximately $233,000 to which he was sole heir. After the passage of several months, Drye disclaimed his interest in his mother's estate, which then passed by operation of state law to his daughter. This case presents the question whether Drye's interest as heir to his mother's estate constituted “property” or a “right to property” to which the federal tax liens attached under 26 U.S.C. §6321, despite Drye's exercise of the prerogative state law accorded him to disclaim the interest retroactively.

She concluded:[56]

[56] *Drye v. United States*, 528 U.S. 49, 52 (citation omitted).

> We hold that the disclaimer did not defeat the federal tax liens. The Internal Revenue Code's prescriptions are most sensibly read to look to state law for delineation of the taxpayer's rights or interests, but to leave to federal law the determination whether those rights or interests constitute “property” or “rights to property” within the meaning of §6321. Once it has been determined that state law creates sufficient interests in the taxpayer to satisfy the requirements of the federal tax lien provision, state law is inoperative to prevent the attachment of liens created by federal statutes in favor of the United States.

In the course of the opi nion, Justice Ginsburg stressed:[57]

[57] *Drye v. United States*, 528 U.S. 49, 61 (citations and internal quotation marks omitted). *Accord United States v. Harris*, 854 F.3d 1053, 1056–1057 (9th Cir. 2017).

> [I]n determining whether a federal taxpayer's state-law rights constitute “property” or “rights to property, the important consideration is the breadth of the control the taxpayer could exercise over the property. Drye had the unqualified right to receive the entire value of his mother's estate (less administrative expenses) or to channel that value to his daughter. The control rein he held under state law, we hold, rendered the inheritance “property” or “rights to property” belonging to him within the meaning of §6321, and hence subject to the federal tax liens that sparked this controversy.

3. **Tenancy-by-the-Entireties Property**

a. **Federal Tax Lien** —

In *United States v. Craft* (2002),[58] another United States Supreme Court case, the Michigan exemption for a spouse's interest in tenancy-by-the-entireties property did not defeat the federal tax lien. Justice O'Conner described the controversy and gave the Court's conclusion at the beginning of the opinion:[59]

[58] *United States v. Craft*, 535 U.S. 274 (2002). *See* George D. Karibjanian, *How Tenancies by the Entirety Can Help Your Clients*, 157 Tr. & Est. 20 (Mar. 2018).

[59] *United States v. Craft*, 535 U.S. 274, 276 (citation omitted).

> This case raises the question whether a tenant by the entirety possesses “property” or “rights to property” to

> which a federal tax lien may attach. Relying on the state law fiction that a tenant by the entirety has no separate interest in entireties property, the United States Court of Appeals for the Sixth Circuit held that such property is exempt from the tax lien. We conclude that, despite the fiction, each tenant possesses individual rights in the estate sufficient to constitute "property" or "rights to property" for the purposes of the lien, and reverse the judgment of the Court of Appeals.

In the course of the opinion, she summarized the interaction of state and federal law as follows:[60]

> Whether the interests of respondent's husband in the property he held as a tenant by the entirety constitutes "property and rights to property" for the purposes of the federal tax lien statute, is ultimately a question of federal law. The answer to this federal question, however, largely depends upon state law. The federal tax lien statute itself creates no property rights but merely attaches consequences, federally defined, to rights created under state law. Accordingly, we look initially to state law to determine what rights the taxpayer has in the property the Government seeks to reach, then to federal law to determine whether the taxpayer's state-delineated rights qualify as "property" or "rights to property" within the compass of the federal tax lien legislation.

Justice O'Connor summed up the Court's analysis:[61]

> We therefore conclude that respondent's husband's interest in the entireties property constituted "property" or "rights to property" for the purposes of the federal tax lien statute. We recognize that Michigan makes a different choice with respect to state law creditors: Land held by husband and wife as tenants by entirety is not subject to levy under execution on judgment rendered against either husband or wife alone. But that by no means dictates our choice. The interpretation of 26 U.S.C. §6321 is a federal question, and in answering that question we are in no way bound by state courts' answers to similar questions involving state law. As we elsewhere have held, exempt status under state law does not bind the federal collector.

In 2004, the Fourth Circuit described the significance of *Craft* to be:[62]

> In *United States v. Craft*, the Supreme Court held that where federal taxes are owed by one spouse, and the spouse has property owned as tenants by the entireties with a spouse who had no delinquent tax liabilities, the IRS may attach the entireties property to collect the tax debt under 26 U.S.C. §6321.

The federal district court in Hawaii has noted that tenancy-by-the-entireties property may shield against state tax claims:[63]

> The State of Hawaii, meanwhile, represents that the amount Defendant Ronald Staton owes it for unpaid taxes is $156,098.14, but it also acknowledges that the Defendants' residence owned as tenants by the entirety is not subject to its claims because the state tax liens are solely against Defendant Ronald Staton. Thus, the

[60] *United States v. Craft*, 535 U.S. 274, 279 (citations and internal quotation marks omitted). *Accord Wadsworth v. Talmage*, 911 F.3d 994, 997 (9th Cir. 2018).

[61] *United States v. Craft*, 535 U.S. 274, 288–289 (citations and internal quotation marks omitted).

[62] *Schlossberg v. Barney*, 380 F.3d 174, 177 (4th Cir. 2004).

[63] *United States v. Staton*, Civ. No. 12-00319, *2018 WL 1737969* at *2, 2018 BL 126842 at *2 (D. Haw. Apr. 10, 2018) (internal quotation marks omitted).

> State of Hawaii does not seek to collect from the sale proceeds of the Defendant's Residence.

At the same time, numerous courts have followed *Craft* and ordered tenancy-by-the-entireties property to be sold to satisfy one spouse's federal taxes.[64]

[64] *See, e.g., United States v. Bogart*, 715 F. App'x 161, 169 (3d Cir. 2017) (Pennsylvania); *United States v. Cardaci*, 856 F.3d 267, 280 (3d Cir. 2017) (New Jersey); *United States v. Adent*, 821 F.3d 911, 916 (7th Cir. 2016) (Wisconsin); *United States v. Davis*, 815 F.3d 253, 260 (6th Cir. 2016) (Michigan); *United States v. Williams*, 796 F.3d 815, 818 (7th Cir. 2015) (Indiana); *United States v. Bettan*, No. 15-cv-5204, 2020 BL 156638, 2020 WL 1989286 at *5 (E.D.N.Y. Apr. 27, 2020); *United States v. Carter*, No. 3:16-cv-674, 2018 BL 329991, 2018 WL 4356773 at *11 (E.D. Va. Sept. 12, 2018) (Virginia); *United States v. Maassen*, No. C17-4026, 2018 BL 345964, *2018 WL 4518989* at *6 (N.D. Iowa Aug. 29, 2018) (Iowa); *United States v. Fitzgerald*, No. 1:17-cv-10322, 2018 BL 222819, 2018 WL 3085211 at *3 (D.N.J. June 22, 2018) (New Jersey); *United States v. Staton*, Civ. No. 12-00319, *2018 WL 1737969* at *8, 2018 BL 126842 at *1 (D. Haw. Apr. 10, 2018) (Hawaii); *United States v. Silverman*, *2017 WL 6598499* at *4 (D. Minn. Nov. 28, 2017) (Minnesota); *United States v. Tannenbaum*, No. 12-cv-5305, 2016 BL 261075, 2016 WL 4261755 at *13 (E.D.N.Y. Aug. 11, 2016) (New York); *United States v. Cazzell*, No. 15-06127, 2016 BL 406778, 2016 WL 7015690 at *4 (W.D. Mo. Aug. 10, 2016) (Missouri); *United States v. Born*, No. 4:14-cv-00008, 2016 BL 96456, *2016 WL 1239219* at *5 (D. Alaska Mar. 29, 2016) (Alaska); *United States v. Hunter*, No. 5:14-cv-17-Oc-10, 2015 BL 213714, 2015 WL 4068374 at *8 (M.D. Fla. July 2, 2015) (Florida); *United States v. Hipolito*, No. 3:13-cv-338, 2015 BL 60579, *2015 WL 1003861* at *4 (M.D. Pa. Mar. 6, 2015) (Pennsylvania); *United States v. Payton*, No. 4:13-cv-55, 2014 BL 28438, 2014 WL 407575 at *3 (E.D.N.C. Feb. 3, 2014) (North Carolina); *In re Browne*, 595 B.R. 195, 201 (Bankr. D. Md. 2018). *See* Notice 2003-60 (guidance following *Craft* decision). *See also United States v. Taylor*, Civ. No. 3:18-cv-00720, 2019 BL 180689, *2019 WL 2161146* at *4 (N.D. Ala. May 17, 2019) (“the United States is entitled to … the sale of this interest [in Alabama joint-tenancy-with-a-right-of-survivorship property] to satisfy Taylor's unpaid tax liabilities”); *United States v. Lain,* No. 17-CV-113, 2019 BL 174385, 2019 WL 2051960 at *11 (D. Wyo. Feb. 5, 2019) (“The United States is therefore entitled to sell the subject [Wyoming tenancy-in-common] property at a foreclosure sale”).

b. **Bankruptcy** —

Although a spouse's interest in tenancy-by-the-entireties property is exempt in a bankruptcy proceeding in certain circumstances,[65] tenancy-by-the-entireties property may be ordered sold in connection with one spouse's bankruptcy proceeding. Hence, §363(h) of the federal bankruptcy code provides in pertinent part:[66]

[65] *See* 11 U.S.C. §522(b)(3)(B).

[66] 11 U.S.C. §363(h).

> Notwithstanding subsection (f) of this section, the trustee may sell both the estate's interest, under subsection (b) or (c) of this section, and the interest of any co-owner in property in which the debtor had, at the time of the commencement of the case, an undivided interest as a tenant in common, joint tenant, or tenant by the entirety ….

Courts have ordered property to be sold pursuant to this provision.[67]

[67] *See, e.g., In re Brannon*, 584 B.R. 417, 425 (Bankr. N.D. Ga. 2018); *In re Rhoads*, 572

B.R. 905, 917 (Bankr. N.D. Ill. 2017). *But see In re Anderson*, 603 B.R. 564 (Bankr. W.D. Va. 2019) ("the Debtor may exempt property held as TbE under 11 U.S.C. § 522 where a tax lien has attached to the property for liabilities owed only by the individual debtor").

Tenancy-by-the-entireties property may lose its exempt status if it is transferred to a revocable trust,[68] unless an applicable state statute[69] provides that the property will retain its character upon transfer to the trust.[70]

[68] *See, e.g.*, *In re Lewiston*, 539 B.R. 154, 161 (E.D. Mich. 2015) ("[A]though Lewiston and his wife are both beneficiaries of the Trust, this does not transform the beneficial interest of each into an asset held by the entirety"). For the distinction between spouses' interests in tenancy-by-the-entireties property and in joint revocable trusts, see *In re Lewiston*, 539 B.R. 154, 158–159. *But see Estate of Van Riper v. Director, Division of Taxation*, 226 A.3d 55, 61 (N.J. 2020) ("New Jersey has no law specifying that the joint conveyance of real property into a single trust destroys a tenancy by the entirety, and the Estate points to none.").

[69] *See* Ark. Code Ann. §28-72-601–§28-72-605; Del. Code Ann. tit. 12, §3334; 765 ILCS 1005/1c; Ind. Code Ann. §30-4-3-35; Md. Code Ann., Est. & Trusts §14.5-511; Mo. Ann. Stat. §456.950; N.C. Gen. Stat. §39-13.7; Tenn. Code Ann. §35-15-510; Va. Code Ann. §55.1-136; Wyo. Stat. §4-10-402.

[70] *See Loventhal v. Edelson*, 844 F.3d 662, 665 (7th Cir. 2016) ("the tenancy by the entirety will perdure no matter what changes Mr. Edelson makes in the trust").

c. **Restitution** —

Tenancy-by-the-entireties property that would otherwise have been exempt in a debtor-spouse's bankruptcy proceeding may nevertheless be subject to a lien for restitution under a federal statute.[71] The federal district court in Maryland described the circumstances as follows:[72]

[71] 18 U.S.C. §3613.

[72] *Conrad v. Schlossberg*, 555 B.R. 514, 517 (D. Md. 2016) (some internal quotation marks omitted; emphasis in original). *Accord Bank of Rushton v. Cardwell*, No. 17-8738, 2018 BL 354665, *2018 WL 4680126* at *7 (E.D. La. Sept. 28, 2018).

> Like the provision permitting the attachment of a tax lien under 6321, the enforcement scheme for restitution judgments provides that "[n]otwithstanding any other Federal law … a judgment imposing a fine may be enforced *against all property or rights to property* of the person fined." Subject to certain exceptions not applicable here. The statute further provides that an order of restitution "is a lien in favor of the United States on all property and rights to property of the person fined as *if the liability of the person fined were a liability for a tax assessed under the Internal Revenue Code of 1986*" and that such a lien arises on the entry of judgment. Additionally, any such lien is not dischargeable in bankruptcy.

The court reasoned:[73]

[73] *Conrad v. Schlossberg*, 555 B.R. 514, 519 (citation omitted).

> [T]he Parties here recognize that the rights of a tenant by the entireties under Maryland law are the same as those under Michigan law, the state law applicable in *Craft*. The Court therefore concludes that the Supreme Court's reasoning in *Craft* applies with respect to the restitution judgment at issue in this case, and thus, a lien in favor of the United States attaches to the Debtor's entireties property.

Finally, the court concluded:[74]

> [W]here no tax lien was in place, the United States government is an actual creditor, not a hypothetical one. As of the date of the entry of judgment in the Debtor's criminal proceeding, the United States obtained a lien on "all property or rights to property" owned by the Debtor. And that lien is to be enforced as if the liability of the person fined were a liability for a tax assessed under the Internal Revenue Code of 1986. Because the Supreme Court has already determined that a tax lien may attach to entireties property, notwithstanding any protections afforded to such property interest under state law. Where, as here, the United States has become a creditor to a bankruptcy estate pursuant to §3613, any entireties property is not exempt from process in the bankruptcy proceeding. In other words, under "applicable nonbankruptcy law," the Debtor's interest as a tenant by the entirety is not exempt from process, and the Bankruptcy Court properly sustained the Trustee's objection to the Debtor's claimed exemption.

4. **Homestead Exemption**

a. **Federal Tax Lien** —

As noted above, the United States Supreme Court has held that the Texas homestead exemption does not prevail over the federal tax lien.[75] There, the Court concluded:[76]

> The issue in both cases is whether §7403 empowers a federal district court to order the sale of a family home in which a delinquent taxpayer had an interest at the time he incurred his indebtedness, but in which the taxpayer's spouse, who does not owe any of the indebtedness, also has a separate "homestead" right as defined by Texas law. We hold that the statute does grant power to order the sale, but that its exercise is limited to some degree by equitable discretion. We also hold that, if the home is sold, the non-delinquent spouse is entitled, as part of the distribution of proceeds required under §7403, to so much of the proceeds as represents complete compensation for the loss of the homestead estate.

The Massachusetts homestead exemption also does not prevail over the federal tax lien. The federal district court there has observed:[77]

> The Supreme Court has held that when a state-created exemption, such as a homestead, conflicts with federal law, the exemption does not immunize a property from federal tax liens under the Supremacy Clause. Exempt status under state law does not bind the federal collector.

b. **Bankruptcy** —

The well-known Florida homestead exemption provides in relevant part:[78]

> There shall be exempt from forced sale under process of any court, and no judgment, decree or execution

[74] *Conrad v. Schlossberg*, 555 B.R. 514, 520 (citations omitted).

[75] *United States v. Rodgers*, 461 U.S. 677 (1983).

[76] *United States v. Rodgers*, 461 U.S. 677, 680.

[77] *United States v. Seeley*, No. 16-cv-10935, 2018 BL 413381, 2018 WL 5845214 at *4 (D. Mass. Nov. 8, 2018) (citations and internal quotation marks omitted). *But see United States v. Goodwin*, 395 F. Supp. 3d 157, 160 (D. Mass. 2019) ("the Homestead Exemption applies").

[78] Fla. Const. Art. X, §4(a).

> shall be a lien thereon, except for [1] the payment of taxes and assessments thereon, [2] obligations contracted for the purchase, improvement or repair thereof, or [3] obligations contracted for house, field or other labor performed on the realty … .

Even though the constitutional provision lists only three exceptions to the protection, courts have imposed equitable liens in certain circumstances. For example, a federal bankruptcy court in Florida imposed an equitable lien on a homestead purchased with the proceeds of a Ponzi scheme in which the purchaser was not implicated:[79]

> The Fidelity Accounts' records demonstrate that the entirety of the funds Debtor used to purchase the home, $227,126.78, came from fraudulent transfers from the Ponzi scheme. The Receiver is entitled to the remedies of an equitable lien and a constructive trust in the amount of $227,126.78, plus pre-judgment interest.

Whereas a federal bankruptcy court held that the Oklahoma homestead exemption had to yield to the federal tax lien in a bankruptcy proceeding,[80] federal bankruptcy courts in Ohio and California and the Supreme Court of North Dakota have held that homestead exemptions were available in other bankruptcy settings.[81]

5. **Third-Party Trusts**

a. **Federal Tax Lien** —

Third-party spendthrift and discretionary trusts sometimes are within the reach of the federal tax lien.

Accordingly, the Sixth Circuit held that the lien applied to a taxpayer's income interest in a third-party trust.[82] The court reasoned:[83]

> Under 26 U.S.C. §6331(a), as noted in Part I of this opinion, the Secretary of the Treasury is authorized to levy not only upon property of the delinquent taxpayer, but also upon property on which there is a lien for payment of the delinquent tax. As demonstrated in Part II of the opinion, the government's lien attached to the income stream several years before the levy was made. It is therefore immaterial that Mr. Reitelbach's interest might

[79] *In re Lee*, 574 B.R. 286, 300 (Bankr. M.D. Fla. 2017); *In re Bifani*, 580 Fed. App'x 740, 748 (11th Cir. 2014) (equitable lien imposed on homestead where transfers constituted actual fraud).

[80] *In re Burge*, 2019 WL 5198911 at *2 (Bankr. W.D. Okla. Oct. 14, 2019) ("the tax lien which is the subject of this dispute is a statutory lien which may not be avoided under [11 U.S.C.] §522(f)").

[81] *In re John D. Temnikar*, 2020 WL 1509590 at *1 (Bankr. N.D. Ohio Mar. 27, 2020) ("Because the trustee has failed to meet his burden of demonstrating that the debtor is not entitled to a homestead exemption, the Court overrules the trustee's objection to the debtor's claim of exemption and denies the trustee's motion to sell"); *In re Johnson*, 604 B.R. 875, 877 (Bankr. S.D. Cal. 2019) ("they created a valid homestead years before the bankruptcy and that they did not abandon the homestead when they faced reality and cooperated with the chapter 7 sales process") (footnote omitted); *In re Anderson*, 932 N.W.2d 506, 510 (N.D. 2019) ("The debtor is entitled to an exemption up to $100,000 for his undivided one-half interest in the jointly held homestead property").

[82] *Bank One Ohio Tr. Co., N.A. v. United States*, 80 F.3d 173 (6th Cir. 1996).

[83] *Bank One Ohio Tr. Co., N.A. v. United States*, 80 F.3d 173, 177 (internal quotation marks omitted).

> have disappeared, like a bursting bubble, when the notice of levy was served in 1993. The government having obtained its lien in 1989 or 1990, the government could enforce the lien regardless of what became of Mr. Reitelbach's interest thereafter.

More recently, the federal district court in Arizona confronted the following issue:[84]

[84] *Duckett v. Enomoto*, No. CV-14-01771, 2016 BL 122633, *2016 WL 1554979* at *6 (D. Ariz. Apr. 18, 2016).

> Here, the question is whether a beneficiary has enough "control" over funds held in a discretionary support trust to trigger federal tax lien attachment. Neither the Supreme Court nor the Ninth Circuit Court of Appeals has addressed this question. Other courts have, with mixed results. It is difficult to harmonize these results in a principled way. Courts appear to be deciding the question ad hoc, based on the unique combination of circumstances before them. In this judicial landscape, the best a court can do is identify the factors most relevant to its decision and explain how those factors compare or contrast with similar cases.

The court held "[t]he federal tax lien attaches to Dr. Enomoto's right to the trust funds."[85]

[85] *Duckett v. Enomoto*, No. CV-14-01771, 2016 BL 122633, *2016 WL 1554979* at 8.

b. **Restitution** —

The federal restitution statute described above[86] enabled the federal government to recover funds that a beneficiary had embezzled from an employee benefit plan from a discretionary support trust.[87] The Ninth Circuit posed the issue as follows:[88]

[86] 18 U.S.C. §3613. *See* I.F.3.c., above.

[87] *United States v. Harris*, 854 F.3d 1053 (9th Cir. 2017).

[88] *United States v. Harris*, 854 F.3d 1053, 1055.

> We … must decide whether a writ of continuing garnishment may attach to a beneficiary's interest in a discretionary support trust.

In the course of the opinion, the court noted that "the trusts' spendthrift clauses have no effect on our analysis because a spendthrift clause does not protect a trust's assets from the enforcement of a federal lien."[89]

[89] *United States v. Harris*, 854 F.3d 1053, 1057.

The court concluded:[90]

[90] *United States v. Harris*, 854 F.3d 1053, 1057.

> [W]e conclude that Harris's interest in the trusts qualifies as property under the federal debt collection procedure that applies in this case. The government is not attempting to compel distributions from the trusts. However, any current or future distributions from the trusts to Harris shall be subject to the continuing writ of garnishment, until the restitution judgment is satisfied.

c. **Child Support**

(1) **Introduction** —

A federal statute–the Full Faith and Credit for Child Support Orders Act–requires the appropriate authorities of each State to "enforce according to its terms a child support order made consistently with this section by a court of another State."[91] The statute also specifies that "[i]n an action to enforce arrears under a child support order, a court shall apply the statute of limitation of the forum State or the State of the court that issued the order, whichever statute provides the longer period of limitation."[92] All states have enacted a version of the Uniform Interstate Family Support Act.[93] Nevertheless, the federal statute also provides that "[i]n a proceeding to establish, modify, or enforce a child support order, the forum State's law shall apply . . . ."[94]

[91] 28 U.S.C. §1738B(a)(1). *See* Kurtis A. Kemper, *Validity, Construction, and Application of Full Faith and Credit for Child Support Orders Act (FFCCSOA), 28 U.S.C.A. § 1738B—State Cases*, 18 A.L.R.6th 97 (2006).

[92] 28 U.S.C. §1738B(h)(3).

[93] *See, e.g.,* Alaska Stat. §25.25.101–§25.25.903; Cal. Fam. Code §5700.101–§5700.905; Del. Code Ann. tit. 13, §6-101–§6-903; Nev. Rev. Stat. §130.0902–§130.802; S.D. Codified Laws §25-9C-101–§25-9C-903.

[94] 28 U.S.C. §1738B(h)(1).

(2) **In re Cleopatra Cameron Gift Trust** —

In its 2019 *In re Cleopatra Cameron Gift Trust* decision, the Supreme Court of South Dakota held that a trust beneficiary could prevent child support payments for which she was responsible from being charged to three third-party spendthrift trusts by changing the trusts' situs from California, where trust assets are subject to such claims, to South Dakota, where they are not.[95] The court summarized the controversy at the beginning of the opinion:[96]

[95] *In re Cleopatra Cameron Gift Trust*, 931 N.W.2d 244 (S.D. 2019).

[96] *In re Cleopatra Cameron Gift Trust*, 931 N.W.2d 244, 245–246(S.D. 2019).

> Trust beneficiary Cleopatra Cameron filed a petition in the circuit court requesting a determination of whether the trust's spendthrift provision prohibits direct payments of her child support obligation to her ex-husband, Christopher Pallanck. A California family court previously ordered the direct payments as part of the couple's divorce, citing a particular feature of California trust law. The circuit court concluded the direct payment order was a method of enforcing Cleopatra's child support obligation to be determined under local law and, therefore, not entitled to full faith and credit. The court further determined that South Dakota law recognizes the validity of spendthrift clauses and their prohibition upon compulsory direct payments to a beneficiary's creditors, like Christopher, who now appeals. We affirm.

At the time of the marriage of Cleopatra Cameron (Ms. Cameron) and Christopher Pallanck (Mr. Pallanck) in 2005, she was the beneficiary of three third-party spendthrift trusts, which the court defined as "the Trust," created by her deceased father. Ms. Cameron and Mr. Pallanck lived with their two minor children in California; he filed for divorce in 2009. In the final divorce decree, the California Family Law Court directed the trustees of the Trust to make monthly child-support payments to Mr. Pallanck in accordance with an exception to California's third-party spendthrift trust statute.[97] In 2012, Ms. Cameron exercised a power granted her in the Trust and transferred the situs of the Trust to South Dakota, where the trustee continued to make child-support payments to Mr. Pallanck until 2017, when Ms. Cameron petitioned a South Dakota court as to whether the payments should continue. The court concluded:[98]

[97] *See* Cal Prob. Code §15305(c).

[98] *In re Cleopatra Cameron Gift Trust*, 931 N.W.2d 244, 251 (S.D. 2019).

> Because the means of enforcing judgments do not implicate full faith and credit considerations, the circuit court here was not required to submit to the California order compelling direct payments from the Trust if this method of self-executing enforcement is not authorized by South Dakota law. Based upon a review of our relevant statutes, it is not authorized and is, in fact, expressly prohibited.

The court continued:[99]

[99] *In re Cleopatra Cameron Gift Trust*, 931 N.W.2d 244, 252 (S.D. 2019).

> [B]ecause Christopher has not registered a judgment for enforcement, it is unnecessary to address his arguments for the application of the Uniform Enforcement of Foreign Judgments Act under SDCL 15-16A and the Uniform Interstate Family Support Act (UIFSA) under SDCL 25-9C. However, even if the order had been registered for enforcement under SDCL 25-9C-602, the registered support order is only enforceable in the same manner and is subject to the same procedures as an order issued by a tribunal of this state. Similarly, the choice of law provisions of the UIFSA provide that an enforcing state shall apply the procedures and remedies of this state.
>
> Under the circumstances, therefore, both the UIFSA and the FFCCSOA leave enforcement mechanisms to the legal standards of the forum state, even if it is without jurisdiction to modify the order. In this regard, a forum state may use its own enforcement mechanisms if it does not alter the amount, scope, or duration of the issuing state's judgment.

(3) **Comments** —

Several comments are in order. First, the court does not discuss whether the courts of California or of South Dakota are the courts of primary supervision that should adjudicate controversies involving the Trust. The author does so in IX.C.1.b., below. Second, the opinion is devoid of any discussion of whether the change of situs effected a change of the law that governs the effectiveness of the spendthrift clause from California to South Dakota. The author covers this issue in IX.G.3.a.(4), below. Third, the outcome is surprising given that the goal of the Full Faith and Credit for Child Support Orders Act is to enforce child support orders. Finally, the Trust was a third-party trust not a self-settled trust. The author explores the use of Alaska, Delaware, Nevada, and South Dakota APTs based on the *Cameron* fact pattern in X.C.4.c., below. Suffice it to say here that if Ms. Cameron had funded a South Dakota APT following the divorce, her trust assets would have been subject to child-support claims. This is because the South Dakota APT legislation provides that:[100]

[100] S.D. Codified Laws §55-16-15(1).

> Notwithstanding the provisions of §§55-16-9 to 55-16-14, inclusive, but subject to subdivision (2) of this section, this chapter does not apply in any respect to any person to whom at the time of transfer 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, to the extent of the debt.

6. **Restitution—Other Contexts** —

Federal district courts have held that criminal restitution orders were superior to anti-alienation provisions in 401(k) plans [101] as well as to Florida's exemption for pension benefits.[102]

[101] *United States v. Frank*, 2020 WL 2205066 at *2 (E.D. Va. May 2020); *United States v. Young*, 325 F. Supp. 3d 830 (W.D. Mich. 2018). *See United States v. Berry*, 951 F.3d 636 (5th Cir. 2020) ("Gwendolyn's one-half interest in Michael's solely managed IRA is part of all property and rights to property of the spouse fined under §3613") (footnote, brackets, and internal quotation marks omitted).

[102] *2018 WL 4242455* at *2. *See United States v. Young*, 325 F. Supp. 3d 830, 832; *United States v. Wilhite*, 774 F. App'x 478, 492 (10th Cir. June 25, 2019) ("[w]e…affirm the district court's order calling for the sale of AFC").

7. **Foreign APTs** —

Foreign APTs are not subject to the Supremacy Clause, but their settlors and trustees still must beware of supercreditors.

For example, as discussed in XI.C.5., below, the IRS may reach the assets of foreign APTs to satisfy a federal tax lien.[103] Similarly, the SEC[104] and the FTC[105] have reached the assets of foreign APTs to satisfy claims.

[103] *See, e.g., United States v. Grant*, No. 00-08986, 2013 BL 105975, 2013 WL 1729380 (S.D. Fla. Apr. 22, 2013); *Eulich v. United States*, 2004 WL 1844821 (N.D. Tex. Aug. 18, 2004).

[104] *See SEC v. Solow*, 682 F. Supp. 2d 1312 (S.D. Fla. 2010), *aff'd*, 396 F. App'x 635 (11th Cir. 2010); *SEC v. Bilzerian*, 131 F. Supp. 2d 10 (D.D.C. 2001), *aff'd*, 75 F. App'x 3 (D.C. Cir. 2003).

[105] *See FTC v. Affordable Media*, 179 F.3d 1228 (9th Cir. 1999); *FTC v. Ameridebt, Inc.*, 373 F. Supp. 2d 558 (D. Md. 2005). *But see In re Rensin*, 600 B.R. 870 (Bankr. S.D. Fla. 2019). *See also* XI.C.5., below.

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G. Reasons Against Recognizing Domestic APTs

Although the Scott treatise[106] objects to domestic APTs, it simply states that they violate public policy and does not explain the opposition to them. Other commentators posit the following reasons for making domestic APTs ineffective against creditors' claims.

[106] 3 Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* §15.4 at 954–955 (5th ed. 2007).

1. **One Should Pay One's Debts** —

The principal objections to recognizing the effectiveness of domestic APTs are that "[y]ou should keep your promises and pay your debts because it is the right thing to do"[107] and that, "there is something disturbing about a country that would allow debtors to leave their debts unpaid and still enjoy an extravagant lifestyle."[108] The author believes, however, that recognizing domestic APTs is not inconsistent with these principles, provided that the fraudulent transfer rules summarized in VIII., below, continue to apply.

[107] Karen E. Boxx, *Gray's Ghost—A Conversation About the Onshore Trust*, 85 Iowa L. Rev. 1195, 1259 (May 2000).

[108] Karen E. Boxx, 85 Iowa L. Rev. 1159, 1259.

2. **Preserve Liability System** —

Another objection to domestic APTs is that allowing debtors to use such trusts to shelter their assets from potential creditors threatens the system of civil enforcement of obligations by undercutting the deterrent effect of our liability system and that the better way to address the excesses of the tort system is through tort reform—not by recognizing domestic APTs.[109] Unfortunately, the pace of tort reform has been glacial, whereas it has been possible to enact APT legislation at home and abroad.

[109] Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts*, 53 Hastings L.J. 287, 364 (Jan. 2002).

3. **Domestic APTs "Always" Are Fraudulent** —

The Bogert treatise opposes domestic APTs because:[110]

[110] Helene S. Shapo, George Gleason Bogert & George Taylor Bogert, *The Law of Trusts and Trustees* §223 at 472 (3d ed. 2007) (footnotes omitted).

> The traditional rule is based on the policy that creditors have a right that their debtor pay their claims before he makes provision for his own support or comfort. Both existing and future creditors may be misled into believing that their debtor's financial situation is sound, because he continues to enjoy the benefits of his property and perhaps is in actual possession of it, although that property has been conveyed by a trust instrument to be held for the debtor. If the spendthrift provision is enforced, the settlor will have removed assets that would have been available to the creditors. Moreover, if the settlor acted fraudulently, that may be difficult to prove, and so the law strikes down the transaction as presumed to be fraudulent.

In the author's experience, the Bogert treatise's assertion that domestic APTs always are created with evil intent simply is not true. Certain legal and practical factors prevent domestic APTs from being fraudulent:[111]

[111] Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts,* 53 Hastings L.J. 287, 360.

> [T]rustees are obligated as fiduciaries to exercise their discretion independent of the wishes or demands of the settlor and after considering the competing desires and needs of the other trust beneficiaries. Contrary to a commonly held belief, the settlor of an APT cannot compel the trustee to distribute all amounts that the settlor may desire, and a trustee who acceded to a settlor's unreasonable demands would be liable to the other trust beneficiaries. Thus, a settlor who establishes an APT gives up substantial control over the settlor's assets. Moreover, as a practical matter, trustees—especially trustees of APTs—will act conservatively in making trust distributions.

H. Reasons for Recognizing Domestic APTs

There are several reasons why domestic APTs should be recognized.

1. **Authorities Do Not Support the Scott Treatise** —

A commentator reports that the cases that the Scott treatise cites in support of the view that domestic APTs should not be honored do not justify that position.[112] The Scott treatise responds as follows: “It has been argued that when the *First Restatement* and the first edition of this treatise appeared there was little, if any, precedent for this position. Whatever the truth of that observation, it is plain that substantial authority for the *Restatement* position now exists.”[113]

[112] Robert T. Danforth, *Rethinking the Law of Creditors’ Rights in Trusts*, 53 Hastings L.J. 287, 360.

[113] 3 Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* §15.4.3 at 967 n.12 (5th ed. 2007) (citation omitted).

One wonders how much of that authority developed in misplaced reliance on the *First Restatement of Trusts* and that edition of the treatise. In addition, the Scott treatise fails to note that, in the interim, several other self-settled vehicles that offer protection from creditors have emerged.[114]

[114] *See* I.H.7., below.

2. **United States Is Unique** —

A commentator observed in 2017 that:[115]

[115] Peter Spero, *Recent Cases Show Need for Strict Compliance With DAPT Statutes*, 44 Est. Plan. 8, 8 (May 2017). *See generally* Helene S. Shapo, George Gleason Bogert & Georga Taylor Bogert, *The Law of Trusts and Trustees* §221 at 389–391 (3d ed. 2007).

> Under the laws of the United Kingdom, which are followed by many English-speaking countries throughout the world, a self-settled discretionary trust is effective for asset protection purposes.

Another commentator reported in 1998 that “America stands virtually alone in its rigid and virtually absolute adherence to the rule against self-settled trusts.”[116] He amplified this point as follows:[117]

[116] John E. Sullivan, III, *Gutting the Rule Against Self-Settled Trusts*, 23 Del. J. Corp. L. 423, 433 (1998) (footnote omitted).

[117] John E. Sullivan, III, *Gutting the Rule Against Self-Settled Trusts*, 23 Del. J. Corp. L. 423, 441.

> [B]etween the traditional English common law protective trust, the related statutory short form, the English discretionary trust, and the contemporary APT statutes of many other common law nations, much of the world allows self-settled trusts as a way to shelter assets from the settlor's creditors, provided that the settlement did not violate fraudulent transfer laws.

3. **Creditors Are Given More Rights Than Settlors** —

Permitting creditors to reach the settlor's interest in a domestic APT, regardless of the circumstances, might give the creditors greater access to trust funds than settlors, whose receipt of funds might be subject to legal and practical limitations.[118]

[118] Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts,* 53 Hastings L.J. 287, 305 (Jan. 2002).

4. **Interests of Other Beneficiaries Are Ignored** —

Giving creditors automatic access to the assets of domestic APTs ignores the rights of trust beneficiaries other than the settlor.[119] To that assertion, the Scott treatise responds:[120]

[119] Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts,* 53 Hastings L.J. 287, 305.

[120] 3 Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* §15.4.3 at 967–968 n.12 (5th ed. 2007) (citation omitted; emphasis in original).

> It has also been argued that the Restatement position is "theoretically unsound," particularly insofar as it seems to allow creditors greater access to the assets of a self-settled trust than the settlor would have had. The obvious response is that it is simply not true that the Restatement position allows the settlor's creditors *greater* access than the settlor might have had. The Restatement position allows creditors the *same* access (but to the maximum extent) that the settlor might have had. It may be that the trustee would not always or ever have exercised the discretion to the fullest extent in favor of the settlor, but there seem ample justifications for allowing creditors to get what the settlor *might* have gotten. Just beneath the surface of the Restatement position is the intuition that a significant percentage of settlors who create trusts on their own behalf do so in large part to evade creditors. Given how "asset protection trusts" are now marketed this intuition seems plainly accurate. No doubt another component of the thinking behind the Restatement position is the knowledge that most settlors (who either are their own trustees or have selected their trustees and retained the right to replace them) have little difficulty obtaining trust distributions, of almost any magnitude.

In the author's experience, the Scott treatise's contention that domestic APTs often are created to "evade" creditors is untrue. In this connection, all of the domestic APT statutes provide for the satisfaction of claims by existing and foreseeable creditors through the statutes' recognition of fraudulent transfer rules. Further, the treatise's assertion that settlors of domestic APTs usually have ready access to trust assets is without basis.[121]

[121] *See* XIII., below.

Rather shockingly, the Scott treatise continues that:[122]

[122] 3 Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* §15.4.3 at 968 n.12 (5th ed. 2007) (emphasis in original).

> In addition, the *Restatement* position, by referring to the *maximum* amount the trustee could distribute to the settlor, allows resolution of many such disputes by reference to only the terms of the trust. A rule that sought to put the creditor precisely in the settlor's shoes would necessarily involve, as well as the terms of the trust, a host of factors relating not only to the settlor but also to the other beneficiaries, and would thus necessitate more detailed fact-finding in a much larger number of instances.

The foregoing rule essentially says that the plaintiff-creditor always wins regardless of the equities, regardless of any other innocent beneficiaries who might be involved, and regardless of whether the plaintiff-creditor winds up with more than the defendant-debtor- settlor would have.

5. **Settlor's Continuing Control Is Relevant** —

Giving creditors automatic access to domestic APT assets fails to distinguish between situations in which the settlor does or does not maintain impermissible control over, or interests in, the trust fund.[123]

[123] Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts,* 53 Hastings L.J. 287, 305–306.

6. **Domestic APTs Create Economic Incentives and Encourage Entrepreneurship** —

Consistent with normal fraudulent transfer laws, domestic APTs allow productive and successful people to shelter assets in advance of a financial storm,[124] thereby enabling such people to stay afloat and continue their productive ways even when times turn bad.

[124] *See* VIII.B., below.

7. **Other Self-Settled Vehicles Are Recognized** —

Clients long have been able to shelter assets from creditors by using a variety of other self-settled vehicles, including tenancy-by-the-entireties property, retirement plans, family limited partnerships (FLPs), limited-liability companies (LLCs), homesteads, life insurance policies, annuity contracts, and transfers to or in trust for "cooperative" friends or family members.[125] Four relatively new vehicles warrant comment.

[125] Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts*, 53 Hastings L.J. 287, 333–347.

The first is a statute that provides protection from creditor claims for the settlor's contingent interest in a qualified terminable interest property (QTIP) trust, a credit shelter trust, a spousal lifetime access trust (SLAT), or other trusts created during life. Such statutes were prompted by clients' desires to make lifetime gifts in trust in light of the dramatic increase in the federal estate tax, gift tax, and generation-skipping transfer tax exemptions over the past decade.[126] As shown in Worksheet 2, at least 16 states had such legislation as of January 1, 2020.

[126] *See* Richard S. Franklin & George D. Karibjanian, *The Lifetime QTIP Trust—the Perfect (Best) Approach to Using Your Spouse's New Applicable Exclusion Amount and GST Exemption*, 44 Tax Mgmt. Est., Gifts & Tr. J. 91 (Mar. 14, 2019).

The second is a statute that authorizes a settlor to include a discretionary income tax reimbursement clause in a grantor trust. These statutes[127] became popular following the issuance of Rev. Rul. 2004-64, which held in pertinent part that:

[127] *See, e.g.,* Del. Code Ann. tit. 12, §3536(c)(2).

> If … the trust's governing instrument or applicable local law gives the trustee the discretion to reimburse the grantor for that portion of the grantor's income tax liability, the existence of that discretion, by itself (whether or not exercised) will not cause the value of the trust's assets to be includible in the grantor's gross estate.

Moreover, statutes in four states now authorize a trustee to reimburse the settlor for income taxes attributable to a grantor trust, absent contrary language in the governing instrument.[128]

[128] *See* Colo. Rev. Stat. §15-5-818; Del. Code Ann. tit. 12, §3344; N.H. Rev. Stat. Ann. §564-B:8-816(c); N.Y. Est. Powers & Trusts Law §7-1.11 (capital gains only).

The third is a statute that offers continued protection from one spouse's creditor claims for tenancy-by-the-entireties property contributed by spouses' to revocable trusts[129] or to irrevocable trusts.[130] The fourth is a statute providing that a trust funded by the lapse of a beneficiary's withdrawal power will not be treated as self-settled with respect to such beneficiary.[131]

[129] *See* Ark. Code Ann. §28-72-601–§28-72-605; Del. Code Ann. tit. 12, §3334; 765 ILCS 1005/1c; Ind. Code Ann. §30-4-3-35; *Md. Code Ann., Est. & Trusts §14.5-511*; Mo. Ann. Stat. §456.950; N.C. Gen. Stat. §39-13.7; Tenn. Code Ann. §35-15-510; Va. Code Ann. §55.1-1362; Wyo. Stat. §4-10-402.

[130] *See, e.g.,* Del. Code Ann. tit. 12, §3574; Haw. Rev. Stat. §554G-10(f); *Md. Code Ann., Est. & Trusts §14.5-511*; N.C. Gen. Stat. §39-13.7; Va. Code Ann. §55-20.2; Wyo. Stat. §4-10-402.

[131] *See, e.g.,* Del. Code Ann. tit. 12, §3536(c)(4).

Consequently, the legal landscape is already awash with many vehicles and devices that enable clients to shelter vast amounts from creditors. In that sense, domestic APTs are nothing new and are simply the latest addition to a long list. Indeed, the similar impact of the APTs to non-APT vehicles prompted a 2002 law review article to liken the homestead exemption to domestic APTs as follows:[132]

[132] John K. Eason, *Developing the Asset Protection Dynamic: A Legacy of Federal Concern*, 31 Hofstra L. Rev. 23, 70 (Fall 2002) (footnotes omitted).

> [T]he limited nature of the congressional response to homestead exemption planning—in light of the significant commentary long accompanying consideration of that issue—provides a potent frame of reference for those who argue that there is absolutely nothing objectionable about a solvent individual setting aside a "nest egg" in a self-settled asset-protection trust where no creditors are looming on the horizon. A belief that individuals concerned about liability exposure would equate the two planning opportunities is anything but tenuous.

And, as a 2007 law review article put it:[133]

[133] Richard C. Ausness, *The Offshore Asset Protection Trust: A Prudent Financial Planning Device or the Last Refuge of a Scoundrel?* 45 Duq. L. Rev. 147, 185 (Winter 2007) (footnotes omitted).

> [S]elf-settled spendthrift trusts, foreign or domestic, are but one way to make oneself judgment proof against creditors… . [T]here are many devices available to business entities to insulate themselves against liability. Individuals can also employ a variety of strategies to limit their liability. Consequently, it seems inconsistent to single out self-settled asset [protection] trusts for condemnation while permitting businesses and individuals to avoid liability in so many other ways.

In 2017, a federal bankruptcy judge in Illinois observed that "avoidance of taxes, concealment of ownership, *even protection from creditors*, are all legitimate purposes for which trusts are formed."[134] Three years later, the Sixth Circuit noted that "asset protection is a legitimate, legally sanctioned objective, though one that has limitations of its own."[135]

[134] *In re Glick*, 568 B.R. 634, 667 (Bankr. N.D. Ill. 2017) (emphasis added).

[135] *Church Joint Ventures, L.P. v. Blasingame*, 947 F.3d 925, 931 (6th Cir. 2020).

With so many other vehicles available, one wonders what all the fuss is regarding APTs.

8. **Congress Blesses Domestic APTs** —

Even the United States Congress sub silentio endorsed APTs that are created on a nonfraudulent basis. Specifically, Congress allows bankruptcy estates to “claw back” assets fraudulently transferred into self-settled trusts or other similar devices if that transfer was made with actual intent to hinder, delay, or defraud creditors.[136]

[136] 11 U.S.C. §548(e)(1) allows a bankruptcy trustee to reach a self-settled trust or similar device that the settlor created within 10 years of the filing of a bankruptcy petition with actual intent to hinder, delay, or defraud an existing or future creditor.

9. **Clients Want APTs** —

Clients plainly want self-settled trusts that protect their assets from creditors. Clearly, there is a huge demand for these vehicles, the only question is where will United States clients go to satisfy this demand.

10. **Domestic APTs Preserve American Business** —

American business interests are best served if APTs are available domestically. If domestic APTs are not allowed, settlors will continue to place assets in foreign APTs. However, a clear acceptance of domestic APTs by American courts and legislators will keep at least some of that business at home and, thereby, provide fees, jobs, and tax revenues for American trustees, their employees, and the tax authorities they annually pay.

11. **Domestic APTs Preserve United States Oversight (the “Safe-Situs” Doctrine)** —

American oversight of APT business is enhanced if domestic APTs are allowed. It is evident from historical trends that settlors will continue to place assets in foreign APTs if domestic APTs are not recognized. Paradoxically, then, legislative and judicial opposition to domestic APTs will actually make it harder for American courts to provide fiduciary oversight or to adjudicate fraudulent transfer claims because many foreign APT statutes include nonrecognition of judgment rules that will bar enforcement of American court judgments.[137] These rules force anybody who is serious about pursuing fiduciary or fraudulent transfer claims into a foreign trustee's home court, which inherently deprives U.S. courts of any meaningful ability to supervise APT affairs. Additionally, this offshore litigation will typically add considerable expense to the U.S. plaintiff who filed such claims.

[137] For example, the Cook Islands International Trusts Act §13D states:

> Notwithstanding the provisions of any treaty or statute, or any rule of law, or equity, to the contrary, no proceedings for or in relation to the enforcement or recognition of a judgement obtained in a jurisdiction other than the Cook Islands against any interested party shall be in any way entertained, recognised or enforced by any Court in the Cook Islands to the extent that the judgement: (a) is based upon the application of any law inconsistent with the provisions of this Act or of the Trustee Companies Act 1981-2; or (b) relates to a matter or particular aspect that is governed by the law of the Cook Islands.

Consequently, rather than impede the use of domestic APTs, American courts and legislatures should encourage the expanded use of domestic APTs because, in the long run, it will be safer and more efficient for American plaintiffs, courts, and regulators if APTs are sitused in the United States, where they are subject to easier oversight, rather than sitused in a distant and inhospitable venue.

Put differently, the question is this: Who do American creditors really want monitoring APTs for possible abuses—a local American court or the High Court of the Cook Islands? When seen in this light, it becomes rather obvious that even domestic American creditors are best served if they accept rather than resist the growth of domestic APTs.

12. **Domestic APTs Can Even Benefit Tort Victims** —

Even the plaintiffs who are allegedly most harmed by domestic APTs can, in many cases, actually benefit from these devices.

Notwithstanding the criticism that is sometimes heaped on the plaintiffs' bar, the fact remains that there are indeed a fair number of valid and legitimate claims by aggrieved plaintiffs, with perhaps the most sympathetic being those asserted by personal injury victims. Although the author has not examined any statistics, it seems likely that only a relatively small percentage of these claims are satisfied out of the assets of individual debtors and that the overwhelming bulk of big personal injury claims are instead satisfied by collections from workers compensation, liability insurance policies, and self-insured corporations or business entities. If so, then domestic APTs result in personal injury plaintiffs as a class giving up relatively little in terms of collectible sources. At the same time, the many accident victims who collect from insurance, workers compensation, or corporations often receive large sums, whereupon the victims also acquire a significant interest in sheltering their damage awards from the claims of the victims' own potential future creditors. APTs are an ideal vehicle for this purpose, particularly for those injury victims who are at risk of dissipating awards because of the victims' own dissolute lifestyles, lack of financial skills, or just plain bad dumb luck.

So, far from causing individual tort victims to be net losers, APTs can make many such victims net winners if, five or 10 years after the victims collect a big award, they are themselves the target of a lawsuit.

13. **Outright Gifts Are at Least as Hurtful to Creditors but Outright Gifts Are Allowed** —

One of the great failings of domestic APT critics is their inability to satisfactorily answer a very simple pair of related questions: First, if clients can nonfraudulently transfer away their assets directly to others, including those close to the clients, or to exempt vehicles, then why can the clients not transfer those same assets to domestic APTs? Second, what might hurt creditors more—a nonfraudulent giving away of assets or a nonfraudulent transfer of those assets into a domestic APT?

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I. Scope

The remainder of this Portfolio: (1) describes the benefits of domestic APTs (II., below); (2) summarizes the Delaware, Alaska, Nevada, and South Dakota statutes (III.–VI., below);[138] (3) discusses federal income-tax and transfer-tax implications (VII., below); (4) covers fraudulent transfer rules and defenses against creditor attacks (VIII. and IX., below); (5) compares Delaware APTs to Alaska, Nevada, and South Dakota APTs (X., below); (6) compares domestic APTs to foreign APTs (XI., below); (7) discusses how to design, establish, and administer a domestic APT (XII. and XIII., below); and (8) alerts practitioners to ethical and practical concerns (XIV., below). The Worksheets, below, include citations to state self-settled trust statutes, state lifetime marital deduction and other trust statutes, and state fraudulent transfer statutes; a practitioner-friendly guide to the Delaware APT; a sample client letter; a solvency affidavit; and two Delaware APT forms.

[138] For the attributes of the other 13 of the 15 domestic APT statutes, see David G. Shaftel, *Twelfth Annual ACTEC Comparison of the Domestic Asset-Protection Trust Statutes* (Aug. 2019), www.actec.org. For a summary of the New Hampshire domestic APT legislation, see Steven M. Burke, Linda R. Garey, Thanda Fields Brassard, Von E. Sanborn & Constance E. Shields, *New Hampshire: Why the Granite State Still Rocks at Trust Administration*, 47 Est. Plan. 27, 27–28 (Mar. 2020). *See also* Todd D. Mayo, *New Hampshire: Several Significant Judicial and Other Developments*, 158 Tr. & Est. 59 (Aug. 2019).

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A. Introduction

A domestic asset protection trust (APT) is a self-settled trust from which the settlor might get funds back in certain circumstances. This vehicle can be beneficial in a variety of situations.

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B. Employ Tax Benefits

1. **General** —

Although clients will likely get more certain tax results if they cut all ties with specific assets, they might not be willing to use certain tax benefits without retaining some potential connections with those assets. A client might be more inclined to create a trust that uses some or all of the gift tax exemption[129] and GST exemption,[130] an irrevocable life insurance trust,[131] a charitable lead trust,[132] a charitable remainder trust (CRT),[133] a grantor retained annuity trust (GRAT),[134] or a qualified personal residence trust (QPRT)[135] if the client knows that funds might be available in an emergency. This is more likely because the foregoing exemptions are $10 million (adjusted for inflation),[136] particularly given that those exemptions are scheduled to decline to $5 million, adjusted for inflation, in 2026 and might decrease sooner depending on political developments.[137] The relevant federal transfer-tax implications are discussed in VII., below.

[129] *See* §2505. See also 845 T.M., *Gifts*.

[130] *See* §2631. See also 850 T.M., *Generation-Skipping Transfer Tax*.

[131] See 807 T.M., *Personal Life Insurance Trusts*.

[132] See 866 T.M., *Charitable Lead Trusts*.

[133] *See* §664. See also 865 T.M., *Charitable Remainder Trusts, Charitiable Gift Annuities, and*

Pooled Income Funds (Sections 664 and 642(c)(5)).

[134] *See* §2702. See also 836 T.M., *Partial Interests—GRATs, GRUTs, QPRTs (Section 2702)*.

[135] *See* §2702. See also 836 T.M., *Partial Interests—GRATs, GRUTs, QPRTs (Section 2702)*.

[136] For the recent inflation-adjusted applicable exclusion amounts, see *Unified Credit for Estate Tax* in Tax Tables, Charts and Lists (Federal). *See* Charles A. Redd, *Assessing the Proper Role of Portability*, 159 Tr. & Est. 12 (Mar. 2020); Gregory D. Singer & Gordon P. Stone, III., *A Taxing Dilemma*, 158 Tr. & Est. 20 (July 2019); Elizabeth Pack, *Income Tax Planning Strategies for Estate Plans Under the TCJA*, 46 Est. Plan. 19 (Feb. 2019); Howard Zaritsky, *Using the Newly Increased GST Exemption*, 45 Est. Plan. 46 (May 2018).

[137] §2010(c)(3).

2. **Make Taxable Gifts to Reduce Federal Transfer Tax** —

Because, in operation, the federal gift tax rate is lower than the federal estate tax rate,[138] clients may save significant amounts of federal transfer tax if they (1) make gifts during their lifetimes that incur gift taxes, (2) live at least three years after making the gift, and (3) die when the federal estate tax is in effect.[139] They might be more inclined to use this strategy if they structure taxable gifts as transfers to domestic APTs because they might be able to get funds back from the trusts if necessary.

[138] For an explanation of the difference between the computation of the tax-exclusive federal gift tax and the tax-inclusive federal estate tax, see Stephanie J. Willbanks, *Gifts in Contemplation of Death: Why Can't Section 2035 Simply Die?* 45 ACTEC L. J. 143, 153–160 (Winter 2020).

[139] *See* Charles A. Redd, *To Give or Not to Give...*, 158 Tr. & Est. 15 (Nov. 2019); Bruce L. Paulson & Will Froelich, *To Gift or Not to Gift?* 158 Tr. & Est. 28 (Aug. 2019).

3. **Make Taxable Gifts to Reduce State Death Tax** —

Given that the federal credit for state death taxes[140] was phased out and replaced with a deduction at the end of 2004,[141] many states "decoupled" their death taxes from the federal transfer tax system. Other states have stand-alone estate- and/or inheritance tax systems.[142] Clients might be able to save such taxes by making gifts before death. Individuals who are nervous about cutting all ties with assets should consider making completed gifts to domestic APTs from which they might be able to get funds back in the event of need. However, to reduce state death taxes, such domestic APTs must be structured as completed gifts (see VII.D.8., below).

[140] §2013.

[141] §2058.

[142] *See* Charles D. Fox, IV, *State Death Tax Chart* (Jan. 26, 2019), www.actec.org.

4. **Assure Favorable Tax Treatment for Grantor Trusts** —

In Rev. Rul. 2004-64,[143] the IRS concluded, inter alia, that a settlor's payment of income taxes attributable to a grantor trust is not a taxable gift and that inclusion in a grantor trust of a provision that gives the trustee discretion to reimburse the settlor for such taxes will not, by itself, cause the trust to be included in the gross estate under §2036(a)(1).[144]

[143] *See* PLR 200822008 (approved modification of trust to which GST exemption had been allocated to give trustee discretion to reimburse grantor for income taxes attributable to trust).

[144] See 819 T.M., *Grantor Trusts (Sections 671–679)*, and 877 T.M., *Retained Beneficial Interests (Sections 2036(a)(1) and 2037)*.

Commentators have explained that settlors should consider establishing certain grantor trusts in domestic APT states for the following reasons:[145]

[145] Mitchell M. Gans, Stephanie E. Heilborn & Jonathan G. Blattmachr, *Some Good News About Grantor Trusts: Rev. Rul. 2004-64* , 31 Est. Plan. 467, 472 (Oct. 2004) (footnotes omitted).

> [Rev. Rul. 2004-64's] Situation 3 also indicates that the mere existence of applicable state law authorizing the grantor's creditors to attach trust assets, by reason of the trustee's discretion to reimburse the grantor for income tax payments, may be sufficient to warrant inclusion of the trust assets in the grantor's estate under Section 2036. This may be reason (perhaps, in addition to others) for grantors, who do not wish to prohibit reimbursement for income taxes, to consider creating grantor trusts in jurisdictions (e.g., Alaska or Delaware) that do not subject the trust assets to the claims of creditors.

Several of the domestic APT statutes expressly permit the governing instrument to give the trustee discretion to reimburse the settlor for income taxes that are attributable to the trust.[146] A Delaware statute allows the trustee to reimburse the settlor for such taxes, unless the governing instrument prohibits it.[147]

[146] *See, e.g.*, Alaska Stat. §34.40.110(m)(2); Del. Code Ann. tit. 12, §3570(11)(b)(9); S.D. Codified Laws §55-16-2(k).

[147] *See, e.g.*, Del. Code Ann. tit. 12, §3344.

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C. Obtain Asset Protection

1. **General** —

Clients might want to create domestic APTs to protect some of their assets from future creditor claims with or without attempting to make completed gifts or to remove assets from their gross estates.

2. **Protect Gifts and Inheritances** —

Clients might want to create domestic APTs to shield gifts or inheritances that they receive outright rather than in trust. For example, in *In re Johannes Trust*,[148] a state agency provided services to a developmentally disabled individual for whom a court had created a trust to receive an inheritance. The Michigan Court of Appeals held that the agency could be reimbursed from the trust for its services because, at the time, Michigan did not honor self-settled spendthrift trusts, but the opinion suggests that the trust might have been protected if Michigan law were different, which now is the case.

[148] *In re Johannes Trust*, 479 N.W.2d 25 (Mich. Ct. App. 1991).

3. **Protect Young Adults' Assets** —

Parents might want to encourage their children to put any assets that the children receive (or may withdraw from trusts) at majority into domestic APTs. Although the children may obtain trust funds, they will not have the unlimited ability to dissipate those funds.

4. **Protect Assets from Future Ventures** —

A client might want to create a domestic APT upon the sale of a business to protect the proceeds from claims that arise in future ventures. This strategy succeeded in a 2015 Delaware case,[149] which is discussed in IX.J.3.b., below.

[149] *TrustCo Bank v. Mathews*, No. 8374, 2015 BL 15306, 2015 WL 295373 (Del. Ch. Jan. 22, 2015). Delaware courts give unpublished opinions substantial precedential weight (*Crystallex*, 879 F.3d 79, 85 n.8 (3d Cir. 2018)).

5. **Protect Vulnerable Persons** —

Domestic APTs might be used to protect the assets of clients (like those described in the following cases) who are mentally, physically, or financially vulnerable.

In *Hanson v. Minette*,[150] a settlor claimed (the court did not believe him) that he had created an irrevocable self-settled trust to help him to control his extravagant spending. Because Iowa law did not honor such trusts, he was unable to prevent creditors from reaching trust assets.

[150] *Hanson v. Minette*, 461 N.W.2d 592 (Iowa 1990).

Similarly, the Michigan Supreme Court held in *Coleman v. Department of Mental Health* [151] that a state agency could be reimbursed for services it provided to the handicapped beneficiary of a trust that was created with funds received in a judicial proceeding against her guardian-mother because Michigan did not recognize self-settled spendthrift trusts.

[151] *Coleman v. Department of Mental Health*, 578 N.W.2d 289 (Mich. 1998).

Moreover, a federal district court in Iowa found in *Harrison v. City National Bank* [152] that a self-settled trust that a chronic alcoholic created to protect his assets was ineffective in part because Iowa did not respect such trusts.

[152] *Harrison v. City National Bank*, 210 F. Supp. 362 (S.D. Iowa 1962).

In addition, a federal bankruptcy court in Arkansas held in *In re Schultz*,[153] that all of the assets of an irrevocable self-settled trust created by a settlor who “poorly handled his finances” were includible in the bankruptcy estate because creditors could reach the assets of self-settled spendthrift trusts under Arkansas law.

[153] *In re Schultz*, 324 B.R. 712 (Bankr. E.D. Ark. 2005).

Each of the settlors of the above trusts would have been far better protected by a domestic APT.

6. **Provide Premarital Planning** —

Given that domestic APTs are immune from spousal claims under certain circumstances, clients might use domestic APTs to shield their assets from such claims without providing the financial disclosure that is required to implement effective prenuptial agreements.[154] Alternatively, as a “belt and suspenders” approach, clients might use both an APT and a prenuptial agreement. Moreover, the APT can be used by the client to hold and segregate any inherited wealth from marital property, which can be very useful for clients who live in a state that recognizes the separate, nonmarital character of inherited property.[155]

[154] *See* Lauren Breitstone & Stephen Breitstone, *Is a Prenup Really Necessary for Assets in a Spendthrift Trust?* 44 Tax Mgmt. Est. Gifts & Tr. J. 243 (Sept. 12, 2019); John Scroggin, *Limit Unwanted Spousal Asset Rights in Estate Plan*, 43 Est. Plan. 30 (Apr. 2016); Sean R. Weissbart, *Estate Planning Strategies for the Young and Wealthy*, 41 Est. Plan. 28, 31–32 (Feb. 2014). *See also* 849 T.M., *Marital Agreements*.

[155] *See, e.g.*, Del. Code Ann. tit. 13, §1513(b)(1) (marital property includes "all property acquired by either party subsequent to the marriage … .").

Practice Tip: The domestic APT might be the preferred approach over the prenuptial agreement for practitioners of certain religions.[156] A commentator pointed out in 2019, for example, that "to be valid in the Catholic Church, a marriage cannot be preceded by a contract such as a prenuptial agreement."[157]

[156] Michael A. Sneeringer, *The Case for Trusts as an Alternative to Prenuptial Agreements When Religion Intervenes*, 33 Prob. & Prop. 33 (May/June 2019).

[157] Michael A. Sneeringer, *The Case for Trusts as an Alternative to Prenuptial Agreements When Religion Intervenes*, 33 Prob. & Prop. 33, 34.

7. **Protect Personal Injury Awards** —

Trusts that courts create with personal-injury awards are often self-settled and, therefore, potentially subject to creditor claims. A domestic APT should be considered to protect such awards.[158]

[158] *See* 3 Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, *Scott and Ascher on Trusts* §15.4.4 at 988 (5th ed. 2007).

Thus, the Ninth Circuit held in *In re Jordan* [159] that the fund established for a debtor under a structured settlement agreement that he entered into with his employer to resolve a personal-injury claim was not excludible from his wife's and his bankruptcy estates under 11 U.S.C. §541(c)(2).[160] The court found that the fund was a self-settled trust and that it was not effective under Washington law.

[159] *In re Jordan*, 914 F.2d 197 (9th Cir. 1990).

[160] *See* 11 U.S.C. §§101 *et seq.*

Similarly, the Bankruptcy Court for the Northern District of Ohio held in *In re Myers* [161] that the payments received by a debtor under a settlement agreement that his mother entered into for him while he was a minor with her automobile insurance carrier to settle a personal-injury claim were not excludible from his bankruptcy estate under 11 U.S.C. §541(c)(2). The court found that the payments constituted a self-settled trust and that it was not effective under Ohio law.

[161] *In re Myers*, 200 B.R. 155 (Bankr. N.D. Ohio 1996).

Likewise, in a case decided before South Dakota adopted its domestic APT statute, the Supreme Court of South Dakota held that a trust created with funds received as a personal-injury award was self-settled and, therefore, ineffective against the settlor's creditors in South Dakota.[162]

[162] *Farmers State Bank v. Janish*, 410 N.W.2d 188 (S.D. 1987).

D. Protect CRTs and Other Estate Planning Vehicles

Several common estate planning vehicles, including CRTs, GRATs, QPRTs, and grantor-retained income trusts (GRITs),[163] are self-settled trusts and, therefore, are vulnerable to creditor claims.

In *In re Mack*,[164] a bankruptcy court in Minnesota held that the debtor's retained rights to (1) receive payments from a 7% charitable-remainder unitrust (CRUT), (2) select the trustees, and (3) amend the trust to preserve the trust's tax qualification were includible in the debtor's bankruptcy estate because neither Minnesota common law or statutory law nor §664 or the regulations under it provided an effective anti-alienation provision. In *In re Mack*, the debtor funded the CRUT in question in 1997 with stock (that had a $10,000 basis) in a successful family company. The value of the remainder interest was only $21, 263. Shortly after the debtor created the CRUT, the trustees sold the stock for $1,655,189 and invested part of the proceeds in a new venture, the failure of which forced him into bankruptcy in 2001.[165]

Similarly, in *In re Brown*,[166] the Eleventh Circuit held that the interest of a debtor in a 7% CRUT (which she created before she became insolvent, and with no intent to defraud creditors) was includible in her bankruptcy estate because self-settled trusts could be reached by creditors under applicable Florida law.

Furthermore, a financial institution was successful in its attempt to attach payments from three CRUTs to satisfy a $2.5 million judgment against the settlor-beneficiary in *Wells Fargo Bank, N.A. v. Hoag*.[167] After determining that Washington state law was applicable, the Court of Appeals of Arizona held:[168]

> Hoag created the CRUTs with his own funds, and made himself one of the trust beneficiaries. Therefore, the spendthrift provisions of the CRUTs are invalid as to Hoag's distributions from the CRUTs pursuant to R.C.W. §6.32.250.

The court also noted that "§664(d)(2) does not prohibit Wells Fargo from reaching Hoag's noncharitable beneficiary interest paid to him in the CRUTs."[169]

Without discussion, a federal bankruptcy court in Alabama indicated in *In re Earle* [170] that the debtor's retained interest in a

[163] For more information on these types of trusts, see 865 T.M., *Charitable Remainder Trusts, Charitiable Gift Annuities, and Pooled Income Funds (Sections 664 and 642(c)(5))*, and 836 T.M., *Partial Interests—GRATs, GRUTs, QPRTs (Section 2702)*.

[164] *In re Mack*, 269 B.R. 392, 412–413 (Bankr. D. Minn. 2001).

[165] *In re Mack*, 269 B.R. 392, 412–413.

[166] *In re Brown*, 303 F.3d 1261, 1271 (11th Cir. 2002).

[167] *Wells Fargo Bank, N.A. v. Hoag*, No. 1-CA-CV-15-0559, 2016 BL 367346, *2016 WL 6436830* (Ariz. Ct. App. Nov. 1, 2016).

[168] *Wells Fargo Bank, N.A. v. Hoag*, No. 1-CA-CV-15-0559, 2016 BL 367346, *2016 WL 6436830* at *2–3.

[169] *Wells Fargo Bank, N.A. v. Hoag*, No. 1-CA-CV-15-0559, 2016 BL 367346, *2016 WL 6436830* at *3.

QPRT was includible in her bankruptcy estate.

[170] *In re Earle* , 307 B.R. 276 (Bankr. S.D. Ala. 2002). *See In re Ferrante*, No. CC-14-1222, 2015 BL 276690, *2015 WL 5064087* at *9 (B.A.P. 9th Cir. Aug. 26, 2015) ("The bankruptcy court did not err in granting partial summary adjudication to Trustee on the basis that the 518 Trust failed to comply with QPRT regulations").

Several domestic APT statutes extend protection to CRTs, QPRTs, and other self-settled arrangements.

In some cases, a CRT that is structured as a domestic APT may be used to defeat a surviving spouse's elective-share rights.[171]

[171] *See* III.C.2.c., below.

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E. Shield Assets of Charitable Organizations

The Delaware Act allows entities as well as individuals to create Delaware APTs.[172] As a result, some commentators recommend that non-profit organizations should use unrestricted gifts to fund Delaware APTs. The author believes that this is unwise given the uncertainty regarding the use of self-settled trusts for this purpose, particularly if the organization conducts activities in states that do not permit APTs. It is also unclear whether officers and directors of a charity would violate their fiduciary duties by giving up control of such gifts to fund the APT.

[172] *See* Del. Code Ann. tit. 12, §3570(5); Del. Code Ann. tit. 1, §302(15).

There are two better options for charitable organizations, the first of which is the third-party spendthrift trust. The authors of a 2016 article wrote:[173]

[173] Richard Fox, Jonathan G. Blattmachr & Benjamin Bolas, *Shield Donations From Bankrupt Charity's Creditors*, 43 Est. Plan. 18, 29 (Jan. 2016). *See* Elizabeth Carrott Minnigh, *Choosing the Entity Format for Your Private Foundation*, 41 Tax Mgmt. Est., Gifts & Tr. J. 90 (Jan. 8, 2016). The author thanks his Wilmington Trust Company colleague, Carol G. Kroch, for her insights regarding this point.

> When a donor is contemplating making a large donation for the benefit of a charity to be held over a long period, consideration should be given to the impact of the charity's bankruptcy on the use of those funds and steps that might be taken to ensure their continued use for charitable purposes, rather than the loss of the funds to the claims of creditors. Maximum protection can be achieved by the donor creating an express trust with an independent trustee, which limits distributions for specified charitable purposes of the charity. Including a spendthrift provision in the trust will provide even further asset protection.

A significant disadvantage of this approach is that such a trust would have to qualify as a private foundation or satisfy the requirements for a supporting organization. These requirements have been severely tightened in recent years.

The second and better option is to make a restricted gift via a “strong gift” agreement. This produces a larger income-tax charitable deduction as well as a full fair-market-value deduction for closely held stock. If the clients are particularly worried either about the long-term viability of the charity or the charity's ability to manage investments well, they can instead set up a separate entity. But that entity will either have to qualify as a supporting organization, which is increasingly difficult, or be a private foundation. Both have exemption-application, payout, and ongoing filing requirements as well as restrictions on holding closely held stock, all of which are disadvantages.

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F. Save State Income Tax

As covered in VII.I., below, clients can reduce state income taxes in certain circumstances by structuring a domestic APT as an incomplete gift and as a nongrantor trust (ING Trust).

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G. Provide Options for NRAs

A nonresident alien (NRA) should consider two planning options involving domestic APTs. A commentator describes the first option as follows:[174]

> Traditionally, foreign persons who wish to own U.S-situs assets (e.g., U.S. real property, shares of U.S. corporations, U.S. tangible personal property) would put those assets into a foreign corporation to protect them from U.S. estate tax. (The corporation might then be held via a revocable or irrevocable offshore trust, although it is the corporation rather than the trust that affords protection from U.S. estate tax at the settlor's death.) However, a foreign corporation results in a variety of problems, including higher tax on capital gains on the sale of real property, FIRPTA withholding, and controlled foreign corporation issues either during the settlor's life or after his death if the trust has U.S. beneficiaries.

An alternative now presents itself: The foreign person can create an irrevocable trust under the laws of one of the American jurisdictions (mentioned above) that have enacted asset protection legislation. (The trust might be made either foreign or domestic for federal income tax purposes, depending on the circumstances and the assets held.) This trust might hold shares of American corporations and United States-situs real property. The United States property is thus sheltered from federal estate tax on the death of the settlor, and the problems of a foreign corporation are eliminated.

[174] G. Warren Whitaker, *The U.S. May Be a Good Trust Jurisdiction for Foreign Persons*, 33 Est. Plan. 36, 37–38 (Feb. 2006) (footnote omitted). FIRPTA is the Foreign Investment in Real Property Tax Act of 1980, Pub. L. No. 96-499.

Second, because NRAs may create trusts with intangible property free of gift and GST tax,[175] NRAs should consider creating domestic APTs before immigrating to this country. The author knows of several NRAs who created domestic APTs before moving to the United States to remove assets from the NRAs' estates, but the NRAs retain the ability to get funds back in case of need.

[175] *See* §2501(a); Reg. §26.2663-2(b). See also 837 T.M., *Non-Citizens—Estate, Gift and Generation-Skipping Transfer Taxation*.

For the time being, this country offers more confidentiality than the many other countries that are subject to the Organization for Economic Cooperation and Development's Common Reporting Standard.

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H. Provide Protection for Trusts Moved From Offshore or Other Domestic Jurisdictions

People create self-settled trusts for a variety of purposes in states that do not provide protection from creditors. For example, in *In re Tosi*,[176] a federal bankruptcy court in Massachusetts held that an irrevocable trust that the debtor had established (allegedly under family duress) with an inheritance that he otherwise would have received outright was self-settled and includible in the bankruptcy estate.[177] Given that a trustee has a fundamental duty to use reasonable care to protect the trust from unnecessary exposure to risk of loss,[178] as well as a continuing duty to ensure that a trust is administered in an appropriate jurisdiction,[179] trustees of such trusts might have an obligation to explore moving them to domestic APT jurisdictions. This obligation is reinforced by statutes in a majority of the states. For example, Uniform Probate Code (UPC) §7-305,[180] which was in effect in at least three states as of January 1, 2020,[181] provides as follows:

> A trustee is under a continuing duty to administer the trust at a place appropriate to the purposes of the trust and to its sound, efficient management. If the principal place of administration becomes inappropriate for any reason, the Court may enter any order furthering efficient administration and the interests of beneficiaries, including, if appropriate, release of registration, removal of the trustee and appointment of a trustee in another state. Trust provisions relating to the place of administration and to changes in the place of administration or of trustee control unless compliance would be contrary to efficient administration or the purposes of the trust. Views of adult beneficiaries shall be given weight in determining the suitability of the trustee and the place of administration.

[176] *In re Tosi*, 383 B.R. 1 (Bankr. D. Mass. 2008).

[177] *In re Tosi*, 383 B.R. 1, 35–36.

[178] *Restatement (Second) of Trusts* §176 (Am. Law Inst. 1959); UTC §809 (Unif. Law Comm'n 2018).

[179] *See In re Joseph Heller Inter Vivos Tr.*, 613 N.Y.S.2d 809 (Sur. Ct. 1994) (trustee petitioned court to divide trust to protect cash and securities from liabilities from realty).

[180] UPC §7-305 (Unif. Law Comm'n 2010). To view the text of the UPC, go to www.uniformlaws.org. Having been superseded by provisions of the UTC, UPC §7-305 and the rest of Article 7 do not appear in the current version of the UPC.

[181] *See, e.g.*, Alaska Stat. §13.36.090; Haw. Rev. Stat. §560:7-305; Idaho Code §15-7-305.

Although the Supreme Court of Nebraska refused to replace a corporate trustee pursuant to Nebraska's version of UPC §7-305 in a 1982 case,[182] the Supreme Court of Alaska replaced the corporate trustee and transferred the situs of the trust out of Alaska in a 2004 case.[183] A Michigan intermediate appellate court replaced the corporate trustee and transferred the trust's situs from Michigan to Georgia in an unpublished 2008 case. [184]

[182] *In re Zoellner Tr.*, 325 N.W.2d 138 (Neb. 1982).

[183] *Marshall v. First Nat'l Bank Alaska*, 97 P.3d 830 (Alaska 2004).

[184] *In re Wege Tr.*, No. 271244, 2008 BL 355629, *2008 WL 2439904* (Mich. Ct. App. June 17, 2008). *See* former Mich. Comp. Laws §700.7305.

Similarly, UTC §108(b),[185] a version of which is the law in 29 states,[186] specifies that “[a] trustee is under a continuing duty to administer the trust at a place appropriate to its purposes, its administration, and the interests of the beneficiaries.”

[185] UTC §108(b) (Unif. Law Comm'n 2018).

[186] *See* Ala. Code §19-3B-108; Ariz. Rev. Stat. Ann. §14-10108; Ark. Code Ann. §28-73-108; Colo. Rev. Stat. §15-5-108; Conn. Gen. Stat. §45a-499h; D.C. Code Ann. §19-1301.08; Fla. Stat. §736.0108 ; 760 ILCS 3/108; Ind. Code §30-4-6-3; Kan. Stat. Ann. §58a-108; Ky. Rev. Stat. §386B.1-060; Me. Rev. Stat. Ann. tit. 18-B, §108; *Md. Code Ann., Est. & Trusts §14.5-108*; Mich. Comp. Laws §700.7108 ; Minn. Stat. Ann. §501C.0108; Miss. Code Ann., §91-8-108; Mont. Code Ann. §72-38-108; Neb. Rev. Stat. §30-3808; N.H. Rev. Stat. Ann. §564-B:1-108; N.J. Stat. Ann. §3B:31-8; N.M. Stat. Ann. §46A-1-108; N.D. Cent. Code §59-09-08; Ohio Rev. Code Ann. §5801.07; Or. Rev. Stat. § 130.022; S.C. Code Ann. §62-7-108; Tenn. Code Ann. §35-15-108; Utah Code Ann. §75-7-108; Vt. Stat. Ann. tit. 14A, §108; Wyo. Stat. §4-10-108. For more on the UTC's progress through various state legislatures, see the Legislative Fact Sheet maintained by the National Conference of Commissioners on Uniform State Laws (www.uniformlaws.org). Note that the UTC is subject to state-by-state modifications that can sometimes cause a local version of the UTC to vary considerably from the model UTC. Thus attorneys should consult the applicable version of the UTC in connection with any UTC-related cases the attorneys handle.

Even in the seven states that have enacted UTC §108 without adopting UTC §108(b) in the above form,[187] and in other states that don't impose this duty by statute, trustees cannot ignore the issue because *Restatement (Third) of Trusts* §76 indicates that the duty exists under common law.[188]

[187] *See, e.g.,* Mass. Gen. L. ch. 203E, §108; Mo. Ann. Stat. §456.1-108; N.C. Gen. Stat. §36C-1-108; 20 Pa. Cons. Stat. §7708; Va. Code Ann. §64.2-706; W. Va. Code §44D-1-108; Wis. Stat. §701.0108.

[188] *Restatement (Third) of Trusts* §76 cmt. b(2) (Am. Law Inst. 2003).

> A trustee's duty to administer a trust includes an initial and continuing duty to administer it at a location that is reasonably suitable to the purposes of the trust, its sound and efficient administration, and the interests of its beneficiaries.

Before a trust is moved, however, the attorney should consider whether or not the change will cause the settlor-beneficiary to make a completed gift.[189]

[189] *See* Rev. Rul. 76-103. See also 845 T.M., *Gifts*.

Similarly, for a variety of reasons, it might be appropriate to relocate a foreign APT to a domestic APT jurisdiction.[190]

[190] *See* Jennifer J. Wioncek, *Making (or Not Making) the Case for Domestication of a Non-U.S. Trust*, 158 Tr. & Est. 47 (July 2019). *See also* XI.C., below.

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A. Introduction

On July 9, 1997, Delaware Governor Carper signed the Delaware Qualified Dispositions in Trust Act (Delaware Act).[191] The Delaware Act has been amended several times since its enactment.[192] Given that it will likely be amended in the future, attorneys should confirm that they are working with the current statute in a particular case.

[191] Del. Code Ann. tit. 12, §3570–§3576, 71 Del. Laws 159. *See Raymond L. Hammond Irrevocable Tr. Agreement*, 2016 WL 359088 (Del. Ch. Jan. 28, 2016) (exercise of nongeneral power of appointment over Delaware APT invalid because formalities for exercising power not observed); *TrustCo Bank v. Mathews*, No. 8374, 2015 BL 15306, 2015 WL 295373 at *11–12 (Del. Ch. Jan. 22, 2015) (Delaware Act summarized but not applied).

[192] *See* 71 Del. Laws 159; 71 Del. Laws 254; 71 Del. Laws 343; 72 Del. Laws 59; 72 Del. Laws 195; 72 Del. Laws 341; 73 Del. Laws 378; 74 Del. Laws 100; 75 Del. Laws 97; 75 Del. Laws 301; 76 Del. Laws 90; 76 Del. Laws 254; 77 Del. Laws 98; 77 Del. Laws 330; 78 Del. Laws 117; 78 Del. Laws 179; 79 Del. Laws 198; 80 Del. Laws 153; 81 Del. Laws 149; 82 Del. Laws 52. The current Delaware Act is available at delcode.delaware.gov/title12/c035/sc06/index.shtml.

It is impossible to obtain a tally of how many Delaware APTs have been created since 1997 because so many individuals and institutions compete for Delaware trust business. In the author's experience, though, roughly one-quarter to one-third of his institution's new trusts are some type of Delaware APT.

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B. How to Create a Delaware APT

To create an asset-protection trust (APT) under the Delaware Act (Delaware APT), a person must make a “qualified disposition” by transferring of property to an irrevocable trust that: (1) contains a spendthrift clause; (2) provides that Delaware law governs the trust's validity, construction, and administration; and (3) appoints at least one “qualified trustee.”[193] For these purposes, a “disposition” does not include “a sale or exchange for full and adequate consideration.”[194] A “qualified trustee” is either an individual who resides in Delaware or a corporation that is authorized to conduct trust business in Delaware and is regulated by the Delaware Bank Commissioner or a federal agency.[195] The qualified trustee or trustees must maintain or arrange for custody in Delaware of some trust property, maintain records for the trust, prepare or arrange for the preparation of fiduciary income-tax returns, or otherwise materially participate in the administration of the trust.[196] If only one qualified trustee is acting, it will be deemed to have resigned if it ceases to meet these requirements.[197] Similarly, a trustee of a Delaware APT will automatically cease to serve if a court declines to apply Delaware law in determining the validity, construction, or administration of such trust (or the effect of its spendthrift clause) in a proceeding that involves such trustee.[198] If a trustee ceases to act for one of these reasons, then any successor trustee who is designated in the trust will take the first trustee's place and the Delaware Court of Chancery may fill any vacancy.[199] The trust may have non-Delaware co-trustees[200] and Delaware or non-Delaware advisers with authority to replace advisers and Delaware trustees, participate in investment decisions, and/or perform other duties.[201]

[193] Del. Code Ann. tit. 12, §3570(11)(a)–(c).

[194] Del. Code Ann. tit. 12, §3570(4).

[195] Del. Code Ann. tit. 12, §3570(8)(a).

[196] Del. Code Ann. tit. 12, §3570(8)(b).

[197] Del. Code Ann. tit. 12, §3570(8)(e).

[198] Del. Code Ann. tit. 12, §3572(g).

[199] Del. Code Ann. tit. 12, §3570(8)(e).

[200] Del. Code Ann. tit. 12, §3570(8)(f).

[201] Del. Code Ann. tit. 12, §3570(8)(c).

The Delaware Act specifically permits the settlor of a Delaware APT to have the power to:

- consent to or direct investment changes;
- veto distributions;
- replace trustees or advisers; and/or
- reacquire trust assets in a nonfiduciary capacity under §675(4)(C).[202]

[202] Del. Code Ann. tit. 12, §3570(8)(d), §3570(11)(b)(8).

The Delaware Act also expressly authorizes the settlor to have:

- the ability to receive income or principal pursuant to broad discretion or a standard as determined by qualified trustees, nonqualified trustees, and/or advisers;
- the right to receive current income distributions;
- an interest in a charitable-remainder trust (CRT), an interest in a qualified personal-residence trust (QPRT), or a qualified annuity interest created if a residence in a QPRT ceases to be used as a personal residence;
- an interest in a grantor-retained annuity trust (GRAT), an interest in a grantor retained unitrust (GRUT), or up to a 5% interest in a total-return unitrust;
- a nongeneral lifetime or testamentary power of appointment;
- the ability to provide for the payment of debts, expenses, and taxes following death; and/or
- the option to appoint and to serve as a designated representative to act on behalf of trust beneficiaries.[203]

[203] Del. Code Ann. tit. 12, §3570(11)(b).

Delaware addresses Rev. Rul. 2004-64, which held, inter alia, that the grant of discretion to a trustee to reimburse the settlor for income taxes that the settlor must pay on a grantor trust will not cause estate tax inclusion under §2036 if applicable local law does not subject the trust assets to the claims of the settlor's creditors.[204] Although the settlor might be reimbursed for such taxes pursuant to discretion given to the trustee, adviser, or protector under a Delaware APT,[205] some settlors might not want to grant such broad discretion. Delaware gives two additional options. First, the Delaware Act permits a Delaware APT simply to grant discretion to reimburse the settlor for income taxes attributable to the trust.[206] Second, Delaware law authorizes a trustee to reimburse the settlor for taxes caused by grantor-trust status unless the governing instrument provides to the contrary.[207]

[204] Rev. Rul. 2004-64.

[205] Del. Code Ann. tit. 12, §3570(11)(b)(3), §3570(11)(b)(6).

[206] Del. Code Ann. tit. 12, §3570(11)(b)(9).

[207] Del. Code Ann. tit. 12, §3344.

Many Delaware APTs are structured as incomplete gifts. In such a trust, it is not disadvantageous from an estate planning standpoint to have the trust pay its share of income taxes. So, a Delaware APT may direct the trustee to pay income taxes attributable to the trust.[208]

[208] Del. Code Ann. tit. 12, §3570(11)(b)(9).

Under the Delaware Act,[209] a spendthrift clause will be deemed to be a restriction on the transfer of the settlor's beneficial interest in the trust that will be enforceable under applicable nonbankruptcy law within the meaning of the United States Bankruptcy Code.[210]

[209] Del. Code Ann. tit. 12, §3570(11)(c).

[210] 11 U.S.C. §541(c)(2).

Practice Tip: Under the Delaware Act, the settlor may not be a trustee[211] and may only have the interests and powers described above.[212] Furthermore, the settlor only has the powers and authorities conferred by the trust instrument, and any agreement or understanding purporting to grant or permit the retention of any greater rights or authority will be void.[213] To be conservative, Delaware attorneys counsel clients not to retain powers and interests that are not specifically authorized by the Delaware Act. Consequently, the settlor probably should not have the express right to get the assets back after a given period of time. Although the Delaware Act permits a variety of interests and powers, certain provisions might be inappropriate in particular cases.[214] For example, the use of non-Delaware co-trustees, advisers, and/or protectors might increase a trust's susceptibility to process in other states and the possibility that Delaware law might be found not to govern the trust (or, more importantly, the rights of beneficiaries and their creditors).

[211] Del. Code Ann. tit. 12, §3570(8)(d).

[212] Del. Code Ann. tit. 12, §3571.

[213] Del. Code Ann. tit. 12, §3571.

[214] *See In re Johnson*, 513 B.R. 333 (Bankr. S.D. Ill. 2014) (“Powers that a debtor may exercise for his own benefit are included in the bankruptcy estate”).

C. Who May Defeat a Delaware APT

1. **Introduction** —

The Delaware Act bars original actions and actions to enforce judgments, including any judgments that are entered elsewhere. Any action to set aside such a trust must be based on the Delaware Uniform Fraudulent Transfer Act (UFTA) (Del. Code Ann. tit. 6, §1304 and Del. Code Ann. tit. 6, §1305) as well as any related changes to the Delaware UFTA that are made by the Delaware Act.[215]

[215] *In re IMO Daniel Kloiber Dynasty Tr.*, 98 A.3d 924, 938 (Del. Ch. 2014).

The Delaware Act vests the Delaware Court of Chancery with "exclusive jurisdiction over any action brought with respect to a qualified disposition."[216] In 2014, Vice Chancellor Laster interpreted this provision in the following manner: "When a Delaware state statute assigns exclusive jurisdiction to a particular Delaware court, the statute is allocating jurisdiction among the Delaware courts. The state is *not* making a claim against the world that no court outside of Delaware can exercise jurisdiction over that type of case."[217]

[216] Del. Code Ann. tit. 12, §3572(a).

[217] *In re IMO Daniel Kloiber Dynasty Tr.*, 98 A.3d 924, 939 (emphasis in original); Del. Code Ann. tit. 6, §1301–§1311.

Practice Tip: As discussed in I.F., above, state law protections must yield to certain supercreditors created by federal law under the Supremacy Clause of the United States Constitution.[218] Any planning that is done with a domestic APT (Alaska, Delaware, Nevada, South Dakota, or otherwise) should proceed with this in mind.

[218] U.S. Const. Art. VI.

2. **Creditors Who May Defeat a Delaware APT** —

Under the Delaware Act, the following four categories of creditors may defeat Delaware APTs.

a. **Pre-Transfer Claims** —

If a creditor's claim arose before a transfer to a Delaware APT, then the creditor must bring suit within four years after the transfer or, if later, within one year after the creditor discovered (or should have discovered) the transfer.[219] The creditor must prove, by clear and convincing evidence, that creation of the trust was a fraudulent transfer.

[219] Del. Code Ann. tit. 12, §3572(b)(1).

Practice Tip: To minimize the effect of the one-year limitation, the settlor might notify known pre-transfer creditors of the trust's existence within three years of its creation.

If multiple transfers are made to the same trust, then a subsequent transfer will be disregarded in determining whether a creditor's claim with respect to a prior transfer will be extinguished.[220] Distributions to beneficiaries are deemed to come first from the latest transfer.[221]

[220] Del. Code Ann. tit. 12, §3572(f)(1).

[221] Del. Code Ann. tit. 12, §3572(f)(2).

b. **Post-Transfer Claims** —

If a creditor's claim arose after a transfer to a Delaware APT, then the creditor must bring suit within four years after the trust's creation and must prove, by clear and convincing evidence, that the transfer was made with actual intent to defraud—not hinder or delay—that creditor.[222] Hence, as a practical matter, this exception will not be available for a creditor who does not exist or is not foreseeable when a Delaware APT is created because it will be extremely difficult to prove that a settlor intended to defraud a nonexistent and unforeseen creditor. If multiple transfers are made to the same trust, then a subsequent transfer will be disregarded in determining whether a creditor's claim with respect to a prior transfer will be extinguished, as provided above.[223] Distributions to beneficiaries are deemed to come first from the latest transfer.[224]

[222] Del. Code Ann. tit. 12, §3572(a), §3572(b)(2).

[223] Del. Code Ann. tit. 12, §3572(f)(1).

[224] Del. Code Ann. tit. 12, §3572(f)(2).

c. **Family Claims** —

A person whose claim results from an agreement or court order providing for alimony, child support, or property division "incident to a judicial proceeding with respect to a separation or divorce" may reach the assets of a Delaware APT.[225] Only a spouse who was married to the settlor of the trust before it was created may invoke this exception because the terms "spouse" and "former spouse" are defined to include "only persons to whom the transferor was married at, or before, the time the qualified disposition is made."[226] Under appropriate circumstances, individuals who create Delaware APTs should have their spouses waive such rights so that this exception will no longer be of concern.

[225] Del. Code Ann. tit. 12, §3573(1).

[226] Del. Code Ann. tit. 12, §3570(9).

Rev. Proc. 2005-24 required spouses of settlors of certain post-June 27, 2005, inter vivos CRTs to waive their rights to reach such trusts by electing against the will.[227] Under Uniform Probate Code (UPC) §2-205, a surviving spouse may reach the assets of an inter vivos CRT that was created during marriage to the deceased spouse (but not while the deceased spouse was unmarried or was married to a prior spouse) by electing against the will. As of January 1, 2020, UPC §2-205 was in effect in at least 13 states—Alaska, Colorado, Hawaii, Kansas, Maine, Minnesota, Nebraska, New Jersey, North Dakota, South Dakota, Utah, Virginia, and West Virginia.[228]

[227] As noted below, in Notice 2006-15, the IRS generally delayed application of Rev. Proc. 2005-24 by extending Rev. Proc. 2005-24's June 28, 2005 grandfathering date until the IRS issues further guidance. The extension applies only if surviving spouses do not exercise elective share rights. *See* Martin D. Begleiter, *Grim Fairy Tales: Studies of Wicked Stepmothers, Poisoned Apples, and the Elective Share*, 78 Alb. L. Rev. 521 (2014/2015).

[228] *See* Alaska Stat. §13.12.205(a)(2)(A); Colo. Rev. Stat. §15-11-205(2)(a); Haw. Rev. Stat. §560:2-205(2)(A); Kan. Stat. Ann. §59-6a205(b)(1); Me. Rev. Stat. Ann. tit. 18-A, §2-205(2)(A); Minn. Stat. §524.2-205(2)(i); Neb. Rev. Stat. §30-2314(a)(1)(i); N.J. Rev. Stat. §3B:8-3(a); N.D. Cent. Code §30.1-05-02(2)(b)(2)(a); S.D. Codified Laws §29A-2-205(2)(i); Utah Code Ann. §75-2-205(2)(a)(i); Va. Code Ann. §64.2-308.6(2)(a); W. Va. Code §42-3-2(b)(2)(iii)(A). For a list of states that have enacted the UPC, see www.uniformlaws.org.

However, the surviving spouse of a Delaware decedent never has been able to reach trust assets by electing against the will,[229] and Delaware law does not defer to the law of a decedent's domicile to determine a surviving spouse's elective-share rights.[230] Since the passage of the Delaware Act, Delaware attorneys have been of the view that a spouse may reach the assets of a Delaware APT only for the specified purposes (such as alimony, child support, or property division incident to a judicial proceeding with respect to a separation or divorce) and that, because the specified purposes do not include elective-share rights, the surviving spouse of the settlor of a Delaware APT may not reach the assets of the trust by electing against the will, whether or not the settlor lived in Delaware at death. To respond to Rev. Proc. 2005-24, the Delaware Act made this explicit. Thus, the final sentence of the pertinent section of the Delaware Act provides that a Delaware APT may not be reached to satisfy a claim for elective share.[231] Although the IRS deferred the effective date of Rev. Proc. 2005-24 in 2006,[232] it alerted taxpayers as recently as 2014 [233] that it has not forgotten the issue by requesting comments on procedures to ensure that elective rights do not affect assets for which a charitable deduction was taken on the creation of a CRT.

[229] Del. Code Ann. tit. 12, §901(a), §908(b). *See Machulski v. Boudart*, No. 06C-06-310, 2008 BL 72398, 2008 WL 836056 at *2 (Del. Super. Ct. Mar. 28, 2008) ("A transfer of the house into a trust, even two months before the decedent's death, would have removed it from his 'contributing estate,' regardless of whether it removed it from his elective estate").

[230] Del. Code Ann. tit. 12, §901(b).

[231] Del. Code Ann. tit. 12, §3573 (flush language at end).

[232] Notice 2006-15.

[233] 2014 Tax Notes Today 67-32 (Apr. 8, 2014).

Practice Tip: A client, therefore, should consider structuring a CRT as a Delaware APT so that the trust's assets will be protected in case the IRS issues similar restrictions in the future or in case a surviving spouse actually elects against the will of a predeceasing spouse.

The settlor of a CRT that is structured as a Delaware APT may release a retained interest in favor of charity.[234]

[234] Del. Code Ann. tit. 12, §3536(e), §3570(11)(b)(4). *See* Rev. Rul. 86-60. *See, e.g.*, PLR 201321012, PLR 201249002.

d. **Tort Claims** —

A person who suffers death, personal injury, or property damage before a Delaware APT is established for which the settlor is liable may reach the trust assets.[235] This exception should not increase the vulnerability of Delaware APTs because such claims should be taken into account in planning to avoid fraudulent transfers.[236]

[235] Del. Code Ann. tit. 12, §3573(2).

[236] Del. Code Ann. tit. 10, §8106 (statute of limitations for tort claims in Delaware is three years).

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D. Consequences if a Delaware APT Is Defeated

If one of the above exceptions applies (and after payment of the trustee's costs, as described below), then the Delaware APT is defeated only to the extent necessary to pay that creditor's claim together with related costs (including attorneys' fees) allowed by the court.[237] Thus, if a settlor is confronted by multiple creditors with the type of claim that is permitted to be pursued, then each creditor must bring a separate action for avoidance.

[237] Del. Code Ann. tit. 12, §3574(a).

Unless a creditor proves by clear and convincing evidence that a trustee acted in bad faith in accepting and administering the trust, then that trustee may use the trust assets to pay such trustee's costs of litigating the claim before satisfying the claim and any related costs.[238] A trustee's mere acceptance of the trust is presumed not to be done in bad faith. Similarly, beneficiaries who received distributions before creditors bring successful suits to defeat Delaware APTs may keep the distributions unless the creditors prove by clear and convincing evidence (by a preponderance of the evidence if the beneficiary is the settlor) that they acted in bad faith.[239]

[238] Del. Code Ann. tit. 12, §3574(b)(1), §3574(c).

[239] Del. Code Ann. tit. 12, §3574(b)(2), §3574(c).

Case law confirms that "the Delaware Fraudulent Transfer Act does not create a cause of action for aiding and abetting, or conspiring to commit, a fraudulent transfer."[240] In addition, the Delaware Act provides that the creation of a Delaware APT will not be treated as fraudulent or otherwise contrary to law for purposes of any action against any trustee, adviser, or protector who is acting under a trust instrument or against any attorney or other professional adviser involved in establishing the APT.[241]

[240] *Edgewater Growth Capital Partners, L.P. v. H.I.G. Capital, Inc.*, No. 3601, 2010 BL 65841 at *2, *2010 WL 720150* at *2 (Del. Ch. Mar. 3, 2010) (citing earlier cases).

[241] Del. Code Ann. tit. 12, §3572(d)–(e).

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E. Moving Trusts to Delaware

A trustee may create a Delaware APT either by establishing a Delaware APT or by effectuating the transfer of a trust that meets the requirements of the Delaware Act to Delaware[242] except that the trust does not have to provide that Delaware law governs.[243] If a trustee of an irrevocable spendthrift trust creates a Delaware APT, then the time that the trust exists before it is moved to Delaware counts toward the four-year period for pursuing post-transfer claims against the trust.[244] Thus, it might be possible for the trustee of an existing onshore or offshore trust to create a Delaware APT that cannot be defeated under the Delaware Act.

[242] Del. Code Ann. tit. 12, §3570(10).

[243] Del. Code Ann. tit. 12, §3570(11) penultimate sentence.

[244] Del. Code Ann. tit. 12, §3572(c), §3575.

Under the Delaware Act, a settlor may have a lifetime or testamentary power to appoint to anyone except the settlor, the settlor's estate, the settlor's creditors, or creditors of the settlor's estate.[245] An existing trust will not qualify under the Delaware Act if the trust gives the settlor an inter vivos or testamentary general power of appointment. The existing trustee may, with the written consent of the settlor, bring such a trust into conformity with the Delaware Act by deleting the excessive power.[246]

[245] Del. Code Ann. tit. 12, §3570(11)(b)(2).

[246] Del. Code Ann. tit. 12, §3572(c).

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F. Infrastructure

The original version of the Delaware Act was written and enacted over a three-month period in 1997, and amendments have been drafted and enacted in short order since that time.

Delaware has been a trust-friendly jurisdiction for generations. As evidence of this, a 2006 empirical study, which analyzed pertinent data beginning in 1969, found that “Delaware was clearly attracting trust funds from out of state in the early 1970s,”[247] and that “[i]n 1986 Delaware had a disproportionate share of the nation's trust funds.”[248]

[247] Max M. Schanzenbach & Robert H. Sitkoff, *Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust*, 27 Cardozo L. Rev. 2465, 2495–2496 (Apr. 2006).

[248] Max M. Schanzenbach & Robert H. Sitkoff, *Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust* 27 Cardozo L. Rev. 2465, 2479 (footnote omitted). *See* Robert H. Sitkoff & Max M. Schanzenbach, *Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds*, 42 U. Miami Inst. on Est. Plan. ¶1400 (2008); Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 Yale L.J. 356, 375 n.62, 393–394 (Nov. 2005).

The Chancellor and Vice Chancellors of the Delaware Court of Chancery (which the Wall Street Journal described in 2014 as “the nation's most influential business court”)[249] and the Delaware Supreme Court (the courts that have jurisdiction over corporate matters as well as trust matters in Delaware) are not elected. Instead, the Delaware Constitution requires that they be appointed by the Governor with the consent of a majority of the members of the Senate and that all Delaware judges come as equally as possible from the two major political parties.[250] Delaware's liability system was ranked as the best in the country by a 2019 U.S. Chamber of Commerce study.[251]

[249] Liz Hoffman, *Tough Judge Policies Merger Scene*, Wall St. J. (July 15, 2014).

[250] Del. Const. art. IV, §3.

[251] The study is available at www.instituteforlegalreform.com/states.

In an unpublished 2015 decision, creditors contended that a non-Delaware resident's transfers to Delaware APTs were fraudulent transfers.[252] Vice Chancellor Parsons held that the creditors’ claims were time-barred.[253] It should be noted that “Delaware courts give such [unpublished] opinions substantial precedential weight.”[254]

[252] *TrustCo Bank v. Mathews*, No. 8374, 2015 BL 15306, 2015 WL 295373 (Del. Ch. Jan. 22, 2015). *See* Alan S. Gassman, Christopher J. Denicolo, Travis Arango & Seaver Brown*Debtor Wins in Court*

with Self-Settled Spendthrift Trust, 42 Est. Plan. 26 (Sept. 2015).

[253] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *14. *See* IX.J.3.b., below.

[254] *Crystallex Int'l Corp. v. Petroleos De Venezuela, S.A.*, 879 F.3d 79, 85 n.8 (3d Cir. 2018).

In other contexts, Delaware judges have demonstrated a willingness to enforce Delaware statutes in difficult cases, similar to cases that might arise if creditors were to challenge Delaware APTs.

The following excerpt from the opinion of Vice Chancellor Berger in *Gibson v. Speegle* is representative:[255]

[255] *Gibson v. Speegle*, 1984 Del. Ch. Lexis 475, 6–7 (Del. Ch. May 30, 1984) (citations and internal quotation marks omitted).

> In the absence of a statute, I would not hesitate to … allow Aetna's claim. I am not at all comfortable with the fact that Virginia Barwick, by use of a spendthrift trust, assisted her son in avoiding his obligation to pay for his crimes. [He was indicted on eight counts of arson, burglary, and criminal mischief and pled guilty to the lesser included offenses of criminal trespass in the first degree, arson in the third degree, and criminal mischief.] However, it is not the Court's function to write the law but only to interpret it. The statute enacted by the General Assembly contains no exceptions… . The proposed statute, which contained an exception for tort claimants … was available to the General Assembly in 1959 when §3536 was amended. The fact that such a modification was not enacted leaves me no choice but to conclude that the General Assembly intended §3536 to [be] an “unrestrained” form of spendthrift provision. As a result, I reluctantly conclude that Aetna is a creditor within the meaning of §3536 and its proof of claim must be denied.

In another difficult case two years later, Chancellor Allen said that:[256]

[256] *Del. Tr. Co. v. Partial*, 517 A.2d 259, 262 (Del. Ch. 1986).

> The policy of the legislature with respect to the seizure or garnishment of funds held by Delaware banks is clear. I cannot conclude that that policy may be ignored by the simple expedient of denominating the writ sought as one of injunction rather than one of garnishment. Therefore, I conclude that irrespective of the strong probability of merit shown by the complaint, it would be inappropriate for this Court to grant the remedy now sought insofar as it seeks to restrain *pendente lite* the disposition by the Wilmington Trust Company of funds held by it.

More recently, Master LeGrow wrote in a report, which was later adopted by Vice Chancellor Laster,[257] which, in turn, was affirmed by the Supreme Court of Delaware,[258] as follows:[259]

[257] *Mennen v. Wilmington Tr. Co.*, No. 8432, 2017 BL 59205, *2017 WL 751201* at *2 (Del. Ch. Feb. 27, 2017).

[258] *Mennen v. Fiduciary Tr. Int'l of Del.*, 166 A.3d 102 (Del. 2017).

[259] *Mennen v. Wilmington Tr. Co.*, No. 8432, 2015 BL 120928, *2015 WL 1897828* at *1 (Del. Ch. Apr. 24, 2015).

> Whatever my personal views regarding the policy supporting spendthrift clauses, I am bound by state statute and controlling precedent to conclude that the spendthrift clause bars the plaintiffs from satisfying the judgment against the individual trustee from the assets in the individual trustee's trust.

The author is not aware of any Delaware statute or case law that addresses the alter-ego, sham, or nominee doctrine in the trust setting.

Delaware courts award counsel fees in trust matters based on the American rule, which generally requires each party to bear its own costs.[260]

[260] Del. Code Ann. tit. 12, §3574(a).

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G. Tenancy-by-the-Entireties Property Contributed to Trust

In 2007, Vice Chancellor Parsons of the Delaware Court of Chancery described the rules for tenancy by the entireties in Delaware real property as follows:[261]

[261] *Wilmington Sav. Fund Soc'y, FSB v. Kaczmarczyk*, Civ. No. 1769-N, 2007 BL 229357, 2007 WL 704937 at *3 (Del. Ch. Mar. 1, 2007) (footnotes omitted). *See* Del. Code Ann. tit. 25, §309.

> In Delaware, a husband and wife generally hold title to real property in a tenancy by the entirety. Consequently, neither interest can be sold, attached, or liened except by the joint act of both spouses. Specifically, a judgment against the husband cannot be executed against a property interest he holds in a tenancy by the entirety.

A tenancy by the entireties also may be created in Delaware personal property.[262]

[262] *Wilmington Sav. Fund Soc'y, FSB v. Kaczmarczyk*, Civ. No. 1769-N, 2007 BL 229357, 2007 WL 704937 at *3.

From an estate planning standpoint, working with tenancy-by-the-entireties property is problematic because “when assets held as TBE are transferred to a trust in which only one party maintains control, the terms of the trust eliminate any TBE protection.”[263]

[263] *Quaid v. Baybrook Home of Polk Cty.*, No. 6:11-cv-0280, 2011 BL 292564, 2011 WL 5572605 at *2 (M.D. Fla. Nov. 16, 2011). *But see Estate of Van Riper v. Director, Division of Taxation*, 226 A.3d 55, 61 (N.J. 2020) (“New Jersey has no law specifiying that the joint conveyance of real property into a single trust destroys a tenancy by the entirety, and the Estate points to none”).

Once the property's character is destroyed, it cannot later be restored:[264]

[264] *In re Cowles*, 143 B.R. 5, 10–11 (Bankr. D. Mass. 1992) (citation omitted). *Accord In re Goldman*, 111 B.R. 230, 232–233 (Bankr. E.D. Mo. 1990).

> [E]ven if the trust were revoked, the Debtor provides no legal support for the assertion that the property will return to the Debtor and his wife as tenants by the entirety, and the Court can find nothing that would support such an assertion. To the contrary, the initial transfer of the property to the trust thirteen years ago terminated the tenancy by the entirety. While it is true that one spouse acting alone cannot terminate a tenancy by the entirety without the consent of the other, nothing prevents such termination by the two acting together. In the present case, when the Debtor and his wife together transferred the property to the trust, to be controlled by the Debtor alone, they terminated the joint ownership and control

> that is a requirement of a tenancy by the entirety. Such a tenancy does not renew itself automatically in the future. For these reasons, the Debtor's argument that creditors will only be able to reach his fifty percent interest in the property is irrelevant.

A Delaware statute allows tenancy-by-the-entireties property contributed to a revocable trust to retain its character and thereby its ability to protect the property from a spouse's separate creditors.[265] Arkansas, Illinois, Indiana, Maryland, Missouri, North Carolina, Tennessee, Virginia, and Wyoming offer similar protection.[266]

The Delaware Act offers one more level of protection for tenancy-by-the-entireties property added to a Delaware APT. Under the Delaware Act, tenancy-by-the entireties property transferred to a Delaware APT retains its character until the death of the first spouse,[267] and if the trust is set aside (e.g., as a fraudulent transfer or a sham), the property retains its traditional protection from each spouse's separate creditors.[268] The current provision says:[269]

> Where spouses 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, 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 such trust property shall be an order directing the trustee to transfer the property to both spouses as tenants by the entireties.

In addition, the Delaware Act allows multiple transferors to contribute undivided interests to a Delaware APT as follows:[270]

> “Qualified disposition” means a disposition by or from a transferor (or multiple transferors in the case of property in which each such transferor owns an undivided interest) to 1 or more trustees, at least 1 of which is a qualified trustee, with or without consideration, by means of a trust instrument.

The conflict-of-laws issues relating to the funding of a Delaware APT with tenancy-by-the-entireties property are comparable to those for Delaware APTs. In short, Delaware and non-Delaware residents should be able to take advantage of this technique for tenancies in personal property, but its effectiveness for tenancies in non-Delaware real property is questionable.[271]

[265] Del. Code Ann. tit. 12, §3334. The author would like to thank Jonathan Gopman of Akerman LLP, Naples, Florida, for suggesting this legislative change.

[266] Ark. Code Ann. §28-72-601–§28-72-605765 ILCS 1005/1c; Ind. Code §30-4-3-35; *Md. Code Ann., Est. & Trusts §14.5-511*, Md. Code Ann., Cts. & Jud. Proc. §11-504(b)(8)–§11-504(b)(9); Mo. Rev. Stat. §456.950; N.C. Gen. Stat. §39-13.7; Tenn. Code Ann. §35-15-510; Va. Code Ann. §55.1-136; Wyo. Stat. §4-10-402(c)–§4-10-402(d).

[267] Del. Code Ann. tit. 12, §3574(f). *See* David Ruben & Jonathan E. Gopman, *Delaware Statutory Tenancy by the Entireties Trusts: Potentially Powerful Asset Protection for Couples Across the Country , 39 Tax Mgmt. Est., Gifts & Tr. J. 123*, 126–128 (May 8, 2014).

[268] Del. Code Ann. tit. 12, §3574(f). *See* Haw. Rev. Stat. §554G-10; *Md. Code Ann., Est. & Trusts §14.5-511*, Md. Code Ann., Cts. & Jud. Proc. §11-504(b)(8)–§11-504(b)(9); N.C. Gen. Stat. §39-13.7; Va. Code Ann. §55.1-136; Wyo. Stat. §4-10-402(c)–§4-10-402(d).

[269] Del. Code Ann. tit. 12, §3574(f).

[270] Del. Code Ann. tit. 12, §3570(7).

[271] *See* IX., below. *See also* David Ruben & Jonathan E. Gopman, *Delaware Statutory Tenancy by the*

Entireties Trusts: Potentially Powerful Asset Protection for Couples Across the Country, 39 Tax Mgmt. Est., Gifts & Tr. J. 123, 126 (May 8, 2014).

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H. Additional Protection for Trust Distributions

Creditors may not reach assets of accounts in Delaware banks. The current statute provides that "Banks, trust companies, savings institutions and loan associations … shall not be subject to the operations of the attachment laws of this State."[272] This protection is not new. In fact, the earliest predecessor of the statute was enacted in 1871.[273] Over the years, Delaware courts have read the protection broadly.[274]

[272] Del. Code Ann. tit. 10, §3502(b).

[273] 14 Del. Laws 90.

[274] *Sterling v. Tantum*, 94 A.176 (Del. Super. Ct. 1915); *Provident Tr. Co. v. Banks*, 9 A.2d 260 (Del. Ch. 1939); *Bank of Del. v. Wilmington Hous. Auth.*, 352 A.2d 420 (Del. Super. Ct. 1976); *Del. Tr. Co. v. Partial*, 517 A.2d 259 (Del. Ch. 1986). *But see Garretson v. Garretson*, 306 A.2d 737, 742 (Del. 1973).

The statute is currently of limited value because most (if not all) institutions that conduct banking business in Delaware are multistate banks. As a result, Delaware accounts can likely be garnished or attached elsewhere.

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IV. Alaska APT Act

A. Introduction

The Alaska Trust Act[275] took effect on April 2, 1997. The pertinent provisions (Alaska Act) have been amended several times.[276]

[275] Alaska Stat. §34.40.110, 1997 Alaska Sess. Laws 6.

[276] 1998 Alaska Sess. Laws 105; 2003 Alaska Sess. Laws 138; 2004 Alaska Sess. Laws 82; 2006 Alaska Sess. Laws 66; 2008 Alaska Sess. Laws 7; 2010 Alaska Sess. Laws 65; 2013 Alaska Sess. Laws 45. The current Alaska Act is available at, www.akleg.gov.

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B. How to Create an Alaska APT

To create an asset-protection trust (APT) under the Alaska Act (Alaska APT), a settlor must create an Alaska spendthrift trust. To do so, some or all of the trust assets must be deposited in Alaska and administered by an Alaska trustee,[277] i.e., a bank with trust powers (state-chartered or nationally chartered) or a state-chartered trust company which has its principal place of business in Alaska or an individual who resides in Alaska.[278] The Alaska trustee must maintain records for the trust on an exclusive or nonexclusive basis and prepare or arrange for the preparation of fiduciary income tax returns for the trust.[279] Part or all of the administration of the trust must take place in Alaska.[280] If at least one Alaska trustee serves, an individual or institution that is not an Alaska trustee also may serve.[281] Settlors may be co-trustees or advisors if they do not have trustee powers over discretionary distributions.[282] The trust also may authorize the settlor to appoint a trustee, a trust protector, or an advisor; remove a trustee or a trust protector and appoint a replacement trustee or trust protector who is not a related or subordinate party under §672(c); or remove an advisor or appoint a replacement advisor.[283] The trust instrument sets the rights of the settlor in trust property, and implied or express understandings are void.[284]

[277] Alaska Stat. §13.36.035(c)(1)–§13.36.035(c)(2).

[278] Alaska Stat. §13.36.390(3).

[279] Alaska Stat. §13.36.035(c)(3).

[280] Alaska Stat. §13.36.035(c)(4).

[281] Alaska Stat. §13.36.320(a).

[282] Alaska Stat. §34.40.110(f).

[283] Alaska Stat. §34.40.110(h).

[284] Alaska Stat. §34.40.110(i).

Before settlors transfer assets to Alaska APTs, they must sign solvency affidavits.[285] In 2011, a federal bankruptcy judge in Alaska held (probably mistakenly) that not only must settlors sign such affidavits, but that they also actually must be solvent upon the funding of Alaska APTs to form valid trusts.[286] A federal district judge in Alaska opined in 2017:[287]

[285] Alaska Stat. §34.40.110(j).

[286] *In re Mortensen*, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 at *4–5 (Bankr. D. Alaska May 26, 2011).

[287] *Bertran v. Compton (In re Bertran)*, No. 4:16-cv-00022, 2017 BL 86453, *2017 WL 1051185* at *6 n.50 (D. Alaska Mar. 20, 2017).

> [T]he Bankruptcy Court found that Ms. Bertran had failed to submit the requisite settlor's affidavit as required by Alaska Stat. AS 34.40.110(j). In the absence of this affidavit, if a trust was established, it may be void and any transfers to the Toni 1 Trust would also be void.

Alaska APTs may provide for trust protectors[288] and trustee advisors.[289] Under the Alaska Act,[290] a term in a trust instrument that provides the restriction described in the Alaska Act is considered to be a restriction on the transfer of the settlors beneficial interest in the trust that is enforceable under applicable nonbankruptcy law under 11 U.S.C. §541(c)(2).[291] The Alaska Act applies to IRAs.[292] The settlor of an Alaska APT may be reimbursed for income taxes attributable to the trust on a discretionary or mandatory basis.[293]

[288] Alaska Stat. §13.36.370.

[289] Alaska Stat. §13.36.375.

[290] Alaska Stat. §34.40.110(a).

[291] 11 U.S.C. §541(c)(2).

[292] Alaska Stat. §34.40.110(b)(2), §34.40.110(b)(3), §34.40.110(n)(1).

[293] Alaska Stat. §34.40.110(m)(2).

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C. Who May Defeat an Alaska APT

An action, including an action to enforce a judgment entered by a court or other body having adjudicative authority, may not be brought for an attachment or other provisional remedy against property in an Alaska APT, unless the action is to set aside a fraudulent transfer and is brought within the limitations periods described below.[294] Under the statute, Alaska's courts have exclusive jurisdiction over controversies involving Alaska APTs.[295] In 2018, though, the Supreme Court of Alaska held that the statute did not "prevent other state and federal courts from exercising subject matter jurisdiction over fraudulent transfer actions against such trusts."[296]

[294] Alaska Stat. §34.40.110(k).

[295] Alaska Stat. §34.40.110(k).

[296] *Toni 1 Trust, by Tangwall v. Wacker*, 413 P.3d 1199, 1203 (Alaska 2018). *See* James P. Menton, Jr., *Domestic Asset Protection Trusts and Fraudulent Transfer Jurisdiction*, 43 Tax Mgmt. Est., Gifts & Tr. J. 263, 263–264 (Sept. 13, 2018); William P. LaPiana, *Alaska Not the Only Venue for Actions Involving Alaska Trusts*, 45 Est. Plan. 46 (July 2018). Gideon Rothschild & Daniel S. Rubin, *Alaska Supreme Court Invalidates Exclusive Jurisdiction Provision*, 157 Tr. & Est. 23 (May 2018); Richard P. Covey & Dan T. Hastings, *Domestic Asset Protection Trusts*, Prac. Drafting at 13124–13129 (Apr. 2018).

In addition to the claims of supercreditors (including minor children seeking support) described in I.F., above, the Alaska Act does not protect the settlor from a creditor's claim if:

- the creditor establishes by clear and convincing evidence that the transfer to the trust was intended to defraud that creditor;
- the settlor may revoke or terminate all or a part of the trust without the consent of a person who has a significant adverse beneficial interest;
- the trust instrument requires that all or a part of the trust income or principal or both be distributed to the settlor; or
- at the time of the transfer, the settlor is in default by 30 or more days of making a payment under a child support judgment or order.[297]

[297] Alaska Stat. §34.40.110(b).

Regarding the first exception above, a settlor's expressed intention to protect trust assets from a beneficiary's potential future creditors is not evidence of an intent to defraud.[298] Nevertheless, by reason of the federal Supremacy Clause, this provision of the Alaska Act will not benefit a debtor in a federal bankruptcy proceeding. Accordingly, a federal bankruptcy judge in Alaska wrote in 2011:[299]

> It would be a very odd result for a court interpreting a federal statute aimed at closing a loophole to apply the state law that permits it. I conclude that a settlor's expressed intention to protect assets placed into a self-settled trust from a beneficiary's potential future creditors can be evidence of an intent to defraud. In this bankruptcy proceeding, AS 34.40.110(b)(1) cannot compel a different conclusion.

Regarding the second exception, above, a settlor's power to revoke or terminate does not include:

- a power to veto trust distributions;
- a lifetime or testamentary nongeneral power of appointment;
- the right to receive:
  - (a) distributions from a CRT;
  - (b) distributions from a total-return unitrust;
  - (c) an interest in a QPRT; or
  - (d) distributions from a GRAT or GRUT.[300]

With respect to a fraudulent-conveyance claim under Alaska law:

- If the creditor's claim arose before the transfer is made, the claim will be extinguished unless the creditor brings an action within four years after the transfer is made or, if later, within one year after the creditor discovers (or reasonably could have discovered) the transfer. To take advantage of this rule regarding pre-transfer claims, a creditor must prove, by a preponderance of the evidence, that the creditor asserted a specific claim against the settlor before the transfer or, within four years of the transfer, file another action against the settlor that asserts a claim based on an act or omission of the settlor that occurred before the transfer.[301]
- If the creditor's claim arose after the transfer is made, the claim will be extinguished unless the creditor brings an action within four years after the transfer is made.[302]

A settlor's interest in an Alaska APT created before marriage is not considered property subject to division or part of a property division in an Alaskan divorce proceeding.[303]

[298] Alaska Stat. §34.40.110(b)(1).

[299] *In re Mortensen*, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 at *7 (Bankr. D. Alaska May 26, 2011).

[300] Alaska Stat. §34.40.110(b)(2)–§34.40.110(b)(3).

[301] Alaska Stat. §34.40.110(d)(1).

[302] Alaska Stat. §34.40.110(d)(2).

[303] Alaska Stat. §34.40.110(l).

Unlike the Delaware Act, the Alaska Act does not contain a separate exception for claims by existing or former spouses and minor children, but this does not necessarily mean that such claimants will be unable to reach the assets of Alaska APTs for two reasons.

First, a federal statute requires each state to enforce child support orders made by courts of other states[304] and, in actions to enforce arrearages in child support orders, the statute requires courts to apply the statute of limitations of the forum state or the state of the court that issued the order, whichever is longer.[305] This limitations rule is significant: the Alaska Act implies that the holders of child support orders can invade an Alaska APT only if the order was 30 or fewer days old at the time of transfer,[306] but the federal limitations rule could conceivably override Alaska's 30-day rule and replace it with the longer limitations period of another state.

[304] 28 U.S.C. §1738B(a).

[305] 28 U.S.C. §1738B(h)(3).

[306] Alaska Stat. §34.40.110(b)(4).

Second, if a spouse elects against the will of the settlor of an Alaska APT, the augmented estate will not include the trust if the settlor lived in Alaska,[307] but the result might be different if the settlor was a nonresident. This is because, under Alaska law, the right of a surviving spouse of a settlor who dies outside Alaska to take an elective share in property in Alaska is governed by the law of the settlor's domicile at death.[308]

[307] Alaska Stat. §13.12.205(b).

[308] Alaska Stat. §13.12.202(d).

Unlike the Delaware Act, the Alaska Act also does not contain an exception for tort claims that existed when an APT was created.

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If one of the above exceptions applies, a creditor may reach trust assets only to the extent necessary to pay that creditor's claim and related costs, including attorney fees.[309] Similarly, a creditor may attach the assets of an Alaska APT only to the extent that one of the above exceptions applies.[310] If the trustee has not acted in bad faith in accepting and administering the trust, the trustee may use trust assets to pay its costs of litigating the claim before satisfying the claim and a beneficiary (including the settlor) who received a proper distribution before a creditor brings a successful suit to defeat a transfer may retain the distribution.[311] Under Alaska law, a trustee may be held liable for participating in a conspiracy to commit a fraudulent conveyance,[312] but the Alaska Act offers protection to trustees and advisors who participate in the preparation and funding of an APT.[313] No-contest clauses are enforceable.[314]

[309] Alaska Stat. §13.36.310(b); *Alaska R. Civ. P. 82(a).*

[310] Alaska Stat. §34.40.110(c).

[311] Alaska Stat. §13.36.310(c).

[312] *See* XIV.C., below.

[313] Alaska Stat. §34.40.110(e).

[314] Alaska Stat. §13.36.330.

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E. Moving Trusts to Alaska

A non-Alaska trust may become an Alaska APT if the trust satisfies the above requirements. A trust that has its situs transferred to Alaska and has provisions that permit payments to the settlor, allow the trust to be perpetual, or are not expressly prohibited by the laws of Alaska is effective and enforceable.[315]

[315] Alaska Stat. §13.36.043.

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F. Infrastructure

Because Alaska did not enact favorable trust laws until 1997, it is not known how Alaska courts and legislators will respond to difficult cases that arise under the Alaska Act. Its liability system was ranked as the 6th best in the country by a 2017 U.S. Chamber of Commerce study.[316]

[316] The study is available at www.instituteforlegalreform.com/states.

In a case that was decided before the Alaska Act was enacted and that involved bad facts for the debtors, the U.S. Bankruptcy Court for the District of Alaska refused to recognize the debtors' Belize APTs.[317]

[317] *In re Brown*, 4 Alaska Bankr. 279 (Bankr. D. Alaska 1996).

Alaska APTs have been set aside in two bad-facts cases. First, in 2011, a federal bankruptcy judge in Alaska set aside a transfer by an Alaska resident of Alaska real property to an Alaska APT under 11 U.S.C. §548(e)(1).[318] Second, in 2013, a bankruptcy judge in Washington State held that Washington law rather than Alaska law applied to determine whether creditors could reach the assets of an Alaska APT created by a Washington resident[319] and held that the trust was void under a Washington statute[320] that does not recognize self-settled trusts.[321] The court also set aside the transfer to the trust for actual fraud under 11 U.S.C. §548(e)(1) [322] and under 11 U.S.C. §544(b)(1) and Washington's version of the UFTA.[323]

[318] *In re Mortensen*, No. A09-90036, 2011 BL 180087, *2011 WL 5025252* (Bankr. D. Alaska July 8, 2011); *In re Mortensen*, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011); *In re Mortensen*, No. A09-90036, No. A09-00565, 2011 BL 387653, *2011 WL 5025288* (Bankr. D. Alaska Jan. 14, 2011). *See* David G. Shaftel, *Court Finds Fraudulent Transfer to Alaska Asset Protection Trust*, 39 Est. Plan. 15 (Apr. 2012).

[319] *Waldron v. Huber (In re Huber)*, 493 B.R. 798, 809 (Bankr. W.D. Wash. 2013). *See* Sean Weissbart, *Estate Planning Strategies for the Young and Wealthy*, 41 Est. Plan. 28, 32–34 (Feb. 2014); Jonathan G. Blattmachr, Jonathan D. Blattmachr, & Matthew Blattmachr, *Avoiding the Adverse Effects of Huber*, 152 Tr. & Est. 20 (July 2013).

[320] Wash. Rev. Code §19.36.020.

[321] *In re Huber*, 493 B.R. 798, 810.

[322] *In re Huber*, 493 B.R. 798, 814.

[323] *In re Huber*, 493 B.R. 798, 816.

Although the issue has not yet arisen with respect to an Alaska APT, the planner must keep in mind that state court judges might create judicial exceptions to state law protections from creditor claims in compelling circumstances.[324] Hence, steps should be taken to ensure that controversies involving domestic APTs will take place in the courts of domestic APT states.[325]

[324] *See* James Massey Draper, *Enforcement of Claim for Alimony or Support, or for Attorneys' Fees and Costs Incurred in Connection Therewith, Against Exemptions*, 52 A.L.R. 5th 221 (2011).

[325] See IX.C., below.

To the author's knowledge, no Alaska statute or court decision addresses the availability of the alter-ego, sham, or nominee doctrine in the trust context.

In state court proceedings, Alaska courts award counsel fees based on the English rule, which generally requires the losing party to bear the winning party's costs,[326] but federal courts in Alaska award counsel fees using the American rule, under which each party usually bears its own costs.[327]

[326] *See* Alaska Stat. §13.36.310(b); *Alaska R. Civ. P. 82(a)*..

[327] *In re Mortensen*, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 at *8 (Bankr. D. Alaska May 26, 2011).

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V. Nevada Spendthrift Trust Act

A. Introduction

Nevada's asset-protection trust (APT) legislation (Nevada Act) became effective October 1, 1999,[328] and was amended in 2007, 2009, 2011, 2017, and 2019.[329]

[328] Nev. Rev. Stat. §166.010–Nev. Rev. Stat. §166.180, 1999 Nev. Stat. 299.

[329] 2007 Nev. Stat. 251; 2009 Nev. Stat. 215; 2011 Nev. Stat. 270; 2017 Nev. Stat. 125; 2019 Nev. Stat. 309. The current Nevada Act is available at, www.leg.state.nv.us/NRS/NRS-166.html.

B. How to Create a Nevada APT

To create an APT under the Nevada Act (Nevada APT), a settlor must create in writing an irrevocable Nevada spendthrift trust.[330] The trust must appoint at least one Nevada trustee, i.e., a natural person who resides and is domiciled in Nevada, a trust company (other than a foreign independent trust company in certain circumstances) that maintains an office in Nevada, or a bank with trust powers that maintains an office in Nevada.[331] The Nevada trustee must maintain records and prepare income tax returns for the trust, and part or all of the administration of the trust must take place in Nevada.[332]

[330] Nev. Rev. Stat. §166.040(1)(b)–§166.040(1)(c). *See Klabacka v. Nelson*, 394 P.3d 940, 947 (Nev. 2017).

[331] Nev. Rev. Stat. §166.015(2), §166.015(3).

[332] Nev. Rev. Stat. §166.015(1)(d).

The Nevada Act does not protect the settlor from creditors' claims if:

- the trust is revocable;
- the trust instrument requires that all or a part of the trust income or principal be distributed to the settlor;
- the transfer was intended to hinder, delay, or defraud known creditors; or
- the settlor keeps the power to make distributions to himself or herself without the consent of another person.[333]

[333] Nev. Rev. Stat. §166.040(1)(b), §166.040(3).

The settlor may keep:

- a power to prevent trust distributions;
- a lifetime or testamentary nongeneral power of appointment;
- the ability to receive a distribution from the trust in the discretion of another person;
- the power to remove or replace a trustee;
- the power to direct trust investments;
- other management powers; or

- the ability to have trust property used to obtain a loan secured by a mortgage or deed of trust on such property.[334]

The Nevada Act permits the settlor to retain the following:

- an interest in a CRT even if the settlor may release that interest in favor of a remainder beneficiary;
- an interest in a total-return unitrust or a qualified retirement or deferred compensation plan;
- an interest in a GRAT or GRUT;
- an interest in a QPRT or a qualified annuity interest; or
- the right to use real or personal property owned by the trust.[335]

The Nevada Act provides that the settlor of a Nevada APT has only the powers and rights that are conferred by the trust instrument and that express or implied agreements or understandings giving the settlor additional rights are void.[336]

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C. Who May Defeat a Nevada APT

As covered in I.F., above, certain supercreditors (possibly including minor children seeking support) may reach the assets of a Nevada APT. In addition, the settlor of a Nevada APT may be treated as the trustee's alter-ego in certain circumstances.[337]

A creditor may bring an action (including an action to enforce a judgment from another jurisdiction) to defeat a Nevada APT in the following circumstances:[338]

> A creditor may not bring an action with respect to transfer of property to a spendthrift trust unless a creditor can prove by clear and convincing evidence that the transfer of property was a fraudulent transfer pursuant to chapter 112 of NRS *or that the transfer violates a legal obligation owed to the creditor under a contract or a valid court order that is legally enforceable by that creditor*. In the absence of such clear and convincing proof, the property transferred is not subject to the claims of the creditor. Proof by one creditor that a transfer of property was fraudulent or wrongful does not constitute proof as to any other creditor and proof of a fraudulent or wrongful transfer of property as to one creditor shall not invalidate any other transfer of property.

[334] Nev. Rev. Stat. §166.040(3), §166.170(4).

[335] Nev. Rev. Stat. §166.040(2).

[336] Nev. Rev. Stat. §166.045.

[337] *See* Nev. Rev. Stat. §163.418, §163.4177.

[338] Nev. Rev. Stat. §166.170(3) (emphasis added).

The above italicized language, of which many practitioners are unaware, might enable numerous creditors, including former spouses, to reach the assets of Nevada APTs.

With respect to a transfer to a Nevada APT:

- if the creditor's claim arose before the trust is created, the creditor must bring an action within two years after the trust's creation or, if later, within six months after the creditor discovers (or reasonably should have discovered) the trust; and
- if the creditor's claim arose after the trust is created, the creditor must bring an action within two years after its creation.[339]

[339] Nev. Rev. Stat. §166.170(1).

The Nevada Act specifies that a creditor is deemed to have discovered a transfer when a public record is made of it.[340]

[340] Nev. Rev. Stat. §166.170(2)

If multiple transfers are made to the same trust, a subsequent transfer is disregarded in determining whether a creditor's claim with respect to a prior transfer is extinguished as provided above;[341] distributions to beneficiaries are deemed to come first from the latest transfer.[342]

[341] Nev. Rev. Stat. §166.170(7)(a).

[342] Nev. Rev. Stat. §166.170(7)(b).

Unlike the Delaware Act, the Nevada Act does not contain explicit exceptions for claims by existing or former spouses and minor children arising from separation or divorce proceedings, but this does not necessarily mean that such claimants will be unable to reach the assets of Nevada APTs.

As discussed in I.F.5.c., above, federal law might make it possible to reach assets of Nevada APTs for child-support claims.

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D. Consequences if a Nevada APT Is Defeated

The Nevada Act does not address the consequences for the trustee or beneficiaries if a creditor is able to reach the assets of a Nevada APT. No one may bring a claim against an adviser to the settlor or trustee of a Nevada APT unless such person can show by clear and convincing evidence that the adviser violated Nevada law, knowingly and in bad faith, and the adviser's actions directly caused the damages suffered by such person.[343] This protection has been extended to the trustee.[344]

[343] Nev. Rev. Stat. §166.170(5), §166.170(10)(a).

[344] Nev. Rev. Stat. §166.170(6).

E. Moving Trusts to Nevada

A Nevada APT may be created by moving a trust, which meets the requirements of the Nevada Act, to Nevada,[345] and the time that the trust existed before it is moved to Nevada will count toward the period for pursuing post-transfer claims against the trust.[346] A similar rule applies if the trustee of a Nevada APT exercises a decanting power to create a new Nevada APT.[347]

[345] Nev. Rev. Stat. §166.180.

[346] Nev. Rev. Stat. §166.180(2).

[347] Nev. Rev. Stat. §166.170(9).

F. Infrastructure

Because Nevada did not enact favorable trust laws until 1999, it is impossible to predict how the Nevada courts will respond to difficult cases that arise under the Nevada Act. Its liability system was rated as the 37th best in the United States by a 2017 U.S. Chamber of Commerce study.[348] In a 2015 case, the Supreme Court of Utah held that the assets of an inartfully drawn Nevada APT could be reached by the settlor's former wife in a Utah divorce proceeding.[349] In 2017, however, the Supreme Court of Nevada, reversing the trial court, held in *Klabacka v. Nelson* that the assets of a Nevada resident husband's Nevada APT were not reachable by the Nevada resident wife for court-ordered child support and spousal support obligations as follows:[350]

[348] The study is available at www.instituteforlegalreform.com/states/.

[349] *Dahl v. Dahl*, 345 P.3d 566 (Utah 2015).

[350] *Klabacka v. Nelson*, 394 P.3d 940, 951 (Nev. 2017) (footnote omitted).

> Nevada SSSTs (self-settled spendthrift trusts) are protected against the court-ordered child-support or spousal-support obligations of the settlor/beneficiary that are not known at the time the trust is created.

In the course of the opinion, the court noted that:[351]

[351] *Klabacka v. Nelson*, 394 P.3d 940, 953 n.8.

> [T]he self-settled spendthrift provisions of NRS Chapter 166 reflect a considered legislative policy choice, and if exceptions to the policy are to be made for equitable remedies, it is for the Legislature to undertake that task.

So far, the legislature has recognized two equitable exceptions to the protection given by Nevada APTs.

Thus, as noted above and as noted by the court itself,[352] a transfer to a Nevada APT may be set aside if the transfer "violates a legal obligation owed to the creditor under a contract or a valid court order that is legally enforceable by that creditor" as well as if the transfer "was a fraudulent transfer pursuant to chapter 112 of NRS."[353]

Although the Supreme Court of Nevada declared in *Klabacka* that the legislature should create any equitable exceptions to the Nevada Act, that court failed to note that it itself has recognized nonstatutory exceptions to the Nevada homestead exemption[354] in the following three instances:

- *Breedlove v. Breedlove* (1984)[355] —In a former wife's action to enforce an Indiana child-support judgment against a former husband who was the sole occupant of the homestead, the court held that the homestead exemption did not insulate the debtor from the claim for the following reason: "[R]espondent [former husband] is not the type of debtor whom the legislature sought to protect, and appellant [former wife], in turn, is not the type of creditor from whom the legislature intended to protect homesteaders."[356]

- *Philips v. Morrow* (1988)[357] —The court recited the facts as follows:[358]

> Respondent Linda June Morrow Anderson (Linda) and appellant Laura Morrow Phillips (Laura) are both ex-wives of William Morrow. During their marriage, Laura and Morrow purchased a house. According to Laura, when she divorced Morrow, the divorce decree awarded her the house "on the condition that she pay to [Morrow] the sum of Seven Thousand dollars or one-third of the net value of the real estate, whichever is greater." Seventeen days after the divorce between Laura and Morrow, Linda recorded a child support judgment against the house. Over five years later, Linda attempted to execute on the house; Laura interposed a homestead exemption as a defense to Linda's judgment lien.
>
> Pursuant to this court's ruling in *Breedlove v. Breedlove*, the district court ruled that Laura's homestead exemption could be disregarded and her house sold to satisfy Linda's child support judgment.

The court held that the homestead that was occupied by a second former wife could be sold to satisfy the first former wife's child-support claim for the following reason:[359]

> Because Laura voluntarily participated in the dissipation of a discrete source of assets from which Linda could have satisfied her judgment against Morrow, the *Breedlove* rationale applies. The district court did not err in holding that Laura's residence is subject to Linda's judgment lien.

[352] *Klabacka v. Nelson*, 394 P.3d 940, 949 n.5.

[353] Nev. Rev. Stat. §166.170(3).

[354] Nev. Rev. Stat. §115.005-§115.090. *See* Jane Massey Draper, *Enforcement of Claim for Alimony or Support, or for Attorney's Fees and Costs Incurred in Connection Therewith, Against Exemptions*, 52 A.L.R. 5th 221 (2011).

[355] *Breedlove v. Breedlove*, 691 P.2d 426 (Nev. 1984).

[356] *Breedlove v. Breedlove*, 691 P.2d 426, 428.

[357] *Philips v. Morrow*, 760 P.2d 115 (Nev. 1988).

[358] *Philips v. Morrow*, 760 P.2d 115, 116 (citation omitted).

[359] *Philips v. Morrow*, 760 P.2d 115, 117.

- *Maki v. Chong* (2003)[360] —In a case decided subsequent to the enactment of the Nevada Act, the court ruled:[361]

> We conclude that, as in the case of a debtor owing child support obligations, debtors who fraudulently acquire funds are not the type of debtor whom the legislature sought to protect.

It would have been helpful if the *Klabacka* court had addressed the significance, if any, of *Breedlove* and its progeny for Nevada APTs.

As noted above but not mentioned by the Supreme Court of Nevada in *Klabacka*, the Nevada legislature, unlike the legislatures in most other states, has recognized that a Nevada trust may be pierced under the alter-ego theory, though in limited circumstances. Accordingly, a Nevada statute provides:[362]

> Absent clear and convincing evidence, a settlor of an irrevocable trust shall not be deemed to be the alter ego of a trustee of an irrevocable trust. If a party asserts that a settlor of an irrevocable trust is the alter ego of a trustee of the trust, the following factors, alone or in combination, are not sufficient evidence for a court to find that the settlor controls or is the alter ego of a trustee:
>
> 1. The settlor has signed checks, made disbursements or executed other documents related to the trust as the trustee and the settlor is not a trustee, if the settlor has done so in isolated incidents.
>
> 2. The settlor has made requests for distributions on behalf of a beneficiary.
>
> 3. The settlor has made requests for the trustee to hold, purchase or sell any trust property.
>
> 4. The Settlor has engaged in any one of the activities, alone or in combination, listed in NRS 163.4177.

A second Nevada statute enumerates non-factors for determining if a settlor exercises dominion or control:[363]

> If a party asserts that a beneficiary or settlor is exercising improper dominion or control over a trust, the following factors, alone or in combination, must not be considered exercising improper dominion or control over a trust:
>
> 1. A beneficiary is serving as a trustee.
>
> 2. The settlor or beneficiary holds unrestricted power to remove or replace a trustee.
>
> 3. The settlor or beneficiary is a trust administrator, general partner of a partnership, manager of a limited-liability company, officer of a corporation or any other manager of any other type of entity and all or part of the trust property consists of an interest in the entity.
>
> 4. The trustee is a person related by blood, adoption or marriage to the settlor or beneficiary.
>
> 5. The trustee is the settlor or beneficiary's agent, accountant, attorney, financial adviser or friend.
>
> 6. The trustee is a business associate of the settlor or beneficiary.

[360] *Maki v. Chong*, 75 P.3d 376 (Nev. 2003).

[361] *Maki v. Chong*, 75 P.3d 376, 379 (footnote and internal quotation marks omitted).

[362] Nev. Rev. Stat. §163.418.

[363] Nev. Rev. Stat. §163.4177.

It's regrettable that the Supreme Court of Nevada in *Klabacka* did not address the alter-ego statutes, particularly because there were indications that trust formalities were ignored[364] and that assets were commingled.[365]

The Supreme Court of Nevada's admonition in *Klabacka* that the creation of equitable exceptions to Nevada's spendthrift protection should be left to the legislature has not kept other courts from creating them.

Hence, on the same day that the Supreme Court of Nevada filed the *Klabacka* decision, the U.S. District Court for the District of Nevada, without reference to the alter-ego statutes just quoted, held that "I will apply alter-ego analysis to the trust defendants."[366] Subsequently, though, that portion of the opinion was withdrawn and the question of whether the assets of a trust may be reached via the alter-ego doctrine under Nevada law was certified to the Supreme Court of Nevada.[367] In turn, the Supreme Court of Nevada held that the alter-ego doctrine applies to LLCs and partnerships,[368] but declined to rule on whether that doctrine extends to the trusts at issue for the following reason:[369]

> Since we are unable to glean from the record provided the nature of the trusts involved, it is unclear to the court whether these two questions of law may be determinative to the pending cause.

In 2019, the United States District Court for the District of Nevada held that the sham and nominee theories extended to trusts under Nevada law.[370]

Moreover, 18 months after the *Klabacka* decision, an intermediate appellate court in Oregon felt free to create an equitable exception to Nevada's spendthrift protection in *Matter of Testamentary Trust Created Under Will of King*.[371] There, the Oregon successor trustee of a trust created by the will of a Nevada decedent sought to surcharge the former trustee/sole income beneficiary for over $900,000 of improper loans and to collect the judgment from her payments from the trust.[372] After confirming that Nevada law governed the issue,[373] the court upheld the surcharge.[374] The court then considered whether the former trustee's beneficial interest could be charged to compensate for her breaches under a Nevada statute that provides:[375]

> 1. A spendthrift trust as defined in this chapter restrains and prohibits generally the assignment, alienation, acceleration

[364] *Klabacka v. Nelson*, 394 P.3d 940, 947–948.

[365] *Klabacka v. Nelson*, 394 P.3d 940, 948.

[366] *Transfirst Grp., Inc. v. Magliarditi*, 2017 WL 2294288 at *5 (D. Nev. May 25, 2017).

[367] *2017 WL 3725304* at *3.

[368] *2017 WL 3723652* at *3.

[369] *2017 WL 3723652* at *6.

[370] *United States v. Steele*, 2019 WL 2411422 at *8 (D. Nev. June 7, 2019).

[371] *Matter of Testamentary Trust Created Under Will of King*, 434 P.3d 502 (Or. Ct. App. 2018). *See* William P. LaPiana, *Interest in Spendthrift Trust Can Compensate Trust for Breach of Fiduciary Duty*, 46 Est. Plan. 42 (Mar. 2019).

[372] *Matter of Testamentary Trust Created Under Will of King*, 434 P.3d 502, 504.

[373] *Matter of Testamentary Trust Created Under Will of King*, 434 P.3d 502, 509 ("Because the trust unambiguously designates Nevada law as the law governing the administration of the trust, the trial court did not err in applying Nevada law to determine the questions of trust administration with which it was presented").

[374] *Matter of Testamentary Trust Created Under Will of King*, 434 P.3d 502, 509.

[375] Nev. Rev. Stat. §166.120.

> and anticipation of any interest of the beneficiary under the trust by the voluntary or involuntary act of the beneficiary, or by operation of law or any process or at all. The trust estate or corpus or capital thereof, shall never be assigned, aliened, diminished or impaired by any alienation, transfer or seizure so as to cut off or diminish the payments, or the rents, profits, earnings or income of the trust estate that would otherwise be currently available for the benefit of the beneficiary.
>
> 2. Payments by the trustee to the beneficiary, whether such payments are mandatory or discretionary, must be made only to or for the benefit of the beneficiary and not by way of acceleration or anticipation, nor to any assignee of the beneficiary, nor to or upon any order, written or oral, given by the beneficiary, whether such assignment or order be the voluntary contractual act of the beneficiary or be made pursuant to or by virtue of any legal process in judgment, execution, attachment, garnishment, bankruptcy or otherwise, or whether it be in connection with any contract, tort or duty. Any action to enforce the beneficiary's rights, to determine if the beneficiary's rights are subject to execution, to levy an attachment or for any other remedy must be made only in a proceeding commenced pursuant to chapter 153 of NRS, if against a testamentary trust … . A court has exclusive jurisdiction over any proceeding pursuant to this section.
>
> 3. The beneficiary shall have no power or capacity to make any disposition whatever of any of the income by his or her order, voluntary or involuntary, and whether made upon the order or direction of any court or courts, whether of bankruptcy or otherwise; nor shall the interest of the beneficiary be subject to any process of attachment issued against the beneficiary, or to be taken in execution under any form of legal process directed against the beneficiary or against the trustee, or the trust estate, or any part of the income thereof, but the whole of the trust estate and the income of the trust estate shall go to and be applied by the trustee solely for the benefit of the beneficiary, free, clear, and discharged of and from any and all obligations of the beneficiary whatsoever and of all responsibility therefor.
>
> 4. The trustee of a spendthrift trust is required to disregard and defeat every assignment or other act, voluntary or involuntary, that is attempted contrary to the provisions of this chapter.

After consulting the three *Restatements of Trust* and California caselaw,[376] the court concluded:[377]

[376] *Matter of Testamentary Trust Created Under Will of King*, 434 P.3d 502, 511–512.

[377] *Matter of Testamentary Trust Created Under Will of King*, 434 P.3d 502, 512.

> NRS 166.120 does not prohibit WNB from applying Sandra's interest in the trust to compensate the trust for losses that the trial court had previously found were caused by her breaches of trust.

This case illustrates the importance of carefully considering in the planning process the state's law that is to govern questions of validity, construction, administration, and creditor rights involving the trust.[378] It also shows the importance of planning to identify which states' courts will have jurisdiction to adjudicate trust questions[379] and which state's courts will be the courts charged with supervising the trust's administration.[380] If litigation develops, a party should not be reluctant to challenge the existence of in-rem and personal jurisdiction or to suggest that a court should defer to the courts of a more appropriate state. A commentator counseled in 2019 that "sometimes the creation of a revocable trust and a pour-over will might indeed be the best solution."[381]

[378] *See* IX.G., below.

[379] *See* IX.B., below.

[380] *See* IX.C., below.

[381] William P. LaPiana, *Interest in Spendthrift Trust Can Compensate Trust for Breach of Fiduciary Duty*, 46 Est. Plan. 42, 44 (Mar. 2019).

As noted above, Nevada has no explicit exceptions for alimony, child support, or similar claims. As discussed in I.F.5.c., above, though, federal law might make it possible to reach the assets of Nevada APTs for child-support claims. In any event, commentators wrote in 2019 that:[382]

[382] Mark Merric, Daniel G. Worthington, Paul MacArthur & John E. Sullivan, *Best Situs for DAPTs in 2019*, 158 Tr. & Est. 60, 69 (Jan. 2019).

> As not paying child support, and in some states, not paying maintenance, is a “go directly to jail” offense, we don't find that preventing these exception creditors does much to enhance the asset protection of Nevada DAPTs for non-Nevada clients.

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A. Introduction

South Dakota's Qualified Dispositions in Trust legislation (South Dakota Act), which is closely modeled on the Delaware Act,[390] took effect on July 1, 2005.[391] The South Dakota Act has been amended several times since its enactment.[392]

[390] Del. Code Ann. tit. 12, §3570–§3576. The Delaware Act is discussed in III., above.

[391] S.D. Codified Laws Ann. Ann. §55-16-1–§55-16-16, 2005 S.D. Laws 261. *See* Mark R. Krogstad & Matthew W. Van Heuvelen, *Domestic Asset Protection Trusts: The Effectiveness of South Dakota Asset Protection Trust Statutes for Removing Assets from a Settlor's Gross Estate*, 61 S.D. L. Rev. 378 (2016).

[392] 2006 S.D. Laws 243; 2007 S.D. Laws 247; 2008 S.D. Laws 257; 2009 S.D. Laws 252; 2010 S.D. Laws 232; 2011 S.D. Laws 212; 2012 S.D. Laws 233; 2013 S.D. Laws 239; 2014 S.D. Laws 226; 2015 S.D. Laws 240; 2016 S.D. Laws 231; 2017 S.D. Laws 204; 2018 S.D. Laws 275; 2019 S.D. Laws 209; 2020 S.D. Laws 206. The South Dakota Act can be viewed at http://sdlegislature.gov/Statutes/Codified_Laws.

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B. How to Create a South Dakota APT

To create an APT under the South Dakota Act (South Dakota APT), a person, which may be an entity as well as an individual,[393] must create an irrevocable trust that: (1) appoints at least one South Dakota trustee (referred to in the statute as a “qualified person”); (2) provides that South Dakota law governs the trust's validity, construction, and administration; and (3) contains a spendthrift clause.[394] A South Dakota trustee is:

[393] S.D. Codified Laws §55-4-1(2).

[394] S.D. Codified Laws §55-16-2.

- an individual who resides in South Dakota;
- a trust company that is organized under South Dakota or federal law and that has its principal place of business in South Dakota; or
- a bank or savings association that has trust powers, that has its principal place of business in South Dakota, and that has deposits insured by the Federal Deposit Insurance Corporation.[395]

[395] S.D. Codified Laws §55-16-3, §55-3-41.

The South Dakota trustee or trustees must hold some trust property in South Dakota and handle some trust administration (e.g., maintain records for the trust and prepare or arrange for the preparation of fiduciary income tax returns in South Dakota).[396] A South Dakota trustee will be deemed to have resigned if it ceases to satisfy these requirements.[397] Similarly, a trustee of a South Dakota APT automatically ceases to serve if a court declines to apply South Dakota law in determining the validity, construction, or administration of such trust, or the effect of its spendthrift clause in a proceeding involving such trustee.[398] If a trustee ceases to act for one of these reasons, any successor trustee designated in the trust will take the former trustee's place and a South Dakota court may fill any vacancy.[399] The trust may have non-South Dakota co-trustees [400] and South Dakota or non-South Dakota trust advisers or trust protectors.[401]

[396] S.D. Codified Laws §55-16-3, §55-3-39.

[397] S.D. Codified Laws §55-16-6.

[398] S.D. Codified Laws §55-3-47.

[399] S.D. Codified Laws §55-16-6, §55-3-47.

[400] S.D. Codified Laws §55-16-7.

[401] S.D. Codified Laws §55-16-4.

The South Dakota Act specifically permits the settlor of a South Dakota APT to have the power to:

- consent to or direct investment changes;
- veto distributions; and/or
- remove a trustee, protector, or trust advisor.[402]

[402] S.D. Codified Laws §55-16-2(2)(a), §55-16-2(2)(h), §55-16-4.

The South Dakota Act also expressly authorizes the settlor to have:

- a nongeneral inter vivos or a testamentary power of appointment;
- the ability to receive income or principal pursuant to broad discretion or a standard as determined by South Dakota trustees, non-South Dakota trustees, and/or trust advisors;
- the right to receive current income distributions;
- an interest in a total-return unitrust;

- an interest in a CRT or a QPRT;
- a pour back provision;
- the ability to pay or to be reimbursed for income taxes attributable to the trust on a mandatory or discretionary basis;
- the ability to serve as a noncontrolling member of a distribution committee; and/or
- the ability to provide for the payment of debts, expenses, and taxes following death.[403]

[403] S.D. Codified Laws §55-16-2, §55-1-36.1.

Under the South Dakota Act, the settlor may not be a trustee[404] and may only have the interests and powers described above.[405] Furthermore, the settlor has only the powers and authorities conferred by the trust instrument, and any agreement or understanding purporting to grant or permit the retention of any greater rights or authority is void.[406] Under the South Dakota Act,[407] a spendthrift clause will be deemed to be 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 the Bankruptcy Code (11 U.S.C. §541(c)(2)).

[404] S.D. Codified Laws §55-16-4, §55-16-5.

[405] S.D. Codified Laws §55-16-5, §55-16-8.

[406] S.D. Codified Laws §55-16-8.

[407] S.D. Codified Laws §55-16-2(3).

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C. Who May Defeat a South Dakota APT

1. **Introduction** —

The South Dakota Act vests South Dakota courts with jurisdiction over any action involving a South Dakota APT but specifically does not intend this to be a conclusive state jurisdiction provision.[409] No action to set aside such a trust may be brought unless the settlor's transfer of property was made with the intent to defraud that specific creditor.[410] A settlor may arrange to secure a loan with assets of a South Dakota APT.[411]

[409] S.D. Codified Laws §55-3-39.

[410] S.D. Codified Laws §55-16-9.

[411] S.D. Codified Laws §55-16-11.

2. **Creditors Who May Defeat a South Dakota APT** —

In addition to supercreditors described in I.F., above, a creditor may reach the assets of a South Dakota APT under the alter-ego theory in some circumstances.[412] The following three categories of creditors may defeat South Dakota APTs.

[412] S.D. Codified Laws §55-1-32–§55-1-33.

a. **Pre-Transfer Claims** —

If a creditor's claim arose before a transfer to the trust, the creditor must bring suit within two years after the transfer or, if later, within six months after the creditor discovered (or should have discovered) the transfer.[413] The six-month alternative is available only if:

[413] S.D. Codified Laws §55-16-10(1).

- the creditor can demonstrate that a specific claim was filed before the transfer; or
- the creditor files a specified action within two years after the transfer.[414]

[414] S.D. Codified Laws §55-16-10(1)(b).

The creditor must prove, by clear and convincing evidence, that a transfer to the trust was intended to defraud that creditor.[415] To minimize the effect of the six-month limitation, the settlor might notify known pre-transfer creditors of the trust's existence within 18 months of its creation. A person is deemed to have discovered a transfer when a public record of the transfer is made.[416] Examples of how to make a public record are provided.[417] Rules to establish the county where a transfer of personal property should be recorded are specified.[418]

[415] S.D. Codified Laws §55-16-10(3).

[416] S.D. Codified Laws §55-16-10(4).

[417] S.D. Codified Laws §55-16-10(4).

[418] S.D. Codified Laws §55-16-10(5).

b. **Post-Transfer Claims** —

If a creditor's claim arose after a transfer to the trust, the creditor must bring suit within two years after the transfer [421] and must prove, by clear and convincing evidence, that the transfer was made with actual intent to defraud that creditor.[422] Hence, as a practical matter, this exception is not available for a creditor who does not exist or is not foreseeable when a South Dakota APT is created because it will be extremely hard to prove that a settlor intended to defraud a nonexistent, unforeseen creditor. If multiple transfers are made to the same trust, then a subsequent transfer will be disregarded in determining whether a creditor's claim with respect to a prior transfer will be extinguished, as provided above; distributions to beneficiaries are deemed to come first from the latest transfer.[424]

[421] S.D. Codified Laws §55-16-10(2).

[422] S.D. Codified Laws §55-16-10(3).

[424] S.D. Codified Laws §55-16-14.

c. **Family Claims** —

A person whose claim results from an agreement or court order providing for alimony, child support, or property division may reach the assets of a South Dakota APT, but only a spouse who was married to the settlor of the trust before it was created may invoke this exception.[426] A transfer of the settlor's separate property to a South Dakota APT is exempt from the claims of a spouse to whom the settlor was married at the time of the transfer,[427] if a spouse or former spouse:

[426] S.D. Codified Laws §55-16-15(1).

[427] S.D. Codified Laws §55-16-15(2)(a).

- was provided with notice in the specified form; or
- executed a written consent to the transfer after being provided with specified information.[428]

[428] S.D. Codified Laws §55-16-15(2)(b).

The statute contains guidelines for the above notice and required language.[429] Limitations periods are set based on whether the notice is given before or after the transfer.[430] In no event may the period to commence an action to challenge a transfer under this VI.C.2.c., exceed the period set forth in VI.C.2.a. and VI.C.2.b., above.[431]

[429] S.D. Codified Laws §55-16-15(3).

[430] S.D. Codified Laws §55-16-15(4).

[431] S.D. Codified Laws §55-16-15(4).

Under UPC §2-205,[432] a surviving spouse may reach the assets of a trust, including a CRT,[433] created during marriage to the deceased spouse (but not while the deceased spouse was unmarried or was married to a prior spouse) by electing against the will. UPC §2-205 is in effect in South Dakota.[434] South Dakota law does defer to the law of a decedent's domicile to determine a surviving spouse's elective-share rights.[435] Nonetheless, a South Dakota APT may not be reached for forced heirship or legitime.[436]

[432] Amended 2010.

[433] *See* Rev. Proc. 2005-24. *See also* III.C., above.

[434] S.D. Codified Laws §29A-2-205(2)(i).

[435] S.D. Codified Laws §29A-2-202(d).

[436] S.D. Codified Laws §55-16-15(5).

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If one of the above exceptions applies, the South Dakota APT is defeated only to the extent necessary to pay that creditor's claim and related costs, including attorney's fees.[437] Thus, if a settlor is confronted by multiple creditors with the type of claim that is permitted to be pursued, each creditor must bring a separate action for avoidance.

[437] S.D. Codified Laws §55-16-16.

Unless a creditor proves that a South Dakota trustee acted in bad faith in accepting and administering the trust, that trustee may use trust assets to pay its costs of litigating the claim before satisfying the claim.[438] A trustee's mere acceptance of the trust is presumed not to be in bad faith. Similarly, a beneficiary who received a distribution before a creditor brings a successful suit to defeat a South Dakota APT may keep the distribution unless the creditor proves that he or she acted in bad faith.[439]

[438] S.D. Codified Laws §55-16-16(1).

[439] S.D. Codified Laws §55-16-16(2).

Under the South Dakota Act, the creation of a South Dakota APT will not be treated as fraudulent or otherwise contrary to law for purposes of any action against any trustee, advisor, or protector acting under a trust instrument or against any attorney or other professional advisor involved in establishing the trust.[440]

[440] S.D. Codified Laws §55-16-12–§55-16-13.

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E. Moving Trusts to South Dakota

A trustee may create a South Dakota APT either by establishing a South Dakota APT or by effectuating the transfer of a trust that satisfies the requirements of the South Dakota Act to South Dakota[441] except that the trust does not have to provide that South Dakota law governs.[442] If a trustee of an irrevocable spendthrift trust creates a South Dakota APT, the time that the trust exists before it is moved to South Dakota counts toward the two-year period for pursuing post-transfer claims against the trust.[443] Thus, it might be possible for the trustee of an existing onshore or offshore trust to create a South Dakota APT that cannot be defeated under the South Dakota Act.

[441] S.D. Codified Laws §55-16-1(8).

[442] S.D. Codified Laws §55-16-2.

[443] S.D. Codified Laws §55-16-11.

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F. Infrastructure

South Dakota has been trust-friendly since 1983, and a South Dakota practitioner reports that "[t]he growth of South Dakota's trust industry is remarkable … ."[444]

[444] Goetzinger, *A Dynamic Duo: South Dakota's Trust Laws and Business Entity Statutes*, 61 S.D. L. Rev. 339, 339 (2016).

South Dakota's liability system was ranked as the 10th best in the country in a 2019 U.S. Chamber of Commerce study.[445] Whereas the Supreme Court of South Dakota has rendered decisions in other trust contexts,[445] South Dakota courts have yet to decide cases involving South Dakota APTs.

[445] The study is available at www.instituteforlegalreform.com/states.

[445] *See e.g., Matter of Elizabeth A. Briggs Revocable Living Trust*, 898 N.W.2d 465 (S.D. 2017) (lifetime validation of trust); *In re Cleopatra Cameron Gift Trust*, 931 N.W.2d 244 (S.D. 2019) (application of Full Faith and Credit Clause); *Matter of Certification of Question of Law From United States District Court, District of South Dakota Southern Division*, 931 N.W.2d 510 (S.D. 2019) (no tort of interference with inheritance or expectancy of inheritance). *See* Terry N. Prendergast & Ashley G. Blake, *South Dakota: Legislative, Judicial, and Executive Developments*, 158 Tr. & Est. 55 (Aug. 2019).

Planners must be concerned that a court might create a judicial exception to the South Dakota Act in compelling circumstances.[445] In this regard, the Supreme Court of South Dakota recognized a common-law exception to a state-law protection in Gunn v. Gunn (1993).[445] The court held that “[a] divorce court, being a court of equity, possesses the power to impose a lien upon a homestead for purposes of spousal or child support.”[445] The author is not aware of an instance in which a state or federal court in South Dakota has been asked to create a comparable exception to the South Dakota Act.

[445] *See* Jane Massey Draper, *Enforcement of Claim for Alimony or Support, or for Attorneys’ Fees and Costs Incurred in Connection Therewith, Against Exemptions*, 52 A.L.R. 5th 221 (2011).

[445] *See Gunn v. Gunn*, 505 N.W.2d 772 (S.D. 1993).

[445] *See Gunn v. Gunn*, 505 N.W.2d 772, 775 (citations omitted).

South Dakota has a statute and case law regarding the alter-ego and nominee theories.

Hence, effective in 2007,[445] South Dakota enacted a statute that limits the availability of the alter-ego doctrine for creditors but does not prohibit it. It reads:[445]

[445] 2007 S.D. Sess. Laws 280, §10.

[445] S.D. Codified Laws §55-1-33.

> Absent clear and convincing evidence, no settlor of an irrevocable trust may be deemed to be the alter ego of a trustee. The following factors by themselves or in combination are not sufficient evidence for a court to conclude that the settlor controls a trustee or is the alter ego of a trustee:
>
> (1) Any combination of the factors listed in §55-1-32.
>
> (2) Isolated occurrences where the settlor has signed checks, made disbursements, or executed other documents related to the trust as a trustee, when in fact the settlor was not a trustee.
>
> (3) Making any requests for distributions on behalf of beneficiaries.
>
> (4) Making any requests to the trustee to hold, purchase, or sell any trust property.

A creditor that proves that the settlor is the trustee's alter ego by clear and convincing evidence therefore will be able to reach the assets of a South Dakota APT.

In *United States v. Nelson*,[445] a federal tax case, the federal government contended that a trust was the taxpayer's nominee or alter ego. Regarding the nominee theory, the South Dakota federal district court observed that:[445]

[445] *United States v. Nelson*, No. 17-40002, 2018 BL 186447, 2018 WL 2390128 (D.S.D. May 25, 2018).

[445] *United States v. Nelson*, No. 17-40002, 2018 BL 186447, 2018 WL 2390128 *5.

> Neither party cites South Dakota cases providing guidance on the nominee theory, and this Court found none. With the lack of South Dakota law regarding whether an entity holds title to property as a nominee, this Court must predict how the South Dakota Supreme Court would decide the issue.

After summarizing the typical framework for analyzing the nominee theory in federal court, the court declared "that faced with a similar situation a South Dakota court would likely apply these factors to determine whether Nelson exercises substantial control over the subject property."[445]

[445] *United States v. Nelson*, No. 17-40002, 2018 BL 186447, 2018 WL 2390128 *5. See IX.F.14., below.

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VII. Federal Income- and Transfer-Tax Consequences of Domestic APTs

A. Income Tax

1. **General** —

If the settlor of an asset protection trust ("APT") retains the option to receive discretionary income and principal distributions, the APT will be a grantor trust with respect to its ordinary income and capital gains under §677 of the Internal Revenue Code ("IRC") unless distributions to the settlor must be approved by an adverse party (e.g., a beneficiary who will receive assets that are not distributed to the settlor).[446] Consequently, a settlor who wants the trust to be a grantor trust does not have to include one of the powers that are typically provided to obtain grantor-trust treatment (e.g., a power to add charitable beneficiaries (§674(c)) or a "swap power" to reacquire trust property in a nonfiduciary capacity (§675(4)(C)).[447] If a domestic APT is designed to be a completed gift and excluded from the gross estate, grantor trust treatment might be desirable because the trust will not be diminished by federal income taxes. The tradeoff is that the settlor might be taxed on income that he or she does not actually receive. As is true in all situations of this type, the planner should make sure that the settlor is ready to assume this burden.[448]

[446] §677(a).

[447] §674(c), §675(4)(C). *See* Hood, *Around the Edges of the Swap Power, Tera Firma or Terra Incognita*, LISI Est. Plan. Newsl. #2707 (Mar. 4, 2019), www.leimbergservices.com; Redd, *Unexpected Consequences of Irrevocable Grantor Trusts*, 157 Tr. & Est. 10, 11–12 (Nov. 2018). *See also* 819 T.M., *Grantor Trusts (Section 671-679)*; Jones & Horne, *Grantor Trust Income Tax Reporting Requirements—A Primer*, 30 Prob. & Prop. 40 (Jan./Feb. 2016).

[448] *See Millstein v. Millstein*, *2018 WL 3005347* (Ohio Ct. App. June 14, 2018) (court *dismissed* grantor's petition for reimbursement of income taxes). For a summary of *Millstein*, see Redd, *Unexpected Consequences of Irrevocable Grantor Trusts*, 157 Tr. & Est. 10, 11–12 (Nov. 2018).

Practice Tip: Even though a settlor does not have to include a swap power in an APT to obtain grantor-trust status, he or she might want to include one if the APT is designed to be a completed gift and if the settlor wants to be able to exchange low-basis assets in the APT for high-basis assets still in the gross estate to get a stepped-up basis for the low-basis assets at death. The Delaware Act allows a settlor to have a swap power.[449] To prevent a creditor from asserting that an APT does not conform to the applicable statute, such a power probably should not be included unless the applicable statute contains a Delaware-like clause.

[449] Del. Code Ann. tit. 12, §3570(11)(b)(8).

2. **Tax Reimbursement—Discretionary** —

Under Delaware law, the trustee of a grantor trust now may reimburse the settlor for income taxes caused by grantor-trust treatment unless the governing instrument provides to the contrary.[450] In addition, the Alaska, Delaware, and South Dakota statutes specifically permit the settlor to include a provision in an APT that authorizes the trustee to reimburse the settlor for income taxes attributable to the trust on a discretionary basis.[451] Inclusion of a discretionary tax-reimbursement clause in an APT governed by the law of a state that does not specifically authorize the settlor to keep such a power might be inadvisable for the reason noted in VII.A.1., above. In such a state, of course, the settlor might be reimbursed for income taxes pursuant to the trustee's power to make distributions for the settlor's benefit. Nevertheless, if the settlor is reimbursed for income taxes too often, the Internal Revenue Service ("IRS") and creditors might contend that the settlor and the trustee had agreed when the trust was created that these distributions would be made. Under the Alaska, Delaware, and South Dakota statutes,[452] though, the settlor retains no rights except those expressly provided by the trust instrument.

[450] Del. Code Ann. tit. 12, §3344.

[451] Alaska Stat. §34.40.110(m)(2); Del. Code Ann. tit. 12, §3570(11)(b)(9); S.D. Codified Laws §55-16-2(2)(k).

[452] *See* Alaska Stat. §34.40.110(i); Del. Code Ann. tit. 12, §3571; S.D. Codified Laws §55-16-8.

3. **Tax Reimbursement—Mandatory** —

Many domestic APTs are designed to be grantor trusts and incomplete gifts. In such a case, it is not disadvantageous from an estate planning standpoint for the APT to pay its own income taxes. With this in mind, the Alaska, Delaware, and South Dakota statutes authorize reimbursement of income taxes on a mandatory basis.[453]

[453] Alaska Stat. §34.40.110(m)(2); Del. Code Ann. tit. 12, §3570(11)(b)(9); S.D. Codified Laws §55-16-2(2)(k).

4. **State Income-Tax Reduction** —

As discussed in VII.H., below, a domestic APT might be used to escape the income taxes of many states if the APT is structured as a nongrantor trust for federal purposes.

B. Transfer Taxes

Domestic APTs present federal gift tax, estate tax, and GST-tax implications. Many domestic APTs are structured to be incomplete gifts for federal gift tax purposes and to be includible in the settlor's gross estate for federal estate tax purposes. Nevertheless, at the end of 2012, some clients created domestic APTs that were intended to be completed gifts and excludible from the gross estate because it appeared that there would be a significant decrease in the federal transfer-tax exemptions as of January 1, 2013. In addition, clients are considering establishing domestic APTs with these attributes to lock in transfer-tax exemptions before they potentially decrease in amount in 2026 or even earlier, depending on political developments. As discussed below, the settlor of a domestic APT may prevent the creation of the trust from being a completed gift by retaining certain powers. As also discussed below, it is possible that such a trust, from which the settlor may receive distributions only on the exercise of discretion, may be structured to be a completed gift for federal gift tax purposes and to be excluded from the gross estate for federal estate tax purposes.

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C. Gift Tax

1. **Introduction** —

Rev. Rul. 2004-64 summarizes the operation of the federal gift tax as follows:[454]

[454] Rev. Rul. 2004-64.

> Section 2501 imposes a tax on the transfer of property by gift by an individual, resident or nonresident. Section 2511(a) provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.
>
> Section 2512(b) provides that the gift tax applies only to the extent that property is transferred for less than an adequate and full consideration in money or money's worth.
>
> Section 25.2511-2(b) of the Gift Tax Regulations provides that a gift is complete and subject to gift tax to the extent the donor has so parted with dominion and control as to leave in the donor no power to change the disposition of the property, whether for the benefit of the donor, or any other person.

The ruling continues:[455]

[455] Rev. Rul. 2004-64 (citations omitted).

> Section 25.2511-1(c)(1) provides that the gift tax applies with respect to any transaction in which an interest in property is gratuitously passed or conferred on another regardless of the means or device employed. Thus, the gift tax may apply if one party forgives or fails to collect on the indebtedness of another. Similarly, the gift tax applies if one person gratuitously pays the tax liability of another.

As will be seen, the settlor's retention of a nongeneral testamentary power of appointment over a domestic APT coupled with a power to veto distributions and/or a nongeneral lifetime power of appointment[456] will prevent him or her from making a completed gift[457] unless distributions actually are made.[458] If the settlor does not keep such powers, however, he or she will make a completed gift upon parting with dominion and control over the property that he or she puts in such a trust.[459]

[456] *See* 825 T.M., *Powers of Appointment—Estate, Gift, and Income Tax Considerations.*

[457] *See, e.g.*, PLR 201925005–PLR 201925010; PLR 201908008; PLR 201908003–PLR 201908007; PLR 201852009, PLR 201852014; PLR 201850001–PLR 201850006; PLR 201848002, PLR 201848009; PLR 201838002–PLR 201838007; PLR 201836006; PLR 201832005–PLR 201832009.

[458] Reg. §25.2511-2(f).

[459] Reg. §25.2511-2(b). *See* 845 T.M., *Gifts*.

2. **Relegation-of-Creditors Doctrine**

a. **Background** —

The *Second Restatement of Trusts*, the *Third Restatement of Trusts*, and the Uniform Trust Code ("UTC") recognize that a client may protect interests in an irrevocable trust that he or she creates for others ("third-party trust") from claims by the beneficiaries' creditors by subjecting such interests to a spendthrift clause[460] or by making them discretionary.[461] But, the *Restatements* and the UTC do not extend creditor protection to a settlor's retained beneficial interest in an irrevocable trust ("self-settled trust"), even if the trust contains a spendthrift clause.[462] For example, §58(2) of the *Third Restatement of Trusts* says that:[463]

[460] *Restatement (Second) of Trusts* §152, §153(1), §157 (1959), §157 cmts. a–e; *Restatement (Third) of Trusts* §58(1), §59 (2003), §58 cmt. a, §59 cmts. a(1), a(2), b–d; UTC §502–§503 (amended 2018). To view the text of the UTC and a list of the states that have enacted it, go to www.uniformlaws.org.

[461] *Restatement (Second) of Trusts* §155(1) (1959), §187, §155 cmt. b, §187 cmts. d–i; *Restatement (Third) of Trusts* §50, §60 (2003), §50 cmts. b, d, §60 cmt. e; UTC §504, §814(a) (amended 2018).

[462] *Restatement (Second) of Trusts* §156(1) (1959); *Restatement (Third) of Trusts* §58(2) (2003), cmt. e; UTC §505(a)(2) (amended 2018).

[463] *Restatement (Third) of Trusts* §58(2) (2003).

> A restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid.

Nor do those authorities give any protection to a settlor-beneficiary's interest in a self-settled discretionary trust.[464] Thus, comment f to §60 of the *Third Restatement of Trusts* provides:[465]

[464] *Restatement (Second) of Trusts* §156(2) (1959), cmt. e; *Restatement (Third) of Trusts* §60 cmt. f (2003); UTC §505(a)(2) (amended 2018).

[465] *Restatement (Third) of Trusts* §60 cmt. f (2003).

> Where the trustee of an irrevocable trust has discretionary authority to pay to the settlor or apply for the settlor's benefit as much of the income or principal as the trustee may determine appropriate, creditors of the settlor can reach the maximum amount the trustee, in the proper exercise of fiduciary discretion, could pay to or apply for the benefit of the settlor.

The 5th edition of the Scott treatise, which was published in 2007, discusses the traditional rule as follows:[466]

[466] 3 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §15.4 at 954–55 (5th ed. 2007) (footnotes omitted). *See Generally*, Shapo, Bogert & Bogert, *The Law of Trusts and Trustees* §223 (3d ed. 2007).

> The controlling policy is clear. The settlor can properly create a trust under which someone else takes a beneficial interest, and the settlor's creditors cannot reach this interest unless the creation of the trust amounted to a fraudulent conveyance. To the extent that the settlor retains a beneficial interest, however, that interest is subject to the claims of the settlor's creditors, even in the absence of fraud. It is plainly against public policy to permit the owner of property to create for his or her own benefit an interest in the property that is beyond the reach of creditors.

The IRS has taken the position that the ability of the settlor-beneficiary of a self-settled spendthrift trust to relegate trust assets to his or her creditors will prevent the making of a completed gift. The below cases and rulings are representative.

b. **Paolozzi v. Commissioner (1954)** —

In *Paolozzi v. Commissioner*,[467] the grantor created a trust, of which she was the sole beneficiary, on June 21, 1938. The trustees had absolute discretion to distribute income to her during her lifetime, with excess income to be added to principal. The court described its inquiry as follows:[468]

[467] 23 T.C. 182 (1954).

[468] 23 T.C. at 183.

> The only question presented is whether petitioner is taxable on the entire value of property transferred to her in trust, or whether she retained a life interest necessary to support a deduction therefor.

The government contended that the entire value of the assets transferred to the trust was subject to gift tax.[469] The grantor argued that she should be able to deduct the value of her income interest as follows:[470]

[469] 23 T.C. at 186.

[470] 23 T.C. at 186.

> Petitioner … argues that under the law of Massachusetts, by which the trust is governed, petitioner's creditors, both prior and subsequent, could reach the maximum amount, which, under the trust, the trustees could, in the exercise of their discretion, pay to her or apply for her benefit. Therefore, petitioner reasons that she could and can at any time realize all of the economic benefit of the income accruing to the trust during her lifetime by the simple expedient of borrowing money or otherwise becoming indebted, and then relegating the creditor to the trust income for reimbursement.

Agreeing with the grantor, the court held:[471]

[471] 23 T.C. at 187.

> It cannot be gainsaid that petitioner's creditors could at any time look to the trust of which she was settlor-beneficiary for settlement of their claims to the full extent of the income thereof. This being true, it follows that petitioner, as she points out, could at any time obtain the enjoyment and economic benefit of the full amount of the trust income. Under the circumstances, therefore, we answer the question posed in the affirmative, and

> hold that petitioner correctly returned the transfer for gift tax purposes.

c. **In re Estate of Uhl (1957)** —

In *In re Estate of Uhl*,[472] which primarily involved estate tax (see below), the decedent had created an irrevocable inter vivos Indiana trust of personal property naming an Indiana bank as trustee. The decedent retained the right to receive $100 per month from income. In addition, the trustee could invade principal for his benefit. The court held that a portion of the transfer was subject to gift tax on creation of the trust:[473]

[472] 241 F.2d 867 (7th Cir. 1957).

[473] 241 F.2d at 871.

> [T]he remainder of the corpus, over which the control of the settlor had ended, subject only to an uncontrolled discretion in the trustee, did not remain his property until his death but passed to the grantee at the time of the creation of the trust without hindrance or suspicion of any fraudulent intent.

d. **Commissioner v. Vander Weele (1958)** —

In *Commissioner v. Vander Weele*,[474] the grantor established an irrevocable inter vivos Michigan trust with stock, securities, and a contingent interest in her grandfather's trust on March 25, 1950. The trustees agreed at inception to exercise discretion to pay the grantor all trust income and as much principal as she needed for her comfort. The court observed:[475]

[474] 254 F.2d 895 (6th Cir. 1958).

[475] 254 F.2d at 898 (citations omitted).

> The transfer in trust was in reality a transfer to preserve her property against waste by her own spendthrift actions, while reserving to herself the income and to the trustees the right to encroach upon the principal for her “comfortable well-being.” Under controlling Michigan law, the donor's creditors could reach her distributable income. The trustees were granted almost unrestricted power to invade the corpus of the trust for the benefit of the settlor, with the possibility of the repayment of the entire trust fund to her. The trust conveyance in effect created no completed taxable gift to the remaindermen—the husband and children of the settlor. There was no assurance that anything of value would pass to the remaindermen. The settlor could in actuality retain the economic benefit and enjoyment of the entire trust income and corpus of the trust estate by borrowing money or by selling, assigning, or transferring her interest in the trust fund and relegating her creditors to the trust fund for payment.

The court therefore held:[476]

[476] 254 F.2d at 899.

> [T]he settlor plainly made the transfers in trust for her own “comfortable well-being” and personal financial security in such fashion that there was no actual gift taxable, as such, at the time of the transfer.

e. **Rev. Rul. 76-103** —

In Rev. Rul. 76-103, the grantor created an irrevocable inter vivos trust on September 2, 1975. The trustee had absolute discretion to distribute income and/or principal to the grantor, with undistributed income to be added to principal. On the grantor's death, any remaining principal was payable to the grantor's issue. Under the applicable state's governing law, the trust was a discretionary trust, which was subject to claims of the grantor's creditors whenever they might arise. The ruling addressed the following question:

> The question presented is whether the transfer in trust is an incomplete gift for Federal gift tax purposes because the assets of the trust are subject to the claims of creditors of the grantor.

Following *Paolozzi*, the ruling concluded:

> As long as the trustee continues to administer the trust under the law of State X, the grantor retains dominion and control over the trust property.
>
> Accordingly, in the instant case, the grantor's transfer of property to the trust does not constitute a completed gift for the Federal gift tax purposes.
>
> The ruling noted, though, that:
>
> If and when the grantor's dominion and control of the trust assets ceases, such as by the trustee's decision to move the situs of the trust to a State where the grantor's creditors cannot reach the trust assets, then the gift is complete for Federal gift tax purposes under the rules set forth in section 25.2511-2 of the regulations ….

f. **Rev. Rul. 77-378** —

In Rev. Rul. 77-378, the grantor conveyed one-half of the grantor's income-producing property to an irrevocable inter vivos trust on January 16, 1975. The trustee—a corporation—had absolute and uncontrolled discretion to distribute income and principal to the grantor. Undistributed income was to be added to principal. On the grantor's death, the trustee was to distribute the remaining principal to the grantor's spouse and children. The ruling described the applicable state law as follows:

> [U]nder the applicable state law the trustee's decision whether to distribute trust assets to the grantor is entirely voluntary. The grantor cannot require that any of the trust's assets be distributed to the grantor nor can the creditors of the grantor reach any of the trust's assets.

The ruling then described the pertinent inquiry as follows:

> The question presented is whether the grantor has parted with dominion and control of the property transferred so that the Federal gift tax is applicable to the transfer, in view of the power of the trustee to return the property to the grantor.

The ruling noted:

> 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 trust. 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.

Again, following *Paolozzi*, the ruling determined that the entire value of the assets contributed to the trust was a completed gift for the following reasons:

> In the instant case, the grantor has parted with dominion and control over the property that the grantor transferred into trust. Although the trustee has an unrestricted power to pay trust assets to the grantor, the grantor cannot require that any of the trust's assets be distributed to the grantor nor can the grantor utilize the

> assets by going into debt and relegating the grantor's creditors to the trust. Whether the grantor would enjoy any of the trust's assets is dependent entirely on the uncontrolled discretion of the trustee. Such a hope or passive expectancy does not lessen the value of the property transferred. Accordingly, the Federal gift tax is applicable to the entire value of the property transferred to the trust by the grantor.

Rev. Rul. 77-378 took the opportunity to clarify an earlier ruling—Rev. Rul. 62-13. The later ruling declared:

> Rev. Rul. 62-13 may be read to imply that broad powers given to a trustee to invade trust income and corpus for the benefit of the grantor may be sufficient to render the gift incomplete even though the grantor's interest in the trust assets is unenforceable. Therefore, Rev. Rul. 62-13 is hereby clarified to remove any implication that an entirely voluntary power held by a trustee to distribute all of the trust's assets to the grantor is sufficient to render a gift incomplete either in whole or in part.

g. **Outwin v. Commissioner (1981)** —

In *Outwin v. Commissioner*,[477] husband created four irrevocable inter vivos Massachusetts trusts on December 24, 1969, under which the trustees had absolute and uncontrolled discretion to distribute income and principal to him. On the same day, wife created an irrevocable inter vivos Massachusetts trust with comparable provisions. In each case, the other spouse had to consent to discretionary distributions. The Tax Court said: “[t]he only issue presented for decision is whether certain transfers in trust made by each petitioner during 1969 constituted taxable gifts for purposes of section 2501.”[478]

[477] 76 T.C. 153 (1981).

[478] 76 T.C. at 153–54 (footnote omitted).

The court observed:[479]

[479] 76 T.C. at 162 (citations omitted).

> Where the trust agreement specifies, as here, 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. A different result obtains, however, where State law permits creditors of the settlor-beneficiary to pierce the trusts for satisfaction of claims.

The court dismissed the significance of the spouses’ veto powers in the following way:[480]

[480] 76 T.C. at 166.

> [I]t is our opinion that the veto power bestowed upon the grantor's spouse in connection with the trusts herein is insufficient to render the *Gulda* rule inapplicable. 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 is given an interest in the trust and the right to veto discretionary distributions which might deplete that interest. It is not unreasonable to assume that, because of the marital relationship, the settlor could anticipate the complete acquiescence of his spouse in any discretionary distributions which he might receive, regardless of their effect on her interest as a remainderman. Thus, in the absence of unforeseen circumstances, such as divorce, the possibility of a spousal veto in such a situation may be at best a remote possibility. This is particularly true in the present cases, where the fact that each spouse has the right to veto distribution from the other's

> discretionary trust(s) could discourage the exercise of that authority through fear of reprisal. For these reasons, we think that the veto powers held by the petitioners do not, by themselves, place the trusts outside the scope of the *Gulda* decision.

The Tax Court held:[481]

> We hold, therefore, that creditors of the petitioners could reach the assets of their respective discretionary trusts for reimbursement under Massachusetts law, and under the holding of *Paolozzi* the petitioners have failed to surrender dominion and control over the trust assets.

h. **Estate of German v. United States (1985)** —

In Estate of German v. United States, [482] the claims court stated the issue at the outset:[483]

> The question presented is whether the decedent divested herself of her interest in property in 1969 when she transferred such property to a trust with a proviso that the trustees might, in their absolute discretion, pay any or all of the income or principal to decedent 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 trust after her death, or, whether she continued to enjoy the right to the income or principal of the trust up to the date of her death, because under Maryland law if she chose to incur any debts her creditors could still attach or levy upon the trust assets to collect them.

The court ultimately determined that the trust was not includible in the decedent's gross estate (see below), but the decedent's estate conceded that gift tax was due.[484]

i. **PLR 9332006** —

In PLR 9332006, the settlors (siblings) established an offshore APT and transferred partnership interests to the trustee. Regarding gift tax, the IRS ruled:

> [T]he Settlors will part with dominion and control over the property being transferred into the trust. Although the Trustee has an unrestricted power to pay over trust assets to the Settlors, the Settlors cannot individually or together require that any of the trust's assets be distributed to themselves. Further, assuming taxpayers' representation regarding the law of Country X is correct, neither of the Settlors can utilize assets transferred to the Trust by incurring debt and relegating the Settlor's creditors to the trust.
>
> Accordingly, based on the taxpayers' representations regarding Country X law, the transfers of interests in the Partnership to the Trust are completed gifts and the entire value of the interests in the Partnership transferred to the Trust by the Settlors is subject to the federal gift tax.

j. **PLR 9837007** —

In PLR 9837007, the donor, an Alaska resident, proposed to create an Alaska APT for the benefit of the donor and

[481] 76 T.C. at 168 (footnote omitted).

[482] 7 Cl. Ct. 641 (1985).

[483] 7 Cl. Ct. at 642.

[484] 7 Cl. Ct. at 646–47.

her descendants. The trustee had absolute discretion to distribute income and principal to the donor and her living descendants. Undistributed income would be added to principal. On the donor's death, the remaining principal would be divided into shares for her then-living descendants. The IRS ruled:

> Based on the representation that there is no express or implied agreement between the Donor and the Trustee as to how Trustee will exercise its sole and absolute discretion to pay income and principal among the beneficiaries, we conclude that the proposed transfer by Donor of property to Trustee to be held under the Trust agreement will be a completed gift for federal gift tax purposes.

k. **Rev. Rul. 2004-64** —

Rev. Rul. 2004-64 addressed the following matters:

> With respect to a trust whose grantor is treated as the owner of the trust under subpart E, part I, subchapter J, chapter 1 of the Internal Revenue Code (subpart E), what are the gift tax consequences when the grantor pays the income tax attributable to the inclusion of the trust's income in the grantor's taxable income, and what are the estate tax consequences if, pursuant to the governing instrument or applicable local law, the grantor may or must be reimbursed by the trust for that income tax?

The ruling considered a grantor trust for the grantor's descendants and addressed three situations:

- situation 1—the settlor pays income taxes attributable to the trust;

- situation 2—the trustee reimburses the grantor for income taxes attributable to the trust as required by the governing instrument;

- situation 3—the trustee reimburses the grantor for income taxes attributable to the trust pursuant to discretion conferred by the governing instrument.

Rev. Rul. 2004-64 gave the following gift tax rulings:

> In Situation 1, A's payment of the $2.5x income tax liability does not constitute a gift by A to Trust's beneficiaries for federal gift tax purposes because A, not Trust, is liable for the taxes. In contrast, in the situation presented in *Doerr v. United States*, cited above, the donor's payment was for the donee's tax liability and, as a result, the payment constituted an additional gift to the donee….
>
> In Situation 2, the governing instrument of Trust requires the trustee to reimburse A from Trust's assets for the amount of income tax A pays that is attributable to Trust's income. A's payment of the $2.5x income tax liability does not constitute a gift by A, because A is liable for the tax. The trustee's distribution of $2.5x to A as reimbursement for the income tax payment by A is not a gift by the trust beneficiaries to A, because the distribution from Trust is mandated by the terms of the trust instrument.
>
> In Situation 3, the governing instrument of Trust provides the trustee with the discretion to reimburse A from Trust's assets for the amount of income tax A pays that is attributable to Trust's income. As is the case in Situation 1 and Situation 2, A's payment of the $2.5x income tax liability does not constitute a gift by A because A is liable for the income tax. Further, the $2.5x paid to A from Trust as reimbursement for A's income tax payment was distributed pursuant to the exercise of the trustee's discretionary authority granted under the terms of the trust instrument. Accordingly, this payment is not a gift by the trust beneficiaries to A.

Thus, the ruling concluded:

> When the grantor of a trust, who is treated as the owner of the trust under subpart E, pays the income tax attributable to the inclusion of the trust's income in the grantor's taxable income, the grantor is not treated as making a gift of the amount of the tax to the trust beneficiaries.

l. **PLR 200944002** —

In PLR 200944002, an Alaska resident proposed to create an Alaska APT, which would give the trustee discretion to distribute income and principal to the grantor, the grantor's spouse, and the grantor's descendants. On the death of the survivor of the grantor and the grantor's spouse, the principal would be divided among the grantor's then-living descendants. No power of appointment would be granted. The IRS ruled:

> Grantor has retained no power to revest beneficial title or reserved any interest to name new beneficiaries or change the interests of the beneficiaries. Consequently, we conclude that Grantor's transfer of $X to trust will be a completed gift of $X.

m. **CCA 201208026** —

In CCA 201208026, the donors created an irrevocable trust and named one of their children trustee. The trustee had absolute discretion to distribute income and principal to the donors' children, other lineal descendants, spouses of lineal descendants, and charitable organizations, for specified charitable purposes. The donors retained nongeneral testamentary powers of appointment. On the death of the surviving spouse, in default of appointment, the trustee will distribute the remaining principal to the donors' children. The guidance concluded that transfers to the trust were completed gifts notwithstanding the powers of appointment for the following reasons:

> In the case at hand, when each Donor transferred property to the Trust on Date, he or she retained a testamentary limited power to appoint so much of it as would still be in the Trust at his or her death. The Trust emphasizes that the Donors do not retain any powers or rights to affect the beneficial term interests of their children, other issue, and their spouses (and charities) during the Trust term. With respect to those interests, the Donors fully divested themselves of dominion and control of the property when they transferred the property to the trust on Date. Indeed, during the period extending from the creation of the Trust until the Donors' deaths, the trustee, Child A, has sole and unquestionable discretion to distribute income and principal to the beneficial term interests. He may even terminate the Trust by distributing all of the property.
>
> Accordingly, for gift tax purposes, the Donors' transfers to the Trust constituted a completed gift of the beneficial term interests. The Donors' testamentary limited powers of appointment relate only to the Trust remainder. Their relinquishment of their testamentary powers during the Trust term would affect only the ultimate disposition of the remainder and, as such would constitute a transfer of the remainder.

3. **Exceptions to Relegation-of-Creditors Doctrine**

a. **Background** —

In many of the cases and rulings summarized in VII.B., above, the settlor's gift was incomplete because he or she kept the ability to incur debt and to relegate creditors to trust assets. Cases, including some decided by the U.S. Supreme Court, and rulings determine that a settlor's gift is complete even if he or she regains the ability to control the disposition of trust assets through the occurrence of events beyond his or her control. Those cases and rulings are summarized below.

b. **Smith v. Shaughnessy (1943)** —

In *Smith v. Shaughnessy*,[485] the grantor sought a refund of gift taxes paid. The grantor created an irrevocable New York trust and directed that the income be paid to his wife for life. On her death, the principal was to be returned to the grantor if living. If the grantor predeceased his wife, the stock was to go to such persons as she appointed by will or, in default of appointment, to her intestate successors.

[485] 318 U.S. 176 (1943).

Justice Black framed the controversy as follows:[486]

[486] *Smith v. Shaughnessy*, 318 U.S. at 178.

> Three interests are involved here: the life estate, the remainder, and the reversion. The taxpayer concedes that the life estate is subject to the gift tax. The government concedes that the right of reversion to the donor in case he outlives his wife is an interest having value which can be calculated by an actuarial device, and that it is immune from the gift tax. The controversy, then, reduces itself to the question of the taxability of the remainder.

He then summarized the positions of the parties:[487]

[487] *Smith*, 318 U.S. at 180.

> The government argues that for gift tax purposes the taxpayer has abandoned control of the remainder and that it is therefore taxable, while the taxpayer contends that no realistic value can be placed on the contingent remainder and that it therefore should not be classed as a gift.

The Court held:[488]

[488] *Smith*, 318 U.S. (footnote omitted; emphasis added).

> In cases such as this, where the grantor has neither the form nor substance of control and never will have *unless he outlives* his wife, we must conclude that he has lost all ‘economic control’ and that the gift is complete except for the value of his reversionary interest.

c. **Robinette v. Helvering (1943)** —

In *Robinette v. Helvering*,[489] a companion case to *Smith v. Shaughnessy*, a daughter created an irrevocable trust in 1936 to pay the income to herself for life. The income then was to be paid to the daughter's mother and her husband (the daughter's stepfather), if living, with remainder to the daughter's issue. At the same time, the mother created a trust to pay the income to herself and the stepfather for life. The income then was to be paid to the daughter, if living, with remainder to the daughter's issue.

[489] 318 U.S. 184 (1943).

Justice Black described the controversy in the following way:[490]

[490] *Robinette v. Helvering*, 318 U.S. at 186.

> The parties agree that the secondary life estates in the income are taxable gifts, and this tax has been paid. The issue is whether there has also been a taxable gift of the remainders of the two trusts.

Following *Smith v. Shaughnessy*, the Court held that the values of the remainder interests were subject to gift tax,[491] where her reacquisition of the power of control "depends not alone upon the possibility of survivorship but also upon the death of the daughter without issue who should reach the age of 21 years."[492]

[491] *Robinette*, 318 U.S. at 189.

[492] *Robinette*, 318 U.S. at 188.

d. **Estate of Kolb v. Commissioner (1945)** —

In *Estate of Kolb v. Commissioner*,[493] the decedent had created an irrevocable inter vivos trust for his grandchildren in 1923, which he funded in stages in subsequent years. He retained the right to designate additional grandchildren to benefit from the trust. The question was whether gifts were complete when the transfers were made or when the decedent relinquished his power to designate additional grandchildren in 1939. The Tax Court described the import of *Smith* and *Robinette* as follows:[494]

[493] 5 T.C. 588 (1945).

[494] 5 T.C. at 593 (footnote omitted).

> The holding in those cases clearly is that where the grantor has surrendered all dominion and control of the property of the trust, which control the grantor can never again exercise except upon the happening of an event beyond his control—in the present case, the birth of an additional grandchild—there had been a completed gift.

The court contrasted the rights retained in *Smith* and *Robinette*, with those in the present case as follows:[495]

[495] 5 T.C. at 595.

> The right to exercise the reserved control in each of the cited cases was equally contingent with that here. In those cases, as in this, that right depended upon the happening of an event beyond the control of the donor. It is true that the quantum of control reserved in each of the cited cases differed from that in the present case. But it was greater in the cited cases—not less. In the *Smith* case, if the contingency occurred, the trust property would then have reverted absolutely to the grantor, and in the *Robinette* case, the grantor would then have had the absolute right by will to dispose of the property of the trust. But in the present case, if the contingency happened, the donor would have had much more limited rights of control. He could merely add additional secondary life beneficiaries and remaindermen to benefit equally with those already named.

The Tax Court therefore held:[496]

[496] 5 T.C. at 597 (citations and footnote omitted).

> We therefore conclude that the several transfers of the decedent donor to the trust constituted completed gifts for gift tax purposes when the transfers occurred. It follows that no gift tax arose upon the relinquishment executed by the donor decedent on May 31, 1939.

e. **Ellis v. Commissioner (1968)** —

In *Ellis v. Commissioner*,[497] the husband created a $200,100 irrevocable trust for his wife in 1963 pursuant to their antenuptial agreement. The question was whether gift tax was due on the gift of the wife's life estate upon creation of the trust or whether the husband had retained enough control over the trust to render the gift incomplete. The Tax Court framed the issue as follows:[498]

[497] 51 T.C. 182 (1968), *aff'd*, 437 F.2d 442 (9th Cir. 1971).

[498] 51 T.C. at 186 (footnote omitted).

> The trust, settled by petitioner, provided that all corpus and accumulated income were to be distributed at Viola's death to one of two groups of individuals none of whom could be petitioner. The parties agree that the gift of the remainder interest in the trust was complete. The issue then is whether there was a completed gift to the trust of a life estate where the trustee, during the life of the petitioner, had the discretion either to accumulate the trusts' income and add it to the corpus of the trust or to distribute it to Viola for her 'care, comfort and support.'

The court summarized the parties' positions as follows:[499]

[499] 51 T.C. at 187.

> Petitioner contends the trustee's discretion was limited to an ascertainable standard of 'care, comfort or support,' thus subjecting the trustee to an enforceable duty under Arizona law. Petitioner contends that the trustee would be required to pay over to Viola the trust's income for her support when she was not adequately maintained by petitioner. Thus, as it was solely within petitioner's power to withhold support and maintenance from Viola, petitioner argues he retained the requisite dominion and control over the disposition of the trust's income to render the transfer incomplete to the extent of the first life estate created therein.
>
> Conversely, the Commissioner asserts that petitioner did not expressly reserve any power or control over the distribution of the income from the trust. The control, i.e., the ability to force the trustee to exercise his discretion and make distributions to Viola, was not the type of control qualifying as a reservation of power under section 25.2511-2(b), Gift Tax Regs.

The Tax Court found that the petitioner had not retained enough “control” over the wife's life interest to prevent the making of a completed gift. The court wrote:[500]

[500] 51 T.C. at 187–88 (footnotes omitted; emphasis added).

> [W]e do not believe that the dominion petitioner may have been able to exercise over the life estate in the trust was sufficient to cause the gift to be incomplete. Petitioner made no express reservation of a right to alter, amend, or revoke any provisions of the trust. Petitioner was not the trustee but merely might have been able to cause a situation to arise wherein the trustee might exercise his discretion in favor of Viola. In theory, this may appear to be control, but as a practical matter it would be extremely difficult for petitioner to exercise this “power.” *For petitioner to cause a situation to occur which would compel the trustee to distribute the trust's income to Viola, petitioner would have to create a major domestic crisis.* Thus, due to the undesirable consequences which would result, we believe it is extremely unlikely that petitioner would or could cut Viola off any time he so desired.
>
> Moreover, petitioner's obligation to support his wife during coverture is firmly established by Arizona law. A breach of this duty would be a violation of the Arizona Revised Statutes, sec. 13-803 (1956). Under these circumstances, petitioner should not be considered to have any control where to exercise the power it would be necessary to do any unlawful act. We find that petitioner failed to retain sufficient dominion over the trust, so as to render the gift to it incomplete.

f. **Rev. Rul. 80-255** —

In Rev. Rul. 80-255, the settlor-decedent created an irrevocable trust for his issue in 1975. The trust instrument provided that the settlor's children born or adopted after the creation of the trust were to be additional beneficiaries. Regarding the gift tax, the ruling declared:

> [A]t the time of creation of the trust, D is not treated as having reserved a power to change beneficial interests under section 25.2511-2(c) of the Gift Tax Regulations as a result of providing in the trust instrument that D's after-born or after-adopted children are to be trust beneficiaries. Therefore, D's establishment of the trust was a completed gift, because D did not retain dominion and control over the transferred property.

g. **Outwin v. Commissioner (1981)** —

In *Outwin v. Commissioner*,[501] summarized in VII.C.2.g., above, the IRS Commissioner contended that the requirement to obtain the other spouse's consent for distributions rendered the grantors' gifts complete. The Tax Court described the commissioner's argument as follows:[502]

> [H]e seeks to distinguish those cases [that permitted creditors to reach the assets of self-settled trusts in Massachusetts] on the ground that discretionary distributions from the trusts herein require the prior individual consent of the grantor's spouse, who is also a remainderman beneficiary thereof. The presence of such a veto power in an interested party, respondent contends, imposes a significant limitation on the trustees' discretion and thereby removes these cases from the general rule of *Gulda*. We disagree.

The court rejected the commissioner's contention but recognized that the result might have been different in other circumstances:[503]

> [I]n the absence of unforeseen circumstances, such as divorce, the possibility of a spousal veto in such a situation may be at best a remote possibility.

4. **Effect of Nongeneral Testamentary Power of Appointment** —

Practitioners long believed that retaining a nongeneral testamentary power of appointment would prevent a settlor from making a completed gift with respect to the income interest as well as the remainder interest in a domestic APT.[504] In CCA 201208026, however, the IRS signaled an apparent change of position on this point. Hence, the guidance opined:

In *Chanler v. Kelsey*, 205 U.S. 466 (1907), the Supreme Court considered, in part, the legal interest that is subject to a testamentary power of appointment. In that case, a grantor created a trust providing a lifetime income interest for his daughter. The trust also provided the daughter with a testamentary limited power to appoint the trust property. If she failed to exercise the power when she died, the trust property was to be distributed to designated persons. The Court held that, for New York inheritance tax purposes, the daughter's execution of her testamentary power was considered "the source of title" to the remainder. As the holder of a testamentary power of appointment, she controlled the remainder passing at her death.

Though it predates the enactment of the gift tax, the *Chanler* opinion supports the proposition that a testamentary

[501] 76 T.C. 153 (1981).

[502] 76 T.C. at 166.

[503] 76 T.C. at 166.

[504] *See* PLR 200731019, PLR 200729025, PLR 200715005, PLR 200647001, PLR 200637025, PLR 200612002, PLR 200502014, PLR 200247013, PLR 200148028.

> power of appointment relates to the remainder of a trust, not the preceding beneficial term interests. The testamentary power does not (and cannot) affect the trust beneficiaries' rights and interests in the property during the trust term. Rather, a trustee with complete discretion to distribute income and principal to the term beneficiaries may, in exercising his discretion, distribute some of all of the trust property during the trust term. The holder of a testamentary power has no authority to control or alter these distributions because his power relates only to the remainder, i.e., the property that will still be in the trust when the beneficial term interests are terminated.

It continued:

> Consistent with *Chanler v. Kelsey*, the Service has maintained in litigation that a power holder's testamentary limited power of appointment relates only to the remainder of the respective trust.

5. **Impact of §2702**

a. **Background** —

Section 2702 took effect on November 5, 1990,[505] and its regulations are generally effective as of January 28, 1992.[506] Let's consider whether §2702 applies to a typical domestic APT in which the settlor establishes an APT with an independent trustee who is given broad discretion to use income and principal for the settlor, the settlor's spouse, and the settlor's issue.

[505] Pub. L. No. 101-508, Title XI, §11602(a) (Nov. 5, 1990). See 836 T.M., *Partial Interests—GRATs, GRUTs, QPRTs (Section 2702)*.

[506] Reg. §25.2702-7.

b. **Scope of §2702** —

Section 2702 contains gift tax rules if a transferor makes a transfer of an interest in trust to or for a member of the transferor's family and the transferor or any applicable family member retains an interest in such trust.[507] A member of the transferor's family is:

[507] *See* Reg. §25.2702-1(a).

(1) the transferor's spouse;

(2) an ancestor or lineal descendant of the transferor or his or her spouse;

(3) a brother or sister of the transferor;

(4) a spouse of an individual described in (2) or (3).[508]

[508] §2702(e), §2704(c)(2). *See* Reg. §25.2702-2(a)(1).

An applicable family member is:

(1) the transferor's spouse;

(2) an ancestor of the transferor or the transferor's spouse; and

(3) the spouse of any such ancestor.[509]

[509] §2702(a)(1), §2701(e)(2).

Section 2702 is implicated in our scenario because the transferor has retained a discretionary interest in a trust for the transferor, his or her spouse and his or her issue.

c. **Implications** —

Under §2702, the value of a retained interest which is not a qualified interest is treated as zero.[510] The transferor's retained interest is not a "qualified interest" because it's not a qualified annuity interest, a qualified unitrust interest, or a qualified remainder interest in a trust whose other interests are annuity or unitrust interests.[511]

[510] §2702(a)(2)(A). *See* Reg. §25.2702-2(b)(1).

[511] §2702(b). *See* Reg. §25.2702-1(b), §25.2702-2(a)(6)–§25.2702-2(a)(9), §25.2702-3.

d. **Exceptions to §2702** —

For present purposes, two exceptions to §2702 are pertinent. First, §2702 does not come into play if the transfer in trust is an incomplete gift.[512] Admittedly, this exception seems to beg the question.

[512] §2702(a)(3). *See* Reg. §25.2702-1(c)(1).

Second, a regulation offers an exception for:[513]

[513] Reg. §25.2702-1(c)(6).

> The assignment of a remainder interest if the only retained interest of the transferor or an applicable family member is as the permissible recipient of distributions of income in the sole discretion of an independent trustee (as defined in section 674(c)).

This suggests that the creation of the discretionary interest was a completed gift at the beginning.

e. **Comment** —

Some uncertainty exists regarding the applicability of §2702 to self-settled spendthrift trusts. Thus, commentators have written:[514]

[514] 836 T.M., *Partial Interests—GRATs, GRUTs, QPRTs (Section 2702)* at A-9–A-10 (footnote omitted).

> Although it is not certain, the Regs. §25.2702-1(c)(6) exception may undermine the purpose of §2702. It is the IRS's position—and, it appears, at least the position of some courts—that if an income interest in a trust may be attached by the grantor's creditors, the gift of the income interest is not complete. Hence, if a property owner creates a trust in which the income interest is attachable by the grantor's creditors, because, for example, the grantor is eligible to receive distributions of income in the discretion of an independent trustee, the gift of the income interest will be regarded as incomplete and, under this regulatory exception, will not be valued at zero. Thus, the remainder should be valued only at its "normal" actuarial value.

f. **Guidance**

(1) **Background** —

The IRS has issued some guidance on the application of §2702.

(2) **PLR 9141027** —

In PLR 9141027, the husband created a trust for his wife. The ruling concluded that §2702 was inapplicable:

> Because any transfer of property to the Spousal Trust that A makes will constitute a completed gift for gift tax purposes, and because B will not have held an interest in the transferred property, *both* before and after the transfer, section 2702 will not apply to the transfer.

(3) **Rev. Rul. 2004-64** —

In Rev. Rul. 2004-64, summarized in VII.C.2.k., above, the IRS ruled that the ability of a settlor to be reimbursed for income taxes attributable to a grantor trust would not prevent the creation of the trust from being a completed gift. Although the ruling did not address the point, §2702 would not apply because that interest would not cause any portion of a transfer to be treated as an incomplete gift.[515]

[515] Reg. §25.2702-2(a)(3), §25.2702-2(a)(4).

(4) **CCA 201208026** —

In CCA 201208026, summarized in VII.C.2.m., above, the donors created a trust for their descendants but retained nongeneral testamentary powers of appointment. Although an opinion on §2702 had not been requested, the pronouncement provided the following guidance:

> It is our belief that §2702 applies in valuing the gifts in this case. Section 2702 provides special valuation rules with respect to transfers of interests in trusts. Generally, under §2702(a)(2), the value of any retained interest which is not a qualified interest shall be treated as being zero. Section 25.2702-2(a)(4) provides that an interest in trust includes a power with respect to a trust if the existence of the power would cause any portion of a transfer to be treated as an incomplete gift. Accordingly, under §25.2702-2(a)(4), the Donors' retained testamentary powers are interests, and the value of their retained interests is zero. Therefore, the value of the Donors' gift is the full value of the transferred property.

6. **Structuring a Domestic APT to Be an Incomplete Gift** —

For federal gift tax purposes, an individual makes a completed gift when he or she parts with dominion and control over trust property.[516] The common-law rule against self-settled spendthrift trusts prevented taxpayers from making taxable gifts because they could incur debt and relegate creditors to trust assets. The domestic APT statutes are intended to change this result.

[516] Reg. §25.2511-2(b).

Early private letter rulings involving domestic APTs concluded that the settlor's retention of a nongeneral testamentary power of appointment was sufficient, by itself, to prevent the making of a completed gift.[517] More recently, however, the IRS announced a change of position.[518] It now requires that the settlor be able to prevent the making of gifts from the trust during lifetime. Thus, in many recent rulings,[519] the IRS has said that a settlor will not make a completed gift to a self-settled spendthrift trust if he or she keeps a nongeneral lifetime power of appointment and/or a power to prevent trustees, advisers, or protectors from making distributions to other beneficiaries as well as a nongeneral testamentary power of appointment.[520]

[517] *See* PLR 200731019, PLR 200729025, PLR 200715005, PLR 200647001, PLR 200637025, PLR 200612002, PLR 200502014, PLR 200247013, PLR 200148028.

[518] *See* CCA 201208026. *See also* Zeydel, When is a Gift to a Trust Complete—Did CCA 201208026 Get it Right? 117 J. Tax'n 142 (Sept. 2012); Covey & Hastings, Powers of Withdrawal; Gift Tax Annual Exclusion; Taxable Gifts; IRC Sec. 2702, Prac. Drafting at 10,770, 10,773–76 (Apr. 2012).

[519] *See, e.g.*, PLR 201925005–PLR 201925010; PLR 201908008; PLR 201908003–PLR 201908007; PLR 201852009, PLR 201852014; PLR 201850001–PLR 201850006; PLR 201848002, PLR 201848009; PLR 201838002–PLR 201838007; PLR 201836006; PLR 201832005–PLR 201832009.

[520] *See* Gideon Rothschild & Daniel S. Rubin*, Minimize Creditor Challenges to Self-Settled Spendthrift Trusts*, 157 Tr. & Est. 14, 16 n.12 (Nov. 2018).

Several of the early rulings in the second round of guidance were issued under Nevada law because, for a time, it was the only state that permitted a settlor to keep a nongeneral inter vivos power of appointment.[521] The same structure currently is available in Alaska, Delaware, and South Dakota which now permit settlors to have such a power.[522]

[521] Nev. Rev. Stat. §166.040(2)(b).

[522] Alaska Stat. §34.40.110(b)(2); Del. Code Ann. tit. 12, §3570(11)(b)(2); S.D. Codified Laws §55-16-2(2)(b).

7. **Structuring a Domestic APT to Be a Completed Gift** —

As described in VII.C.2.l., above, the IRS ruled in 2009 that the transfer of assets by an Alaska resident to an Alaska APT was a completed gift.[523] Alaska, Delaware, Nevada, and South Dakota do allow the assets of APTs to be reached by creditors in certain circumstances. Although some commentators have opined that Nevada has no exception creditors,[524] Nevada permits the assets of APTs to be accessed not only to pay fraudulent transfer claims but also if "the transfer violates a legal obligation owed to the creditor under a contract or a valid court order that is legally enforceable by that creditor."[525]

[523] PLR 200944002.

[524] *See* Gideon Rothschild et al., *IRS Rules Self-Settled Alaska Trust Will Not Be in Grantor's Estate*, 37 Est. Plan. 3, 12 (Jan. 2010).

[525] Nev. Rev. Stat. §166.170(3).

The author of the Chief Counsel Advice memorandum summarized in VII.C.2.m., and VII.C.5.f.(4), above, observed that:[526]

[526] CCA 201208026.

> The Supreme Court considered various situations in which a trust instrument purported to divest the respective grantor of all dominion and control over property to the extent that the property could not be returned to the grantor except by reason of contingencies beyond his control. In these cases, the Court noted that the respective grantor lost all economic control upon making the transfer, which he would not regain unless certain contingencies occurred. The Court concluded that the respective gifts were complete ….

To support the above proposition, the writer of that guidance cited the two U.S. Supreme Court cases and the Tax Court case described in VII.C.3.b.–d., above.[527] The foregoing authorities indicate that completed-gift treatment should be available in all of these states.[528]

[527] *See Smith v. Shaughnessy*, 318 U.S. 176, 181 (1943) ("grantor has neither the form nor substance of control and never will have unless he outlives his wife"); *Robinette v. Helvering*, 318 U.S. 184, 187 (1943) (property "could not be returned to them except because of contingencies beyond their control"—whether daughter had children); *Estate of Kolb v. Commissioner*, 5 T.C. 588, 596 (T.C. 1945) ("the donor decedent had no power to modify the trust in any way and never could have except upon the happening of an event beyond his control"—birth of more grandchildren).

[528] *See United States v. Byrum*, 408 U.S. 125, 150 (1972); *Ellis v. Commissioner*, 51 T.C. 182, 187–188 (1968), *aff'd*, 437 F.2d 442 (9th Cir. 1971); *Estate of Tully*, 528 F.2d 1401 (Cl. Ct. 1976); TAM 8819001; PLR 9141027.

In 2011, the author's organization—Wilmington Trust Company—engaged counsel to attempt to obtain a Delaware private letter ruling comparable to the Alaska ruling. Late in the year, counsel learned that the IRS was not willing to do so. According to counsel, the IRS's unwillingness to rule was not attributable to Delaware's family or other exceptions. Rather, the IRS was troubled by the 2011 *In re Mortensen* bankruptcy case in Alaska.[529] An IRS representative said that the Alaska ruling probably would not have been issued post-*Mortensen* and that the IRS since had declined other Alaska ruling requests.

[529] No. A09-00565, 2011 BL 387653, *2011 WL 5025288* (Bankr. D. Alaska Jan. 14, 2011); *In re Mortensen*, Adv. No. A09-90036, 2011 BL 180087, *2011 WL 5025252* (Bankr. D. Alaska July 8, 2011); *In re Mortensen*, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011).

8. **Report Gift** —

A settlor who creates a domestic APT that is designed to be a completed gift and excludible from the gross estate should report the transfer on a timely gift tax return. Adequate disclosure of the transfer will commence the running of the period of limitations for assessment of gift tax even if the transfer is ultimately determined to be an incomplete gift. Once the period of assessment expires, the transfer will be subject to inclusion in the settlor's gross estate only to the extent that a completed gift would be so included.[530]

[530] Reg. §301.6501(c)-1(f)(5). *See* FAA 20172801F (disclosure was adequate), FAA 20152201F (disclosure was inadequate). *See also* Kevin E. Packman, *Windfall From Abroad Brings Home IRS Compliance Issues*, 43 Est. Plan. 3 (May 2016); Scott A. Bieber & Sarah J. Chang, *Filing Form 709—Beyond the Basics of Gift Tax Returns*, 43 Est. Plan. 3, 4–6 (Apr. 2016).

Practice Tip: The author is aware of instances in which a settlor reported the creation of a Delaware APT as a completed gift, the settlor then died, and the IRS did not seek to include the trust in the gross estate before issuing its closing letter.

Estates, Gifts and Trusts Portfolios
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Detailed Analysis
VII. Federal Income- and Transfer-Tax Consequences of Domestic APTs

D. Estate Tax

1. **Background** —

To determine whether a domestic APT is includible in the settlor's gross estate for federal estate tax purposes, the planner must consider §2033, §2036(a)(1), §2036(a)(2), §2037, §2038(a)(1), §2041, and §2042(2). Estate tax inclusion can be triggered under any of these sections.

a. **Section 2033** —

The domestic APT will be includible in the gross estate if the settlor has an interest at death within the meaning of §2033.

b. **Section 2036(a)(1)** —

A trust will be included in the settlor's gross estate if, at death, the settlor has "the possession or enjoyment of, or the right to the income from, the property" within the meaning of §2036(a)(1).[531] If the settlor of a domestic APT retains the right to receive current income distributions (not all domestic APT statutes permit this), then the trust will be included in the settlor's gross estate under this section. If the settlor of a domestic APT may receive distributions only upon the exercise of absolute discretion, however, the issue is whether or not this trust provision is enough, by itself, to cause estate tax inclusion. Cases and rulings support the view that it is not.[532]

[531] *See* 877 T.M., *Retained Beneficial Interests (Sections 2036(a)(1) and 2037). See also* Levy, *Section 2036 of the Internal Revenue Code: A Practitioner's Guide*, 51 Real Prop., Tr. & Est. L.J. 75 (Spr. 2016).

[532] *See* David G. Shaftel, *IRS Letter Ruling Approves Estate Tax Planning Using Domestic Asset Protection Trusts*, 112 J. Tax'n 213 (Apr. 2010); Covey & Hastings, *IRC Sec. 2036(a)(1); Grantor as Beneficiary of Discretionary or Ascertainable Standard Trust*, Prac. Drafting at 9953–9958 (Jan. 2010); Gideon Rothschild, et al., *IRS Rules Self-Settled Alaska Trust Will Not Be in Grantor's Estate*, 37 Est. Plan. 3 (Jan. 2010).

Shortly after the Alaska Act became law in 1997, commentators described its transfer-tax implications in the following way: "If the grantor's retained interest is discretionary, his creditors cannot reach the trust property, except as provided in the statute. Thus, under existing estate tax authority, the trust property would not be includible in the grantor's gross estate."[533]

[533] Covey & Hastings, *Discretionary Trust With Grantor as Beneficiary; Ability of Creditors of Grantor to Reach Trust Property; Alaska Law*, Prac. Drafting at 4889, 4891 (July 1997).

Another authority comments on the same issue as follows:[534]

[534] This example is from 877 T.M., *Retained Beneficial Interests (Sections 2036(a)(1) and 2037)*, A-12 (footnote omitted).

Example: X transfers property irrevocably in trust, naming as trustee a person other than X, with income, during X's lifetime, to be paid to X or accumulated in the trustee's discretion, then remainder to C. From the date of the lifetime transfer up to the date of X's death, X has received various irregular amounts equal to 40% of the income from the trust over that time period. The general rule in such a case, with exceptions described below, is that nothing is includible in X's gross estate under §2036(a)(1), not even 40% of the corpus. Any income actually received from the trustee will augment X's potential §2033 gross estate (to the extent not consumed before death).

In discussing this issue, other commentators conclude that "[i]f some meaning is to be accorded the word 'retained,' some showing of an arrangement, more than the fact that income was paid to the decedent, should be required."[535] An interest or right is treated as having been retained or reserved if, at the time of the transfer, an express or implied understanding existed that distributions would be made[536] and, if a pattern of distributions can be established, it is likely that an arrangement will be inferred.[537] Put differently, an objectively observable pattern or set of transactions can support an inferential finding that an understanding existed. As noted in VII.A.2., above, some domestic APT laws expressly provide that such an understanding is invalid.[538]

[535] Stephens et al., *Federal Estate and Gift Taxation* ¶4.08[4][c] at 4-154 (8th ed. 2002).

[536] Reg. §20.2036-1(a), §20.2036-1(c)(1)(i). *See also* Reg. §20.2036-1(b)(3).

[537] *See Estate of Skinner v. United States*, 316 F.2d 517 (3d Cir. 1963); *Estate of Green v. Commissioner*, 64 T.C. 1049, 1058–1064 (1975).

[538] *See* Alaska Stat. §34.40.110(i); Del. Code Ann. tit. 12, §3571; S.D. Codified Laws §55-16-8.

c. **Section 2036(a)(2)** —

A trust will be included in the settlor's gross estate if, at death, the settlor has "the right … to designate the persons who shall possess or enjoy the property or the income therefrom" within the meaning of §2036(a)(2).[539] The issue under this section is whether or not the settlor has retained too much power to enable others, including creditors, to reach trust assets.

[539] See 876 T.M., *Retained Powers (Sections 2036(a)(2) and 2038).*

d. **Section 2037** —

The domestic APT will be includible in the gross estate if the settlor has a reversionary interest within the meaning of §2037.

e. **Section 2038(a)(1)** —

A trust will be included in the settlor's gross estate under §2038(a)(1) if, at death, the settlor has a power to alter, amend, revoke, or terminate the trust.[540] Whether or not §2038(a)(1) prevents estate tax exclusion depends on whether or not the settlor retains enough power to enable creditors to reach trust assets so as to fall within §2038(a)(1)'s scope.

[540] 876 T.M., *Retained Powers (Sections 2036(a)(2) and 2038).*

f. **Section 2041** —

The domestic APT will be includible in the gross estate if the settlor holds a general power of appointment at death within the meaning of §2041.

g. **Section 2042(2)** —

The domestic APT will be includible in the gross estate if the settlor has an incident of ownership within the meaning of §2042(2).

2. **Relegation-of-Creditors Doctrine**

a. **Background** —

As in the gift tax context, a domestic APT will be includible in the gross estate if the settlor retains the ability to incur debt and to relegate creditors to trust assets.

b. **In re Estate of Uhl (1957)** —

In *In re Estate of Uhl*,[541] summarized in VII.C.2.c., above, the Seventh Circuit concluded:[542]

[541] 241 F.2d 867 (7th Cir. 1957).

[542] 241 F.2d at 871–872.

> Here, that part of the estate the income from which the settlor did not enjoy was not held for his use. Therefore, it was not within the statute of Indiana. The Indiana case had to do with a trust where the enjoyment of all the trust property was retained in the settlor. In the present case that part of the estate other than the part necessary to produce the $100.00 a month income was not put in trust for the benefit, use or enjoyment of the settlor. He parted with dominion over it forever. Even granting that, under the Indiana authorities, that part of the estate which produced his $100.00 a month might have been reached by his creditors, the statute itself does not apply, under its express terms, to property or the income therefrom over which the settlor retained no dominion and no control. All that part of the corpus of the estate was, after the creation of the trust, the property of the beneficiaries, subject only to an uncontrolled discretion in the trustee to divert to the settlor something the settlor could not have compelled the trustee to give him. Consequently, on the face of the record, the Indiana Statute has no application. It should be observed also that, in Indiana, in order to avoid a transfer, fraud must be proved as a fact. Here there is not the slightest inference to be drawn from the record that any part of the corpus of the estate was conveyed for the purpose of defeating creditors.
>
> We conclude that the Commissioner properly levied a deficiency estate tax for that part of the corpus necessary to produce the $100.00 a month. But the remainder of the corpus, over which the control of the settlor had ended, subject only to an uncontrolled discretion in the trustee, did not remain his property until his death but passed to the grantee at the time of the creation of the trust without hindrance or suspicion of any fraudulent intent.

c. **Rev. Rul. 76-103** —

In Rev. Rul. 76-103, summarized in VII.C.2.e., above, the IRS concluded:

> [I]f 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, for Federal estate tax purposes, under section 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.

d. **Outwin v. Commissioner (1981)** —

In *Outwin v. Commissioner*,[543] summarized in VII.C.2.g., and VII.C.3.g., above, the Tax Court declared:[544]

[543] *Outwin v. Commissioner*, 76 T.C. 153 (1981)

[544] *Outwin v. Commissioner*, 76 T.C. 153, 168 n.5 (citations omitted).

> Although the transfers in trust in these cases are not subject to gift tax, the settlor's ability to secure the economic benefit of the trust assets by borrowing and relegating creditors to those assets for repayment may well trigger inclusion of the property in the settlor's gross estate under secs. 2036(a)(1) or 2038(a)(1).

3. **Retained Powers Not Resulting in Estate Tax Inclusion**

a. **Background** —

A domestic APT might be susceptible to the claims of certain creditors without causing estate tax inclusion.

b. **United States v. Byrum (1972)** —

In *United States v. Byrum*,[545] the decedent created an irrevocable trust for his issue in 1958 and appointed an independent trustee. He retained the following powers:[546]

[545] *United States v. Byrum*, 408 U.S. 125 (1972).

[546] *United States v. Byrum*, 408 U.S. 125, 127.

> (i) to vote the shares of unlisted stock held in the trust estate; (ii) to disapprove the sale or transfer of any trust assets, including the shares transferred to the trust; (iii) to approve investments and reinvestments; and (iv) to remove the trustee and designate another corporate Trustee to serve as successor.

The Court held that he had not kept enough control to cause inclusion in the gross estate under §2036(a)(1) or §2036(a)(2), saying:[547]

[547] *United States v. Byrum*, 408 U.S. 125, 149–150 (footnotes, citation, and internal quotation marks omitted).

> Even if Byrum had transferred a majority of the stock, but had retained voting control, he would not have retained substantial present economic benefit. The Government points to the retention of two benefits. The first of these, the power to liquidate or merge, is not a present benefit; rather, it is a speculative and contingent benefit which may or may not be realized. Nor is the probability of continued employment and compensation the substantial enjoyment of the transferred property within the meaning of the statute. The dominant stockholder in a closely held corporation, if he is active and productive, is likely to hold a senior position and to enjoy the advantage of a significant voice in his own compensation. These are inevitable facts of the free-enterprise system, but the influence and capability of a controlling stockholder to favor himself are not without constraints. Where there are minority stockholders, as in this case, directors may be held accountable if their employment, compensation, and retention of officers violate their duty to act reasonably in the best interest of the corporation and all of its stockholders. Moreover, this duty is policed, albeit indirectly, by the Internal Revenue Service, which disallows the deduction of unreasonable compensation paid to a corporate executive as a business expense. We conclude that Byrum's retention of voting control was not the retention of the enjoyment of the transferred property within the meaning of the statute.

Following *Byrum*, §2036 was amended to provide for gross estate inclusion for a decedent who retained 20% voting control.[548]

[548] *See* §2036(b).

c. **Estate of Tully (1976)** —

In *Estate of Tully*,[549] the IRS sought to include a decedent's death benefit plan benefits in his gross estate under §2038(a)(1) and §2033 by reason of his ability to change the disposition of the benefits by divorce. The court discussed this issue as follows:[550]

[549] 528 F.2d 1401 (Ct. C1. 1976).

[550] 528 F.2d at 1406 (footnotes, citations, and internal quotation marks omitted).

> Tully did not retain a section 2038(a)(1) power to revoke or terminate the transfer to his wife by virtue of the possibility that he could have divorced her. The contract called for T & D to make the death benefit payments to Tully's widow. It might be argued that Tully could have divorced his wife to terminate her interest in the death benefits, but again such an argument ignores practicalities, reduces the term power to the speculative realm, and is not in accord with prior cases. In reality, a man might divorce his wife, but to assume that he would fight through an entire divorce process merely to alter employee death benefits approaches the absurd. Further, in various cases, death benefits payable to the widow or wife were not thereby held includable in the gross estate. The possibility of divorce in the instant situation is so de minimis and so speculative rather than demonstrative, real, apparent and evident that it cannot rise to the level of a section 2038(a)(1) power. Thus the use of widow in the death benefit contract did not give Tully a real power to revoke or terminate the death benefit transfer to his wife.

The court therefor held:[551]

[551] 528 F.2d at 1406–07 (internal quotation marks omitted).

> If controls over property cannot rise to the dignity of 2038(a)(1) powers they equally cannot create section 2033 interests. In the instant case, having failed to establish that corporate stock ownership, pegging the benefits to Tully's salary and naming the widow as beneficiary created section 2038(a)(1) powers. Defendant equally fails to demonstrate that the same facts create section 2033 interests.

d. **PLR 8037116** —

In PLR 8037116, the IRS sought to include a grantor trust that a nonresident alien created for his mother's issue (including himself) under §2036(a)(2) and §2037. The ruling rejected inclusion under §2036(a)(2) as follows:

> Section 2036(a)(2) requires inclusion where the decedent retained the right to designate beneficiaries of property transferred. In this case, the decedent gave the trustee sole discretion to distribute principal and income to the beneficiaries designated in Paragraph First of the trust agreement. Paragraph Fifth provides the decedent with the right to settle accounts and 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. We conclude that this power is not the same as giving the decedent the right to designate beneficiaries but is a more limited power retained by the decedent for purposes of administrative convenience. Thus, the trust property is not includible under section 2036(a)(2) of the Code.

Similarly, the ruling found no inclusion under §2037:

> With respect to section 2037 of the Code, all beneficiaries (including the decedent) were eligible to possess or enjoy principal and income from the trust during the decedent's lifetime, at the trustee's discretion. This provision falls outside the language of section 2037(a)(1) where a beneficiary could assume ownership of trust property only by surviving the decedent. Furthermore, we conclude that the decedent did not retain a reversionary interest subject to the decedent's power of disposition, or to benefit himself or his estate, since Paragraph First of the trust agreement provides an irrevocable distribution of property to the trustee during the decedent's life, upon death to others, and any benefits that the decedent could have received would have been at the sole discretion of the trustee. These provisions are not enough to constitute a reversionary interest in the decedent. Consequently, the value of the trust property is not includible in the gross estate under section

> 2037(a) or (b) of the Code.

e. **Rev. Rul. 80-255** —

In Rev. Rul. 80-255, summarized in VII.C.3.f., above, the decedent had kept the ability to designate after-born and after-adopted grandchildren to benefit from trust assets. The ruling rejected inclusion under §2036(a)(2) and §2038(a)(1) in the following manner:

> D did not retain a power to change the beneficial interests of the trust, for purposes of sections 2036(a)(2) and 2038(a)(1) of the Code, notwithstanding that all of D's after-born and after-adopted children were to become beneficiaries. Therefore, the trust property is not includible in D's gross estate.

f. **Estate of Wells v. Commissioner (1981)** —

Estate of Wells v. Commissioner [552] was an estate tax case only, the lifetime gift tax exemption having been applied. The IRS contended that the decedent and the trustee had agreed that the decedent would receive distributions when requested so as to cause inclusion in the gross estate under §2036(a)(1).[553] The Tax Court rejected the IRS's argument as follows:

> [P]etitioner has sustained his burden of proving that decedent transferred the property to the trust absolutely, unequivocally, irrevocably, and without possible reservations and that she did not receive the trust income pursuant to an agreement entered into contemporaneously with the transfer of the property to the trust. Respondent's various contentions must fail, since the mere receipt of trust income is not enough to trigger section 2036(a)(1) and the record is devoid of any other factual support for his position.

g. **Estate of German v. United States (1985)** —

In *Estate of German v. United States*,[554] summarized in VII.C.2.h., above, the IRS sought estate inclusion of the decedent's self-settled discretionary trust under §2036 and §2038. The Claims Court found no inclusion, declaring: [555]

> [D]efendant has not established that under Maryland law creditors of the settlor could have reached the trust income or principal of her discretionary trusts up to the time of her death.

h. **Estate of Paxton v. Commissioner (1986)** —

In *Estate of Paxton v. Commissioner*,[556] the Tax Court described the trust arrangement in the following way:[557]

> As we read the PFO and IDT declarations of trust and related instruments, they created discretionary trusts subject to certain retained interests discussed below. Decedent and Grace Paxton transferred property to the trustees of PFO and IDT, respectively, and the trustees accepted the property as trust assets for which they

[552] T.C. Memo 1981-574.

[553] *See* Leslie M. Levy, *Section 2036 of the Internal Revenue Code: A Practitioner's Guide*, 51 Real Prop., Tr. & Est. L.J. 75, 80–86 (Spr. 2016).

[554] 7 Cl. Ct. 641 (1985).

[555] 7 Cl. Ct. 641, 645.

[556] 86 T.C. 785 (1986).

[557] 86 T.C. 785, 804 (footnotes and internal quotation marks omitted).

> assumed fiduciary responsibilities. As consideration for the transfers, decedent and Grace Paxton, and others who transferred Kwik Lok stock to the trusts, received beneficial interests in the trusts evidenced by certificates of interest. The trust declarations expressly provide that the certificates of interest evidence the equitable interest contributing to the Trust Estate. The PFO trustees, as explained by the Yakima County Superior Court, were given discretion to distribute both income and corpus to the certificate holders and the distributions were not required to be proportionate to the holdings of such certificates. In our view, the certificate holders, including decedent, were, thus, the beneficiaries of the trusts.

No gift tax return was filed in connection with the establishment of the trust.[558] The Tax Court held that the trust was includible in the gross estate because the settlor and the trustees had an agreement regarding distributions:[559]

[558] 86 T.C. at 809.

[559] 86 T.C. at 813–814 (footnote omitted).

> Based on all of the foregoing circumstances, we think it was understood between decedent and his son, Jerre, at or before the execution of the PFO and IDT trusts, that decedent would receive distributions of income or corpus or both upon demand or at the expiration of decedent's patent licensing agreement. Given the agreement of the parties that the certificates of interest that he received had no fair market value, we can find no other explanation for Mr. Paxton's statement that he received something of value equal to the value of the property he transferred to the trusts. Accordingly, we hold that decedent retained for his life possession or enjoyment of the property he transferred to the trusts; and, therefore, the value of the property transferred to the PFO and IDT trusts is includable in his gross estate under section 2036(a)(1).

The court also found inclusion under the creditor-relegation theory of §2036(a)(1):[560]

[560] 86 T.C. at 814 (citation omitted).

> As settlor-beneficiary, decedent retained the economic benefit and enjoyment of the entire trust income and corpus because he could borrow money or otherwise incur indebtedness and relegate his creditors to the trust for payment. Retention of the right to use the trust as a form of security for his indebtedness in this manner left Mr. Paxton with a significant interest in the property. In our opinion, that is sufficient to require his transfers to the trusts to be included in his gross estate under section 2036(a)(1).

i. **TAM 8819001** —

TAM 8819001 considered whether the ability to divorce a spouse was an incident of ownership under §2042(2) that would cause an insurance policy held by a trustee to be included in the gross estate. The guidance indicated that it would not as follows:

> We believe the *Estate of Tully* and Rev. Rul. 80-255 are more closely analogous to the situation here than is *Estate of Thacher v. Commissioner*. The act of divorcing one's spouse is an act of independent significance, the incidental and collateral consequences of which is to terminate the spouse's interest in the trust. Thus, we do not believe the decedent possessed an “incident of ownership” in the insurance policy as a result of the trust provision which would terminate the interest of the decedent's spouse in the event of a divorce.

The advice therefore concluded:

> The value of the life insurance policy is not includible in the decedent's gross estate under section 2042 of the Code, because the trust provision terminating the decedent's spouse's interest in the trust in the event of a divorce is not an “incident of ownership.”

j. **PLR 9141027** —

PLR 9141027 involved §2041. The ruling describes the controversy and its conclusion as follows:

> Under the Spousal Trust, B has a power to terminate the trust and receive all of the trust assets if A and B divorce or are legally separated. Assuming A and B are not divorced or legally separated when B dies, B's termination power will not constitute a general power of appointment in the existence of decedent's death that would cause the value of the Spousal Trust to be included in B's gross estate. A power that is exercisable only in the event of divorce or legal separation constitutes an act of independent significance.

k. **PLR 9332006** —

In PLR 9332006, summarized in VII.C.2.i., above, the IRS found no reason to include the offshore APT in question in the gross estate under §2033, §2036, §2037, or §2038.

l. **PLR 9837007** —

In PLR 9837007, the first Alaska APT ruling mentioned in VII.C.2.j., above, the IRS declined to opine on the estate tax implications of the arrangement as follows:

> 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.

m. **Rev. Rul. 2004-64** —

Rev. Rul. 2004-64, the gift tax issues of which were discussed in VII.C.2.k., above, also had estate tax implications. Regarding Situation 1, under which the grantor pays income taxes attributable to a grantor trust, the ruling stated:[561]

[561] Rev. Rul. 2004-64.

> [N]o portion of Trust is includible in A's gross estate for federal estate tax purposes under §2036, because A has not retained the right to have trust property expended in discharge of A's legal obligation.

Regarding Situation 2, under which the governing instrument or state law requires the trustee to reimburse the settlor for income taxes attributable to a grantor trust, the ruling said:[562]

[562] Rev. Rul. 2004-64.

> If pursuant to the trust's governing instrument or applicable local law, the grantor must be reimbursed by the trust for the income tax payable by the grantor that is attributable to the trust's income, the full value of the trust's assets is includible in the grantor's gross estate under §2036(a)(1).

Finally, regarding Situation 3, under which the governing instrument or local law gave the trustee discretion to reimburse the settlor for income taxes attributable to a grantor trust, the ruling concluded that there would not be estate inclusion with some caveats:[563]

[563] Rev. Rul. 2004-64.

> In addition, assuming there is no understanding, express or implied, between A and the trustee regarding the trustee's exercise of discretion, the trustee's discretion to satisfy A's obligation would not alone cause the

> inclusion of the trust in A's gross estate for federal estate tax purposes. This is the case regardless of whether or not the trustee actually reimburses A from Trust assets for the amount of income tax A pays that is attributable to Trust's income. The result would be the same if the trustee's discretion to reimburse A for this income tax is granted under applicable state law rather than under the governing instrument. However, such discretion combined with other facts (including but not limited to: an understanding or pre-existing arrangement between A and the trustee regarding the trustee's exercise of this discretion; a power retained by A to remove the trustee and name A as successor trustee; or applicable local law subjecting the trust assets to the claims of A's creditors) may cause inclusion of Trust's assets in A's gross estate for federal estate tax purposes.

n. **PLR 200944002** —

In PLR 200944002, the second Alaska APT ruling summarized in VII.C.2.I., above, the IRS gave a favorable estate tax ruling as follows:

> [T]he trustee's discretionary authority to distribute income and/or principal to Grantor, does not, by itself, cause the Trust corpus to be includible in Grantor's gross estate under §2036.

The ruling cautioned, though:

> We are specifically not ruling on whether Trustee's discretion to distribute income and principal of Trust to Grantor combined with other facts (such as, but not limited to, an understanding or pre-existing arrangement between Grantor and trustee regarding the exercise of this discretion) may cause inclusion of Trust's assets in Grantor's gross estate for federal estate tax purposes under §2036.

Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Detailed Analysis
VII. Federal Income- and Transfer-Tax Consequences of Domestic APTs

E. Assessing Creditors Who May Reach Domestic APT Assets

The foregoing authorities indicate that the issue is not whether a creditor may reach the assets of a domestic APT. Instead, the issue is whether the settlor has kept enough control so that he or she may incur debt after transferring assets to a domestic APT that will enable creditors to access the transferred assets. At least three categories of potential creditors must be considered:

- possessors of fraudulent transfer claims;
- possessors of federal claims;
- possessors of claims as “exception creditors.”

All domestic APT statutes allow creditors to set aside transfers to domestic APTs that are fraudulent transfers. But, the determination as to whether a transaction is a fraudulent transfer is made as of the date of the transfer—not at some later time—so that the settlor's post-transfer activity is irrelevant. Hence, good creditor planning should produce good tax planning.

Post-transfer conduct might affect domestic APTs if federal claims are involved. Thus, the IRS might step in if the settlor doesn't pay federal taxes, the SEC might step in if the settlor cheats investors, the FTC might step in if the settlor misleads consumers, a bankruptcy trustee might step in if the settlor ends up in bankruptcy, and those representing minor children might step in if the settlor fails to support them. Nevertheless, claims of this type do not seem to have emerged in the authorities involving transfer-tax planning.

Finally, "exception creditors" recognized by a domestic APT statute must be assessed.

In Delaware, for example, the assets of an APT are vulnerable:[564]

[564] Del. Code Ann. tit. 12, §3573(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 such transferor's spouse, former spouse or children, or for a division or distribution of property incident to a judicial proceeding with respect to a separation or divorce in favor of such transferor's spouse or former spouse, but only to the extent of such debt….

Concerning a current spouse, the settlor of a Delaware APT could enable such a spouse to reach trust assets by divorcing the spouse. The authorities discussed above indicate that this should not prevent transfers to the APT from being completed gifts or from removing the trust assets from the gross estate.

Concerning a former spouse or a minor child, failing to live up to court-ordered support or alimony would be a drastic way to give settlors access to trust funds and might involve punishment by the legal system. Again, this is a far cry from incurring debt and relegating creditors to trust assets.

The protections of the Delaware Act also do not apply:[565]

[565] Del. Code Ann. tit. 12, §3573(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.

Given that such a claim relates to pre-transfer conduct, it should be taken into account in fraudulent transfer planning. The settlor's post-transfer activity is irrelevant so the creditor-relegation theory is inapplicable.

As indicated above, the Alaska Act[566] and the South Dakota Act[567] recognize that a surviving spouse may access the assets of an APT by electing against the will. Accordingly, the settlor may alter the disposition of the trust assets by leaving so little to the surviving spouse that the latter exercises elective-share rights. This seems dangerously close to being able to relegate trust assets to creditors, particularly since the settlor won't be around to bear the consequences.

[566] Alaska Stat. §13.12.205(a)(2)(A).

[567] S.D. Codified Laws §29A-2-202, §29A-2-205(2).

F. Planning Considerations

Besides being mindful of the types of creditor claims to which the settlor of an APT might be vulnerable, the biggest challenge to removing trust assets from the gross estate is ensuring that there will be no express or implied understanding regarding distributions so as to cause inclusion under §2036. At least two steps should be taken to minimize this risk. First, the governing instrument should put an independent trustee rather than a family member, friend, etc., in charge of distributions. Second, the settlor should not expect to receive regular distributions from the trust. If regular distributions are made, a pre-existing arrangement is likely to be inferred.

Also, if the settlor wishes to exclude trust assets from the gross estate, he or she should not keep a nongeneral testamentary power of appointment.[568]

[568] *See* CCA 201208026.

G. Domestic APT Rulings

In 1998, the IRS ruled that a transfer by an Alaska resident to an Alaska APT was a completed gift but refused to rule on whether or not assets in the trust at the settlor's death would be subject to estate tax.[569] A few months later, the IRS confirmed that transfers to seven irrevocable California self-settled spendthrift trusts were not completed gifts and that the trusts were includible in the settlor's gross estate because California did not recognize self-settled spendthrift trusts.[570]

[569] *See* PLR 9837007. *See also* VII.C.2.j., and VII.D.3.1., above.

[570] *See* TAM 199917001.

In 2009, the IRS again ruled that the transfer of assets by an Alaska resident to an Alaska APT was a completed gift.[571] This time, the IRS concluded that the trustee's discretion to pay income and principal to the settlor, the settlor's spouse, and the settlor's descendants was not sufficient, by itself, to cause inclusion of the trust's assets in the settlor's gross estate.[572]

[571] PLR 200944002. *See* VII.C.2.1., above. *See also* Rothschild, et al., *IRS Rules Self-Settled Alaska Trust Will Not Be in Grantor's Estate*, 37 Est. Plan. 3 (Jan. 2010).

[572] PLR 200944002. *See* VII.D.3.n., above.

H. Structuring a Domestic APT to Be an Incomplete Gift and a Nongrantor Trust: The ING Trust

Most domestic APTs are grantor trusts for federal income-tax purposes under §677(a) because the trustee may distribute income to—or accumulate it for—the settlor without the approval of an adverse party. However, a client might use a type of domestic APT known as the incomplete gift nongrantor trust ("ING Trust") to eliminate income tax on undistributed ordinary income and capital gains imposed by Pennsylvania, which has not adopted the federal grantor-trust rules for irrevocable trusts, or, if clients are willing to subject distributions to themselves to the control of adverse parties, to eliminate income tax on such income imposed by one of the 43 states that have adopted the federal grantor-trust rules. In dozens of private letter rulings issued since 2013,[573] the IRS has ruled that domestic APTs that followed the ING-Trust approach qualified as incomplete gifts and as nongrantor trusts. Most—if not all—of the early rulings involved Nevada law in large part because, at the time, Nevada was the only domestic APT state that allowed a settlor to keep a nongeneral lifetime power of appointment. Alaska, Delaware, and South Dakota now offer that option as well.[574]

[573] *See, e.g.*, PLR 201925005–PLR 201925010; PLR 201908008; PLR 201908003–007; PLR 201852009, PLR 201852014; PLR 201850001–PLR 201850006; PLR 201848002, PLR 201848009; PLR 201838002–PLR 201838007; PLR 201836006; PLR 201832005–PLR 201832009.

[574] Alaska Stat. §34.40.110(b)(2); Del. Code Ann. tit. 12, §3570(11)(b)(2); Nev. Rev. Stat. §166.040(2)(b); S.D. Codified Laws §55-16-2(2)(b).

The settlor of an ING Trust might be able to receive tax-free distributions of the untaxed income in later years.[575] Since 2014, ING Trusts might no longer work in New York,[576] but the technique is still viable for residents of other states. In 2015, Wilmington Trust Company successfully resisted the California Franchise Tax Board's efforts to tax an ING Trust, thus saving the settlor millions of dollars of California income tax.

[575] *See* Stone, *Tax Planning Techniques for Client Selling a Business*, 43 Est. Plan. 3 (Oct. 2016); Robert W. Wood, *Sellers and Settling Litigants Lured by Tax Savings of NING and DING Trusts*, 77 State Tax Notes 565 (Aug. 10, 2015).

[576] *See* N.Y. Tax Law §612(b)(41).

The author of a 2015 article concluded:[577]

[577] Robert W. Wood, *Sellers and Settling Litigants Lured by Tax Savings of NING and DING Trusts,* 77 State Tax Notes at 568.

> Few advisers are likely to say that the NING or DING trust is guaranteed to provide the desired results. A better question is: Are they worth the effort? This can be debated, but in some cases they will be.
>
> With every i dotted and t crossed, the informed and non-risk-averse client may go from the certainty of paying significant state income tax to the reporting position of paying little. Of course, the facts, documents, and details matter. The entire exercise can also be a helpful push into the related and often uncomfortable topic of estate planning.

I. GST Tax

The settlor's allocation of exemption from the federal generation-skipping transfer tax (“GST tax”) to transfers to a domestic APT will not be effective as long as the trust is subject to an estate tax inclusion period, i.e., as long as the trust is includible in his or her gross estate,[578] and that issue may not be resolved conclusively until after the settlor's death (when the IRS, with hindsight as to patterns of distribution and claims of creditors, may establish estate tax inclusion). Consequently, the settlor might want to fund a trust to which GST exemption is to be allocated with assets that he or she will not need and in which he or she reserves no interest. He or she might then place the balance of the assets to be protected in a domestic APT that is not structured to be a completed gift or excludible from the gross estate.

[578] §2642(f); Reg. §26.2632-1(c). *See* Howard Zaritsky, *Using the Newly Increased GST Exemption*, 45 Est. Plan. 46 (May 2018). See also 850 T.M., *Generation-Skipping Transfer Tax.*

Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Detailed Analysis
VIII. Fraudulent Transfer Rules

A. Introduction

1. **Background** —

All U.S. jurisdictions permit creditors to set aside fraudulent or voidable transfers, conveyances, or transactions.[579] At present, 45 states and the District of Columbia follow the 1984 Uniform Fraudulent Transfer Act (“UFTA”).[580] Twenty-one of those states have enacted the 2014 amendments to the UFTA, which, inter alia, changed the name to the Uniform Voidable Transactions Act (“UVTA”).[581] Only one state—Maryland—still follows the 1918 Uniform Fraudulent Conveyance Act (“UFCA”).[582] In 2019, New York replaced its version of the UFCA with the UFTA, including the UVTA amendments. Three states—Alaska, South Carolina, and Virginia—follow the Statute of Elizabeth (1571).[583] Louisiana follows a separate approach, given its unique legal history.[584]

[579] For a general discussion of this subject, see Daniel S. Rubin, *Asset Protection Planning—Ethical? Legal? Obligatory?* 48 Heckerling Inst. on Est. Plan. ¶1800 at 18-2–18-15 (2014). *See also* Shapo, Bogert & Bogert, *The Law of Trusts and Trustees* §211 at 60–90 (3d ed. 2007).

[580] To view the text of the UFTA and a list of the jurisdictions that have adopted it (currently 46), go to www.uniformlaws.org. *See Collier on Bankruptcy* P548.01B (Resnick & Sommer eds., 16th ed. 2014). Participation in a fraudulent transfer is a crime under California law (Cal. Pen. Code §531).

[581] To view the text of the UFTA, as modified by the UVTA, and a list of the jurisdictions that have adopted the UVTA (currently 21), go to www.uniformlaws.org.

[582] *See* Md. Code Ann., Com. Law §15-201–§15-214. *See also*, *e.g.*, *Brooke Grove Found., Inc. v. Bradford*, *2018 WL 6417082* at *4 (D. Md. Dec. 4, 2018) (“This transaction [personal representatives transfer of real property in estate to self] constitutes a fraudulent conveyance under Md. Code Ann., Com. Law §15-204 [constructive fraud]”). For cases interpreting New York's former version of the UFCA (N.Y. Debt. & Cred. Law §270–§281, *see, e.g.*, *In re Sterman*, 594 B.R. 229, 239 (Bankr. S.D.N.Y. 2018) (“[T]ransfers to or for the benefit of Alexandra and

Samantha after they reached the age of 21 for college tuition and related expenses are avoidable as constructive fraudulent transfers if the Debtors were insolvent at the times the transfers were made. On the other hand, on the record before the Court, transfers to or for the benefit of Samantha while she was a minor for college tuition and related expenses were supported by reasonably equivalent value and, therefore, are not avoidable"); *In re Michel*, 572 B.R. 463, 477–78, 482 (Bankr. E.D.N.Y. 2017) (payment of private school tuition for minor children was not actual or constructive fraud under New York UFCA); *In re Xiang Yong Gao*, 560 B.R. 50, 68 (Bankr. E.D.N.Y. 2016) (transfers of cash and real property were actual and constructive fraud under New York UFCA). In New York, a transfer during litigation could have been a fraudulent conveyance, per se (N.Y. Debt. & Cred. Law §273-a).

[583] *See* Alaska Stat. §34.40.010, §34.40.090; S.C. Code Ann. §27-23-10–§27-23-90; Va. Code Ann. §55.1-400–§55.1-414.

[584] La. Civ. Code Ann. art. 2036–2043. *See Collier on Bankruptcy* P548.01[2] (Resnick & Sommer eds., 16th ed. 2014).

The provisions of the UFTA, as amended by the UVTA, are:

Section 1. Definitions

Section 2. Insolvency

Section 3. Value

Section 4. Transfer or Obligation Voidable as to Present or Future Creditor

Section 5. Transfer or Obligation Voidable as to Present Creditor

Section 6. When Transfer is Made or Obligation is Incurred

Section 7. Remedies of Creditor

Section 8. Defenses, Liability, and Protection of Transferee or Obligee

Section 9. Extinguishment of Claim for Relief

Section 10. Governing Law

Section 11. Application to Series Organization

Section 12. Supplementary Provisions

Section 13. Uniformity of Application and Construction

Section 14. Relation to *Electronic Signatures in Global and National Commerce Act*

Section 15. Short Title

Section 16. Repeals; Conforming Amendments

The Supreme Court of Connecticut explained in 2019 that "[a]lthough our court has not expressly addressed the purpose of the act, many other jurisdictions have recognized that the purpose of a fraudulent transfer statutory scheme is to prevent debtors from placing assets out of the reach of unsecured creditors."[585]

[585] *Geriatrics, Inc. v. McGee*, *2019 WL 2482179* at *7 n.17 (Conn. June 18, 2019).

2. **A "Transfer" Must Occur** —

To have a fraudulent transfer, there must be a "transfer"[586] by a "debtor." A federal bankruptcy court in North Carolina held that the conveyance of tenancy-by-the entireties property was not a "transfer" under the North Carolina UFTA for the following reasons:[587]

[586] *See, e.g., United States v. Baker,* 2015 WL 4886081 at *13 (D. Mass. Aug. 17, 2015) (bona fide or sham divorce may be "transfer" under Massachusetts UFTA); *United States v. Spencer*, 2012 WL 4577927 at *7 (N.D. Okla. Oct. 2, 2012) (deposit into joint bank account and subsequent withdrawals constituted "transfers" under Oklahoma UFTA); *Sturm v. Moyer*, *243 Cal. Rptr.3d 556*, 568 (Cal. Ct. App. 2019) ("UFTA *can* apply to a premarital agreement"). *But see In re Lapido*, *2018 WL 1121590* at *1 (Bankr. D. Conn. Feb. 27, 2018) ("transfer of the proceeds of Parent PLUS loan payments … do not constitute a transfer of property of the Debtor's estate" under Connecticut UFTA). *Accord In re Demitrus*, 2018 WL 1121589 at *5 (D. Conn. Feb. 27, 2018); *In re Demauro*, *2018 WL 3064231* at *7 (Bankr. D. Conn. June 19, 2018).

[587] *In re Hock*, 577 B.R. 202, 222 (Bankr. E.D.N.C. 2017) (internal quotation marks omitted).

> North Carolina General Statutes §39-23.1(2) expressly excludes from the definition of asset an interest in property held in tenancy by the entireties to the extent it is not subject to process by a creditor holding a claim against only one tenant.

But the Connecticut Supreme Court concluded in 2019 that "[t]he trial court improperly rejected the plaintiff's fraudulent transfer claim on the ground that the defendant's transfers of Helen's assets pursuant to a power of attorney were not transfers made by the debtor."[588]

[588] *Geriatrics*, *2019 WL 2482179* at *11.

3. **Actual Fraud and Constructive Fraud** —

As to present and future creditors, UFTA §4(a) provides in pertinent part as follows:[589]

[589] UFTA §4(a) (1984). *See Kloiber v. Daniel Kloiber Dynasty Tr.*, No. 2013-CA-000436, 2014 BL 341661, *2014 WL 6882265* at *4 (Ky. Ct. App. Dec. 5, 2014) (appellant "has failed to explain to this Court how a spouse, ten years prior to the filing of the dissolution of the marriage, qualifies as a creditor").

> A transfer made … by a debtor is voidable as to a creditor, whether the creditor's claim arose before or after the transfer was made … , if the debtor made the transfer … :
>
> (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 … , and the debtor:
>
>> (i) 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
>>
>> (ii) intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due.

A claim under UFTA §4(a)(1) is referred to as a claim for "actual fraud."[590] In 2015, a federal district court judge in Massachusetts explained the "hinder, delay, or defraud" test in UFTA §4(a)(1) as follows: "The phrase 'to hinder, delay, or defraud' is to be read in its natural disjunctive sense. Thus, proof of an intent to defraud is not always necessary, but rather an intent to hinder or delay is sufficient for a finding of liability."[591] In applying Delaware's UFTA, the Third Circuit has explained:[592]

[590] *See, e.g., United States v. Wilhite*, *2019 WL 2593009* at *8 (10th Cir. June 25, 2019) ("Mr. Wilhite fraudulently transferred his interest in the company to his wife at its inception"); *Leather v. Leathers*, 856 F.3d 729, 763 (10th Cir. 2017) ("Ronald's transfer to the Trust was fraudulent as to Ronald's debt to the IRS" under Kansas UFTA); *LaMarca v. Jansen (In re Bifani)*, 580 Fed. App'x 740, 746–47 (11th Cir. 2014) (transfers to girlfriend constituted actual fraud under Florida UFTA); *United States v. Patras*, 544 Fed. App'x 137, 145 (3d Cir. 2013) ("the transfer of the property occurred with the intent to hinder a creditor's ability to satisfy a judgment and hence constituted fraud under NJFTA"); *United States v. Kraus*, 2018 WL 1610225 at *6 (W.D. Wash. Apr. 3, 2018) ("the Government can show actual intent to defraud …"); *Fifth Third Bank v. Morales*, 2017 WL 6492108 at *5 (D. Colo. Dec. 19, 2017) ("the Court finds that the transfer was fraudulently made pursuant to §38-8-105(a)"); *United States v. Balice*, 2017 WL 3420918 at *15 n.16 (D.N.J. Aug. 9, 2017) ("the evidence leaves no doubt that a fraudulent conveyance did occur"); *United States v. Shaw*, 2017 WL 2791512 at *5 (M.D. Fla. June 28, 2017) ("transfer of the Florida Parcel from Richard Shaw to Saint Andrews Ivy, B.T. was fraudulent against the United States"); *United States v. Wilhite*, 2016 WL 5720702 at *13 (D. Colo. June 23, 2016) (transfers to wife constituted actual fraud under Colorado UFTA); *United States v. Baker*, 2015 WL 4886081 at *14 (D. Mass. Aug. 17, 2015) (transfers constituted actual fraud under Massachusetts UFTA); *United States v. Martin*, *2015 WL 4496869* at *7–8 (D. Haw. May 29, 2015) (transfers to wife and daughter constituted actual fraud under Hawaii law); *United States v. Fraughton*, *2015 WL 915434* at *7 (D. Utah Mar. 3, 2015) (transfer to corporation actual fraud under Utah UFTA); *United States v. Payton*, 2014 WL 407575 at *3 (E.D.N.C. Feb. 3, 2014), *aff'd*, 583 Fed. App'x 215 (4th Cir. 2014) (transfer of interest in jointly owned real property to wife was actual fraud under North Carolina UFTA); *United States v. Smith*, 2012 WL 1977964 at *7 (W.D. Wash. June 1, 2012) ("the transfers of the Subject Properties were fraudulent and of no effect to the lien claims of the United States"); *In re Ruvalcaba*, 2018 WL 2317682 at *7 (Bankr. N.D. Ill. May 18, 2018) (pre-petition transfer of commercial property to wife was actual fraud under Illinois UFTA); *In re Chiang*, 2016 WL 7396708 at *16 (Bankr. D. Mass. Dec. 21, 2016) (transfer of interest in real property to son was actual fraud under Massachusetts UFTA); *In re Cowin*, 2014 WL 1168714 at *39 (Bankr. S.D. Tex. Mar. 21, 2014) (transfer of note was actual fraud under Texas UFTA); *In re Huber*, 493 B.R. 798, 816 (Bankr. W.D. Wash. 2013) (transfers to Alaska APT constituted actual fraud under Washington UFTA); *In re Mastro*, 465 B.R. 576, 611–12 (Bankr. W.D. Wash. 2011) (transfers to self-settled trusts were made with actual intent under Washington law); *Hardy v. Hardy*, 2014 WL 3736331 at *19 (Del. Ch. July 29, 2014) (transfer of automobile was actual fraud under Delaware UFTA). *But see In re Noll*, *2018 WL 4693813* at *8 (Bankr. D. Minn. Sept. 27, 2018) ("The plaintiff may not avoid the transfers based on actual fraud"); *In re Palladino*, 556 B.R. 10, 14–15 (Bankr. D. Mass. 2016) (payment of daughter's college expenses not actual fraud under Massachusetts UFTA); *In re Pollack*, *2016 WL 270012* at *6 (Bankr. D.N.H.) ("Trustee has failed to establish that the Debtor's transfer of $60,741.84 was fraudulent under … the New Hampshire UFTA"); *Gibson v. Gibson*, 801 S.E.2d 40, 46 (Ga. 2017) ("Husband's transfers of property to the Trusts were not fraudulent").

[591] *United States v. Banker*, 2015 WL 4886081 at *12 (D. Mass. Aug. 17, 2015) (some internal quotation marks omitted). Under New York's version of the UFCA, since replaced with the UFTA, "Fraudulent intent can be found where the debtor either specifically intends to defraud a creditor or simply hinder or delay collection efforts" (*United States v. Nassar*, 2014 WL 5822677 at *7 (S.D.N.Y. Nov. 10, 2014).

[592] *Crystallex Int'l Corp. v. Petroleos De Venezuela, S.A.*, 879 F.3d 79, 84 (3d Cir. 2018).

> To withstand a motion to dismiss a claim under DUFTA, therefore, Crystallex must successfully plead three things: (1) a transfer, (2) by a debtor, (3) with actual intent to hinder, delay, or defraud a creditor.

Because it is difficult to prove a debtor's state of mind, §4(b) of the UFTA[593] provides 11 badges of fraud that a creditor may use to establish actual intent under UFTA.

[593] UFTA §4(b) (1984). *See In re Cowin*, 2014 WL 1168714 at *17 (Bankr. S.D. Tex. Mar. 21, 2014) (the list is not exclusive; courts recognize additional badges of fraud).

A claim under UFTA §4(a)(2) is referred to as a claim for "constructive fraud."[594] A Michigan intermediate appellate court has explained:[595]

[594] *See, e.g., United States v. Wight*, *2018 WL 2849773* at *2 (W.D. Wash. June 11, 2018) ("The conveyance to Mr. Migel is vacated as constructively fraudulent"); *United States v. Kraus*, 2018 WL 1610225 at *6 (W.D. Wash. Apr. 3, 2018) ("there was no adequate consideration"); *Fifth Third Bank v. Morales*, 2017 WL 6492108 at *6 (D. Colo. Dec. 19, 2017) ("The Court accordingly grants Plaintiff's request for summary judgment on its second claim for relief—fraudulent transfer pursuant to §38-8-105(b)"); *In re Knight*, 2017 WL 4410455 at *2 (D. Conn. Sept. 29, 2017) (debtor did not receive, "reasonably equivalent value" for college tuition payments under Connecticut UFTA); *United States v. Major*, 551 B.R. 531, 542 (M.D. Fla. 2016) (debtor's transfer of residence to wife and himself as tenants by the entirety was constructive fraud under Florida UFTA); *United States v. Lazare*, *2016 WL 1127627* at *6 (D. Nev. Mar. 4, 2016) (transfer of trust interest to another trust was constructive fraud under Nevada UFTA); *United States v. Martens*, 2016 WL 1212704 at *9 (D. Colo. Feb. 23, 2016) (transfer of property to trust was constructive fraud under Colorado UFTA); *United States v. Martin*, *2015 WL 4496869* at *8 (D. Haw. May 29, 2015) (debtor's and wife's transfer of real property to daughter was constructive fraud under Hawaii UFTA); *In re Noll*, *2018 WL 4693813* at *8 (Bankr. D. Minn. Sept. 27, 2018) ("the plaintiff may avoid transfers to the extent of $6,120.00"); *In re Libra*, 584 B.R. 550, 567 (Bankr. E.D. Mich. 2018) ("Trustee may avoid the monetary transfer in the amount of $21,900 under M.C.L. §566.35(1)"); *In re Ruvalcaba*, 2018 WL 2317682 at *18 (Bankr. N.D. Ill. May 18, 2018) (pre-petition transfer of commercial property to wife was constructive fraud under Illinois UFTA); *In re Orton*, 2018 WL 1577927 at *4 (Bankr. M.D. Fla. Mar. 28, 2018 ("[T]he transfer of the Debtors' pro rata share of the insurance proceeds, equaling $2,860.03, is avoidable as constructively fraudulent" under the Florida UFTA); *In re Rosich*, 570 B.R. 278, 281 (Bankr. W.D. Mich. 2017) (transfer of debtor's interest in revocable trust into tenancy-by-the-entireties property was constructive fraud under Michigan UFTA); *In re Altier*, 2017 WL 1011416 at *4 (Bankr. M.D. Fla. Mar. 15, 2017) (transfers of two parcels of real property were constructive fraud under Florida UFTA); *In re Chiang*, 2016 WL 7396708 at *16 (Bankr. D. Mass. Dec. 21, 2016) (transfer of real property to son was constructive fraud under Massachusetts UFTA); *In re Mastro*, 465 B.R. 576, 611–12 (Bankr. W.D. Wash. 2011) (transfers to self-settled trusts were constructive fraud under Washington law). *But see In re Gomez*, 560 B.R. 866, 874 (Bankr. S.D. Fla. 2016) (stock payment not constructive fraud under Florida UFTA); *In re Palladino*, 556 B.R. 10, 15 (Bankr. D. Mass. 2016) (payment of daughter's college expenses not constructive fraud under Massachusetts UFTA); *In re Pollack*, *2016 WL 270012* at *6 (Bankr. D.N.H. Jan. 20, 2016) ("Trustee has failed to establish that the Debtor's transfer of $60,741.84 was fraudulent under … the New Hampshire UFTA"). Effective October 1, 2017, a creditor may not recover college expense payments from an institution as constructive fraud under the Connecticut UFTA (Conn. Gen. Stat. §52-552i(f)).

[595] *Dillard v. Schlussel*, 865 N.W.2d 648, 656 (Mich. Ct. App. 2014) (internal quotation marks omitted).

> The second, commonly called "fraud in law" or constructive fraud, deems certain transactions fraudulent regardless of the creditor's ability to prove the debtor's actual intent. It applies only to transfers made after the creditor's claim arose. Three elements of proof are required: (1) the creditor's claim arose before the transfer, (2) the debtor was insolvent or became insolvent as a result of the transfer, and (3) the debtor did not receive reasonably equivalent value in exchange for the transfer.

For fraudulent transfer purposes, a claim arises when the underlying action takes place.[596] Thus, a malpractice claim against a surgeon arises when he or she botches an operation, not when the patient discovers the mistake or files suit. Similarly, a fraudulent transfer may take place when a revocable trust is amended to make it irrevocable.[597]

[596] *See* UVTA §1(3) (2014).

[597] *See In re Crawford*, 172 B.R. 365 (Bankr. M.D. Fla. 1994).

There are four possible classes of UFTA violations: present actual fraud, present constructive fraud, future constructive fraud, and future actual fraud. Three of the four classes are relatively easy to handle. Present fraud, whether actual or constructive, is resolved merely by paying just debts when they come due, thereby satisfying present creditors. Constructive fraud, whether present or future, is resolved by planning a transaction so that the transferor either receives reasonably equivalent value in exchange for the transfer or, alternatively, remains solvent after a transfer. Consequently, the most difficult problems arise in connection with future actual fraud.[598]

[598] John E. Sullivan, *The Often Overlooked Role of Disclosure in Asset Protection Planning: Part I* , 2 Asset Prot. J. 1, 2 (Spring 2000).

4. **Creditors' Remedies** —

Section 7(a) of the UFTA, as amended slightly by the UVTA, gives a successful creditor the following remedies:[599]

[599] UFTA §7(a) (1984), as amended by UVTA (2014).

> (a) In an action for relief against a transfer or obligation under this [Act], a creditor, subject to the limitations in Section 8, may obtain:
>
>> (1) avoidance of the transfer or obligation to the extent necessary to satisfy the creditor's claim;
>>
>> (2) an attachment or other provisional remedy against the asset transferred or other property of the transferee if available under applicable law; and
>>
>> (3) subject to applicable principles of equity and in accordance with applicable rules of civil procedure:
>>
>> (i) an injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property;
>>
>> (ii) appointment of a receiver to take charge of the asset transferred or of other property of the transferee; or
>>
>> (iii) any other relief the circumstances may require.

Accordingly, if a creditor is able to demonstrate that a transaction was a voidable transfer, then the primary effect is as follows: "If a court concludes that a transfer is fraudulent, it will set aside the transfer and allow the creditor to satisfy the debt from the transferred property."[600]

[600] Richard C. Ausness, *The Offshore Asset Protection Trust: A Prudent Financial Planning Device or the Last Refuge of a Scoundrel?* 45 Duq. L. Rev. 147, 158 (Winter 2007) (footnote omitted). *See* Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts*, 53 Hastings L.J. 287, 326 (Jan. 2002). *See also In re Anderson*, 2018 WL 3197746 at *9 n.8 (D. Conn. June 26, 2018) ("It has long been established under Connecticut law that common law principles do not authorize a general creditor to pursue the transferee in a fraudulent conveyance action for anything other than the specific property transferred or the proceeds thereof") (citation and internal quotation marks omitted).

In addition, a creditor may obtain relief from a first transferee of property and from an immediate or mediate transferee from a first transferee in certain circumstances.[601] When an issue of state law is unsettled, a federal court adjudicating a matter involving the issue must "predict" what the highest court of a state would decide.[602] In *Crystallex International Corp. v. Petroleos De Venezuela* (2018), a federal district court in Delaware said "[w]e are constrained to conclude that a transfer by a non-debtor cannot be a fraudulent transfer under DUFTA."[603] Nevertheless, creditors sometimes seek money damages from attorneys and others for aiding and abetting or for conspiracy to commit a fraudulent transfer. As will be covered in XIV.C., below, these efforts usually are unsuccessful.[604]

[601] UFTA §8(b)(1) (1984).

[602] *Crystallex Int'l Corp. v. Petroleos De Venezuela*, 879 F.3d 79, 81 (3d Cir. 2018).

[603] 879 F.3d at 81.

[604] *In re Madeoy*, 576 B.R. 484, 497 (Bankr. D. Md. 2017).

5. **Burden of Proof** —

Regarding the burden-of-proof standard that is applicable in fraudulent transfer disputes, the Supreme Court of Hawaii explained in 2006 why the clear and convincing evidence standard should apply:[605]

[605] *Kekona v. Abastillas*, 150 P.3d 823, 830 (Haw. 2006) (internal quotation marks omitted).

> At first glance, the present matter appears to consist of a monetary dispute between private parties, thus suggesting that a preponderance of the evidence standard is sufficient. However, we believe that the higher protections afforded by the clear and convincing standard of proof were necessary inasmuch as a finding of liability for a fraudulent transfer produces the reputational harm that should not be inflicted absent the degree of proof which will produce in the mind of the trier of fact a firm belief or conviction as to the allegations sought to be established. Indeed the element of fraud connotes dishonesty and effectively brands the liable defendant with an imprimatur of quasi-criminality.

But, in 2009, a federal bankruptcy court in Georgia observed that "under Florida law, movants bear the burden of proof to show such fraud by a preponderance of the evidence."[606] In an attempt to bring uniformity, the UVTA places the burden of proof on the creditor and imposes only the preponderance of the evidence standard.[607]

[606] *In re Allan*, 449 B.R. 628, 634 (Bankr. S.D. Ga. 2009), *aff'd*, 423 Fed. App'x 966 (11th Cir. 2011).

[607] UVTA §4(c) (Unif. Law Comm'n 2014).

6. **Limitations Periods**

a. **General** —

Section 9 of the UFTA provides statutes of limitations for the bringing of fraudulent transfer claims.[608] Thus, a cause of action for actual fraud under UFTA §4(a)(1) is extinguished unless an action is brought within four years after the transfer was made or, if later, within one year after the transfer was or could reasonably have been discovered by the claimant.[609] A cause of action for constructive fraud under UFTA §4(a)(2) is extinguished unless an action is brought within four years after the transfer was made.[610]

[608] UFTA §9 (Unif. Law Comm'n 1984). *See Dillard v. Schlussel*, 865 N.W.2d 648, 649 (Mich. Ct. App. 2014) ("MUFTA's six-year limitations period bars plaintiff Bentley Terrance Dillard's fraudulent transfer claims arising before June 23, 2005"). *See also In re Walker*, *2017 WL 1239561* at *24, 27 (Bankr. E.D. Tenn. Apr. 3, 2017) ("causes of action for the 2007 and 2008 Transfers under the TFTA are time barred," but "the Trustee's claims under Tenn. Code Ann. §66-3-101 … are not barred by the statute of limitations"). For an analysis of whether a fraudulent transfer claim is a tort or another type of claim for determining the applicable statute of limitations, see *In re Walker*, *2017 WL 1239561* at *25–27 (Bankr. E.D. Tenn. Apr. 3, 2017). For a decision under New York's former version of the UFCA, see *In re Conti*, 572 B.R. 73, 77 (W.D.N.Y. 2017) ("the second cause of action to avoid the transfer of property in 2003 is barred under the applicable statute of limitations").

[609] UFTA §9(a) (Unif. Law Comm'n 1984). *See In re Conti*, 572 B.R. 73, 76 ("New York law has long recognized that recording gives constructive notice of the debtor's transfer of an interest in his homestead").

[610] UFTA §9(a) (Unif. Law Comm'n 1984).

The effect of the above statutes of limitations for domestic APTs should be as follows:[611]

[611] Robert T. Danforth, *Rethinking the Law of Creditors' Rights in Trusts*, 53 Hastings L.J. 287, 329–330 (Jan. 2002) (footnote omitted).

> For persons using APTs to shelter their assets from creditors' claims, the statutes of limitation for fraudulent transfer actions afford substantial protection. In most cases, as long as a fraudulent transfer claim arises four years or more after the transfer of assets to an APT, the claim will be barred by the statute of limitations. Only in those cases in which the creditor successfully asserts actual fraud under section 4(a)(1) will a different limitations period potentially apply, but … a future creditor (as opposed to a present creditor) in general will have a difficult burden in establishing actual fraud. Thus, as long as a settlor is planning with respect to future creditors only, with the passage of time the statute of limitations will bar most fraudulent transfer claims.

The federal government is not bound by the above limitations periods, however. A federal district court in New York explained in 2015:[612]

[612] *United States v. Halpern*, 2015 WL 5821620 at *4–5 (E.D.N.Y. Oct. 5, 2015) (citations and some internal quotation marks omitted). *Accord United States v. Wilhite*, *2019 WL 2593009* at *4 (10th Cir. June 25, 2019) ("CUFTA's limitations periods do not apply"); *United States v. Patras*, 544 Fed. App'x 137, 143 (3d Cir. 2013) ("the United States is not bound by state statutes of limitation or subject to the defense of laches in enforcing its rights") (citation omitted); *United States v. Shearer*, *2018 WL 3770042* at *7 (E.D. Cal. Aug. 7, 2018) ("Plaintiff's suit is not barred by the statutes of limitation in either CUFTA or the FDCPA"); *United States v. Wight*, *2018 WL 2849773* at *1 (W.D. Wash. June 11, 2018) ("there is no

operative statute of limitations here"); *United States v. Park*, 2017 WL 4417826 at *2 (N.D. Ill. Oct. 5, 2017) ("the United states is not bound by state statutes of limitation … in enforcing its rights in proceedings it institutes to collect taxes, even those involving state fraudulent transfer law") (citations omitted).

> The New York State statute of limitations applicable to fraudulent conveyances does not apply to the United States because it "acts in its sovereign capacity when it brings suit to set aside a fraudulent conveyance or to enforce a tax lien," and "is not bound by state statutes of limitation in enforcing its rights."

The Government is, however, bound by the statute of limitations contained in 26 U.S.C. Section 6502(a)(1). That statute provides, in relevant part, that "where the assessment of any tax imposed by this title has been made within the period of limitation properly applicable thereto, such tax may be collected by levy or by a proceeding in court, but only if the levy is made or the proceeding begun—(1) within 10 years after the assessment of the tax."

Furthermore, a Florida appellate court described another situation in which the statute of limitations is not determinative in 2014. The court said:[613]

[613] *Biel Reo, LLC v. Barefoot Cottages Dev. Co. LLC*, 156 So.3d 506, 511 (Fla. Dist. Ct. App. 2014) (footnote omitted).

> Although the Trustees are correct that the manner of proving and defending fraudulent transfer claims under §56.29 borrow substantively from the UFTA, this fact does not require the adoption of the UFTA's much shorter limitations period, because §56.29's contrary scheme and precedent broadly establish the availability of proceedings supplementary for the life of the judgment, when a valid, unsatisfied execution exists.

b. **TrustCo Bank v. Mathews (2015)** —

As covered more fully in VIII.D.5., below, Vice Chancellor Parsons held in 2015 that creditors' claims that transfers to Delaware APTs were fraudulent transfers to be time-barred.[614]

[614] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 (Del. Ch. Jan. 22, 2015). "Delaware courts give such [unpublished] opinions substantial precedential weight" (*Crystallex Int'l Corp. v. Petroleos De Venezuela, S.A.*, 879 F.3d 79, 85 n.8 (3d Cir. 2018)).

7. **Rules in Alaska** —

Unlike Delaware, Nevada, and South Dakota (which follow the UFTA), Alaska follows the common law.[615] The U.S. Bankruptcy Court for the District of Alaska has summarized the fraudulent-conveyance rules in that state as follows:[616]

[615] Alaska Stat. §34.40.010, §34.40.090. *See Blumenstein v. Phillips Ins. Ctr., Inc.*, 490 P.2d 1213, 1222 n.12 (Alaska 1971).

[616] *In re Giordano*, *2004 WL 6002207* at *3 (Bankr. D. Alaska Jan. 7, 2004) (footnotes omitted).

> Alaska law allows unsecured creditors to invalidate fraudulent transfers pursuant to AS 34.40.010. It invalidates transfers "made with the intent to hinder, delay or defraud creditors." The burden of proving a fraudulent transfer is on the plaintiff, by a preponderance of the evidence. Clear and convincing proof is not required. The statute of limitations on fraudulent transfers is 6 years. Fraudulent transfers of cash can be recovered by a trustee.

Alaska recognizes numerous badges of fraud to establish actual intent.[617]

[617] *See 2004 WL 6002207* at *3–5. *See also In re Brown*, *1996 WL 33657614* at *6 (Bankr. D. Alaska Mar. 11, 1996) (transfers to two Belizean APTs were fraudulent transfers under Alaska law).

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B. Claims by Future Creditors—Cases

1. **Introduction** —

It is important to note the theory underlying claims by future creditors and the limited nature of their rights.

Future creditors are protected for two primary reasons—first, to prevent individuals from stripping themselves of their assets on the eve of undertaking risky transactions or incurring debt; and second, to prevent debtors from obtaining credit by misrepresenting that they own assets that appear to be available to creditors but that have instead been furtively retitled in nominees who hold for the sake of the borrower. This view was summed up by the U.S. Supreme Court in its 1890 *Schreyer v. Scott* opinion:[618]

> The theory upon which deeds conveying the property of an individual to some third party have been set aside as fraudulent in regard to subsequent creditors of the grantor has been that he has made a secret conveyance of his property while remaining in the possession and seeming ownership thereof, and has obtained credit thereby, while embarking in some hazardous business requiring such credit, or the debts which he has incurred were incurred soon after the conveyance, thus making the fraudulent intent a natural and almost a necessary inference, and in this way he has been enabled to obtain the property of others who were relying upon an appearance which was wholly delusive.

As a result, the law of future creditors is primarily concerned with persons who may not hold a claim today but who are highly likely to hold a claim in the near future. As *Schreyer* states:[619]

> In order to defeat a settlement made by a husband upon his wife, it must be intended to defraud existing creditors, or creditors whose rights are expected shortly to supervene, or creditors whose rights may and do so supervene; the settlor purposing to throw the hazards of business in which he is about to engage upon others, instead of honestly holding his means subject to the chance of those adverse results to which all business enterprises are liable.

Consequently, a transfer "is good as against subsequent creditors, unless executed as cover for future schemes of fraud,"[620] such as obtaining credit on false pretenses,[621] or unless the "transfer was made with a view of entering into some new and hazardous business, the risk of which the grantor intended should be cast upon the parties having dealings with him in the new business."[622] And, although there may be other circumstances showing that a transfer was

[618] 134 U.S. 405, 409 (1890) (citations and internal quotation marks omitted).

[619] 134 U.S. at 410 (citations and internal quotation marks omitted).

made with an impermissible intent to defraud future creditors,[623] this is difficult to prove unless there is some specific future creditor in mind. After all, it is hard to argue that somebody acted with intent to defraud a plaintiff if, at the time of transfer, the transferor had no claims looming on the horizon.

[620] 134 U.S. at 411.

[621] 134 U.S. at 411 (referring to "secrecy in [a] transaction" which amounts to misrepresentation designed to induce extension of credit).

[622] 134 U.S. at 411

[623] *See, e.g.*, 134 U.S. at 411 (generically referring to transfers "made with the intent to defraud such subsequent creditors").

Further, and perhaps most significantly, it is well settled that individuals have a right to protect against future adversity, as shown by *Schreyer*:[624]

[624] 134 U.S. at 414–415 (citations and internal quotation marks omitted; emphasis added).

> Reverses came unexpectedly, while in the pursuit of his ordinary business, without any intention on his part to defraud his creditors, and it may be said that, without any fault on his part, except a want of human foresight, he became embarrassed and insolvent. It is not apparent that [the transferor] had in view, at the time of the execution of the deed to his wife, any such result, or that he in any way contributed to produce the result which followed, for the purpose of defrauding his creditors and enjoying the advantages to be derived from the provisions made for his wife. *Under such circumstances, the presumption of any fraudulent intent is rebutted, and it is manifest that he had done no more than any businessman has a right to do, to provide against future misfortune when he is abundantly able to do so.*

2. **Cases Recognizing Limited Nature of Future Creditors' Rights**

a. **Background** —

This theory of future creditors' rights was adopted by other cases. For example, as the Massachusetts Supreme Judicial Court stated:[625]

[625] *Stratton v. Edwards*, 54 N.E. 886, 887 (Mass. 1899) (emphasis added). *Stratton* is still good law. *See, e.g.*, *Fleet Nat'l Bank v. Booth*, *2001 WL 292417* at *5 (Mass. Super. Ct. Feb. 28, 2001) (quoting *Stratton* for other propositions); *Innis v. Robertson*, *2001 WL 755843* at *11–12 (Mass. Super. Ct. May 21, 2001), *aff'd*, 854 N.E.2d 105 (Mass. App. Ct. 2006), (similar). *See also Shamrock, Inc. v. FDIC*, 629 N.E.2d 344, 349 (Mass. App. Ct. 1994) (noting in general terms that "[i]t is a perfectly usual employment of the trust device to place property in a safe harbor against the possibility of future rough financial seas, although the nominee trust would generally not be the form of choice for that purpose because of its susceptibility to penetration by creditors of the beneficiaries").

> *[I]t is not enough to show that the grantor had a general purpose to secure the property from the hazards of future business and the claims of future creditors.* But it must appear that at the time of the conveyance he had an actual intent to contract debts, and a purpose to avoid the payment of them by the conveyance.

b. **Jayne v. Hymer (1902)** —

In *Jayne v. Hymer*,[626] a creditor attempted to reach real property owned by the debtor's wife to satisfy a judgment against the debtor. In rejecting the creditor's claim, the court observed:[627]

[626] *Jayne v. Hymer*, 92 N.W. 1019 (Neb. 1902).

[627] *Jayne v. Hymer*, 92 N.W. 1019, 1020.

> Because neither the petition nor the evidence discloses that at the time the conveyance complained of was made the appellant was a creditor of William E. Hymer in any amount or to any extent whatever. Neither does it appear that the conveyance was procured by Hymer to be made to his wife in anticipation of the fact that he would become indebted to the appellant. In order to maintain a creditors' suit against a wife to set aside a conveyance of property made by a third person to her, the relation of debtor and creditor must have existed between the plaintiff and her husband at the time such conveyance was executed, or it must have been executed fraudulently, with the expectation on the part of the husband that he would become indebted to the plaintiff at a future time, and for the purpose of preventing, hindering, and delaying the collection of the debt when it should finally be contracted.

c. **Coleman v. Tepel (1916)** —

In *Coleman v. Tepel*,[628] the Third Circuit dealt with allegations that certain shareholders pursued corporate financing plans that inappropriately depleted a corporation's capital to the detriment of the corporation's creditors. One of the litigants claimed that the transactions and transfers in question might be void as to existing creditors but not as to future creditors. The court disagreed and noted that future creditors have rights. However, a shareholder's action would create liability to existing or future creditors only when the transaction's "direct object or immediate consequence is the insolvency of the corporation *and* injury to creditors."[629] On this theory, fraud against future creditors cannot be proven unless there is shown that a transferor rendered himself or herself insolvent to injure those creditors. However, transferors who retain a reasonable degree of post-transfer solvency will be well positioned to refute such allegations, particularly if the track record between the time of transfer and any subsequent catastrophe is lengthy and shows that all pre-catastrophe debts were paid.

[628] *Coleman v. Tepel*, 230 F. 63 (3d Cir. 1916).

[629] 230 F. 63, 71 (emphasis added).

d. **Cram v. Cram (1928)** —

In *Cram v. Cram*,[630] the husband sought to establish a trust with funds that he had given to his wife. In the course of the opinion, the court said:[631]

[630] *Cram v. Cram*, 160 N.E. 337 (Mass. 1928).

[631] 160 N.E. 337, 339 (citations omitted).

> The allegations of the bill are not equivalent to a purpose on the part of the plaintiff to defraud present or future creditors by transferring the property to his wife. When such a purpose is shown, the conduct of the party making the conveyance is so tainted with illegality as to bar relief, no matter how faithless may be the party receiving the property. Where, however, one substantially free from debt transfers property to or for the benefit of his wife or family, so that it shall not be exposed to the hazards of future business or be subjected to the risks of improvidence, this is not fraudulent as to subsequent creditors. The same principle applies where one who, although having some debts, still is possessed of estate largely in excess of existing obligations, transfers such excess of property with that purpose. In order that such transfer may be set aside or be tainted with fraud, it must further appear expressly or impliedly that there was an intent on the part of the transferrer to contract debts in the future and avoid payment of them because of the transfer of his property.

e. **Wantulok v. Wantulok (1950)** —

In *Wantulok v. Wantulok*,[632] the court stated the following general principles: “Fraud is not presumed. There must be definite proof that the creditors existed who were able to be defrauded.”[633] However, it is inherently difficult for a future creditor to satisfy this standard if he or she was not a known or likely creditor at the time of transfer.

[632] 214 P.2d 477 (Wyo. 1950).

[633] 214 P.2d 477 at 484.

f. **Klein v. Klein (1952)** —

Klein v. Klein [634] involved a marital separation proceeding in which the husband was trying to reacquire land that he had titled in the name of his wife to protect it from possible job-related claims. The husband was a retired Buffalo police officer, and, during his tenure, the city lacked any insurance to cover claims. At the time of transfer, the husband had no claims pending against him. However, his job exposed him to possible future suits for police misconduct. He and his wife, therefore, titled the land in the wife's name, even though he paid for it, so that the land might be available as an asset to help care for their five children, three of whom were incompetent. This arrangement was made with the understanding that the land would be reconveyed to the husband as a tenant by the entirety with his wife upon his retirement. However, a separation arose at or about the time of the husband's retirement, and the wife refused to reconvey title. The court sided with the husband. In reaching its decision, the court called the husband's arrangement “most reasonable”[635] and further stated:[636]

[634] *Klein v. Klein*, 112 N.Y.S.2d 546 (Sup. Ct. 1952).

[635] 112 N.Y.S.2d 546, 547.

[636] 112 N.Y.S.2d 546, 548.

> [T]here has been found no authority that an action such as this must fail for the reason that the grantor, who was without creditors, feared for future dangers, real or imaginative. Surely his hands were as clean as any one who ever came into equity. What he did amounted to no more than insurance against a possible disaster.

g. **Pagano v. Pagano (1955)** —

In *Pagano v. Pagano*,[637] the court imposed a constructive trust on real property owned by a brother. In rejecting that brother's contention that his brothers had unclean hands, the court said:[638]

[637] *Pagano v. Pagano*, 139 N.Y.S.2d 219 (Sup. Ct. 1955).

[638] 139 N.Y.S.2d 219, 223 (citations omitted).

> The contention that plaintiffs do not come into court with clean hands and that, therefore, this court should not aid them has been examined and is rejected. It is clear that the contract and deed were taken in the name of the defendant because of the advice of a reputable attorney. A conference was had in which the attorney and all members of the family participated. It was then decided that the defendant was the best person to hold the title because he was the one member of the family who was not then engaged in business ventures. There was no actual intent then present to impede or defraud creditors. It is true the parties did have in mind the uncertainty of their business ventures and that they did desire to keep this property as a family asset free from business entanglements. However, it does not appear that any of them had any intent to evade responsibility for their business obligations. There was absent any fraudulent intent. Therefore, these plaintiffs may not be said to have unclean hands barring them from the help of this court to remedy the fraud being perpetrated upon them by the defendant.

h. **Palumbo v. Palumbo (1967)** —

In *Palumbo v. Palumbo*,[639] a husband sought to recover from his wife two parcels of real estate that he had conveyed to her after a lawsuit was filed against him. The court noted that "a transfer made prior to embarking upon a business in order to keep property free of claims that may arise out of the business is not tainted."[640]

[639] 284 N.Y.S.2d 884 (Sup. Ct. 1967).

[640] 284 N.Y.S.2d 884, 890.

i. **First National Bank in Kearney v. Bunn (1976)** —

In *First National Bank in Kearney v. Bunn*,[641] a creditor sought to reach real property owned by the debtor's wife for repayment of a loan on which he had defaulted. The court rejected the creditor's contention, saying:[642]

[641] 241 N.W.2d 127 (Neb. 1976).

[642] 241 N.W.2d 127, 132–133 (citations omitted). *Accord U.S. Nat'l Bank of Omaha v. Rupe*, 296 N.W.2d 474, 476 (Neb. 1980).

> A different standard is applied to creditors whose debts are in existence at the time of conveyance, as opposed to subsequent creditors. A creditor whose debts did not exist at the date of a voluntary conveyance by the debtor cannot attack such conveyance for fraud unless he pleads and proves that the same was made to defraud subsequent creditors whose debts were in contemplation at the time. No such evidence was adduced by the plaintiff at the trial herein.

j. **In re Oberst (1988)** —

In *In re Oberst*,[643] a debtor's right to a bankruptcy discharge was challenged on the ground that he made fraudulent transfers by converting nonexempt assets into exempt form in contemplation of bankruptcy. The court acknowledged the existence of a "grey area between bankruptcy planning and intent to hinder, delay or defraud a creditor."[644] The court went on to state:[645]

[643] 91 B.R. 97 (Bankr. C.D. Cal. 1988).

[644] 91 B.R. 97, 99 (internal quotation marks omitted).

[645] 91 B.R. 97, 101.

> If the debtor has a particular creditor or series of creditors in mind and is trying to remove his assets from their reach, this would be grounds to deny the discharge. If the debtor is merely looking to his future well-being, the discharge will be granted.

k. **Hurlbert v. Shackelton (1990)** —

Hurlbert v. Shackleton [646] was a medical malpractice action. The court observed that "[w]here the creditor is not in existence at the time of the conveyance, there must be evidence establishing actual fraudulent intent by one who seeks to have the transaction set aside."[647]

[646] 560 So.2d 1276 (Fla. Dist. Ct. App. 1990).

[647] 560 So.2d at 1279 (citations omitted).

l. **Matter of Joseph Heller Inter Vivos Trust (1994)** —

In *Matter of Joseph Heller Inter Vivos Trust*,[648] the trustee requested court approval to split a trust to insulate cash and securities from claims that might arise from real property. In granting the request, the court noted:[649]

[648] 613 N.Y.S.2d 809 (Surr. Ct. 1994).

[649] 613 N.Y.S.2d at 810–811 (citations omitted).

> New York law recognizes the right of individuals to arrange their affairs so as to limit their liability to creditors, including the holding of assets in corporate form, making irrevocable transfers of their assets, outright or in trust, as long as such transfers are not in fraud of existing creditors, establishing spendthrift trusts to protect the assets from the beneficiary's creditors and renouncing property interests that otherwise would be subject to creditor's claims.
>
> The most significant of the foregoing examples is the availability of renunciation for the sole purpose of defeating existing creditors' claims. Indeed, one of the earliest purposes of a renunciation was to defeat such claims. Renunciations have been held valid to defeat the claims of both ordinary and judgment creditors and even the welfare claims of the government.
>
> Clearly, if New York law allows a beneficiary to defeat existing creditors by a renunciation, a trust can be severed for the purpose of limiting liability to nonexistent, but possible, future creditors.

m. **In re Piper Aircraft Corp. (1994)** —

In *In re Piper Aircraft Corp.*,[650] a federal district court in Florida considered whether a claim should be honored in a bankruptcy proceeding. In the course of the opinion, the court observed:[651]

[650] 168 B.R. 434 (S.D. Fla. 1994), *aff'd*, 58 F.3d 1573 (11th Cir. 1995).

[651] 168 B.R. at 439 (citation and internal quotation marks omitted).

> [F]or a claim to exist, there must be some way to connect the future claims to the debtor today, such that it can be fairly said that Piper's obligations to the Future Claimants are sufficiently rooted in the present.

The court rejected the claim as follows:[652]

[652] 168 B.R. at 440.

> Where, as here, there is no known defective product, no known prepetition exposure, contact or impact and no known prepetition injury, the circumstances simply are too attenuated to find a prepetition relationship between Piper and the Future Claimants so as to obligate Piper today to satisfy potential future claims out of existing assets.

n. **Riechers v. Riechers (1998)** —

In *Riechers v. Riechers*,[653] a husband and wife settled a Cook Islands asset protection trust ("APT") to protect family assets from possible malpractice claims against the husband, who was a urologist. Thereafter, the spouses divorced. In discussing how to allocate marital assets, the court noted in dictum that "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."[654]

[653] 679 N.Y.S.2d 233 (Sup. Ct. 1998).

[654] 3679 N.Y.S.2d at 236 (emphasis added).

o. **Case v. Fargnoli (1999)** —

In *Case v. Fargnoli*,[655] the plaintiff was a New York official who prosecuted a Medicaid cost recovery action against a husband in connection with government outlays made on behalf of the defendant's wife. The state argued that assets the husband transferred into an irrevocable trust in 1987 should have been included in financial analyses undertaken to determine the wife's eligibility for assistance, which was first sought in 1990. Under the trust, the settlor-husband was a lifetime beneficiary and his children were remainder beneficiaries. The husband disputed the state's claim on various grounds. The court concluded that cost recovery should be allowed: The husband was legally obligated to reimburse the state; the trust was self-settled and could be invaded for his benefit; and, therefore, the state could invade the trust to obtain reimbursement. In this regard, the court merely applied the traditional rule against self-settled spendthrift trusts. However, the court denied the state's motion for attorneys' fees, which was based on the ground that the transfer into trust was fraudulent. In so doing, the court stated:[656]

[655] 702 N.Y.S.2d 764 (Sup. Ct. 1999).

[656] 702 N.Y.S.2d at 768 (citations omitted).

> Plaintiff also contends that the husband's transfer of assets to the trust in November 1987 was fraudulent as to future creditors. Concededly, the trust was designed to shelter assets from possible future estate tax liability and claims by medical service providers …There is no evidence that, in 1987, defendant was either insolvent or knew he would incur debts beyond his ability to pay. In fact, no such occasion arose until December 1990, some three years later.

The court further noted that the fraudulent transfer law "requires proof that defendant had some good indication of oncoming insolvency" and the settlor's receipt of "only a minimal distribution of income from the trust … following 1987 is persuasive evidence to the contrary."[657] The court stated:[658]

[657] 702 N.Y.S.2d (citation and internal quotation marks omitted).

[658] 702 N.Y.S.2d (citations omitted).

> Given the continued solvency of defendant after 1987, the plaintiff must show, by clear and convincing evidence, that defendant intended to hinder, delay, or defraud the plaintiff by creating the trust in order to recover … . [W]e conclude, as a matter of law, that plaintiff has failed to show, by the required clear and convincing evidence, that the 1987 transfer was intentionally fraudulent.

p. **In re Earle (2002)** —

In *In re Earle*,[659] an Alabama bankruptcy case, the debtor settled a qualified personal residence trust ("QPRT") in June 1998 and thereafter filed a joint bankruptcy with her husband in late 2001. A creditor commenced an adversary proceeding against the debtor, challenging the QPRT as a fraudulent transfer. The court denied the creditor's claim for various reasons. Among other things, the court stated, "there was no evidence indicating that at the time the trust was created Mrs. Earle knew that she was about to incur debt beyond her ability to pay."[660] The court also quoted cases from around the country for the following propositions:[661]

[659] 307 B.R. 276 (S.D. Ala. 2002).

[660] 307 B.R. at 296.

[661] 307 B.R. (citations and internal quotation marks omitted).

> [E]very conveyance that frustrates a creditor is not a fraudulent conveyance under the statute … . [A]lthough a transfer may have the effect of hindering or delaying or defrauding creditors, incidental effect is not enough to

> satisfy the requirement of actual intent to defraud. And, it has been recognized that where there is significantly clear evidence of a legitimate supervening purpose, a court may find no intent to defraud even in the presence of several badges of fraud.

q. **Danis v. Great American Insurance Co. (2004)** —

In *Danis v. Great American Insurance Co.*,[662] a case from Ohio, the court dealt with a complex insurance coverage dispute arising out of environmental claims. As part of the dispute, some of the defendants were alleged to have made fraudulent transfers. The court, in analyzing this claim, noted that claims of fraud on future creditors can prevail only if the transferor is seeking to evade "anticipated" claims, as shown by the following passage (citing the Ohio Rev. Code Ann. as "R.C."):[663]

[662] 823 N.E.2d 59 (Ohio Ct. App. 2004).

[663] 823 N.E.2d at 70 ¶62 (emphasis added).

> Count ten of the federal complaint alleges fraudulent transfers under R.C. 1336.04 and R.C. 1336.05 and violation of R.C. 1701.35(B). R.C. 1336.04 and 1336.05 are part of the Ohio Uniform Fraudulent Transfers Act, and prohibit transfers that defraud creditors. *Underlying both these statutes is a requirement* of either existing or *anticipated obligations* that a debtor is attempting to evade.

Practice Tip: Thus, it is perfectly permissible for transferors to protect against future reverses by placing assets into a domestic APT, provided that the settlor retains solvency, is not acting with particular creditors in mind, and is not subject to likely or anticipated claims.[664]

[664] *Cf. In re Bergman*, 293 B.R. 580 (Bankr. W.D.N.Y. 2003) (debtor-wife's transfer of assets to husband nonfraudulent because transfer disclosed and business reverses were unexpected; "While a company must be adequately capitalized, it does not need resources sufficient to withstand any and all setbacks," and "the question the court must decide is not whether the projection was correct, for clearly it was not, but whether it was reasonable and prudent when made") (citations, internal quotation marks, and brackets omitted).

3. **Cases Not Recognizing Limited Nature of Future Creditors' Rights**

a. **Background** —

Notwithstanding the above caselaw, some cases do recognize the ability of unknown future creditors to set aside transfers.

b. **United States v. Townley (2006)** —

In *United States v. Townley*,[665] the Ninth Circuit wrote:[666]

[665] 181 Fed. App'x 630 (9th Cir. 2006).

[666] 181 Fed. App'x at 631 (citations omitted; emphasis added).

> The district court did not err in holding that the Townleys transferred their real property into the Beaver Valley Trust in violation of the Washington Uniform Fraudulent Transfers Act. The Townleys' repeated admissions that they transferred property to the Trust in order to avoid *potential future creditors* provide direct evidence of fraud. Further, by demonstrating that the property transfer was characterized by multiple badges of fraud, the government also showed compelling circumstantial evidence of fraud. Therefore, the government provided the

requisite 'clear and satisfactory proof,' that the Townleys possessed an 'actual intent to hinder, delay or defraud a creditor' under the UFTA.

c. **United States v. Nassar (2014)** —

In *United States v. Nassar*,[667] a decision the continued relevance of which is unclear given that New York now follows the UFTA, a federal district court in New York observed:[668]

> New York courts have observed that the "plain language" of NYDCL §276 reaches conveyances intended to defraud *future* creditors, including conveyances which occurred *prior* to the time the obligation to the plaintiff arose. It is sufficient if such fraudulent intent existed either specifically or generally with respect to the subsequent creditor or creditor.

4. **Estate Planning Motives Not Determinative** —

Commentators advised in 2018 that "[t]he risk of a fraudulent transfer being found is also lessened when some other, non-fraudulent, purpose exists for the transfer of assets to a self-settled spendthrift trust."[669] It should be noted, however, that estate planning motives do not, by themselves, prevent transfers from being set aside. In this regard, in 2012, the U.S. Bankruptcy Court for the Central District of Illinois said:[670]

> The published caselaw is replete with cases where a transferor cries estate planning when accused of transferring an asset with the intent to hinder, delay or defraud a creditor. Sometimes that defense is successful. *In re Nichols*, 447 B.R. 97 (Bankr. N.D.N.Y. 2010) [transfer to LLC]; *In re Burzee*, 402 B.R. 8 (Bankr. M.D. Fla. 2008) [transfers to grandmother and friend]; *In re Meyer*, 307 B.R. 87 (Bankr. N.D. Ill. 2004) [transfers to wife]; *In re Earle*, 307 B.R. 276 (Bankr. S.D. Ala. 2002) [transfer to QPRT]. Sometimes the defense of estate planning fails. *Merchant Transaction Systems, Inc. v. Necela, Inc.*, 2010 U.S. Dist., Lexis 12607, 2010 WL 382886 (D. Ariz. 2010) [transfer to QPRT]; *U.S. v. Sherrill*, 626 F. Supp. 2d 1267 (M.D. Ga. 2009) [transfers to wife]; *Casey Nat. Bank v. Roan*, 282 Ill. App. 3d 55, 668 N.E.2d 608, 281 Ill. Dec. 124 (Ill. App. 4 Dist. 1996) [transfer to children]. But it is always a factually intense analysis.

In *Dillard v. Schlussel* (2014),[671] an intermediate appellate court in Michigan opined that "the transfer bears many indicia of actual fraud, and these indicia are not cleansed by Mark's claim that he was merely planning his 'estate.'"[672] But, in *Gorrin v. Poker Run Acquisitions, Inc.*,[673] a Florida intermediate appellate court noted that:[674]

[667] *United States v. Nassar,* No. 13-civ-8174, 2014 BL 316738, 2014 WL 5822677 (S.D.N.Y. Nov. 10, 2014).

[668] *United States v. Nassar,* No. 13-civ-8174, 2014 BL 316738, 2014 WL 5822677 at *9 (emphasis in original; citations and internal quotation marks omitted).

[669] Gideon Rothschild & Daniel S. Rubin, *Minimize Creditor Challenges to Self-Settled Spendthrift Trusts*, 157 Tr. & Est. 14, 16 (Nov. 2018).

[670] *Barber v. Grube (In re Grube)*, 462 B.R. 663, 665 (Bankr. C.D. Ill. 2012) (internal quotation marks omitted). *See Waldron v. Huber (In re Huber)*, 493 B.R. 798, 815–816 (Bankr. W.D. Wash. 2013) (estate planning motives did not prevent transfers to Alaska APT from being fraudulent transfers under Washington law).

[671] 865 N.W.2d 648 (Mich. Ct. App. 2014).

[672] 865 N.W.2d at 664 n.8.

[673] 237 So.3d 1149 (Fla.3d DCA 2018).

[674] 237 So.3d 1149, 1155.

> If believed by the trier of fact, Gorrin's evidence that the transfer was made for estate planning purposes, pursuant to a promise that he had made to his wife and without the intent to defraud any creditor, could rebut the presumption of fraud.

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C. Claims by Future Creditors—Commentary

Based on the above caselaw, six commentators confirm that not all future creditors may use the fraudulent transfer rules to reach transferred assets.

According to the first commentator:[675]

[675] John E. Sullivan, *Future Creditors and Fraudulent Transfers*, 22 Del. J. Corp. L. 955, 1049 (1997). For a contrary view, see Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?* 85 Cornell L. Rev. 1035, 1045 n.62 (May 2000).

> [M]any future plaintiffs do not have “claims,” and do not even amount to “creditors” under UFTA. UFTA also imposes a “rule of reason” that requires transferors to protect against reasonably foreseeable claims, as recognized by today's law. The statute does not require transferors to protect against claims that are not reasonably foreseeable, and this limitation fully conforms with many other areas of law. In this country, transferors who intentionally create reserves to protect their legitimate creditors, and who restrict their asset protection planning to their surplus assets, are intentionally protecting their creditors. This negates any fraudulent intent, even when good faith mistakes in calculations or financial assumptions are later discovered. There are also many other key technical or legal concerns that limit UTFA's reach. For instance, passage of time is recognized as a valid defense.

The second commentator states:[676]

[676] Danforth, *Rethinking the Law of Creditors’ Rights in Trusts*, 53 Hastings L.J. 287, 330 (Jan. 2002) (footnote omitted).

> Under what circumstances will transfers to APTs be deemed fraudulent under the fraudulent transfer laws? More particularly, if a settlor transfers assets to an APT not with a specific creditor in mind, but rather with the general goal of shielding assets from potential future creditors, will the transfer be deemed fraudulent and thus voidable under the UFTA or similar laws? Although the answer to this question is not without doubt, it appears that most courts are unwilling to void transfers whose purpose and effect is to shelter assets from creditors that were unknown at the time of the transfer. Furthermore, the more remote in time the claim of a future creditor, the less likely a court will be to find that an earlier transfer was fraudulent with respect to that creditor. Thus, as long as a person creating an APT does so well in advance of a creditor's claim, and especially if the creditor was unknown and unforeseeable at the time of the transfer to the trust, it is likely that the transfer will not be deemed fraudulent.

The third commentator is of the view that:[677]

> There must be a causal connection between the alleged fraud and the injury claimed by the plaintiff-creditor in order to find that the creditor may prosecute the fraud action. This focus on causality provides a means to distinguish between the actions that operate directly to the prejudice of a particular creditor and those actions that in some remote, unforeseeable way, have, after the passage of considerable time or the occurrence of an intervening cause, compromised a creditor's financial interest.

The fourth commentator wrote in 2009 that:[678]

> The difficulty in the asset protection context arises because the purpose of all asset protection transfers is to defeat the claims of creditors. Moreover, the Uniform Fraudulent Transfers Act specifically states that the transfer may be set aside if it is fraudulent with respect to a creditor whose “claim arose before or *after* the transfer.” Therefore, the literal terms of the act renders voidable any transfer intended to defeat anyone who may become a creditor. This would, of course, vitiate the value of any asset protection transfer.
>
> Case law, however, makes a distinction between future creditors whose debts were in “contemplation” at the time of the transfer and other future creditors. Transactions intended to protect assets from contemplated future creditors are fraudulent with respect to those creditors. In contrast, a transfer may not be set aside by a creditor who was not contemplated at the time of the transfer.

The author often is asked whether a physician may engage in asset protection planning. On this issue, the same commentator observed:[679]

> [W]hether a subsequent creditor was contemplated at the time of the transfer is also a subtle distinction. For example, suppose a doctor creates an asset protection trust because she fears being sued for malpractice at some point in the future. If the doctor later commits malpractice, may the injured patient set aside the transfer as fraudulent with respect to that injured patient? Generally, such a patient may not set aside the transfer because the patient was not a contemplated creditor at the time of the transfer.

In 2010, the fifth commentator observed that “a future creditor must not only be foreseeable at the time of the transfer of assets, the timing of such creditor's claim must be proximate to the time of the transfer. In one case, the court defined the term ‘future creditor’ as one whose claim is ‘reasonably foreseen as arising in the immediate future.”‘[680]

Finally, the sixth commentator wrote in 2017 that “[u]nder the weight of authority, a transfer made out of caution without regard to a particular future creditor is not subject to avoidance.”[681]

[677] Alces, *The Law of Fraudulent Transactions* §5:85 at 5-172 (2006) (footnotes omitted).

[678] Fogel, *Scylla and Charybdis Attack: Using Trusts for Medicaid Planning and Non-Medicaid Asset Protection*, 35 ACTEC J. 45, 47 (Summer 2009) (footnotes omitted; emphasis in original).

[679] Fogel, 35 ACTEC J. 45, 47 (footnotes omitted).

[680] Stein, *Asset Protection May Risk Fraudulent Transfer Violations*, 37 Est. Plan. 12, 15 (Aug. 2010) (footnote omitted).

[681] Spero, *Recent Cases Show Need for Strict Compliance With DAPT Statutes*, 44 Est. Plan 8, 11 (May 2017) (footnote omitted).

A common misconception is that a transaction that is entered into exclusively for asset protection automatically is a fraudulent transfer. The above cases and commentary demonstrate that if a client's sole purpose is asset-protection planning but he or she does it at a time when the coast is clear, the client is on very firm footing because he or she has a right to do that.

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D. Applicable Law

1. **Introduction** —

Most of the domestic APT statutes adhere closely to the UFTA's rules so that choosing between the law of the forum state and the law of the state where a domestic APT is created will not be a matter of great import in many situations. As discussed above, however, the domestic APT statutes of Alaska and South Dakota set requirements that holders of outstanding claims when an APT is created must satisfy to preserve their claims,[682] while Nevada and South Dakota set shorter statutes of limitations than the UFTA.[683] Nevertheless, given that whether or not a transaction is considered a fraudulent transfer is determined as of the date of the transfer, the statute of limitations should rarely come into play. Proper planning therefore will eliminate the fraudulent transfer issue in most instances.

[682] *See* Alaska Stat. §34.40.110(d)(1); S.D. Codified Laws §55-16-10(1).

[683] *See* Nev. Rev. Stat. §166.170(1); S.D. Codified Laws §55-16-10.

When discrepancies between the forum state's and the domestic APT state's governing law arise, determining the applicable law becomes critical. One might expect that a court where a creditor brings suit always will apply that court's law, but that is not the case. Caselaw confirms that, when an alleged fraudulent transfer involves real property, many "jurisdictions apply the general rule that the law of the situs of the land governs whether or not the property was fraudulently transferred."[684] In states such as Pennsylvania, however, the location of real property is only one factor to be considered.[685] Surprisingly, when the transfer in question involves real property but the property's location is not dispositive or when the transfer involves personal property, state law has considerable variation.

[684] *Metex Mfg. Corp. v. Manson Envtl. Corp.*, No. 05-2948, 2008 BL 298665, 2008 WL 474100 (D.N.J. Feb. 15, 2008) (citing cases from Connecticut, Texas, Illinois, Alabama, Colorado, Alaska, New York, and Massachusetts). The court said that "a New Jersey court would not apply NJFTA to a transaction of property in another jurisdiction," 2008 WL 474100 at *10. *See Restatement (Second) of Conflict of Laws* §223 (Am. Law Inst. 1971). *See also In re Bullseye Holdings, LLC*, *2018 WL 4998089* at *7 (Bankr. D. Ariz. Oct. 15, 2018) (relying on *Restatement (Second) of Conflict of Laws* §223).

[685] *State Farm Mut. Auto. Ins. Co. v. Snyder*, *2013 WL 5948089* at *7 (E.D. Pa. Nov. 6, 2013).

Some courts have held that a fraudulent transfer claim sounds in equity;[686] other courts have held that such a claim sounds in contract.[687] However, it appears that most courts now will classify a fraudulent transfer claim as a tort[688] and will choose the applicable law either based on where the last act necessary to complete the fraudulent conveyance took place or under §145 of the *Second Restatement of Conflict of Laws*.[689] Both approaches are illustrated below.

[686] *See, e.g., Lumbermens Mut. Cas. Ins. Co. v. Maffei,* 2006 WL 2709835 at *2 n.4 (D. Alaska Sept. 20, 2006)*; United States v. Franklin Nat'l Bank,* 376 F. Supp. 378, 384 (E.D.N.Y. 1973); *Double Oak Const., LLC v. Cornerstone Dev. Intern., LLC,* 97 P.3d 140, 147 (Colo. App. 2003).

[687] *See, e.g., United States v. Neidorf,* 522 F.2d 916, 920 (9th Cir. 1975); *Desmond v. Moffie,* 375 F.2d 742, 743–44 (lst Cir. 1967); *In re Astropower Liquidating Tr.*, 2006 WL 2850110 at *5 (Bankr. D. Del. Oct. 2, 2006); *FDIC v. S. Prawer & Co.*, 829 F. Supp. 453, 455 (D. Me. 1993); *Beta Real Corp. v. Graham*, 839 So.2d 890, 891–92 (Fla. Dist. Ct. App. 2003); *Summers v. Hagen*, 852 P.2d 1165, 1170 (Alaska 1993).

[688] *See, e.g., United States v. Forbes*, 2009 WL 1011475 (D. Conn. Apr. 15, 2009); *In re Heritage Org., LLC,* 413 B.R. 438, 462 (Bankr. N.D. Tex. 2009); *Terry v. June,* 420 F. Supp. 2d 493, 503 (W.D. Va. 2006); *Drenis v. Haligiannis*, 452 F. Supp. 2d 418, 427–28 (S.D.N.Y. 2006); *SEC v. Infinity Group Co.*, 27 F. Supp. 2d 559, 564 (E.D. Pa. 1998).

[689] *See, e.g., United States v. Forbes*, 2009 WL 1011475 (D. Conn. Apr. 15, 2009); *In re Heritage Org., LLC*, 413 B.R. 438, 462 (Bankr. N.D. Tex. 2009); *SEC v. Infinity Group Co.*, 27 F. Supp. 2d 559, 564 (E.D. Pa. 1998).

The author has not come across a case in which a court in a jurisdiction that classifies a fraudulent transfer claim as sounding in equity or contract had to resolve a conflict-of-laws issue, but courts in Delaware (which appears to fall into that category)[690] apply the "most significant relationship" test [of §188 of the *Second Restatement of Conflict of Laws*][691] to resolve conflicts issues arising out of the interpretation and validity of contracts."[692] As mentioned above, when a fraudulent transfer claim is classified as a tort, some courts choose the applicable law either based on lex loci delicti (the place of the wrong)[693] or based on an analysis of the factors prescribed by §145 of the *Second Restatement of Conflict of Laws*.[694]

[690] *See In re Astropower Liquidating Tr.*, 2006 WL 2850110 at *5 (Bankr. D. Del. Oct. 2, 2006) (the claims "are only for recovery of a constructively fraudulent transfer, which is not a tort but a contract claim").

[691] *Restatement (Second) of Conflict of Laws* §188 (Am. Law Inst. 1971).

[692] *Travelers Indem. Co. v. Lake*, 594 A.2d 38, 41 (Del. 1991).

[693] *See, e.g., MainStreet Bank v. Nat'l Excavating Corp.*, 791 F. Supp. 2d 520, 530 (E.D. Va. 2011) (both Maryland and Virginia employ lex loci delicti but apply it differently); *Terry v. June*, 420 F. Supp. 2d 493 (W.D. Va. 2006).

[694] *Restatement (Second) of Conflict of Laws* §145 (Am. Law Inst. 1971). *See, e.g., In re Mirant Corp.*, 675 F.3d 530, 536–38 (5th Cir. 2012) (Texas court applied §145 factors and chose New York not Georgia law); *Feuerbacher v. Moser*, 2012 WL 1070138 (E.D. Tex. Mar. 29, 2012) (Texas court applied §145 factors and chose Texas not Colorado law); *SEC v. Infinity Grp. Co.*, 27 F. Supp. 2d 559, 564–65 (E.D. Pa. 1998) (Pennsylvania court applied §145 factors and chose Ohio not Virginia law); *In re The Heritage Org., LLC*, 413 B.R. 438, 462 (Bankr. N.D. Tex. 2009) (Texas court applied §145 factors and chose Texas not Delaware law); *In re Brown*, *1996 WL 33657614* at *3 (Bankr. D. Alaska Mar. 11, 1996) (Alaska court applied §145 factors and chose Alaska not Belizean law). It appears that Mississippi and Delaware courts will follow this approach if they treat a fraudulent transfer as a tort, *see Hobbs v. Legg Mason Inv. Counsel & Tr. Co.*, *2011 WL 39044* at *3 (N.D. Miss. Jan. 11, 2011) ("Mississippi applies the 'center of gravity' rule to tort matters"); *Sinnott v. Thompson*, 32 A.3d 351, 354 (Del. 2011) ("When conducting a choice of law analysis [in tort matters] Delaware courts follow the most significant relationship test [of §145] in the *Restatement (Second) of Conflict of Laws*"); *Travelers Indem. Co. v. Lake*, 594 A.2d 38, 47 (Del. 1991) (replacing lex loci delicti test with most significant relationship test). For a summary of state choice-of-law methodologies, see Symeonides, *Choice of Law in the American Courts in 2018: Thirty-Second Annual Survey*, 67 Am. J. Comp. L. 1 (Mar. 2019).

Judge MacDonald of the U.S. Bankruptcy Court for the District of Alaska has explained that:[695]

[695] *In re Brown*, *1996 WL 33657614* at *2 (Bankr. D. Alaska Mar. 11, 1996) (citation omitted).

> Two tests have evolved over time to determine the proper choice of law in tort cases. The first is the "lex loci delicti" rule. Under this older rule, the law of the place of the wrong was uniformly applied to all tort cases. In later cases, however, the place of injury alone was not the controlling factor. Alaska has now adopted a second test, "the most significant relationship test," for conflicts of law questions.

Accordingly, if a Virginian created a Nevada APT, then a court in Virginia (which is still governed by the lex loci delicti rule) would probably use Nevada law to determine whether the transfer was fraudulent, unless the court decided that Virginia recognized a strong public policy exception to the application of domestic as well as to foreign law. Given the factors that courts consider under *Restatement* §145 and §188,[696] a court in another state will often be able to use the law of its own state to determine whether the creation of a domestic APT was a fraudulent transfer as well as to set limitations periods.[697]

[696] *Restatement (Second) of Conflict of Laws* §145, §188 (Am. Law Inst. 1971).

[697] *See* Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?* 85 Cornell L. Rev. 1035, 1075–1081 (May 2000).

2. **Terry v. June (2006)** —

Judge Moon of the U.S. District Court for the Western District of Virginia grappled with the choice-of-law rules for fraudulent transfers in *Terry v. June,* [698] which involved the efforts of a receiver appointed by the court to recover funds allegedly distributed by the operator of a Ponzi scheme in violation of federal securities laws. The judge began by describing his task:[699]

[698] 420 F. Supp. 2d 493 (W.D. Va. 2006).

[699] 420 F. Supp. 2d at 499–500.

> [A] United States District Court's choice of law inquiry traditionally occurs as a two step process. First, the court must determine whether federal or state choice of law rules govern. Second, once the court has determined which choice of law rules apply, it must apply these rules to the facts of the case to determine the appropriate substantive laws.

The judge continued:[700]

[700] 420 F. Supp. 2d at 500 (citations and internal quotation marks omitted; cases cited within quote are *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938), and *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941)).

> A federal court exercising diversity or pendent jurisdiction over state law claims must apply the choice of law rules of the forum in determining which law governs those claims. This rule is based on the recognition that the holding of *Erie v. Tompkins* extends to the field of conflict of laws because federal choice of law rules are themselves a species of federal common law. Despite this general prohibition on applying federal choice of law rules to state law claims, the Fourth Circuit has indicated that the presence of a compelling federal interest which dictates otherwise may justify departure from the rule established in *Klaxon*. At issue, therefore, is whether there exists a compelling federal interest in this case sufficient to justify application of federal choice of law rules.

The judge then concluded that no overriding federal interest existed and proceeded to apply Virginia choice-of-law principles.[701]

[701] 420 F. Supp. 2d at 500–02.

Judge Moon considered the nature of a fraudulent transfer claim as follows:[702]

[702] 420 F. Supp. 2d at 502–03 (citations omitted).

> The first step in applying Virginia's choice of law rules is to determine how Virginia would characterize the claim of fraudulent conveyance for choice of law purposes. How Virginia would classify a fraudulent conveyance is a matter of first impression. The Receiver contends, and the Defendant appears to concede, that it should be treated as a claim sounding in tort.

Classification of fraudulent conveyance is not a completely straightforward matter. On the one hand, a claim of fraudulent conveyance resembles an action in tort in that the ultimate issue is not whether the conveyance from grantor to grantee was formally valid as a matter of property law, but rather whether it was done for the purposes of defrauding one's creditors. Many courts and a number of leading commentators have agreed with this approach and have classified these claims as sounding in tort. On the other hand, a number of courts have rejected this tort characterization, holding that fraudulent conveyance claims sound in equity because they seek the equitable remedy of voiding a conveyance rather than damages.

The judge held that, under Virginia law, a fraudulent transfer claim is a tort rather than a matter of equity for the following reasons:[703]

[703] 420 F. Supp. 2d at 503 (citations and internal quotation marks omitted). *Accord Roanoke Cement Co., LLC v. Chesapeake Prods., Inc.*, 2007 WL 2071731 at *7 (E.D. Va. July 13, 2007); *In re Rescue Rangers, LLC*, 576 B.R. 521, 529 (Bankr. E.D. Va. 2017).

> The Court, however, finds that a claim of fraudulent conveyance under Virginia law falls into the sphere of torts. Fraudulent conveyance goes beyond questions of property law since such a conveyance is valid between the parties, and in fact as to the whole world, except those within the protection of the statutes. Such a conveyance, in fact, is valid even as to creditors until they seek protection provided by law. The purpose of a fraudulent conveyance claim is not to determine whether the transfer was void ab initio, but rather it is to determine whether the debtor's actions amounted to a fraud on a creditor, allowing him to recover property notwithstanding its transfer. This focus on the improper and fraudulent character of the debtor's conduct and the injury caused to his creditors places these claims most appropriately in tort law. These claims will therefore be treated as sounding in tort for choice of law purposes.

The court described the implications of its holding that a fraudulent transfer claim sounded in tort as follows:[704]

[704] 420 F. Supp. 2d at 503 (citations and internal quotation marks omitted). *Accord Lucent Techs., Inc. v. Gateway, Inc.*, *2007 WL 1449809* at *13 (S.D. Cal. Oct. 1, 2007); *Roanoke Cement Co., LLC v. Chesapeake Prods., Inc.*, 2007 WL 2071731 at *7–9 (E.D. Va. July 13, 2007); *Terry v. Dowdell*, 2006 WL 2360933 at *2 (W.D. Va. Aug. 11, 2006); *Rescue Rangers*, 576 B.R. at 529.

> It is well established under Virginia law that actions sounding in tort are governed by the law of the place of the wrong, a principle known otherwise as lex loci delicti. It is also established that the place of the wrong for choice of law purposes is the place where the last event necessary to make an actor liable for an alleged tort takes place. No

> Virginia court has determined where the last act necessary to complete a fraudulent conveyance takes place.

Judge Moon concluded:[705]

[705] 420 F. Supp. 2d at 506. *See Rescue Rangers*, 576 B.R. at 529–30.

> The Court finds that Virginia's choice of law principles govern this case. With respect to alleged fraudulent conveyances made by wire transfer, the applicable law will be that of the jurisdiction wherein the receiving bank is located. Thus, wire transfers made to the Defendant's bank in Michigan will be governed by Michigan law and the August 2001 transfer to VRJ, Ltd.'s account in the Bahamas will be governed by Bahamian law. With respect to fraudulent conveyances made by check payments, the applicable law will be that of the jurisdiction wherein the drawee bank is located. Thus, Florida law will govern conveyances made by checks drawn on Dowdell's bank account in Florida.

Although the court held that Bahamian law applied to one of the transfers in question, the court recognized that it might later come to a different conclusion:[706]

[706] 420 F. Supp. 2d (citations and internal quotation marks omitted).

> [T]he Court is aware that the Bahamian law has a reputation for being very debtor-friendly with respect to fraudulent conveyances, to the point where the Bahamas has been used as a jurisdiction to shield funds from creditors. A mechanical application of the lex loci delicti rules, therefore, presents two risks in this context. First, there is the possibility that Bahamian law might be contrary to fundamental forum public policy respecting the ability of creditors to recover funds that have been fraudulently transferred away. Second, there is the risk that blindly applying such law might, in effect, give transferee's of fraudulent conveyances the ability to unilaterally choose the applicable fraudulent conveyance law by structuring their transactions in a way that lead to the application of the desired body of law. That risk is especially apparent in cases where investment conduits are established in countries that have debtor-friendly laws and which otherwise bear no legitimate relationship to the transferee.
>
> The Court is of the opinion that these two risks, depending on the substance of Bahamian law, could lead a Virginia court deciding this matter to eschew application of Bahamian law on public policy grounds. It is well established that although Virginia courts will frequently apply foreign substantive law as a matter of comity, they will not do so if this would contravene fundamental policy interests of the forum. The Court declines to exercise this public policy exception at this time since the parties have not briefed the Court on the substantive provisions of Bahamian fraudulent conveyance law and on whether they conflict with Virginia's public policy. Unless and until the Court becomes convinced that Bahamian law would contravene Virginia public policy, Bahamian law will govern as to the August 2001 conveyance sent to VRJ, Ltd.

Accordingly, if a Virginian created a Nevada APT, a Virginia court probably would use Nevada law to determine whether the transfer was fraudulent, unless it decided that Virginia recognized a strong public policy exception to the application of domestic as well as to foreign law.

3. **In re Heritage Organization, LLC (2009)** —

Judge Houser of the U.S. Bankruptcy Court for the Northern District of Texas struggled with these concepts in *In re Heritage Organization, LLC*,[707] in which the bankruptcy trustee sought to recover $46 million of alleged fraudulent transfers. The choice of the applicable law was critical in determining whether a four-year or a three-year statute of limitations applied.[708] Judge Houser found that she should use Texas choice-of-law principles[709] and that a fraudulent transfer claim was a tort.[710] Quoting from *ASARCO LLC v. Americas Mining Corp.*,[711] she summarized the rules that

Texas courts employ in selecting the law that governs such a claim as follows:[712]

> A claim for fraudulent transfer arises in tort. Texas choice-of law rules for causes of action in tort apply section 145 of the *Restatement (Second) Conflict of Laws*, also described as the “most significant relationship test.” According to section 145, the local law of the state which has the “most significant relationship to the occurrence and the parties” will govern the claim. In applying the *Restatement's* “most significant relationship test,” this Court considers the following factors: (1) the place where the injury occurred; (2) the place where the conduct causing the injury occurred; (3) the domicile, residence, nationality, place of incorporation, and place of business of the parties; and (4) the place where the relationship between the parties is centered. When weighing these four factors, it is not the number of contacts, but the qualitative nature of those particular contacts that determines which state has the most significant relationship to the occurrence and the parties.

In concluding that Texas rather than Delaware law applied, Judge Houser said “as relevant here, the injury occurred in Texas; the conduct causing the injury occurred in Texas; the principal place of business of the Member Defendants and Heritage is in Texas, and the parties’ relationship is centered in Texas.”[713]

Heritage Organization, LLC is not a simple apply-the-law-of-the-forum case. As evidence of this, Judge Houser later used Delaware and Tennessee law rather than Texas law in assessing whether the veils of a variety of entities could be pierced as alter egos.[714]

Given the factors that courts consider under *Restatement (Second) Conflict of Laws* §145, a court in another state often will be able to use its law to determine whether the creation of a domestic APT was a fraudulent transfer and to set limitations periods.[715]

4. **Other Authorities** —

New Jersey's conflicts rules for fraudulent transfers were summarized and applied in a 2008 case.[716] In dictum in a 2011 case,[717] a federal district court in Virginia summarized Maryland's and Virginia's conflicts rules for fraudulent transfers[718] and applied Virginia's fraudulent transfer rules.[719] And, in a 2013 case,[720] the court summarized and applied Pennsylvania's conflicts rules for fraudulent transfers[721] and applied the fraudulent transfer rules of both Pennsylvania[722] and New Jersey.[723]

[707] 413 B.R. 438 (Bankr. N.D. Tex. 2009).

[708] 413 B.R. at 461–62.

[709] 413 B.R. at 462.

[710] 413 B.R. at 462. *Accord In re Cyrus II P'ship*, 413 B.R. 609, 619–21 (Bankr. S.D. Tex. 2008); *Warfield v. Carnie*, 2007 WL 1112591 at *7 (N.D. Tex. Apr. 13, 2007).

[711] 382 B.R. 49, 61–62 (S.D. Tex. 2007).

[712] 413 B.R. at 462.

[713] 413 B.R. at 463.

[714] 413 B.R. at 510–511.

[715] *See* Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?* 85 Cornell L. Rev. 1035, 1075–1081 (May 2000).

[716] *Metex Mfg. Corp. v. Manson Envtl. Corp.*, No. 05-2948, 2008 BL 298665, 2008 WL 474100 (D.N.J. Feb. 15, 2008).

[717] *MainStreet Bank v. Nat'l Excavating Corp.*, 791 F. Supp. 2d 520, 531 (E.D. Va. 2011).

[718] 791 F. Supp. 2d at 529–531.

[719] 791 F. Supp. 2d at 532.

[720] *State Farm Mut. Auto. Ins. Co. v. Snyder*, *2013 WL 5948089* (E.D. Pa. Nov. 6, 2013).

[721] *2013 WL 5948089* at *8.

[722] *2013 WL 5948089* at *4.

[723] *2013 WL 5948089* at *6.

The author addresses the various considerations that come into play when a state is asked to enforce a sister state's judgment in IX.H., below.

5. **TrustCo Bank v. Mathews (2015)** —

Delaware Vice Chancellor Parsons considered conflict-of-laws rules in the fraudulent transfer context in *TrustCo. Bank v. Mathews*,[724] in which creditors attempted to reach the assets of Delaware APTs to satisfy the settlor's loan guarantees. He summarized the controversy at the outset:[725]

[724] 2015 WL 295373 (Del. Ch. Jan. 22, 2015).

[725] 2015 WL 295373 at *1.

> This action involves allegedly fraudulent transfers. The parties dispute which state's law and, more importantly, which state's statute of limitations applies. The plaintiffs assert that New York's six-year or two-years-from-discovery statute of limitations governs the plaintiffs' claims. The defendants argue that either Delaware or Florida law controls and that most of the plaintiffs' claims are barred by the identical four-year or one-year-from-notice statutes of limitations adopted by both of those states. Before the Court is the defendants' motion for partial summary judgment on the statute of limitations issue. For the reasons that follow, I conclude that New York's statute of limitations does not apply to this case and grant the defendants' motion for partial summary judgment. Even if New York law did apply, however, the defendants still would be entitled to summary judgment. The plaintiffs' primary fraudulent transfer claims, therefore, are time barred.

The Vice Chancellor then summarized the pertinent restatement rules:[726]

[726] 2015 WL 295373 at *9 (footnotes and internal quotation marks omitted).

> The *Restatement* factors differ slightly depending on whether the alleged wrong sounds in tort or contract. For torts, the relevant factors are: (a) the place where the injury occurred, (b) the place where the conduct causing the injury occurred, (c) the domicil, residence, nationality, place of incorporation and place of business of the parties, and (d) the place where the relationship, if any, between the parties is centered. For contract claims, the relevant factors are: (a) the place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject matter of the contract, and (e) the domicil, residence, nationality, place of incorporation and place of business of the parties. In both the tort and the contract contexts, the *Restatement* directs that these factors are to be evaluated according to their relative importance with respect to the particular issue.

He then described the difficulty in classifying a fraudulent transfer:[727]

[727] 2015 WL 295373 (footnotes omitted).

> Fraudulent transfers bear some resemblance to both tort and contract claims and do not fit neatly into either

> category. Fraud claims, for example, sound in tort. A fraudulent transfer, however, does not necessarily require misrepresentation or scienter. Indeed, such a transfer can occur even without proof of fraudulent intent if, for example, the debtor did not receive reasonably equivalent value in the exchange and the transfer results in the debtor having unreasonably small assets in relation to its business. Transactions of this kind can reduce the likelihood that the debtor will be able to satisfy its contractual obligations, such as, for example, paying off a loan obtained from a creditor. From this perspective, a fraudulent transfer may appear more like a contract claim and some courts have so concluded.

Given this difficulty, Vice Chancellor Parsons applied both tests.[728] Regarding the tort test, the Vice Chancellor stated: "Overall, I conclude that the tort factors from the *Restatement* moderately favor Florida. Delaware has the next strongest connection to this case, with New York having the weakest relationship to it."[729] Regarding the contract test, he found that "the contract factors therefore are either in equipoise between New York and Florida or only weakly favor New York."[730] After analyzing all the above factors, Vice Chancellor Parsons held:[731]

[728] 2015 WL 295373.

[729] 2015 WL 295373 at *10.

[730] 2015 WL 295373 at *11.

[731] 2015 WL 295373 Vice Chancellor Parsons summarized the Delaware Act but found it unnecessary to apply it (2015 WL 295373 at * 11–12).

> Regardless of which of these three states has the most significant relationship with this case, therefore, I conclude that Plaintiffs still 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 is longer. Because Plaintiffs did not file this action relating to the ITRAX Transfers until after the expiration of that time period, I hold that their claims regarding the ITRAX Transfers are barred by laches.

6. **Implications of the UVTA** —

As will be covered in VIII.E., below, the UVTA confronts the choice-of-laws issues for fraudulent transfers directly.

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E. The Uniform Voidable Transactions Act

1. **Introduction** —

It is clear from the preceding section that the conflicts rules in the fraudulent transfer context are muddled.[732] In 2014, the Uniform Law Commission ("ULC"), also known as the National Conference of Commissioners on Uniform State Laws, adopted amendments to the Uniform Fraudulent Transfer Act ("UFTA") and "refreshed" the UFTA's official comments (the "Comments"). Among other things, the amendments renamed the UFTA as the Uniform Voidable Transactions Act ("UVTA") and added a new §10 [733] that provides that the law of an individual's residence is to be the governing law concerning whether such individual has made a voidable transfer. The true impact of §10 is most felt with respect to self-settled spendthrift trusts ("SSSTs"), which are most often referred to as "asset-protection trusts" ("APTs"), where the settlor of an irrevocable trust remains a permissible recipient of the income and principal from such trust.

[732] This Section E is derived from George D. Karibjanian, Richard W. Nenno & Daniel S. Rubin, *The Uniform Voidable Transactions Act: Why Transfers to Self-Settled Spendthrift Trusts by Settlors in Non-APT States Are Not Voidable Transfers Per Se*, 42 Tax Mgmt. Est., Gifts & Tr. J. 173 (July 14, 2017).

[733] Unless otherwise specified, section references throughout this Section E refer to sections of the UVTA.

Unfortunately, the revisions to the Comments state that a transfer to an SSST is automatically a voidable transfer without more and, therefore, an individual who lives in a state that does not recognize APTs[734] (a "Non-SSST State") cannot protect assets from even a mere potential future (and unknown) creditor by creating an APT in a state that recognizes APTs (an "SSST State").[735] Inasmuch as such comments are erroneous and do not in any way reflect the actual state of the law in this regard, states considering adopting the UVTA should delete and disavow the comments and replace them with language that reflects the actual state of the law.

[734] The author intends that, in an effort to succinctly denote certain issues, he may refer to a jurisdiction that does not "recognize" an SSST or an APT as a "Non-SSST State"; such phrase is intended to mean that the particular state does not recognize the creditor protection afforded to the trustor of the APT, thereby allowing the creditors of the trustor to reach the assets held in the trust even though the trust is irrevocable. *See, e.g.*, Unif. Trust Code §505(a) (amended 2018).

[735] As explained later in this Section E, APTs have only existed in the United States since 1997 when Alaska adopted Alaska Stat. §34.40.110. It is noted that a state that recognizes the validity of APTs has, obviously, modified its law in this regard.

The author will use the term "UFTA" when referring to pre-UVTA law and the term "UVTA" when referring to the 2014 amendments and to the laws of states that have adopted such amendments. Additionally, because the effect of the erroneous comments extends to lifetime marital deduction trusts, lifetime credit shelter trusts, charitable remainder trusts, grantor retained annuity trusts, and qualified personal residence trusts, all self-settled spendthrift trusts, as well as to APTs, this Section E will refer to SSSTs, in general, and not simply to APTs.

2. **Background** —

Throughout the history of SSSTs, primarily for those SSSTs created by individuals who are domiciled in a Non-SSST state, creditors have consistently argued that the transfer to the SSST is a violation of the domiciliary state's fraudulent transfer laws. Citing the domiciliary state's version of §4(a)(1) of the UFTA (or similar statute if the domiciliary state has not adopted the UFTA), the creditor often argued that the transfer was done with actual intent to hinder, delay, or defraud the debtor's creditors.[736] The debtor's defense was that the debtor was free to create the SSST in the SSST State so long as the requisite contacts to the SSST State were present, and, under the laws of the SSST State, a transfer to an SSST was valid and authorized. Further, unless the creditor could prove that the debtor's transfer to the SSST was intended to avoid that specific creditor, the SSST State's laws would prohibit the trustee of the SSST from satisfying the debt.[737] As a result, the two states' laws appeared to be in conflict so there was no definitive law upon which a court could rely.

[736] UFTA §4(a)(1) (1984), prior to its modification by the UVTA, provides as follows:

> "(a) 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…"

[737] *See, e.g.*, Del. Code Ann. tit. 12, §3572(a), which provides as follows:

> "§3572 Avoidance of qualified dispositions.
>
> (a) Notwithstanding any other provision of this Code, no action of any kind, including, without limitation, 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 avoidance of a qualified disposition unless such action shall be brought pursuant to the provisions of §1304 or §1305 of Title 6 and, in the case of a creditor whose claim arose after a qualified disposition, unless the qualified disposition was made with actual intent to defraud such creditor. The Court of Chancery shall have exclusive jurisdiction over any action brought with respect to a qualified disposition."

3. **Creation of UVTA §10** —

In 2012, the ULC formed a committee ("Committee") to draft amendments to the UFTA. As referenced above, in addition to renaming the UFTA, the UVTA contains a new §10 that focused on the question of which state's law determines whether a voidable transfer has occurred when contacts with multiple states are involved.[738] For an individual debtor, §10(b) provides that "[a] claim for relief in the nature of a claim for relief under this [Act] is governed by the local law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred."[739]

[738] UVTA §10 (2014).

[739] UVTA §10(b) (2014).

In this regard, §10(a) provides that "[a] debtor who is an individual is located at the individual's principal residence…"[740]

[740] UVTA §10(a) (2014).

4. **Apparent Intent Behind UVTA §10** —

Hence, although the question of which state's law was the applicable law before the UVTA was often unclear, the determination of whether an individual has made a voidable transfer in a state that has enacted the UVTA is clearly based on the law of the state of the debtor's principal residence.

5. **Connecting the Dots in the Comments** —

Specifically, the final paragraph of Comment 8 under §4 of the UVTA (which section specifies the transfers that shall be deemed voidable), says:[741]

[741] UVTA §4 cmt. 8 (2014).

> Because the laws of different jurisdictions differ in their tolerance of particular creditor-thwarting devices, choice of law considerations may be important in interpreting §4(a)(1) as in force in a given jurisdiction. For example…the language of §4(a)(1) historically has been interpreted to render voidable a transfer to a self-settled spendthrift trust. Suppose that jurisdiction X, in which this Act is in force, also has in force a statute permitting an individual to

> establish a self-settled spendthrift trust and transfer assets thereto, subject to stated conditions. If an individual Debtor whose principal residence is in X establishes such a trust and transfers assets thereto, then under §10 of this Act the voidable transfer law of X applies to that transfer. That transfer cannot be considered voidable in itself under §4(a)(1) as in force in X, for the legislature of X, having authorized the establishment of such trusts, must have expected them to be used.…By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has no legislation validating such trusts, and if Debtor establishes such a trust under the law of X and transfers assets to it, then the result would be different. Under §10 of this Act, the voidable transfer law of Y would apply to the transfer. If Y follows the historical interpretation referred to in Comment 2, the transfer would be voidable under §4(a)(1) as in force in Y.

In this regard, Comment 2 under §4 of the UVTA provides in pertinent part:[742]

[742] UVTA §4 cmt. 2 (2014).

> Section 4, unlike §5, protects creditors of a debtor whose claims arise after as well as before the debtor made or incurred the challenged transfer or obligation. Similarly, there is no requirement in §4(a)(1) that the intent referred to be directed at a creditor existing or identified at the time of transfer or incurrence. For example, promptly after the invention in Pennsylvania of the spendthrift trust, the assets and beneficial interest of which are immune from attachment by the beneficiary's creditors, courts held that a debtor's establishment of a spendthrift trust for the debtor's own benefit is a voidable transfer under the Statute of 13 Elizabeth, without regard to whether the transaction is directed at an existing or identified creditor…

Therefore, the gist of Comment 8 under §4 of the UVTA, in light of the historic interpretation referred to in Comment 2, is the following: Suppose that New York, which has not adopted SSST legislation, adopts the UVTA. If a New York resident thereafter creates an SSST in Delaware (which is an SSST State and also permits a nonresident of Delaware to create such trusts),[743] pursuant to §10 of the UVTA, New York law would apply as if the UVTA had been enacted in Delaware. As a consequence, the creation of the SSST would be deemed a voidable transfer per se, thereby undoing all transfers to the SSST, and every creditor—even a completely unanticipated future creditor—would be able to enforce claims against the trust's assets.

[743] For example, pursuant to Del. Code Ann. tit. 12, §3570(8), this is accomplished in large part through the simple expedient of naming a Delaware-sitused trustee as at least one of the trustees of the trust.

Is this really what was intended by the enactment of §10 and all referencing Comments? As noted, when adopting the UVTA, the Reporter took the opportunity to “refresh” the Comments. If, upon analyzing §10 and all referencing Comments, the intention behind such provisions were unclear, the Reporter, in his “white paper” discussing the UVTA and the Comments, left no doubt as to the intentions by stating the following: [744]

[744] Kettering, *The Uniform Voidable Transactions Act; or, the 2014 Amendments to the Uniform Fraudulent Transfer Act*, 70 Bus. Law. 777, 800–01 (Summer 2015) (cited as the “White Paper”).

> The avoidance laws of some jurisdictions are substantially debased by comparison with the UVTA. That is notably so in “asset havens” that have eviscerated, or completely expunged, their avoidance laws, commonly as part of a package of local laws that facilitate the local formation of so-called “asset-protection trusts” by persons seeking to shield their assets from their creditors…Section 10 reflects the committee's conclusion, which was to include no escape hatch in the statutory text. It addresses asset tourism through a comment stating that a debtor's “principal residence,” “place of business,” or “chief executive office” should be determined on the basis of genuine and sustained activity, not on the basis of artificial manipulations.

6. **Dissecting SSST Law—Trust Law or Voidable Transfer Law?** —

Regrettably, the Reporter's Comments about SSSTs appear to reflect his individual disapproval of these vehicles and, perhaps on that basis, seriously misstate the law. The result that follows from Comment 8 is flawed in two important respects.

First, the law does not provide that a transfer to an SSST is a voidable transfer per se but rather that the transfer must still be proven to have been made either with an intent to hinder, delay, or defraud creditors or in connection with the debtor's insolvency.

Second, the applicable law in connection with the question of the creditor protection afforded through a transfer to a trust, including an SSST, has historically been determined (including under the Pennsylvania cases referenced in Comment 2 under §4 of the Comments) under Chapter 10 (§267–§282) of the Second Restatement of Conflict of Laws, [745] and not fraudulent transfer law (including the UFTA and the UVTA).

[745] *Restatement (Second) of Conflict of Laws* §267–§282 (Am. Law Inst. 1971).

7. **Origins in English Law—The Statute of Henry VII vs. the Statute of Elizabeth I** —

The rules that allow creditors to set aside voidable transfers began with a single statute, called the Statute of Elizabeth, [746] which was enacted in England in 1571 during the reign of Queen Elizabeth I, the last Tudor monarch. However, the ability of creditors to reach the assets of SSSTs comes from an entirely different English statute[747] —one which was enacted almost a century earlier during the reign of Queen Elizabeth's forebear, King Henry VII.[748]

[746] Statute of 13 Eliz. I, c.5 (1571).

[747] Statute 3 Hen. VII, c.4 (1487).

[748] History notes that it was King Henry VII who founded the Tudor dynasty in 1485 when he and his forces defeated the infamous King Richard III (who was the last Plantagenet ruler) and his supporters at the battle of Bosworth Field, thus ending the War of the Roses.

This distinction plays an important role in understanding the origins of current law. Dean Griswold explained this distinction in 1947:[749]

[749] Griswold, *Spendthrift Trusts* §473 at 539–40 (2d ed. 1947) (footnotes omitted).

> Many states have expressly reenacted the substance of a statute which was first passed in England in 1487. This statute provided that “All 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.” In its original form the statute applies in terms only to gifts of goods and chattels, and it has been held that it applies only to gifts made for the sole benefit of the settlor. It was not directed against trusts made with fraudulent intent, but was a prohibition of trusts for the benefit of the settlor on the ground that such a trust was against public policy. All trusts to which a statute of this type applies are invalid against the claims of any creditor, whether the trusts are spendthrift trusts or not.

Hence, there was no need for the later-enacted Statute of Elizabeth to cover the potential abuses of SSSTs because that issue already had been addressed almost a century earlier!

8. **Application of the Restatements of Trusts and the Uniform Trust Code** —

The *Restatements of Trusts* incorporate this historic rule against SSSTs (the “Historic Self-Settled Trust Rule”). The pertinent provision of the *Second Restatement of Trusts* provides: [750]

[750] *Restatement (Second) of Trusts* §156 (Am. Law Inst. 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.

Existing and subsequent creditors may reach a settlor-beneficiary's interest regardless of whether the creation of the trust was a fraudulent transfer: [751]

[751] *Restatement (Second) of Trusts* §156 cmt. a (Am. Law Inst. 1959).

> The rules stated in this Section are applicable although the transfer is not a fraudulent conveyance. The interest of the settlor-beneficiary can be reached by subsequent creditors as well as by those who were creditors at the time of the creation of the trust, and it is immaterial that the settlor-beneficiary had no intention to defraud his creditors.

Similarly, the relevant section of the *Third Restatement* provides that: "[a] restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid."[752]

[752] *Restatement (Third) of Trusts* §58(2) (Am. Law Inst. 2003). *See* Scott, Fratcher & Ascher, 3 *Scott and Ascher on Trusts* §15.4–§15.4.4 at 951–989 (5th ed. 2007); Shapo, Bogert & Bogert, *The Law of Trusts and Trustees* §223 at 423–491 (3d ed. 2007).

Like the *Second Restatement*, the *Third Restatement* provides that "the rule of this subsection does not depend on the settlor having made a transfer in fraud of creditors." [753]

[753] *Restatement (Third) of Trusts* §58(2) cmt. e (Am. Law Inst. 2003).

The comparable rule in the Uniform Trust Code ("UTC") is §505(a)(2), which provides, in pertinent part: [754]

[754] UTC §505(a)(2) (amended 2018). To view the text of the UTC and a list of jurisdictions that have enacted it (currently 35), go to www.uniformlaws.org.

> Section 505. Creditor's Claim Against Settlor.
>
> (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...

Again, a fraudulent transfer showing is not required: [755]

[755] UTC §505(a)(2) cmt. (amended 2018).

> This section does not address possible rights against a settlor who was insolvent at the time of the trust's creation or was rendered insolvent by the transfer of property to the trust. This subject is instead left to the State's law on fraudulent transfers.

To summarize, the Historic Self-Settled Trust Rule stands for the proposition that a transfer by the settlor to a trust for the benefit of the settlor is reachable by the settlor's creditors. This infers that the transfer itself is a valid transfer, but that it is ineffective in insulating the assets from the settlor's creditors. Accordingly, the Historic Self-Settled Trust Rule continues to be applicable, generally, under modern trust law (with the exception of those states that have chosen to permit SSSTs to be created under their respective laws).[756]

[756] Notably, as of July 1, 2019, 19 states—Alaska, Connecticut, Delaware, Hawaii, Indiana, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming—authorize some form of domestic APT. The District of Columbia and every other state (except Connecticut, where the question is governed by caselaw) follow the Historic Self-Settled Trust Rule and have a trust statute that either is derived from, or resembles, UTC §505 and authorizes creditors to reach the settlor's retained interest or the assets of an SSST at least under its own law, irrespective of whether the transfer funding the trust was a voidable transfer.

What is missing from this historical analysis is the phrase “voidable transfer per se.” Voidable transfer per se means that the entire transaction is a nullity. As stated above, the Historic Self-Settled Trust Rule does not provide that the transaction is a nullity. The transfer is valid, but the settlor's creditors may reach the assets held in the trust. The most interesting element to the “voidable transfer per se” argument is that no statutory provision of the UFTA or the UVTA provides that a transfer to an SSST is automatically a voidable transfer. To the best of the author's knowledge, no statute exists that declares a transfer to an SSST to be a voidable transfer per se. Instead, creditors’ rights vis-à-vis SSSTs are governed by trust law and not voidable-transfer law.

9. **Historical Caselaw Analysis—Flawed Arguments for Support** —

In an attempt to support the proposition that established law provides that a transfer to an SSST is automatically a voidable transfer, Comment 2 under §4 of the UVTA cites to three Pennsylvania cases from the nineteenth century; to wit, *Mackason's Appeal*,[757] *Ghormley v. Smith*,[758] and *Patrick v. Smith* [759] (the 19th-Century Decisions). The problem with reliance on the 19th-Century Decisions is that neither Pennsylvania's version of the UFTA,[760] enacted in 1993, nor its version of the UVTA amendments, enacted in 2017,[761] provides that a transfer to an SSST is a voidable transfer per se. Moreover, in 2010, Pennsylvania enacted UTC §505(a)(2) to the effect that “[a] judgment creditor or assignee of the settlor of an irrevocable trust may reach the maximum amount that can be distributed to or for the settlor's benefit,”[762] thereby obviating through its trust law any need for a transfer to an SSST created under Pennsylvania law to be deemed a voidable transfer per se. Clearly, if the Pennsylvania legislature deemed a transfer to an SSST to be a voidable transfer without more, it would have so provided in its version of UTC §505. It did not. That, in and of itself, should invalidate any reliance on the 19th-Century Decisions in determining the legal effect of transfers to an SSST.

[757] 42 Pa. 330, 338–39 (1862).

[758] 21 A. 135, 137 (Pa. 1891).

[759] 2 Pa. Super. 113, 199 (1896).

[760] 12 Pa. Cons. Stat. §5101–§5110.

[761] 2017, Dec. 22, P.L. 1249, No. 78, §2.

[762] 20 Pa. Cons. Stat. §7745(2).

Subsequent to the release of the UVTA and the Comments, the White Paper similarly cited early cases from Missouri,[763] Tennessee,[764] and Virginia[765] in support of the Comment's approach.[766] As in Pennsylvania, however, whatever precedential effect those decisions may have had no longer exists. Again, this is because neither Missouri's nor Tennessee's version of the UFTA,[767] or Virginia's idiosyncratic voidable-conveyance statute,[768] actually states that a transfer to an SSST is a voidable transfer per se. In addition, all three states now permit APTs.[769]

[763] *Jamison v. Miss. Valley Tr. Co.*, 207 S.W. 788, 789 (Mo. 1918).

[764] *Menken Co. v. Brinkley*, 31 S.W. 92, 94–95 (Tenn. 1895).

[765] *Petty v. Moores Brook Sanitarium*, 67 S.E. 355, 356–57 (Va. 1910).

[766] Kettering, *The Uniform Voidable Transactions Act; Or the 2014 Amendments to the Uniform Fraudulent Transfer Act*, 70 Bus. Law. 777, 802 n.110 (Summer 2015).

[767] Mo. Rev. Stat. §428.005–§428.059; Tenn. Code Ann. §66-3-301–§66-3-313.

[768] Va. Code Ann. §55-80–§55-105.

[769] Mo. Rev. Stat. §456.5-505(3); Tenn. Code Ann. §35-16-101–§35-16-112; Va. Code Ann. §64.2-747, §64.2-745.1–§64.2-745.2.

10. **Recent Case Analysis Actually Supports Historic Self-Settled Trust Rule**

a. **Introduction** —

Recent cases in other jurisdictions demonstrate that the creditor protection afforded by an SSST is an issue that is to be resolved using trust law principles and that the transfers of property funding such trusts are not to be deemed voidable transfers per se.

b. **Rush University Medical Center v. Sessions (2012)** —

In *Rush University Medical Center v. Sessions*,[770] the Illinois Supreme Court set aside transfers to an offshore trust that were frustrating a creditor's ability to enforce a large charitable pledge of the debtor. The issue was whether the debtor's trust was invalid vis-à-vis the creditor's claim under the Historic Self-Settled Trust Rule or whether Illinois's adoption of the UFTA had supplanted that rule, in which event the creditor would have been required to prove that transfers to the trust were fraudulent transfers.

[770] 980 N.E.2d 45 (Ill. 2012).

The court first noted that Illinois's adoption of the UFTA generally supplemented—and did not supplant—common-law principles and found no irreconcilable difference between the Historic Self-Settled Trust Rule and the UFTA.[771] The court then contrasted the purposes of the UFTA and the Historic Self-Settled Trust Rule. Regarding the UFTA, it said, "[i]t has been stated that the general purpose of the Act is to "protect a debtor's unsecured creditors from unfair reductions in the debtor's estate to which creditors usually look to security."[772]

[771] 980 N.E.2d at 51–52.

[772] 980 N.E.2d at 52 (citation and internal quotation marks omitted).

In contrast, the Court described the purpose of the Historic Self-Settled Trust Rule as follows:[773]

[773] 980 N.E.2d at 52 (footnote, citation, and internal quotation marks omitted).

> The common law rule also has a general purpose of protecting creditors, but it addresses the specific situation where an interest is retained in a self-settled trust with a spendthrift provision. Traditional law is that if a settlor creates a trust for the settlor's own benefit and inserts a spendthrift clause, the clause is void as to the then-existing and future creditors, and creditors can reach the settlor's interest under the trust. And the 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 reconciled the two doctrines as follows:[774]

[774] 980 N.E.2d at 52.

> Both 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. Additionally, the Act and the common law rule each operate in some circumstances where the other does not, thus negating any inference that the common law rule would render the Act superfluous. The Act is effective, but the common law rule is not, in a much larger sphere, which includes both situations that do not involve trusts and in connection with transfers into trusts that are not for the settlor's benefit because they permit distributions only to other persons.

Importantly, the court continued:[775]

[775] 980 N.E.2d at 53. *Accord Hickory Point Bank & Trust, FSB v. Natural Concepts, Inc.*, 2017 WL 1392860 at *3 (Ill. App. Ct. Apr. 11, 2017).

> We also do not find any displacement of the common law rule by the language in section 5 of the Act, as it is not a fraudulent transfer of funds that renders the trust void as to creditors under the common law, but rather it is the spendthrift provision in the self-settled trust and the settlor's retention of the benefits that renders the trust void as to creditors.

The *Rush University* decision illustrates that the Historic Self-Settled Trust Rule is alive and well in Illinois and in many other states notwithstanding enactment of the UFTA (or, now, the UVTA). This means that statutes of limitations, fraudulent transfer rules, and burdens of proof will be of no avail to a trustee who defends an SSST created under the law of a state that does not yet have SSST legislation. Under the law of a state that does have such legislation, a creditor must prove the necessary facts underlying the claim of a voidable transfer in connection with the funding of the trust—and not merely allege that all transfers to self-settled spendthrift trusts are voidable transfers per se.

c. **Waldron v. Huber (In re Huber) (2013)** —

In *Waldron v. Huber (In re Huber)*,[776] the Bankruptcy Court for the Western District of Washington allowed a Washington bankruptcy trustee to access the assets of an Alaska APT created by a Washington resident.

[776] 493 B.R. 798 (Bankr. W.D. Wash. 2013).

The first issue that the court had to decide was whether to apply Alaska or Washington law to the trust. Regarding this issue, the court began:[777]

[777] 493 B.R. at 807.

> In federal question cases with exclusive jurisdiction in federal court, such as bankruptcy, the court should apply federal, not forum state, choice of law rules. In applying federal choice of law rules, courts in the Ninth Circuit follow the approach of the Restatement (Second) of Conflict of Laws (1971).

The court continued by quoting §270(a) of the *Second Restatement of Conflict of Laws* [778] (referred to in this section as the "*Restatement*"), which provides:[779]

[778] 493 B.R. at 807.

[779] *Restatement (Second) of Conflict of Laws* §270 (Am. Law Inst. 1971).

> 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 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.

The court then applied the above principles to the case at hand:[780]

[780] *Huber*, 493 B.R. at 808–09 (citation and internal quotation marks omitted).

> Under the *Restatement*, the Debtor's choice of Alaska law designated in the Trust should be upheld if Alaska has a substantial relation to the Trust. *Restatement* §270(a). Comment b 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. These contacts with the state are not exclusive. In the instant case, it is undisputed that at the time the Trust was created, the settlor was not domiciled in Alaska, the assets were not located in Alaska, and the beneficiaries were not domiciled in Alaska. The only relation to Alaska was that it was the location in which the Trust was to be administered and the location of one of the trustees, AUSA.

Conversely, it is undisputed that at the time the Trust was created, the Debtor resided in Washington; all of the property placed into the Trust, except a $10,000 certificate of deposit, was transferred to the Trust from Washington; the creditors of the Debtor were located in Washington; the Trust beneficiaries were Washington residents; and the attorney who prepared the Trust documents and transferred the assets into the Trust was located in Washington. Accordingly, while Alaska had only a minimal relation to the Trust, using the test set forth in Comment b, Washington had a substantial relation to the Trust when the Trust was created.

Having determined that Washington rather than Alaska had the most substantial relation to the trust, the court continued:[781]

[781] 493 B.R. at 809 (citation omitted).

> Additionally, Washington State has a strong public policy against self-settled asset protection trusts. Specifically, pursuant to RCW 19.36.020, transfers made to self-settled trusts are void as against existing or future creditors. This statute has been in existence for well over a century, as it was first enacted in 1854.

The court concluded that "[i]n accordance with §270 of the Restatement, this court will disregard the settlor's choice of Alaska law, which is obviously more favorable to him, and will apply Washington law in determining the Trustee's claim regarding validity of the Trust."[782]

[782] 493 B.R. at 809.

As an aside, albeit an important one, the court misapplied the *Restatement*, under which issues are divided into matters of validity, governed by §270, and construction, administration, and creditor rights, governed by other sections of the *Restatement*. Under this framework, matters of "validity" are confined to issues such as whether the trust violates the rule against perpetuities or the rule against accumulations.[783] In contrast, it is §273 of the *Restatement* [784] that deals specifically with the question of a creditor's ability to reach trust assets, and provides that the law designated by the settlor governs—without stated exception. Section 273 of the *Restatement* provides, in pertinent part, as follows:[785]

[783] *Restatement (Second) of Conflict of Laws* §269 cmt. d (Am. Law Inst. 1971).

[784] *Restatement (Second) of Conflict of Laws* §273 (Am. Law Inst. 1971).

[785] *Restatement (Second) of Conflict of Laws* §273(d) (Am. Law Inst. 1971).

> §273 Restraints on Alienation of Beneficiaries' Interests.
>
> Whether the interest of a beneficiary of a trust of movables is assignable by him and can be reached by his creditors is determined …
>
> (b) in the case of an inter vivos trust, by the local law of the state, if any, in which the settlor has manifested an intention that the trust is to be administered, and otherwise by the local law of the state to which the administration of the trust is most substantially related.

Referring to §273, commentators wrote in 2018:[786]

[786] Gideon Rothschild & Daniel S. Rubin, *Minimize Creditor Challenges to Self-Settled Spendthrift Trusts*, 157 Tr. & Est. 14, 19 n.26 (Nov. 2018).

> It would seem as though there should be no question under the conflicts of law that whether a self-settled trust is available to the settlor's creditors is a question governed by the law set forth by the settlor within the trust instrument as being its governing law.

Having found that Washington law governed, the court turned to Wash. Rev. Code §19.36.020,[787] which provides:[788]

[787] *Huber*, 493 B.R. at 809.

[788] Wash. Rev. Code §19.36.020.

> That all deeds of gift, all conveyances, and all transfers or assignments, verbal or written, of goods, chattels or things in action, made in trust for the use of the person making the same, shall be void as against the existing or subsequent creditors of such person.

The court concluded that "[t]he Trust is admittedly a self-settled trust. In accordance with RCW §19.36.020, the Debtor's transfers of assets into the Trust were void as transfers made into a self-settled trust."[789]

[789] *Huber*, 493 B.R. at 809.

Based on this conclusion alone, it would appear that, (a) the plain language of Wash. Rev. Code §19.36.020, by the use of the word "void," adopts the "voidable transfer per se" approach, and (b) the Court agreed that all of the transfers into the Alaska APT were void. This, however, is incorrect. Read carefully, Wash. Rev. Code §19.36.020 is stating that the transfers are void as to existing or subsequent creditors, meaning that they are reachable by the creditors. If the transfers were voidable per se, the transfers would be void as to all parties, not just to the existing or subsequent creditors. Read differently, the transfers to the trust are valid, but not as to any existing or subsequent creditor, which is another way of stating that assets are reachable by such creditors. As to the second point, if that were the court's conclusion, that would be the end of the opinion and analysis. Often, if a court is presented with two arguments, and it finds that a clear decision is reached on the first point, there is no need to discuss the second issue. This did not occur with the Huber decision. Instead, the court continued with the next issue.

The bankruptcy trustee had also alternatively sought summary judgment arguing that transfers to the trust were voidable under 11 U.S.C. §548(e)(1),[790] which provides:

[790] 493 B.R. at 811.

> 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.

The parties agreed that the first three elements were satisfied and that the controversy involved the fourth element.[791] After analyzing various badges of fraud,[792] the court determined:[793]

[791] *Huber*, 493 B.R. at 811.

[792] 493 B.R. at 812–14.

[793] 493 B.R. at 814.

> [T]he evidence presented by the Trustee supports an inference of actual fraudulent intent by the Debtor to hinder, delay, or defraud his current or future creditors, in violation of §548(e)(1)(D). The Trustee is entitled to summary judgment on this claim as a matter of law.

Clearly, however, the above analysis regarding the actual fraudulent intent of the debtor to hinder, delay, or defraud his current or future creditors, would have been unnecessary if a transfer to an SSST constituted a voidable transfer per se under 11 U.S.C. §548(e)(1).

The court next turned to the bankruptcy trustee's contention that summary judgment was warranted because transfers to the trust constituted fraudulent transfers under 11 U.S.C. §544(b)(1) and Wash. Rev. Code §19.40.041(a).[794]

[794] 493 B.R. at 814. 11 U.S.C. 544(b)(1) provides, in pertinent part, as follows: “[T]he 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.”

Under 11 U.S.C. §544(b)(1) and applicable Washington law, the bankruptcy trustee could set transfers to the trust aside under Wash. Rev. Code §19.40.041(a)(1),[795] which provides:[796]

[795] *Huber*, 493 B.R. at 814.

[796] Wash. Rev. Code §19.40.041(a)(1). Effective July 23, 2017, Washington replaced §19.40.041 with the corresponding provision of the UVTA (2017 Wash. Sess. Laws 57).

> (a) 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 ….

After analyzing badges of fraud,[797] the court concluded:[798]

> [V]iewing the evidence in the light most favorable to the Debtor, the Trustee has established that there is no genuine dispute as to any material fact, and the Trustee is entitled to summary judgment as a matter of law on its UFTA claim based on actual fraudulent intent.

Again, the court would not have had to go through this analysis if a transfer to an SSST were a fraudulent transfer per se under Washington's UFTA.

d. **In re Mortensen (2011)** —

In *In re Mortensen*,[799] the Bankruptcy Court in the District of Alaska considered, inter alia, the debtor's motion to reconsider a holding that the transfer of a parcel of Alaska real property to an Alaska APT should be set aside under 11 U.S.C. §548(e)(1). The court rejected the debtor's contention that the Court's prior ruling meant that the transfer was a voidable transfer per se:[800]

> The defendants contend the essence of the court's ruling is that any transfer to a self-settled trust made within 10 years of the filing of a bankruptcy petition is a fraudulent conveyance. They base this contention on my finding that a settlor's expressed intention to protect assets placed into a self-settled trust from a beneficiary's potential future creditors can be evidence of an intent to defraud. I made this finding notwithstanding AS 34.40.110(b)(1), which specifies that a settlor's expressed intention to protect trust assets from a beneficiary's potential future creditors is not evidence of an intent to defraud.
>
> The defendants say the court should not use the creation of the trust itself as evidence of fraudulent intent, but should instead deal solely with the transfer of the property. However, when property is transferred to a self-settled trust with the intention of protecting it from creditors, and the trust's express purpose is to protect that asset from creditors, both the trust and the transfer manifest the same intent. In this case, I found that the trust's express purpose could provide evidence of fraudulent intent. However, it was not the only evidence upon which I based my decision.

The court analyzed the additional evidence as follows:[801]

> The defendants contend there is scant evidence of Mortensen's actual intent to defraud his creditors. Mortensen's intent goes to the heart of this matter. Because this element is often difficult to prove with direct evidence, courts will look to circumstantial “badges of fraud” to determine fraudulent intent.
>
> Among the more common circumstantial indicia of fraudulent intent at the time of the transfer are: (1) actual or threatened litigation against the debtor; (2) a purported transfer of all or substantially all of the debtor's

[797] *Huber*, 493 B.R. at 814–16.

[798] 493 B.R. at 816 (footnote omitted).

[799] *2011 WL 5025252* (Bankr. D. Alaska July 8, 2011). The prior opinions were *In re Mortensen*, *2011 WL 5025288* (Bankr. D. Alaska Jan. 14, 2011), and *In re Mortensen*, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011).

[800] *2011 WL 5025252* at *1 (footnotes and internal quotation marks omitted).

[801] *2011 WL 5025252* at *2 (footnotes and internal quotation marks omitted).

> property; (3) insolvency or other unmanageable indebtedness on the part of the debtor; (4) a special relationship between the debtor and the transferee; and, after the transfer, (5) retention by the debtor of the property involved in the putative transfer.
>
> The defendants argue that when Mortensen placed the Seldovia property in trust he actually increased his vulnerability to creditors because he replaced an exempt homestead with non-exempt cash. I disagree. He placed most of the cash he received from his mother into the trust as well, insulating it from creditors' claims. In other words, substantially all of his property was transferred to the trust…
>
> Further, evidence at trial refutes Mortensen's claim that he was making all required payments on his debts when the Seldovia property was transferred. He had burned through a $100,000.00 annuity, and his credit card debt was between $49,711.00 and $85,000.00 when the trust was created. It was difficult to determine the true nature of Mortensen's finances; he was not a credible witness. Even accepting the defendants' contention that Mortensen's monthly expenses at that time were $3,000.00, rather than $5,000.00, he was still under water when he put the realty (and then the cash) into the trust. His existing creditors were never paid off, and his debts were already unmanageable when the property was transferred. The timeline provided by the plaintiff in his opposition highlights this point. Mortensen used the Seldovia property after he transferred it to the trust, but did not regularly pay rent to the trust. He also invested the funds he had transferred to the trust and lent funds to a friend for a vehicle purchase. Based on this evidence, I found sufficient badges of fraud to determine that Mortensen intended to hinder, delay and defraud his creditors when he transferred the Seldovia property to the trust.

Like the Washington court in Huber, the Alaska court in Mortensen thus did not hold the transfer to the SSST to be a voidable transfer per se—instead, proof of the debtor's intent to hinder, delay, or defraud creditors was an essential element that had to be present to reach such a conclusion.

e. **Other Cases** —

Other cases agree with this conclusion.

Thus, in *Menotte v. Champalanne (In re Champalanne)*,[802] a federal bankruptcy judge in Florida wrote:[803]

[802] 425 B.R. 707 (Bankr. S.D. Fla. 2010).

[803] 425 B.R. at 713.

> The Defendants argue that the California Property Transfer was not fraudulent because under California law, the California Property remained subject to the claims of creditors after the transfer to the Family Trust. Even if that is a correct statement of California law, the transfer may nevertheless be avoidable if the Debtor acted with actual intent to hinder, delay, or defraud creditors.

Finally, in *Rigby v. Mastro (In re Mastro)*,[804] a federal bankruptcy judge in Washington wrote:[805]

[804] 465 B.R. 576 (Bankr. W.D. Wash. 2011).

[805] 465 B.R. at 611–12.

> The LCY Trust is a self-settled trust. Thus, the transfers of assets into the LCY Trust by placing ownership of the assets in the LCY LLC Entities are void as transfers made into a self-settled trust, and avoidable as fraudulent transfers.

11. **Why This Is a Distinction With a Difference!** —

The misclassification (as a voidable transfer per se) of the transfer of property by an individual located in a Non-SSST State to an SSST created under the law of an SSST State through the back-door device of a Comment to the UVTA, has important implications.

The first important point has been explained, as follows:[806]

> [N]otwithstanding the language of the Uniform Fraudulent Transfer Act, the common law has drawn an important distinction between those future creditors whose claims were, or at least could have been, reasonably anticipated at the time of the transfer, and those future creditors who were not, and perhaps could not have been, contemplated by the debtor at the time of the transfer (which latter class of future creditors was referred to at the beginning of this article as "potential future creditors"). This is a logical distinction because it speaks to the question of whether, in effecting the transfer, the debtor could have possessed the required actual intent to hinder, delay or defraud creditors; specifically, the more remote the future creditor, the less likely that the debtor might be found to have had such intent.

It is well-settled that individuals have a right to protect against future adversity. Citing a 19th century case where the holding still has relevance, in *Schreyer v. Scott*, the U.S. Supreme Court stated:[807]

> Reverses came unexpectedly, while in the pursuit of his ordinary business, without any intention on his part to defraud his creditors, and it may be said that, without any fault on his part, except a want of human foresight, he became embarrassed and insolvent. It is not apparent that [the transferor] had in view, at the time of the execution of the deed to his wife, any such result, or that he in any way contributed to produce the result which followed, for the purpose of defrauding his creditors and enjoying the advantages to be derived from the provisions made for his wife. Under such circumstances, the presumption of any fraudulent intent is rebutted, and it is manifest that he had done no more than any business man has a right to do, to provide against future misfortune when he is abundantly able to do so.

More recently, in connection with the question of whether to deny a bankruptcy debtor his discharge in bankruptcy due to the debtor having undertaken a fraudulent transfer, the Bankruptcy Court in the Central District of California in *Oberst v. Oberst (In re Oberst)* [808] stated that:[809]

> If the debtor has a particular creditor or series of creditors in mind and is trying to remove his assets from their reach, this would be grounds to deny the discharge. If the debtor is merely looking to his future well-being, the discharge will be granted.

Thus, the concept of a fraudulent transfer per se—even if the concept should only apply to transfers to SSSTs by individuals who reside in Non-SSST states—turns existing voidable-transfer law on its head. The fact that such result is to be reached through the back-door device of a Comment, rather than the statute itself, is particularly inappropriate.

A second important implication involves the upending of the established conflict-of-laws rules that have long been used in determining whether creditors may reach trust assets. As noted, the ability of creditors to reach trust assets, including

[806] Rubin, *Asset Protection Planning—Ethical? Legal? Obligatory?* 48 Heckerling Inst. on Est. Plan ¶1802 at 18-4 (2014) (footnote omitted).

[807] *Schreyer v. Scott*, 134 U.S. 405, 414–15 (1890) (internal quotation marks omitted).

[808] 91 B.R. 97 (Bankr. C.D. Cal. 1988).

[809] 91 B.R. at 101.

SSST assets, has historically been based on trust law principles under the rules set forth in the Second Restatement of Conflict of Laws. To reiterate, under those rules, the law of the trust jurisdiction designated by the settlor would apply to validate the protections afforded by a properly designed and implemented APT arrangement, even in instances where the settlor is a resident of another state.

In fact, in some jurisdictions, a settlor's ability to designate the law of a particular jurisdiction as the governing law of the trust is expressly provided for by statute. For example, §7-1.10 of New York's Estates, Powers and Trusts Law provides:

> §7-1.10. Provision by non-domiciliary creator as to law to govern trust
>
> (a) Whenever a person, not domiciled in this state, creates a trust which provides that it shall be governed by the laws of this state, such provision shall be given effect in determining the validity, effect and interpretation of the disposition in such trust…
>
> Interpreting a prior version of this statute, New York's highest court stated that "[t]he statute makes [a settlor's] express declaration of intention [of controlling law] conclusive … ."[810]

[810] *Hutchison v. Ross*, 187 N.E. 65, 71 (N.Y. 1933).

Furthermore, although the prima facie ability of a New York domiciliary settlor to create a valid trust governed by the laws of a foreign jurisdiction is not expressly conferred by this statute, it is logically inferred and has been so recognized by the courts. For example, it was stated in *Matter of Matthiessen*,[811] that "[i]t is inconceivable that a state committed to [the policy of Estates, Powers and Trusts Law §7-1.10] would deny its own residents the corresponding right to establish trusts in other states…. [U]nder the law of this state, a New York resident may choose another state as the situs of a trust as freely as a non-resident may create a trust in New York."

[811] 87 N.Y.S.2d 787, 792 (Sup. Ct. 1949).

The introduction of Comment 8 under §4 of the UVTA creates a conflict whereby practitioners can no longer be certain as to whether the law of the jurisdiction set forth by the settlor in the trust instrument is to apply. The author had thought that the purpose of statutory law was to negate uncertainty, rather than to introduce new uncertainties to established law.

12. **Significance of the Comments and Backlash** —

Commentators differ on the significance of the Comments. One commentator asserts that "[t]he Comments in short, are no more than a law journal article on steroids."[812] Other commentators point out that courts are likely to refer to the Comments in interpreting §10 of the UVTA. [813] Irrespective of which commentator is more correct, the fact remains that the Comments do not accurately interpret existing law and, on this basis alone, they should not have been included in the UVTA and should not be adopted by states enacting the UVTA.

[812] Adkisson, *Jay Adkisson & the Reporter's Comments to the Uniform Voidable Transactions Act* , LISI Asset Prot. Newsl. #319 (Apr. 11, 2016), www.leimbergservices.com.

[813] George D. Karibjanian, Wehle, & Lancaster, *History Has Its Eyes on UVTA—A Response to Asset Protection Newsletter #319*, LISI Asset Prot. Newsl. #320 (Apr. 18, 2016), www.leimbergservices.com.

During the UVTA drafting process, the Chair invited the author to be an observer to the Committee ("Observer"), as he has great familiarity with domestic APTs.[814] As described above, it would appear that the Comments were inserted with the objective of making it impossible for a resident of a Non-SSST State to establish an APT in an SSST State. Shortly after the Reporter issued the Comments, the author sent him the above authorities. Subsequently, though, in a communication to the author, the Reporter denied receiving the authorities until the author subsequently directed him to the message acknowledging their receipt. When the author attempted to press his points, the Reporter refused to allow him to resume his discussion with the Committee. The author's subsequent efforts to pursue his points with the Chair and the then-President of the ULC also were unavailing. The author understands that the Chair and the Reporter now express surprise at the substantial push-back from the trusts and estates bar on these and other issues as they, and other members of the Committee, lobby for enactment of the UVTA around the country. It is also the author's understanding that the Committee has refused to consider any revisions to the Comments notwithstanding the request of the Joint Editorial Board for Uniform Trust and Estate Acts, which, the author was informed, was not consulted in connection with the UVTA's approval.

[814] In his capacity as Observer, the author repeatedly raised the concerns described in this Section E and distributed authorities described herein. The Reporter, the Chair, the American Bar Association Advisors in attendance, the participating Commissioners, and the then-President of the ULC, all chose not to acknowledge their import.

13. **State Enactments of the UVTA**

a. **Introduction** —

With or without comprehending the controversy described above, several states have adopted the UVTA and its comments as proposed.[815] Others have addressed the erroneous nature of certain of the UVTA comments.

[815] *See* Worksheet 3.

b. **Arkansas** —

The pertinent part of the relevant provision of the 2017 legislation by which Arkansas enacted the UVTA says:[816]

[816] 2017 Ark. Acts 1086, §2.

> The General Assembly finds that although the text of this act is in agreement with and will improve Arkansas law, the 2014 Official Uniform Law Commission comment no. 2 and comment no. 8 to Section 4 of the uniform act, which is codified at §4-59-204, is intended to be persuasive authority but does not represent Arkansas law and should not be considered when interpreting this act.

c. **Indiana** —

The 2017 enacting legislation in Indiana provides in relevant part:[817]

[817] 2017 Ind. Pub. Laws 61, §23.

> This chapter:
>
> (1) adopts, in part, provisions of the Uniform Voidable Transactions Act as released by the National Conference of Commissioners on Uniform State Laws; and
>
> (2) may be cited as the Indiana Uniform Voidable Transactions Act.
>
> However, in interpreting solely this chapter, comments released by a committee of the National Conference of Commissioners on Uniform State Laws shall not be considered as authority.

d. **New York** —

The prestigious New York City Bar Association issued a report in support of the state's 2019 adoption of the UVTA in which it took issue with certain comments.[818] Hence, the report stated:[819]

[818] New York City Bar Association, *Report on Legislation by the Committee on Commercial and Uniform State Laws and Committee on Bankruptcy and Corporate Reorganization* (Mar. 6, 2019) (available at www.nycbar.org).

[819] New York City Bar Association, *Report on Legislation by the Committee on Commercial and Uniform State Laws and Committee on Bankruptcy and Corporate Reorganization* at 8 (footnote omitted; emphasis added).

> Section 273 is substantially similar to existing New York law and not intended to affect any material changes to that law. Because of this, the City Bar does not regard the general discussion of fraudulent transfer law in the Official Comments to Section 4 of the UVTA to be necessary or authoritative to interpret this section. *Specifically, comment number 2 and comment number 8 to Section 4 of the UVTA are inconsistent with New York law and are not supported by the text of the UVTA. Therefore, these two comments should not be considered when interpreting the UVTA, as enacted in New York. It is worth noting that other jurisdictions have reached the same conclusion regarding these two comments*.

The author is informed that the report represents legislative history.

Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Detailed Analysis
IX. Defenses to Creditor Attacks on Domestic APTs

A. Introduction

Even if a creditor cannot set aside a transfer to a domestic asset protection trust (APT)[820] as a fraudulent transfer or if the statute of limitations for bringing a fraudulent transfer claim has run, critics of domestic APTs—foreign APT proponents and APT opponents—contend that various U.S. constitutional strictures (such as the Full Faith and Credit Clause, the Due Process Clause, or the Supremacy Clause) will fatally compromise a domestic APT's ability to protect assets. Nonetheless, a resident of a U.S. jurisdiction that does not have its own APT statute (a “non-DAPT state”) or a resident of a jurisdiction that does have such a statute should consider a domestic APT because, as discussed below, domestic APT critics have offered overly superficial analyses of the situation to date.

[820] A domestic APT is sometimes referred to as a DAPT. *See generally* Shapo, Bogert & Bogert, *The Law of Trusts and Trustees* §223 at 482–491 (3d ed. 2007). For a summary of creditors’ rights and remedies, see Shapo, Bogert & Bogert, *The Law of Trusts and Trustees* §227 at 541–561 (3d ed. 2007).

Issues regarding full faith and credit, jurisdiction, and choice of law become relevant in two contexts:

- when a creditor obtains a judgment against the settlor of a domestic APT in a court in a non-DAPT state (a “non-DAPT court”) and tries to enforce the judgment against the domestic APT in a domestic APT court; or

- when a creditor seeks to obtain a judgment against a domestic APT or a trustee of a domestic APT in a non-DAPT court.

Such a creditor will face at least eight substantial obstacles.

Estates, Gifts and Trusts Portfolios
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IX. Defenses to Creditor Attacks on Domestic APTs

B. Obstacle 1: Non-DAPT Court Might Lack Jurisdiction

1. **Introduction** —

Restatement (Second) of Conflict of Laws states in relevant part:[821]

[821] *Restatement (Second) of Conflict of Laws* §104 cmt. a (Am. Law Inst. 1971). *See Wilkes v. Phoenix Home Life Mut. Ins. Co.*, 902 A.2d 366, 382 (Pa. 2006); *Estate of Waitzman*, 507 So.2d 24, 25 (Miss. 1987). Courts in the Ninth Circuit as well as courts in Delaware and Mississippi follow the *Restatement (Second) of Conflict of Laws*. *In re Bullseye Holdings, LLC*, 2018 BL 379908, *2018 WL 4998089* at *7 (Bankr. D. Ariz. Oct. 15, 2018); *In re Peierls Family Inter Vivos Tr.,* 77 A.3d 249, 255 (Del. 2013); *In re Delta Investments & Development, LLC*, No. 12-01160, 2019 BL 7900, 2019 WL 137578 at *16 (Bankr. S.D. Miss. Jan. 8, 2019) (citing *Zurich American Ins. Co. v. Goodwin*, 920 So.2d 427, 433–434 (Miss. 2006)). *See also* Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §292 (3d ed. 2014).

> Due process forbids the rendition of a judgment within the United States unless the State of rendition has judicial jurisdiction … . A judgment rendered in violation of these requirements is void in the State of rendition itself, and due process forbids the recognition and enforcement of such a judgment in sister States ….

Hence, a creditor can obtain a valid judgment against a trustee of a domestic APT, or an attachment of the assets of a domestic APT, in a non-DAPT court only if that court has jurisdiction. Such jurisdiction might be based on in rem jurisdiction over trust assets or personal jurisdiction over a trustee.

2. **In Rem Jurisdiction** —

A non-DAPT court will have in rem jurisdiction over trust assets that are held in the court's jurisdiction.[822] To prevent a non-DAPT court from having in rem jurisdiction over a domestic APT, the trustee should hold all assets in the jurisdiction where the trust is created because "[a] court sitting in [one state] … cannot assert jurisdiction over the corpus of a trust with a situs outside the State."[823]

[822] *Hanson v. Denckla*, 357 U.S. 235, 246 (1958).

[823] *Walker v. W. Mich. Nat'l Bank & Tr.*, 324 F. Supp. 2d 529, 534 n.3 (D. Del. 2004), *aff'd*, 145 Fed. App'x 718 (3d Cir. 2005).

3. **Personal Jurisdiction—General Principles** —

State courts, federal courts sitting in diversity,[824] and federal courts considering many federal questions[825] may exercise personal jurisdiction over a defendant only if constitutional due process requirements are satisfied.[826] (The rule for satisfying these requirements can differ somewhat in connection with federal questions arising under statutes providing for nationwide service of process, but even then the venue rules can still raise many similar issues and yield similar practical results.) The classic *International Shoe Co. v. Washington* [827] test determines whether a nonresident defendant has "certain minimum contacts with [the forum state] such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice."[828] A court may satisfy this test under either of two theories: "general jurisdiction" or "specific jurisdiction."[829]

[824] *See* 28 U.S.C. §1332.

[825] *See* 28 U.S.C. §1331.

[826] *See, e.g.*, *Ins. Corp. of Ireland v. Compagnie Des Bauxites*, 456 U.S. 694 (1982); *World-Wide Volkswagen Corp. v. Woodson,* 444 U.S. 286 (1980); *Int'l Shoe Co. v. Washington*, 326 U.S. 310 (1945). This discussion assumes that the local long-arm statute has also been satisfied, which is another prerequisite for the exercise of personal jurisdiction over out-of-state defendants by a state court or a federal court sitting in diversity. *See, e.g.*, *Fed. R. Civ. P. 4(k)(2); Herman v. BRP, Inc.,* No. N13C-11-105, 2015 BL 104658, 2015 WL 1733805 at *3 (Del. Super. Ct. Apr. 13, 2015); *Covenant Tr. Co. v. Guardianship of Ihrman*, 45 So.3d 499, 502 (Fla. Dist. Ct. App. 2010).

[827] 326 U.S. 310 (1945).

[828] 326 U.S. 310, 316 (internal quotation marks omitted).

[829] *See generally Helicopteros Nacionales de Columbia v. Hall*, 466 U.S. 408, 414 (1984); *Emberton v. Rutt*, No. 1:07-cv-01200, 2008 BL 348180, 2008 WL 4093714 at *7 (D.N.M. Mar. 31, 2008); *Walker v. N. Tr. Co.,* 2007 WL 178392 at *5 (N.D. Ill. Jan. 18, 2007).

The U.S. Supreme Court addressed the limits of personal jurisdiction in 2017 in *Bristol-Myers Squibb Co. v. Superior Court of California*.[830] There, Justice Alito, writing for himself and seven other Justices (Justice Sotomayor dissented), described the limits on forum courts' exercise of personal jurisdiction:[831]

[830] *Bristol-Myers Squibb Co. v. Superior Court of California*, 137 S. Ct. 1773 (2017).

[831] 137 S. Ct. 1773, 1779 (citations and internal quotation marks omitted; emphasis added).

> It has long been established that the Fourteenth Amendment limits the personal jurisdiction of state courts. Because a state court's assertion of jurisdiction exposes defendants to the State's coercive power, it is subject to review for compatibility with the Fourteenth Amendment's Due Process Clause, which limits the power of a state court to render a valid personal judgment against a nonresident defendant. The primary focus of our personal jurisdiction inquiry is the *defendant's* relationship to the forum State.

He elaborated:[832]

[832] 137 S. Ct. 1773, 1779–1780 (citations and internal quotation marks omitted; emphasis in original). *Accord Genuine Parts Co. v. Cepec*, 137 A.3d 123, 129–130 (Del. 2016). Other recent U.S. Supreme Court decisions addressing general jurisdiction are: *Daimler A.G. v. Bauman*, 571 U.S. 117 (2014); *Goodyear Dunlop Tire Operations, S.A. v. Brown*, 564 U.S. 915 (2011).

> Since our seminal decision in *International Shoe*, our decisions have recognized two types of personal jurisdiction: "general" (sometimes called "all-purpose") jurisdiction and "specific" (sometimes called "case-linked") jurisdiction. For an individual, the paradigm forum for the exercise of general jurisdiction is the individual's domicile; for a corporation, it is an equivalent place, one in which the corporation is fairly regarded as at home. A court with general jurisdiction may hear *any* claim against that defendant, even if all the incidents underlying the claim

> occurred in a different State. But only a limited set of affiliations with a forum will render a defendant amenable to general jurisdiction in that State.
>
> Specific jurisdiction is very different. In order for a state court to exercise specific jurisdiction, the *suit* must arise out of or relate to the defendant's contacts with the *forum*. In other words, there must be an affiliation between the forum and the underlying controversy, principally, an activity or an occurrence that takes place in the forum State and is therefore subject to the State's regulation. For this reason, specific jurisdiction is confined to adjudication of issues deriving from, or connected with, the very controversy that establishes jurisdiction.

Justice Alito continued:[833]

> In determining whether personal jurisdiction is present, a court must consider a variety of interests. These include the interests of the forum State and of the plaintiff in proceeding with the cause in the plaintiff's forum of choice. But the primary concern is the burden on the defendant. Assessing this burden obviously requires a court to consider the practical problems resulting from litigating in the forum, but it also encompasses the more abstract matter of submitting to the coercive power of a State that may have little legitimate interest in the claims in question. As we have put it, restrictions on personal jurisdiction are more than a guarantee of immunity from inconvenient or distant litigation. They are a consequence of territorial limitations on the power of the respective States. The States retain many essential attributes of sovereignty, including, in particular, the sovereign power to try causes in their courts. The sovereignty of each State implies a limitation on the sovereignty of all its sister States. And at times, this federalism interest may be decisive. As we explained in *World-Wide Volkswagen, even if the defendant would suffer minimal or no inconvenience from being forced to litigate before the tribunals of another State; even if the forum State has a strong interest in applying its law to the controversy; even if the forum State is the most convenient location for litigation, the Due Process Clause, acting as an instrument of interstate federalism, may sometimes act to divest the State of its power to render a valid judgment*.

Justice Alito described the controversy in *Bristol-Myers* at the beginning of the opinion:[834]

> More than 600 plaintiffs, most of whom are not California residents, filed this civil action in a California state court against Bristol-Myers Squibb Company (BMS), asserting a variety of state-law claims based on injuries allegedly caused by a BMS drug called Plavix. The California Supreme Court held that the California courts have specific Jurisdiction to entertain the nonresidents' claims. We now reverse.

He observed:[835]

> Our settled principles regarding specific jurisdiction control this case. In order for a court to exercise specific jurisdiction over a claim, there must be an affiliation between the forum and the underlying controversy, principally, an activity or an occurrence that takes place in the forum State. When there is no such connection, specific jurisdiction is lacking regardless of the extent of a defendant's unconnected activities in the State. Even regularly occurring sales of a product in a State do not justify the exercise of jurisdiction over a claim unrelated to those

[833] 137 S. Ct. 1773, 1780–1781 (citations and internal quotation marks omitted; emphasis added).

[834] 137 S. Ct. 1773, 1777. Other recent U.S. Supreme Court decisions involving specific jurisdiction are: *Walden v. Fiore*, 571 U.S. 277 (2014) and *J. McIntyre Mach. Ltd. v. Nicastro*, 564 U.S. 873 (2011).

[835] 137 S. Ct. 1773, 1781 (citations and internal quotation marks omitted).

> sales.

He continued:[836]

[836] 137 S. Ct. 1773, 1781 (citation and internal quotation marks omitted; emphasis in original).

> The present case illustrates the danger of the California approach. The State Supreme Court found that specific jurisdiction was present without identifying any adequate link between the State and the nonresidents' claims. As noted, the nonresidents were not prescribed Plavix in California, did not purchase Plavix in California, did not ingest Plavix in California, and were not injured by Plavix in California. The mere fact that *other* plaintiffs were prescribed, obtained, and ingested Plavix in California—and allegedly sustained the same injuries as did the nonresidents—does not allow the State to assert specific jurisdiction over the nonresidents' claims. As we have explained, a defendant's relationship with a third party, standing alone, is an insufficient basis for jurisdiction. This remains true even when third parties (here, the plaintiffs who reside in California) can bring claims similar to those brought by the nonresidents. Nor is it sufficient—or even relevant—that BMS conducted research in California on matters unrelated to Plavix. What is needed—and what is missing here—is a connection between the forum and the specific claims at issue.

The Court concluded that California courts lacked specific personal jurisdiction as follows:[837]

[837] 137 S. Ct. 1773, 1782.

> In today's case, the connection between the nonresidents' claims and the forum is even weaker. The relevant plaintiffs are not California residents and do not claim to have suffered harm in that State. In addition, as in *Walden*, all the conduct giving rise to the nonresidents' claims occurred elsewhere. It follows that the California courts cannot claim specific jurisdiction.

Practice Tip: A court will have personal jurisdiction over a foreign trustee in certain situations, such as when it appointed the trustee.[838] But, the foregoing cases demonstrate that nonresident trustees should not automatically concede that personal jurisdiction exists.

[838] *See, e.g., Ohlheiser v. Shepherd*, 228 N.E.2d 210, 215 (Ill. App. Ct. 1967).

Courts consider various factors to determine whether sufficient minimum contacts exist to establish specific personal jurisdiction. These were catalogued, in part, by the U.S. Supreme Court in *World-Wide Volkswagen Corp. v. Woodson*[839] and include the following acts in the forum state:

[839] 444 U.S. 286 (1980).

- closing sales;
- performing services;
- soliciting business;
- availing themselves of the privileges and benefits of the forum state's law;
- indirectly, through others, serving or seeking to serve the forum state's market;
- delivering products into the stream of commerce with the expectation that they will be purchased by consumers in

the forum state.[840]

[840] 444 U.S. at 295–298. *See United States v. Wunder*, No. 16-9452, 2019 BL 250593, 2019 WL 2928842 at *9 (D.N.J. July 8, 2019) (court had personal jurisdiction because "[p]laintiff's claims are directly connected to that property, and the exercise of jurisdiction over Country House would not conflict with traditional notions of fair play and substantial justice because its purposeful availment of the economic market and legal protections of this District in the course of purchasing the Wantage Property made it foreseeable that it would be called into this Court").

However, not all acts within a state will create an adequate nexus for jurisdiction: as a general proposition, occasional trips into a state or receipt of payments issued from inside a state will be insufficient.[841] And, as shown in the trustee-specific cases discussed below, the fact that "several bits of trust administration"[842] may be carried on is also routinely inadequate for establishing jurisdiction.

[841] *See Helicopteros Nacionales de Colom. v. Hall*, 466 U.S. 408, 414 (1984).

[842] *Hanson v. Denckla*, 357 U.S. 235, 252 (1958).

According to one opinion—*Emberton v. Rutt* (2008)—a change of trustee will not defeat a court's personal jurisdiction if the court had valid jurisdiction over the outgoing trustee.[843] The court seemed heavily influenced by the facts that the incoming trustee, a Texas resident with no ties to New Mexico other than the trust, accepted the trusteeship while the trust was still administered in New Mexico, which was also the forum state, and while one of the New Mexico settlors was acting as co-trustee. The court reached this result even though there were no trust assets or trust beneficiaries in New Mexico after the New Mexico settlor-trustee died. It is unclear whether the court would have reached the same result if the situs of administration had moved to Texas before the incoming trustee accepted the trusteeship, or if there was no co-trusteeship, although the sweeping language used by the court suggests it would have reached the same result. However, at some point, asserting jurisdiction over an incoming trustee will raise serious, and perhaps insurmountable, problems for a court attempting to assert personal jurisdiction over the new trustee.

[843] *Emberton v. Rutt*, No. 1:07-cv-01200, 2008 BL 348180, 2008 WL 4093714 at *6 (D.N.M. Mar. 31, 2008) (quoting *Michigan Tr. Co. v. Ferry*, 228 U.S. 346, 353 (1913)).

4. **Personal Jurisdiction—Trustee Concerns** —

A non-DAPT court might be able to adjudicate a creditor's claim if the court has personal jurisdiction over a trustee. One way a client may avoid this pitfall is to use only trustees with little or no contact with the settlor's home state (or, if different, the settlor's state of employment or business). If the settlor wants to use a co-trustee from outside the domestic APT state, the co-trustee should be from outside the settlor's home state (and state of business). This situation gives courts in the settlor's home or work state substantially less basis to assert general jurisdiction over the trustees and the court may be able to assert only specific personal jurisdiction over the trustee. This is not always an easy task, however. Although the issue turns on the specific facts of each case, many opinions have shown that specific personal jurisdiction may not be established over an out-of-state trustee merely because of routine trustee activities, such as mailings and phone calls from the defendant trustee's state into the plaintiff's state.

The leading case in this area is *Hanson v. Denckla*,[844] which involved a controversy concerning the right to part of the principal of a trust established in Delaware by a Pennsylvania settlor who subsequently moved to Florida. The U.S. Supreme Court held that a Delaware court was under no obligation to give full faith and credit to a judgment of a Florida court that lacked jurisdiction over the trust's assets and the trustee. The Court, affirming the decision of the Supreme Court of Delaware,[845] discussed the jurisdictional issues as follows:[846]

[844] 357 U.S. 235, 253 (1958).

[845] *Lewis v. Hanson*, 128 A.2d 819 (Del. 1957), *aff'd sub nom,. Hanson v. Denckla*, 357 U.S. 235 (1958).

[846] 357 U.S. 235, 253–254.

> [I]t is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws. The settlor's execution in Florida of her power of appointment cannot remedy the absence of such an act in this case.

Hanson remains controlling precedent, as shown by the following cases:

- *In re Ducey* (1990)[847]—The Montana Supreme Court held that Montana lacked jurisdiction over the Nevada corporate trustee of a trust created by a Montana testator. The court reached this conclusion even though the Nevada trustee mailed payments to the deceased Montana beneficiary and also telephoned the decedent in Montana in connection with modifications to her estate plan, including changes designed to benefit other Montana residents.

- *First American Bank of Virginia v. Reilly* (1990)[848] —The Court of Appeals of Indiana held that Indiana courts lacked personal jurisdiction over the non-Indiana corporate trustee even though the trust was created by the will of an Indiana decedent. The court said:[849]

[847] *In re Ducey*, 787 P.2d 749, 752 (Mont. 1990).

[848] *First Am. Bank of Virginia v. Reilly*, 563 N.E.2d 142 (Ind. Ct. App. 1990).

[849] *First Am. Bank of Virginia v. Reilly*, 563 N.E.2d 142, 145.

> None of the contacts identified by Ms. Reilly can be said to have proximately resulted from actions of the trustee that create a substantial connection with the state of Indiana. Consequently, First American Bank does not have the sufficient minimum contacts necessary for an exercise of in personam jurisdiction.

- *In re Will of Frumkin* (1995)[850]—The Tennessee Court of Appeals held that Tennessee lacked jurisdiction over the Florida corporate trustee of a trust created by a Florida testator. The court so ruled even though the Florida trustee mailed some checks and letters to the Tennessee beneficiary.

- *Dreher v. Smithson* (1999)[851]—The Oregon Court of Appeals held that Oregon lacked jurisdiction over the individual trustees of a trust created by a Massachusetts settlor. The court so ruled even though the trustees: (1) accepted the trusteeship knowing that the trust had an Oregon beneficiary; (2) wrote and telephoned the beneficiary in Oregon; and (3) mailed distribution checks to the Oregon beneficiary.

- *Rose v. Firstar Bank* (2003)[852]—The Rhode Island Supreme Court held that Rhode Island lacked jurisdiction over the Ohio corporate trustee of a trust created by an Ohio testator. The court so ruled even though the trustee: (1) mailed checks, statements, and other trust documents to Rhode Island; and (2) periodically communicated with the Rhode Island beneficiaries.

- *Nastro v. D'Onofrio* (2003)[853]—A Connecticut federal district court held that it lacked jurisdiction over the trustee of a Jersey, Channel Islands, trust created by a Connecticut settlor. The court found insufficient contacts between Connecticut and the trustee, even though the trust was funded with stock in Connecticut corporations.

- *Walker v. West Michigan National Bank & Trust* (2004)[854] —A Delaware federal district court held that it lacked jurisdiction over the Michigan corporate trustee of a trust created by a Montana resident even though the Delaware beneficiary bringing the action had contributed assets to the trust and the trustee filed income tax returns for the trust. The court noted that a plaintiff's "mere beneficial interest in a trust is insufficient to assert personal jurisdiction over a nonresident trustee."[855]

- *Walker v. Northern Trust Co.* (2004)[856]—In a companion case to *Walker v. West Michigan National Bank & Trust*, another Delaware federal district judge ruled that the court lacked jurisdiction over the Illinois corporate trustee of a trust created by a Montana resident to which the Delaware beneficiary bringing the action had not contributed assets.

- *In re Estate of Stisser* (2006)—A Florida intermediate appellate court held that Florida courts did not have jurisdiction to adjudicate the claim by the personal representative of a Florida decedent against the trustees of the Minnesota trust that she created while she resided in Minnesota for funds to pay estate expenses. The court did so because the trustees were indispensable parties over which Florida courts lacked personal and in rem jurisdiction.[857]

- *Walker v. Northern Trust Co.* (2007)[858]—In a subsequent proceeding to the 2004 *Walker v. Northern Trust Co.* case discussed above, an Illinois federal district court held that it lacked personal jurisdiction over the nonresident settlor of an irrevocable trust regarding a beneficiary's claim that the settlor was unjustly enriched through the payment of his attorney fees from the trust.

- *Fellows v. Colburn* (2011)[859] —The Supreme Court of New Hampshire held that New Hampshire courts did not have jurisdiction over the individual successor trustees of a non-New Hampshire trust that held New Hampshire real property because "the defendants did not purposefully avail themselves of the protections of New Hampshire law."[860]

- *Bernstein v. Stiller* (2013)—In *Bernstein*, trust beneficiaries sought accountings and removal of the trustees in a Pennsylvania court and contended that the trustees' filing of a state income-tax return declaring the trust to be a resident trust gave the court jurisdiction.[861] Judge Surrick held that "[t]he declared residency of the trust assets is insufficient to give the Court personal jurisdiction over Respondent Trustees."[862]

[850] *In re Will of Frumkin*, 912 S.W.2d 138 (Tenn. Ct. App. 1995).

[851] *Dreher v. Smithson*, 986 P.2d 721 (Or. Ct. App. 1999).

[852] *Rose v. Firstar Bank*, 819 A.2d 1247, 1255 (R.I. 2003).

[853] *Nastro v. D'Onofrio*, 263 F. Supp. 2d 446, 453 (D. Conn. 2003).

[854] *Walker v. W. Michigan Nat'l Bank & Tr.*, 324 F. Supp. 2d 529 (D. Del. 2004), *aff'd*, 145 Fed. App'x 718 (3d Cir. 2005).

[855] *Walker v. W. Michigan Nat'l Bank & Tr.*, 324 F. Supp. 2d 529, 534.

[856] *Walker v. N. Tr. Co., 2004 WL 1588287* (D. Del. July 14, 2004), *aff'd*, 145 Fed. App'x 718 (3d Cir. 2005).

[857] *In re Estate of Stisser*, 932 So.2d 400, 402 (Fla. Dist. Ct. App. 2006).

[858] *Walker v. N. Tr. Co.,* No. 06-C-4901, 2007 BL 310409, 2007 WL 178392 at *5 (N.D. Ill. Jan. 18, 2007).

[859] *Fellows v. Colburn*, 34 A.3d 552 (N.H. 2011).

[860] *Fellows v. Colburn,* 34 A.3d 552, 562.

[861] *Bernstein v. Stiller*, No. 09-659, 2013 BL 172426, *2013 WL 3305219* at *1 (E.D. Pa. June 27, 2013).

[862] *Bernstein v. Stiller*, No. 09-659, 2013 BL 172426, *2013 WL 3305219* at *7.

In contrast, the courts in the following cases held that they did have personal jurisdiction over a trustee:

- *Ohlheiser v. Shepherd* (1967)[863] —The Appellate Court of Illinois held that it had personal jurisdiction over the nonresident successor individual trustee of a trust created by the will of an Illinois decedent for the following reasons:[864]

> Applying the foregoing principles here, we consider that defendant, as successor trustee of a testamentary trust, became an officer of the court appointing him when he accepted the appointment by entering upon his duties as successor trustee. Although these duties did not require him to perform any act while physically within the State of Illinois, he impliedly submitted himself to the in personam jurisdiction of the court of appointment until discharged from his office. He exercised the right of acting as successor trustee by the appointment of an Illinois court and has enjoyed the benefits and protection of the laws of Illinois. The exercise of that right gave rise to the obligation to respond to the court that appointed him. We think defendant has sufficient contact with the State of Illinois to subject him to its in personam jurisdiction and to satisfy due process. To hold that an appointing court be found to have jurisdiction in personam over its officer does not offend "traditional notions of fair play and substantial justice," provided he is adequately notified of the action against him so that he may defend himself.

- *Johnson v. Witkowski* (1991)[865] —The Appeals Court of Massachusetts held that the courts of the Commonwealth had personal jurisdiction over a nonresident individual trustee in a breach-of-fiduciary-duty case because:[866]

> [T]he touchstone remains whether the defendant purposefully established "minimum contacts" in the forum State and whether specific jurisdiction over the defendant comports with "fair play and substantial justice." Here, the activity conducted by the defendants, including the corporation, in regard to the trust gave them sufficient warning that a particular activity may subject them to the jurisdiction of a foreign sovereign. The trust was formed in Massachusetts and was funded by the estate of a Massachusetts resident. Most of the beneficiaries are Massachusetts residents. Witkowski signed the trust in Massachusetts and has continued to manage and administer the trust while maintaining numerous contacts with the plaintiff in Massachusetts. Consequently, the courts of Massachusetts could constitutionally exercise jurisdiction over the defendant Witkowski.

- *Seijo v. Miller* (2006)[867] —The Federal District Court for the District of Puerto Rico denied the Louisiana trustees' motion to dismiss, for lack of specific personal jurisdiction, claims brought by the heirs of the income beneficiary of a trust created by a Puerto Rican settlor in Louisiana for Puerto Rican beneficiaries. The court concluded:[868]

> [T]his court finds that in the instant case, they point to the exercise of jurisdiction. First, the defendants are not burdened by appearing before this Court because they travel to Puerto Rico to conduct business activities. The possibility that most of the evidence will have to be brought from Louisiana to Puerto Rico does not overly burden defendants. Second, Puerto Rico has an interest in having a Puerto Rico-based court adjudicate this dispute because a State has a "manifest interest" in providing its residents with a convenient forum for redressing injuries

[863] *Ohlheiser v. Shepherd*, 228 N.E.2d 210 (Ill. Dist. Ct. 1967).

[864] *Ohlheiser v. Shepherd*, 228 N.E.2d 210, 215.

[865] *Johnson v. Witkowski*, 573 N.E.2d 513 (Mass. App. Ct. 1991).

[866] *Johnson v. Witkowski,* 573 N.E.2d 513, 523–524 (citations and internal quotation marks omitted).

[867] *Seijo v. Miller*, 425 F. Supp. 2d 194 (D.P.R. 2006).

[868] *Seijo v. Miller*, 425 F. Supp. 2d 194, 201 (citations and internal quotation marks omitted).

> inflicted by out-of-state actors. Third, the plaintiffs' choice of forum must be accorded a degree of deference regarding their own convenience, and without a doubt, it is more convenient for the plaintiffs to litigate in Puerto Rico than in Louisiana. Fourth, the judicial system's interest in obtaining the most effective resolution of the controversy does not cut in either direction. Fifth, there is shared interest that Puerto Rico provide its residents a means of redress against out-of-state tortfeasors. Taken collectively, the gestalt factors discussed above indicate that the exercise of personal jurisdiction over the defendants in this case does not offend due process.

- *Cummings v. Pitman* (2007)[869] —The Supreme Court of Kentucky held that Kentucky courts had personal jurisdiction over the individual trustee of a trust created by a Kentucky settlor even though the trustee resided in New York and the trust was governed by New York law. The court summarized its analysis at the beginning of the opinion as follows:[870]

[869] *Cummings v. Pitman*, 239 S.W.3d 77 (Ky. 2007).

[870] *Cummings v. Pitman*, 239 S.W.3d 77, 80.

> Due process of law imposes limitations on a court's exercise of personal jurisdiction over nonresident defendants. In the instant case, a nonresident attorney engaged in significant legal and fiduciary activities in Kentucky. Conceding that he is subject to personal jurisdiction in Kentucky for claims arising from legal services performed, he seeks to avoid personal jurisdiction in this forum for actions in his role as trustee of the trust agreement he drafted. Appellee, R. Andrew Boose, analogizes himself to one with two hats and posits that in Kentucky he wore only his "attorney hat" but never donned his trustee hat except for one brief moment. As Mr. Boose appears to have engaged in a fully anticipated continuing course of conduct in Kentucky sufficient to meet statutory and federal due process standards for personal jurisdiction, we are unable to accept his contention that though he acted as an attorney in Kentucky, only in New York did he act as trustee.

Along the way, the *Cummings* court distinguished the case at bar from *Hanson v. Denckla* [871] as follows:[872]

[871] 357 U.S. 235 (1958).

[872] 239 S.W.3d at 89 (footnotes and internal quotation marks omitted).

> We have not overlooked *Hanson v. Denckla*, a case regarding the validity of a trust agreement without any connection with the forum state. In *Hanson*, the trustee's contact with the forum at issue came not as a result of doing or soliciting business there, but rather as a result of the settlor's decision to move there after the trust agreement had been executed. The Court held that the mere fact that the beneficiary resides in a forum state is not of itself sufficient to justify long-arm jurisdiction over the trustee. However, even *Hanson* suggested that if the agreement was negotiated with a settlor residing in the forum state at the time of formation of the trust, long-arm jurisdiction would be appropriate. From the facts in evidence, we have no doubt that Kentucky is a reasonable forum choice. Mr. Boose admitted in his answer that the Kentucky court had personal jurisdiction over him in his individual capacity. We are unable to divide his responsibilities between attorney and trustee so as to make the distinction meaningful.

In the course of the opinion, the court noted that:[873]

[873] 239 S.W.3d at 82 n.3 (citations omitted).

> While the trust agreement provided for application of the substantive law of New York, the determination of whether Kentucky may exercise personal jurisdiction is a matter of state law, particularly where, as here, the trust agreement is silent with respect to forum selection, Paragraph 15, according to its plain language is a choice of law provision rather than a forum selection clause. The provision relates only to what law is to govern a dispute

between the parties, it is silent concerning where the parties may bring an action.

The failure of a trust instrument to designate a jurisdiction in which legal proceedings involving a trust are to be brought to establish personal jurisdiction over an out-of-state trustee has been given significance in no other case discussed in this IX.B.4. Given that the *Cummings* court did so, it would do no harm—and might be beneficial—to include such a designation.

- *Sloan v. Segal* (2008)[874] —A Delaware Vice Chancellor held that the court had specific personal jurisdiction over a Florida resident for the following reasons:[875]

> Segal's continuous course of Delaware-directed conduct makes it obviously reasonable for this court to exercise jurisdiction over him. Indeed, this state has an important interest at stake in this case. Patricia Sloan was a Delaware resident for virtually her entire life. Segal appears to have moved Patricia Sloan from this state at a time when she had started to display the symptoms of Alzheimer's and may have been unable to make an informed, uncoerced judgment about departing. In a situation such as this, Delaware has a legitimate interest in applying its law to determine whether its longtime resident exercised her right of appointment over a Delaware-based trust in an uncoerced and knowing manner. Having repeatedly engaged in conduct in Delaware relevant to the Martin Sloan Trust and having brought suit in this very court to obtain a position as one of the trustees of that Trust, Segal has no colorable basis to claim that his due process rights will be violated if he has to defend this lawsuit in this court.

- *Emberton v. Rutt* (2008)[876]—As covered in IX.B.3., above, a federal district court in New Mexico held that the court possessed jurisdiction over a successor trustee because it had possessed jurisdiction over the outgoing trustee.

- *Ango Irish Bank Corp., PLC v. Superior Court* (2008)—The Court of Appeal of California held that California courts possessed personal jurisdiction over defendants, including an Isle of Man trust company, because the defendants had purposely availed themselves of forum benefits, because the dispute was substantially connected to petitioners' California activities, and because the exercise of personal jurisdiction would be fair and reasonable.[877]

A 2014 decision of an intermediate appellate court in Kentucky illustrates how proper corporate structure can defeat personal jurisdiction. Hence, in *Kloiber v. Daniel Kloiber Dynasty Trust,* [878] the court considered whether or not the trial court had personal jurisdiction over the Delaware trustee of a trust created by the husband's father in a divorce proceeding. In affirming the lower court's dismissal of the wife's claims against the trustee, the court opined:[879]

[874] *Sloan v. Segal*, No. 2319, 2008 BL 662, 2008 WL 81513 (Del. Ch. Jan. 3, 2008).

[875] *Sloan v. Segal*, No. 2319, 2008 BL 662, 2008 WL 81513 at *9 (footnote omitted). *See also Emberton v. Rutt*, No. 1:07-cv-01200, 2008 BL 348180, 2008 WL 4093714 (D.N.M. Mar. 31, 2008); *Anglo Irish Bank Corp., PLC v. Superior Court*, 165 Cal. App. 4th 969, 981–986 (2008).

[876] *Emberton v. Rutt*, No. 1:07-cv-01200, 2008 BL 348180, 2008 WL 4093714.

[877] *Anglo Irish Bank Corp, PLC v. Superior Court*, 165 Cal. App. 4th 969, 981–986 (Cal. App. Ct. 2008).

[878] *Kloiber v. Daniel Kloiber Dynasty Tr.*, No. 2013-CA-000436, 2014 BL 341661, *2014 WL 6882265* (Ky. Ct. App. Dec. 5, 2014).

[879] *Kloiber v. Daniel Kloiber Dynasty Tr.*, No. 2013-CA-000436, 2014 BL 341661, *2014 WL 6882265* at *8 n.11.

> Beth presented to the trial court internet printouts concerning PNC's wealth management services, of which establishing a trust was one such service. We note that PNC does indeed offer wealth management services in some Kentucky locations and provided appropriate Kentucky-based contact information, but the website concerning PNC Delaware Trust Co. clearly listed its contact information in Delaware. Given that PNC Delaware Trust Co. is a distinct corporate entity from PNC Financial Services Group, Inc., we are unprepared to say that such printouts were sufficient to sustain Beth's burden of proof.

UTC §202(a) provides that:[880]

[880] UTC §202(a) (Unif. Law Comm'n amended 2018).

> By accepting the trusteeship of a trust having its principal place of administration in this State … the trustee submits personally to the jurisdiction of the courts of this State regarding any matter involving the trust.

Thus, in the 2015 *Queen v. Schmidt* case, a federal district judge in the District of Columbia held that "DC Code §19-1302.02 provides a statutory basis for this Court's assertion of jurisdiction over Cera and Miller."[881]

[881] *Queen v. Schmidt*, No. 10-2017, 2015 BL 286543, 2015 WL 5175712 at *10 (D.D.C. Sept. 3, 2015).

In 2012, a New York trial court concluded that it could exercise personal jurisdiction over a Cook Islands corporate trustee for the following reason:[882]

[882] *Weitz v. Weitz*, *2012 WL 1079203* (N.Y. Sup. Ct. Mar. 22, 2012).

> The Court concludes that the exercise of jurisdiction over Southpac is appropriate in light of the allegations that Southpac participated in the fraudulent conveyance of assets in an effort to avoid the satisfaction of the judgment in the New York divorce action.

A 1995 Florida case is a cautionary tale for corporate trustees trying to limit where they are subject to personal jurisdiction.[883] In this case, the beneficiaries of a Cayman Islands trust sought to have the successor trustee (an Isle of Man corporation) account in Florida for the trust administration. The court denied the trustee's motion to dismiss the complaint for lack of personal jurisdiction because it was not clear whether the trustee's Florida attorney, over which the court had jurisdiction, acted solely as the trustee's legal counsel or as the trustee's managing agent.[884]

[883] *Beaubien v. Cambridge*, 652 So.2d 936 (Fla. Dist. Ct. App. 1995).

[884] *Beaubien v. Cambridge*, 652 So.2d 936, 940.

5. **Personal Jurisdiction—Federal Courts** —

The circumstances under which a federal district court in a non-DAPT state may assert personal jurisdiction over a trustee of a domestic APT under federal question jurisdiction[885] or diversity jurisdiction[886] often will be as described above.[887] In 2014, the U.S. Supreme Court described the limits on such a court's exercise of jurisdiction as follows:[888]

[885] 28 U.S.C. §1331.

[886] 28 U.S.C. §1332. *See Moore v. Chase*, No. 14-CV-2119, 2014 BL 169378, 2014 WL 2759960 at *3 (D. Kan. June 18, 2014) (in action to remove trustee, "amount in controversy" for diversity purposes is "capped at the value of the trust"). The citizenship of the trustee, not of the beneficiaries, is determinative for diversity purposes (*Americold Realty Tr. v. Con Agra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016)). *Accord Raymond Loubier Irrev. Tr. v. Loubier*, 858 F.3d 719,

722 (2d Cir. 2017) ("it is the trustees' citizenship, not that of beneficiaries, that matters for purposes of diversity"). *Wang by and Through Wong v. New Mighty U.S. Tr.*, 843 F.3d 487, 487 (D.C. Cir. 2016) ("we conclude that a so-called traditional trust carries the citizenship of its trustees").

[887] Fed. R. Civ. P. 4(k)(1)(A).

[888] *Daimler A.G. v. Bauman*, 571 U.S. 117, 125 (2014). *See* Spero, *Recent Cases Show Need for Strict Compliance With DAPT Statutes*, 44 Est. Plan. 8, 9 (May 2017).

Federal courts ordinarily follow state law in determining the bounds of their jurisdiction over persons.

As covered in IX.F., below, "it is possible to obtain jurisdiction over trust assets if the debtor/settlor (who resides in the state in which the district court sits) is treated as the owner thereof."[889]

[889] *Spero*, *Recent Cases Show Need for Strict Compliance With DAPT Statutes,* 44 Est. Plan. at 9.

Federal courts exercising federal-question jurisdiction may assert nationwide personal jurisdiction over defendants, particularly in connection with federal laws providing for nationwide service of process.[890] Such rules or statutes include the Racketeer Influenced and Corrupt Organizations ("RICO") Act,[891] the Bankruptcy Rules,[892] and the Federal Debt Collection Procedures Act.[893] These and other federal statutes might come into play in suits regarding transfers to domestic APTs.[894] However, even if nationwide personal jurisdiction exists, venue factors similar to *International Shoe Co. v. Washington's* [895] "traditional notions of fair play and substantial justice"[896] can still result in trials in a trustee's home state rather than a plaintiff's home state.

[890] *See, e.g.*, *United Rope Distribs. v. Seatriumph Marine Corp.*, 930 F.2d 532, 534 (7th Cir. 1991); *FTC v. Jim Walter Corp.*, 651 F.2d 251, 256 (5th Cir. 1981); *Rolls-Royce Motors, Inc. v. Charles Schmitt & Co.*, 657 F. Supp. 1040, 1055 (S.D.N.Y. 1987).

[891] 18 U.S.C. §1965(d) (RICO).

[892] Bankr. R. 7004(d) (governing service in adversary proceedings).

[893] 28 U.S.C. §3004(b) (Federal Debt Collection Practices Act (FDCPA)).

[894] *See, e.g.*, *Gutierrez v. Givens*, 989 F. Supp. 1033 (S.D. Cal. 1998) (applying RICO in fraudulent transfer case); *Cadle Co. v. Schultz*, 779 F. Supp. 392 (N.D. Tex. 1991) (similar); 11 U.S.C. §548 (Bankruptcy Code's federal fraudulent transfer statute); 11 U.S.C. §544(b)(2) (allowing bankruptcy trustee to invoke state law creditors' rights, which would include state fraudulent transfer law). *See also* Fed. R. Bankr. P. 7001 (making adversary proceeding rules applicable to suits to recover property and suits under §544(b)(2)). Further, the FDCPA contains fraudulent transfer provisions (28 U.S.C. §3301, *et seq.*).

[895] *Int'l Shoe Co. v. Washington*, 326 U.S. 310 (1945).

[896] *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 316.

The rationale for nationwide personal jurisdiction is as follows—if a federal question is involved, then the sovereign asserting authority is the United States, not just a specific state. Moreover, a grant of nationwide service of process shows that Congress intended its laws to be enforced against any defendant who has any presence in or meaningful connection with the United States. Consequently, any federal district court anywhere in the country has personal jurisdiction if a defendant has sufficient minimum contacts with the United States.[897] This rationale has, in large measure, been codified in the Federal Rules of Civil Procedure, which now allow nationwide personal jurisdiction in any federal question case in which "the defendant is not subject to jurisdiction in any state's courts of general jurisdiction."[898]

[897] See, e.g., *United Rope Distribs. v. Seatriumph Marine Corp.*, 930 F.2d 532, 534 (7th Cir. 1991); *FTC v. Jim Walter Corp.*, 651 F.2d 251, 256 (5th Cir. 1981); *Rolls-Royce Motors*, *Inc. v. Charles Schmitt & Co.*, 657 F. Supp. 1040, 1055 (S.D.N.Y. 1987).

[898] Fed. R. Civ. P. 4(k)(2). *See also Porina v. Marward*, 521 F.3d 122, 127 (2d Cir. 2008) ("In the case before us, the question is whether Marward has sufficient affiliating contacts with the United States in general, rather than with New York in particular, with which it has none"); *Chew v. Dietrich*, 143 F.3d 24, 27 (2d Cir. 1998) ("When a complaint asserts federal jurisdiction, Rule 4 … now extends the reach of federal courts to impose jurisdiction over the person of all defendants against whom federal law claims are made and who can be constitutionally subjected to the jurisdiction of the courts of the United States.") (citations and internal quotation marks omitted); Advisory Committee Notes to Fed. R. Civ. P. 4(k) (1993 amendments).

Under this expansive theory, if a plaintiff files a bankruptcy adversary proceeding or a RICO suit in the Northern District of Ohio, for example, the court has personal jurisdiction over any trustee-defendant who has sufficient contacts with the United States, even though the defendant has no specific ties to Ohio. This, though, isn't the end of the story. Even if a federal court thinks a defendant is subject to nationwide personal jurisdiction, there are still serious questions as to whether a nonresident defendant may properly be subjected to venue in a distant forum.[899]

[899] *Cf. United Rope Distribs. v. Seatriumph Marine Corp.*, 930 F.2d 532, 534 (7th Cir. 1991) ("Whether the forum within the United States is convenient for the defendant is a question of venue and discretionary doctrines allowing transfers; it has nothing to do with judicial power."); Advisory Committee Notes to Fed. R. Civ. P. 4(k) (1993 amendments) ("The availability of transfer for fairness and convenience under §1404 should preclude most conflicts between the full exercise of territorial jurisdiction permitted by this rule [4(k)] and the Fifth Amendment requirement of 'fair play and substantial justice'"). *See also* 28 U.S.C. §1391, 28 U.S.C. §1404, 28 U.S.C. §1406 (general venue statutes), 28 U.S.C. §1408–§1412 (bankruptcy venue statutes); Fed. R. Bankr. P. 1014 (additional authority for changing venue in bankruptcy cases).

A defendant may move to dismiss a case on grounds of improper venue.[900] Additionally, district courts that do not want to dismiss a case have broad discretionary authority[901] to change venue "[f]or the convenience of the parties and witnesses, [or] in the interest of justice."[902] If a change of venue is granted, the case can be reassigned to "any other district or division where it might have been brought."[903] Motions to change venue should be evaluated "according to an individualized, case-by-case consideration of convenience and fairness."[904]

[900] Fed. R. Civ. P. 12(b)(3).

[901] *Phelps v. McClellan*, 30 F.3d 658, 663 (6th Cir. 1994) (regarding court's discretion).

[902] 28 U.S.C. §1404(a). Similar language is used by 28 U.S.C. §1404(a), the bankruptcy change-of-venue statute, and the related Fed. R. Bankr. P. 1014. For a detailed discussion of certain aspects of the bankruptcy venue rules, see *In re Sorrells*, 218 B.R. 580 (B.A.P. 10th Cir. 1998). *See also Emberton v. Rutt*, No. 1:07-cv-01200, 2008 BL 348180, 2008 WL 4093714 (D.N.M. Mar. 31, 2008) (denying defendant's request to change venue).

[903] 28 U.S.C. §1404(a). *See* 28 U.S.C. §1412; Fed. R. Bankr. P. 1014.

[904] *Stewart Org., Inc. v. Ricoh Corp.*, 487 U.S. 22, 29 (1988) (citation and internal quotation marks omitted).

The statutes governing change of venue in federal court are "procedural rule[s]" and "a federal judicial housekeeping measure."[905] Moreover, these statutes were "drafted in accordance with the doctrine of forum non conveniens" and were also meant to revise the common law so that "courts were given more discretion to transfer … than they had to dismiss on grounds of forum non conveniens."[906]

[905] 487 U.S. at 32 (discussing 28 U.S.C. §1404(a)) (citation and internal quotation marks omitted).

[906] *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 253 (1981) (discussing 28 U.S.C. §1404(a)) (citations omitted).

Because federal change-of-venue rules are based on the forum non conveniens doctrine,[907] courts consider the same factors when deciding whether to dismiss a case due to improper venue or to change venue.

[907] *Piper Aircraft Co. v. Reyno,* 454 U.S. 235, 253.

Some of the usual factors were catalogued in *American Dredging Co. v. Miller* [908] and include the following:

[908] 510 U.S. 443, 447–449 (1994) (citations and internal quotation marks omitted).

- Will “trial in the chosen forum … establish oppressiveness and vexation to a defendant … out of all proportion to plaintiff's convenience”?
- Is the plaintiff's chosen forum “inappropriate because of considerations affecting the court's own administrative and legal problems”?
- Will it be easier or harder to gain access to sources of proof?
- Will it be easier or harder to compel attendance of witnesses at trial?
- Will a trial involve a view of any premises or other physical items located in one district but not another?
- Will it be easier to enforce a judgment against the defendant if the judgment is rendered in the plaintiff's chosen forum instead of the forum asserted by defendant?
- Are there any other factors that will make a trial easier or harder if the plaintiff's preferred venue is chosen over the defendant's venue?
- If some counts in a complaint raise unique questions of state law to go along with the federal questions raised by other counts, then “[t]here is an appropriateness, too, in having the trial … in a forum that is at home with the state law that must govern the case, rather than having a court in some other forum untangle problems in conflict of laws, and in law foreign to itself.”[909]

[909] This quoted passage from *American Dredging* refers to state law in the context of diversity cases. However, state law can be significant in cases involving both federal question and state law claims, as well as in bankruptcy proceedings trying to determine property interests established by state law.

Taken together, these factors raise many of the same concerns prompted by due process constraints on personal jurisdiction under *International Shoe*. Those federal judges who are sensitive to the risks of a trustee being unreasonably “hale[d] … into a vast and geographically limitless diaspora spanning any and all jurisdictions”[910] are also the judges most likely to care about forum non conveniens concerns. Hence, the venue rules enable judges to protect trustees from burdensome litigation in distant forums (and to relieve the judges’ own dockets) even if the court has nationwide personal jurisdiction over a trustee.

[910] *Rose v. Firstar Bank*, 819 A.2d 1247, 1254 (discussing personal jurisdiction issues).

6. **Implications** —

If the trustee of a DAPT has extensive contacts in the non-DAPT court's jurisdiction, the court will have jurisdiction, but if all trustees and trust assets are located in the state where the trust was established and if the trustees have no such contacts, the non-DAPT court should fail to have jurisdiction over the trustee. Admittedly, the minimum contacts issue can provoke sharp debate, but this is still a significant hurdle for plaintiffs to overcome, especially when proceeding before overworked judges who may be inclined to affirmatively look for legitimate reasons to remove a case from their dockets. Settlors and their advisers should keep this in mind in choosing trustees.

Nonetheless, although the facts may sometimes be murky, the law is very clear: courts from outside DAPT states cannot enter valid orders or judgments against a DAPT trustee unless the court has personal jurisdiction over the trustee, nor can it enter orders or judgments against trust assets that are safely beyond the forum state's borders. This will indeed be a serious obstacle in many cases. But even if jurisdiction is good, the court's analysis is only beginning.

If a non-DAPT court lacks jurisdiction over a DAPT's assets and trustee and if a creditor seeks to enforce a judgment that the creditor holds against the settlor in DAPT state courts, then the creditor will be unable to reach the assets of the trust unless the claim falls within one of the limited exceptions in the DAPT states act.[911]

[911] *See, e.g.*, Del. Code Ann. tit. 12, §3572–§3573.

A commentator summarized the governing principles in 2017, in the following way “[i]t may be difficult to obtain jurisdiction over the trustee of the DAPT, assuming the trustee does not have a presence in the state of the debtor's domicile.”[912]

[912] Spero, *Recent Cases Show Need for Strict Compliance With DAPT Statutes*, 44 Est. Plan. 8, 9 (May 2017) (footnotes omitted).

Normally, the non-DAPT state will not have jurisdiction over the DAPT trust or trustee. This presents a practical problem of selecting a forum to challenge the effectiveness of the DAPT. Litigating the issue in the DAPT state will normally involve inconvenience and additional cost (i.e., engaging out-of-state counsel and potential travelling costs); further, the result is subject to the vicissitudes of litigation, including the assumed tendency of a DAPT state to uphold its state's legislation.

In this regard, a DAPT does not violate the public policy of the DAPT state. The public policy of a state is reflected in its legislation, so states that have authorized self-settled DAPTs have effectively declared that such trusts do not violate public policy.

C. Obstacle 2: Non-DAPT Court Should/Must Decline Jurisdiction

1. **Restatement Approach—Movables** —

For trusts of movables (i.e., personal property) created inter vivos, §267 of the *Second Restatement of Conflict of Laws* provides “[t]he administration of a trust of interests in movables is usually supervised … by the courts of the state in which the trust is to be administered.”[913]

Restatement (Second) of Conflict of Laws §267 cmt. c provides the following guidance for determining where a trust is to be administered:

> The question frequently arises whether a testator or settlor has manifested an intention that the trust be administered in a state other than that of his domicile. It may be expressly provided in the will or trust instrument that the trust is to be administered in a particular state. In the absence of such a provision, it is reasonable to infer in most situations that the testator or settlor expected the trustee to administer the trust at his or its place of business or domicil. This is especially true of a corporate trustee which will ordinarily administer its trust business at its principal trust office.

Restatement (Second) of Conflict of Laws §267, comment c, indicates that the trust instrument may designate the state of administration,[914] and a later comment describes the implications of such a designation as follows:[915]

> If the trust is to be administered in a particular state, that state has jurisdiction to determine through its courts not only the interests of the beneficiaries in the trust property but also the liabilities of the trustee to the beneficiaries, even though it does not have jurisdiction over the beneficiaries, or some of them….
>
> So also a court of the state in which the trust is administered may give instructions as to the powers and duties of the trustee, although the beneficiaries or some of them are not subject to the jurisdiction of the court, provided they are given opportunity to appear and be heard.

Another comment discusses the role of the court of primary supervision as follows:[916]

> Where the trustee has not qualified as trustee in any court and the trust is to be administered in a particular state, the courts of that state have primary supervision over the administration of the trust. They have and will exercise jurisdiction as to all questions which may arise in the administration of the trust. Thus, if an inter vivos trust is created with a trust company as trustee, the courts of the state in which the trust company was organized and does business will exercise jurisdiction over the administration of the trust.

If the non-DAPT court has jurisdiction over the trustee or the trust, *Restatement (Second) of Conflict of Laws* §267, comment e, suggests that the court should defer to the domestic APT state's courts:[917]

[913] *Restatement (Second) of Conflict of Laws* §267 (Am. Law Inst. 1971). In 2013, the Supreme Court of Delaware confirmed that “[i]n cases such as these where a trust maintains contacts with multiple states, we prefer to consult the *Restatement (Second) of Conflict of Laws* [particularly §267] to resolve the issue of jurisdiction” (*In re Peierls Family Testamentary Trusts*, 77 A.3d 223, 227 (Del. 2013)). *See* 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.2.2.4.1 at 3102–3114, §45.2.2.4.2 at 3114–3122, §45.2.2.5 at 3122–3125 (5th ed. 2010); Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §292 at 222–233 (3d ed. 2014).

[914] *Restatement (Second) of Conflict of Laws* §267 cmt. c (Am. Law Inst. 1971).

[915] *Restatement (Second) of Conflict of Laws* §267 cmt. d (Am. Law Inst. 1971).

[916] *Restatement (Second) of Conflict of Laws* §267 cmt. e (Am. Law Inst. 1971).

[917] *Restatement (Second) of Conflict of Laws* §267 cmt. e (Am. Law Inst. 1971). *See Holdeen Tr.*, 58 Pa. D.&C.2d 602, 622–625 (O.C. Div. Phila. 1972) (summarizing cases in which home state

court deferred to court of primary supervision).

> A court of a state other than that of the testator's domicil or that in which the trust is to be administered will not exercise jurisdiction if to do so would be an undue interference with the supervision of the trust by the court which has primary supervision. Whether there is such interference depends on the relief sought. Thus, if a court acquires jurisdiction over the trustee it may entertain a suit to compel him to redress a breach of trust, even though the trustee has qualified as trustee in a court of another state or the administration of the trust is in another state. It may compel the trustee to render an accounting or it may even remove the trustee. On the other hand, it will ordinarily decline to deal with questions of construction or validity or administration of the trust, leaving these matters to be dealt with by the court of primary supervision. Thus, it will not ordinarily give instructions to the trustee as to his powers and duties.

The Scott treatise summarizes the applicable principles as follows:[918]

[918] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.2.2.6 at 3125 (5th ed. 2010).

> Trust administration is ordinarily governed by the law of the state of primary supervision, and the rights of the parties ought not depend on the fact that a court of some other state happens to have acquired jurisdiction. Such a court may give a judgment based on its own local law, or it may attempt to apply the law of the state of primary supervision but apply it incorrectly.

These principles have been codified in some states. Hence, Uniform Probate Code (UPC) §7-203 provides as follows:[919]

[919] Article 7 (including §7-203) does not appear in the current version of the UPC.

> The Court will not, over the objection of a party, entertain proceedings under Section 7-201 involving a trust registered or having its principal place of administration in another state, unless (1) when all appropriate parties could not be bound by litigation in the courts of the state where the trust is registered or has its principal place of administration or (2) when the interests of justice otherwise would seriously be impaired.

As of July 1, 2019, UPC §7-203 was in effect in the above form in at least seven states.[920] Applying Michigan's version of UPC §7-203,[921] the Court of Appeals of Michigan held in 2015:[922]

[920] *See* Alaska Stat. §13.36.045; Haw. Rev. Stat. §560:7-203; Idaho Code §15-7-203; Mass. Gen. Laws Ch. 203E, §203; Mich. Comp. Laws §700.7205; N.C. Gen. Stat. §36C-2-203; Utah Code Ann. §75-7-204.

[921] Mich. Comp. Laws §700.7205.

[922] *In re Seneker Tr.*, No. 317003, No. 317096, 2015 BL 51771, *2015 WL 847129* at *1 (Mich. Ct. App. Feb. 26, 2015).

> Appellant argues, and we agree, that the Trust's principal place of administration is in Florida and, therefore, the Michigan probate court was without subject-manner jurisdiction over appellees' petition.

The Florida statute, which since was repealed, was considered in *Meyer v. Meyer*.[923] There, a beneficiary of a trust, which was created by a New York resident but, which was governed by Florida law, brought suit in Florida to obtain funds to which she allegedly was entitled. As permitted by the trust, the trustee had relocated the trust from Florida to New York. The court reversed the lower court and held:[924]

[923] *Meyer v. Meyer,* 931 So.2d 268 (Fla. Dist. Ct. App. 2006).

[924] *Meyer v. Meyer,* 931 So.2d 268, 270–271.

> New York is the principal place for administration of the trust because the trustee is a resident of that state and the trustee's attorney for legal matters pertaining to the trust is also in New York. In any event, the trust agreement provides the trustee discretion to remove the principal place of the trust from Florida to another state if he or she desires. Since the trustee has chosen New York, the choice of law provision in the trust agreement does not present a sufficient legal basis for affirmance.

Caselaw confirms that courts are cautious about construing trust questions governed by the laws of other states and that, consequently, they often abstain from exercising jurisdiction. For example, in *Bartlett v. Dumaine*,[925] the New Hampshire Supreme Court deferred to Massachusetts courts in a suit regarding the duties of trustees of a Massachusetts trust to account to its beneficiaries, even though the New Hampshire court had personal jurisdiction over all interested parties. The Scott treatise cites cases from Illinois, New York, Pennsylvania, and Texas[926] that reached comparable results.

[925] *Bartlett v. Dumaine*, 523 A.2d 1, 14–15 (N.H. 1986). *But see Flaherty v. Flaherty*, 638 A.2d 1254, 1255–1257 (N.H. 1994) ("Since the New Hampshire Superior Court issued the divorce decree, it should decide every facet of the property division," but Massachusetts law governs construction, administration, and creditor rights issues); *Balt. Nat'l Bank v. Cent. Pub. Util. Corp.*, 28 A.2d 244, 246 (Del. Ch. 1942) (Delaware Court of Chancery deferred to Maryland courts in case involving trust to be administered in Maryland).

[926] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.2.2.4.1 at 3112 n.36 (5th ed. 2010). *See, e.g.*, *Walton v. Harris*, 647 N.E.2d 65, 67–69 (Mass. App. Ct. 1995) (Massachusetts courts could exercise jurisdiction because Massachusetts continued to be situs even though assets had been moved to Florida); *Holdeen Tr.*, 58 Pa. D. & C.2d 602, 612–622 (Ct. Com. Pl. 1972) (Pennsylvania courts could exercise jurisdiction because trustor set administration in Pennsylvania even though assets were in New York).

Practice Tip: Given that it is important that judicial proceedings involving a domestic APT be handled by a domestic APT court, the trustee and beneficiaries of such a trust might commence a proceeding (e.g., to appoint a successor trustee) early in the trust's existence to confirm jurisdiction. In this regard, a Delaware Vice Chancellor wrote in 2016 that:[927]

[927] *In re IMO Ronald J. Mount 2012 Irrevocable Dynasty Tr.*, No. 10991, 2016 BL 18383, 2016 WL 297655 at *3 (Del. Ch. Jan. 21, 2016) (quoting *Pipal Tech. Ventures Private Ltd. v. MoEngage, Inc.*, No. 10381, 2015 BL 413630, 2015 WL 9257869 at *5 (Del. Ch. Dec. 17, 2015)).

> [A] court—in the absence of a prior-filed action elsewhere—should respect a plaintiff's choice of forum except in the rare case where the defendant demonstrates with particularity that it will be subjected to overwhelming hardship and inconvenience if required to litigate in Delaware, thereby warranting drastic relief.

2. **Restatement Approach—Land** —

The settlor is much more constrained for trusts that hold interests in land created inter vivos. Hence, *Second Restatement of Conflict of Laws* §276 provides that "[t]he administration of a trust of an interest in land is supervised by the courts of the situs as long as the land remains subject to the trust."[928]

[928] *Restatement (Second) of Conflict of Laws* §276 (Am. Law Inst. 1971). *See Restatement (Second) of Conflict of Laws* §276 cmt. b (Am. Law Inst. 1971); 7 Scott, Fratcher & Ascher, *Scott*

and Ascher on Trusts §46.2.2–§46.2.2.2 at 3373–3382, §46.2.3–§46.2.3.2 at 3382–3389 (5th ed. 2010); Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §292 at 20–21 (3d ed. 2014).

One of *Restatement (Second) of Conflict of Laws*§276's comments expands upon the general rule as follows:[929]

> [T]he courts of the situs have jurisdiction over the administration of the trust as long as the land remains subject to the trust. The courts of the situs have and will exercise jurisdiction to determine the construction, validity and effect of the will or trust instrument insofar as interests in the land are concerned. A court of the situs has power to remove the trustee and vest the title to the land in a substitute trustee, even though it does not have jurisdiction over the trustee personally. It has and will exercise jurisdiction over the administration of the trust. It can determine the powers and duties of the trustee and the rights of the beneficiaries.

That comment describes the role of courts outside the situs as follows:[930]

> A court of a state other than that of the situs may exercise jurisdiction if this does not unduly interfere with the control by the courts of the situs. Thus, if it has jurisdiction over the trustee it may entertain a proceeding to surcharge the trustee for a breach of trust, although in determining whether the trustee has incurred a liability it will apply the law that would be applied by the courts of the situs. It may even remove the trustee and compel him to make a conveyance to a successor trustee. It cannot, however, by its judgment directly affect interests in the land.

A court other than that of the situs will not exercise jurisdiction if such exercise would be an undue interference with the supervision of the trust by the courts of the situs. Thus, courts will not ordinarily deal with questions of construction, validity, or administration of the trust and will leave these matters to be dealt with by the courts of the situs. It will not ordinarily give instructions to the trustee as to his or her powers and duties.

Practice Tip: Therefore, under the *Restatement (Second) of Conflict of Laws*, the settlor of a domestic APT that holds real property is much more limited in his or her choice of a supervising court than is the settlor of such a trust that holds personal property.

3. **UTC Approach** —

No UTC provision covers this subject. Indeed, when enacting their versions of the UTC, several states repealed and (except for Massachusetts and Michigan) did not replace their versions of UPC §7-203.

4. **Federal District Court** —

When a case involving a trust meets the requirements for diversity jurisdiction,[931] so that the case may be removed from state to federal court, the federal district court must decide whether to exercise jurisdiction. Sometimes such courts decline to exercise jurisdiction,[932] while at other times they do not.[933]

[929] *Restatement (Second) of Conflict of Laws* §276 cmt. b (Am. Law Inst. 1971).

[930] *Restatement (Second) of Conflict of Laws* §276 cmt. b (Am. Law Inst. 1971).

[931] *See* 28 U.S.C. §1332. *See also* Joshua S. Rubenstein & Bonnie Lynn Chmil, *Getting Out of Federal Court*, 156 Tr. & Est. 14 (Dec. 2017).

[932] *See, e.g., Norton v. Bridges*, 712 F.2d 1156 (7th Cir. 1983).

[933] *See, e.g., Barnes v. Brandrup*, 506 F. Supp. 396 (S.D.N.Y. 1981).

D. Obstacle 3: Venue Might Be Bad

An out-of-state trustee may also contest venue, even when personal jurisdiction is good. Such federal venue issues are potentially relevant to all federal litigation. State law often (but not always) contains similar venue rules under local civil rules and/or the forum non conveniens doctrine.[934] Although a plaintiff's choice of venue typically should not be disturbed absent compelling reason to do so,[935] many overworked judges consider their crowded dockets to be reason enough to change venue, especially if any other plausible justification exists. Even the U.S. Supreme Court has euphemistically but, nonetheless, expressly noted that docket control is a valid factor to consider.[936] Accordingly, out-of-state trustees might still get a suit transferred out of the plaintiff's chosen court simply because the judge is too busy to be bothered.

[934] *See, e.g.*, *Chambers v. Merrell-Dow Pharm., Inc.*, 519 N.E.2d 370 (Ohio 1988) (endorsing common law of forum non conveniens); Ohio R. Civ. P. 3; *W.R. Grace & Co. v. Hartford Accident & Indemnity Co.*, 555 N.E.2d 214 (Mass. 1990).

[935] *W.R. Grace & Co.*, 555 N.E.2d 214, 217–218.

[936] *Am. Dredging Co. v. Miller*, 510 U.S. 443, 448 (1994) (venue may be “inappropriate because of considerations affecting the court's own administrative and legal problems”).

In 2011, Judge Howell of the U.S. District Court for the District of Columbia considered a request to transfer venue to the U.S. District Court for the Western District of Missouri.[937] She summarized the factors to be considered as follows:[938]

[937] *United States v. H&R Block*, 789 F. Supp. 2d 74, 78 (D.D.C. 2011). *Accord Burke, Warren, Mackay & Serritella, P.C. v. Tamposi*, No. 10-CV-8267, 2011 BL 425701, 2011 WL 5373981 at *5 (N.D. Ill. Nov. 4, 2011) (venue transferred from Illinois to Massachusetts); *Am. Institutional Partners, LLC v. Fairstar Res., Ltd.*, No. 10-489, 2011 BL 87243, *2011 WL 1230074* at *4 (D. Del. Mar. 31, 2011). For choice-of-laws considerations involved in a change of venue, see *Klatte v. Buckman*, No. 14-0699, 2016 BL 86593, *2016 WL 1090437* at *3–4 (D.N.J. Mar. 21, 2016). For the impact of a forum-selection clause on venue selection, see *Atlantic Marine Const. Co. v. U.S. Dist. Ct. for the W. Dist. of Tex.*, 571 U.S. 49 (2013); *LVAR, L.P. v. Bermuda Commercial Bank Ltd.,* 649 Fed. App'x 25 (2d Cir. 2016).

[938] *United States v. H&R Block*, 789 F. Supp. 2d at II.A. (citations and internal quotation marks omitted).

> Under the federal venue transfer statute a district court may transfer a case to another district for the convenience of parties and witnesses, in the interest of justice. The Court may only transfer a case to another district where it might have been brought. This statute vests discretion in the District Court to adjudicate motions for transfer on an individualized, case-by-case consideration of convenience and fairness. Courts evaluate a series of public and private interest factors in determining whether to grant a transfer of venue. The private interest factors that are considered include: (1) the plaintiff's choice of forum; (2) the defendant's choice of forum; (3) where the claim arose; (4) the convenience of the parties; (5) the inconvenience of the witnesses; and (6) the ease of access to the sources of proof. The public interest factors … include: (1) the local interest in making local decisions regarding local controversies; (2) the relative congestion of the transferee and transferor courts; and (3) the potential transferee court's familiarity with the governing law. Courts have imposed a heavy burden on those who seek transfer and a court will not order transfer unless the balance is strongly in favor of the defendant.

After analyzing the private interest factors and the public interest factors enumerated above, Judge Howell denied the requested change of venue.[939]

[939] 789 F. Supp. 2d 74. *See United States v. Busch*, No. 4:17-CV-183, 2017 BL 455149, 2017 WL 6512229 at *1 (E.D. Tex. Dec. 20, 2017) (“Motion to Transfer Venue is Denied”).

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Portfolio 868-2nd: Domestic Asset Protection Trusts
Detailed Analysis
IX. Defenses to Creditor Attacks on Domestic APTs

E. Obstacle 4: Domestic APT States May and Do Limit the Remedies Available for Judgments Given Full Faith and Credit

1. **Introduction** —

Domestic APT states may and do restrict the remedies available to most judgment creditors who must prove a fraudulent transfer before they can collect.

2. **The Right to Limit Remedies** —

A domestic APT state may regulate the method by which other states’ judgments are enforced within its borders. As noted by the U.S. Supreme Court in *Baker v. General Motors Corp.*:[940]

[940] *Baker v. Gen. Motors Corp.,* 522 U.S. 222, 235 (1998). *Accord Nastro v. D'Onofrio*, 822 A.2d 286, 291 (Conn. App. Ct. 2003). *See Restatement (Second) of Conflict of Laws* §99 (Am. Law Inst. 1971); Uniform Enforcement of Foreign Judgments Act (UEFJA) §2, 13 U.L.A. 160 et seq. (2002); Del. Code Ann. tit. 10, §4782.

> Full faith and credit, however, does not mean that States must adopt the practices of other States regarding the time, manner, and mechanisms for enforcing judgments. Enforcement measures do not travel with the sister state judgment as preclusive effects do; such measures remain subject to the even-handed control of forum law.

The Full Faith and Credit Clause merely creates a rule of evidence that a plaintiff's out-of-state judgment is valid, whereas the rules for enforcing a judgment are established by the state in which enforcement is sought.[941]

[941] *Baker v. Gen. Motors Corp.,* 522 U.S. 222, 241–242 (Scalia, J., concurring). *See also In re Cochrane*, 178 B.R. 1011, 1018 n.8 (Bankr. D. Minn. 1995) (“The state of Minnesota has no business dictating to Florida judgment creditors, as to how they may enforce their claims against assets that are situated in Florida”).

The *Restatement (Second) of Conflict of Laws* adopts a comparable view,[942] as does caselaw.[943] Likewise, the Uniform Enforcement of Foreign Judgments Act (UEFJA) provides that a judgment from another state may be satisfied only pursuant to the procedures established by local law.[944] In addition, as a matter of federal practice, judgments rendered by federal courts outside domestic APT states are enforceable by the domestic APT states’ federal courts only to the same extent and in the same manner as judgments rendered in the domestic APT state.[945] Hence, the theme is clear and consistent—although a state has limited authority to ignore another states’ judgment, it has broad authority to regulate how that judgment is enforced.

[942] *Restatement (Second) of Conflict of Laws* §142, §142 cmt. d (states may set limitations periods for enforcing out-of-state judgments).

[943] *Nastro v. D'Onofrio*, 822 A.2d 286, 291 (Conn. 2003) ("The full faith and credit clause does not impose procedural constraints on the time and manner in which an out-of-state judgment is enforceable in the courts of this state").

[944] UEFJA, 13 U.L.A. 160, *et seq*. (2002); 13 U.L.A. 160 §2 (judgment filed with clerk of courts pursuant to act "has the same effect and is subject to the same procedures, defenses and proceedings … as a judgment of a [court] of this state and may be enforced or satisfied in like manner"); Del. Code Ann. tit. 10, §4782 (similar). *See also Nastro*, 822 A.2d 286, 291 (similar).

[945] *Powles v. Kandrasiewicz*, 886 F. Supp. 1261, 1266 (W.D.N.C. 1995); Fed. R. Civ. P. 69.

The domestic APT statutes work within these limits. They restrict a plaintiffs' actions, rather than their claims, and bar actions to enforce judgments against or collect funds from domestic APTs, unless brought within the appropriate time periods and under the procedures allowed by the domestic APT statutes.[946] This comports with caselaw. In *Matanuska Valley Lines, Inc. v. Molitor*,[947] the Ninth Circuit held that a federal district court in Washington state, where the plaintiff sought to enforce a judgment, could apply its shorter statute of limitations than would be the case in Alaska, where the plaintiff obtained the original judgment. In the course of the opinion, the court wrote:[948]

[946] *See, e.g.*, Del. Code Ann. tit. 12, §3572(a).

[947] *Matanuska Valley Lines, Inc. v. Molitor,* 365 F.2d 358 (9th Cir. 1966).

[948] *Matanuska Valley Lines, Inc. v. Molitor,* 365 F.2d 358, 359–360. *Accord Powles v. Kandrasiewicz*, 886 F. Supp. at 1268. *See Restatement (Second) of Conflict of Laws* §142 (Am. Law Inst. 1971).

> It has long been established that the enforcement of a judgment of a sister state may be barred by application of the statute of limitations of the forum state. Application of the forum's statute of limitations entails no violation of the full faith and credit clause of the Constitution since such statutes are deemed to affect procedure only and not the substance of the action.

Practice Tip: The domestic APT statutes do not distinguish between domestic APT state judgments and those of other states. No action to enforce any judgment against a domestic APT trustee or trust fund, whether rendered in a domestic APT state or elsewhere, may proceed unless brought within the appropriate periods prescribed by the domestic APT statute and pursuant to the prescribed remedy, which is to prove a fraudulent transfer to a trustee.[949] This provides the "even-handed control" required by *Baker*.[950] Given that the U.S. Constitution does not require states to adopt one set of collections procedures for their own citizens and another more favorable set for citizens of other states, the domestic APT statutes satisfy the Full Faith and Credit Clause.

[949] *See, e.g.*, Del. Code Ann. tit. 12, §3572; Del. Code Ann. tit. 6, §1304, §1305, §1309.

[950] *Baker v. Gen. Motors Corp.*, 522 U.S. 222 (1998).

3. **The Restrictive Domestic APT Remedy** —

Subject to certain limited exceptions, creditors seeking to attach funds in a domestic APT must prove that the funds were fraudulently transferred into trust.[951] In Delaware, for example, the exceptions are for a handful of preferred creditors: current and former spouses who benefit from child or spousal support orders; spouses or ex-spouses holding property-division orders (other than orders for forced heirship, legitime, or elective share); and persons whose claims for death, personal injury, or property damage arose before the transfer in question.[952] Any other creditors will find their remedies to be severely limited.

[951] *See, e.g.*, Del. Code Ann. tit. 12, §3572(a), §3572(b).

[952] *See, e.g.*, Del. Code Ann. tit. 12, §3573.

4. **APTs Are Not Inherently Fraudulent**

a. **Introduction** —

Many creditors' counsel argue that transfers to APTs are inherently fraudulent because the transfers are designed to frustrate known existing creditors and a potentially vast array of foreseeable or unknown future creditors. However, APTs can be validly used, even in the face of existing claims.

b. **Implications**

(1) **Background** —

These issues were examined at length in VIII.B. and VIII.C., above. The authorities discussed at VIII.B. and VIII.C. emphasize two key points, one applicable to both present and future creditors and one that is uniquely relevant to future creditors.

(2) **Post-Transfer Solvency (Present and Future Creditors)** —

Clients should consider the likely needs of known and reasonably foreseeable future creditors and keep out of their APTs enough assets and/or future earning capacity to satisfy those needs. Such intentional post-transfer solvency is the mark of responsible planning, not a fraudulent transfer. However, a transferor's solvency will be subjected to more rigorous scrutiny if a complaining creditor held a claim that arose before the transfer (i.e., the plaintiff is a present creditor).

(3) **Disclosed Transfers (Future Creditors)** —

The authorities are abundant and clear—future creditors with actual or constructive knowledge of a prior transfer have no basis to complain. Clients should therefore look for ways to disclose a transfer whenever possible.

In addition to these points, it is important to note the theory underlying claims by future creditors and the limited nature of their rights. These matters are discussed in VIII.B., above.

5. **APTs, Alter Egos, Sham Trusts, Nominee Trusts, and Related Issues** —

Statutory limitations on creditor remedies apply in connection with claims against domestic APTs. For instance, Delaware's Act states that "no action of any kind… 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 avoidance of a qualified disposition,"[953] except for the fraudulent transfer remedies provided by the statute.

[953] Del. Code Ann. tit. 12, §3572(a).

The question, therefore, becomes whether this statutory limitation of remedies bars creditors from alleging that a domestic APT is a sham trust. There are competing arguments. On the one hand, the statutes plainly contemplate that the only creditor remedy is the limited one provided by law, and so long as a domestic APT meets the basic criteria for a qualified disposition, then creditors should be so limited.[954] On the other hand, the statutes presuppose the existence of a real trust, and if a trust is a sham, then there may be no basis to protect any assets that have been placed into a sham arrangement. Similarly, if a trust is a settlor's alter ego or nominee, then there is no separation of legal and equitable title and again no trust or trust assets deserving of protection (although as discussed in IX.F., below, the entire concept of an "alter ego trust" is inherently illogical once the true nature of a trust is understood).

[954] For reference, the basic criteria for establishing a qualified disposition are a "disposition" of "property" to a "qualified trustee" by means of a "trust instrument" that: (1) is "irrevocable" within the meaning of the Delaware statute; (2) contains an anti-alienation spendthrift clause; and (3) "[e]xpressly incorporates the law of [Delaware] to govern the validity, construction and administration of the trust." *See* Del. Code Ann. tit. 12, §3570(11).

Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Detailed Analysis
IX. Defenses to Creditor Attacks on Domestic APTs

F. Obstacle 5: Judgments Against Settlors Are Not Enough

1. **Introduction** —

Creditors who obtain judgments against settlors but not trustees of properly established domestic APTs will not have access to the assets of such trusts. Given that the trust fund is titled in the name of the trustee and not the settlor-debtor, efforts to levy or attach the settlor's property will not reach the trust fund. In determining whether a bankruptcy trustee could reach the assets of a Belizean APT, a federal bankruptcy court in Florida wrote in 2019 that "[t]o the extent the plaintiff is asking the Court to order Mr. Rensin to cause the Joren Trust to turn over assets, Mr. Rensin has no legal right under the Joren Trust documents to cause the Joren Trustee to take any such action."[955] Accordingly, judgment creditors who want to attach trust funds will be forced to start actions that somehow attack the validity of the trustees' title.

[955] *In re Rensin*, *2019 WL 2004000* at *11 (Bankr. S.D. Fla. May 6, 2019).

In 2019, the federal district court in Nevada described four theories that may be pursued to collect taxes:[956]

[956] *United States v. Steele*, No. 3:18-cv-00063, 2019 BL 210937, *2019 WL 2411422* at *8 (D. Nev. June 7, 2019).

> The Government argues: (1) the nominee doctrine; (2) the alter ego doctrine; (3) the sham trust doctrine; and (4) that DLT's purchase of the Property was a fraudulent transfer as to the United States.

The fourth doctrine was covered in VIII., above; the other three doctrines are explained below.

In 2017, the Third Circuit distinguished between the alter-ego theory and the nominee theory in the following manner:[957]

[957] *United States v. Bogart*, 715 Fed. App'x 161, n.4 (3d Cir. 2017). *Accord United States v. Hovnanian*, No. 18-15099, 2019 BL 91135, 2019 WL 1233082 at *4 n.4 (D.N.J. Mar. 18, 2019); *United States v. Nassar*, No. 13-civ-8174, 2014 BL 316738, 2014 WL 5822677 at *5 (S.D.N.Y. Nov. 10, 2014); *Campbell v. Commissioner,* T.C. Memo 2019-4 at *7.

> Under a nominee theory, the Government may levy upon only those assets to which a third party holds legal title, but from which the delinquent taxpayer enjoys the true beneficial ownership. Under an alter ego theory, however, the Government may seize all of the assets of an alter ego corporation if the separate entity is merely a sham.

As will be seen, all three theories may be countered by proper construction of the APT. In addition, much of the jurisprudence surrounding these theories has been developed in federal tax litigation, which might or might not apply to creditor actions to recover assets under state law. There is no doubt that the federal government may reach assets that a third party holds as a debtor's alter ego or nominee to collect delinquent taxes.[958]

[958] *See, e.g.*, *Saepoff v. N. Cascade Trustee Servs., Inc.*, No. 2:17-CV-957, 2019 BL, 140759, *2019 WL 1759836* at *2 (W.D. Wash. Apr. 19, 2019); *United States v. Hovnanian*, No. 18-15099, 2019 BL 91135, 2019 WL 1233082 at *3 (D.N.J. Mar. 18, 2019); *United States v. Birdsong*, No. CV 17-72-M-DWM, *2018 BL 4467869*, *2018 WL 6330112* at *7 (D. Mont. Dec. 4, 2018); *United States v. RAJMP, Inc.*, No. 17-cv-00515, 2018 BL 419197, 2018 WL 5920145 at *7 (S.D. Cal. Nov. 13, 2018); *United States v. Kraus*, No. C16-5449, 2018 BL 117156, 2018 WL 1610225 at *5 (W.D. Wash. Apr. 3, 2018).

2. **Background: Trusts Are Relationships, Not Entities** —

A great source of confusion involves the alter-ego doctrine. Black's Law Dictionary defines alter ego as "[a] corporation used by an individual or a subservient corporation in conducting personal business, the result being that a court may impose liability on the individual or subservient corporation by piercing the corporate veil when someone dealing with the corporation is the victim of fraud, illegality, or injustice."[959] But a trust is different from a corporation!

[959] *Black's Law Dictionary* 98 (11th ed. 2019).

The general proposition that a trust is a relationship rather than an entity is universally recognized by U.S. cases[960] and statutes[961] and is consistent with the prevailing norms of the entire common-law world. The fundamental nature of this relationship is that one person holds legal title for the benefit of another person. The U.S. Supreme Court has explained:[962]

[960] *See Americold Realty Tr. v. Conagra Foods, Inc.*, 136 S. Ct. 1012, 1016 (2016). *Accord Raymond Loubier Irrevocable Tr. v. Loubier*, 858 F.3d 719, 722 (2d Cir. 2017) ("[I]t is the trustees' citizenship, not that of beneficiaries, that matters for purposes of diversity"); *Wang by and through Wong v. New Mighty U.S. Tr.*, 843 F.3d 487, 487 (D.C. Cir. 2016) ("a so-called 'traditional trust' carries the citizenship of its trustees"). For a review of relevant authorities, see *Loubier*, 858 F.3d at 725–731.

[961] *See, e.g.,* S.D. Codified Laws §55-1-3 ("An express trust is an obligation arising out of a personal confidence reposed in and voluntarily accepted by one for the benefit of another").

[962] *Americold*, 136 S. Ct. at 1016 (citations omitted).

> Traditionally, a trust was not considered a distinct legal entity, but a "fiduciary relationship" between multiple people. Such a relationship was not a thing that could be haled into court; legal proceedings involving a trust were brought by or against the trustees in their own name. And when a trustee files a lawsuit or is sued in her own name, her citizenship is all that matters for diversity purposes. For a traditional trust, therefore, there is no need to determine its membership, as would be true if the trust, as an entity, were sued.

To reiterate, because a trust is not a legal entity, "legal proceeding involving a trust were brought by or against the trustees in their own name."[963] As Illinois practitioners wrote in 2015 "[w]hen a trustee enters into a contract with a nonbeneficiary third party, the contract is between the third party and the trustee as opposed to the third party and the trust."[964]

[963] 136 S. Ct. at 1016.

[964] Lauren J. Wolven & Carrie Harrington, *Beneficiary Loans: Obvious Problems and Subtle Solutions*, 42 Est. Plan. 18, 19 (June 2015).

3. **Trusts Cannot Be Alter Egos Because Trusts Are Not Persons** —

Given that a trust is not an entity, it's impossible for a trust to be anybody's alter ego because alter-ego theory, which is simply one of the grounds to "pierce the corporate veil," is inescapably linked to the notion that one person or entity exercises undue control over another person or entity.[965] However, a trust's status as a non-entity logically precludes a trust from being an alter ego. A few states have implicitly recognized this distinction. Hence, Nevada's and South Dakota's trust statutes outline and limit the circumstances in which trustees, not trusts, can be said to be a settlor's alter ego or subject to undue dominion and control.[966]

[965] *See, e.g.*, *Trustees of Vill. of Arden v. Unity Constr. Co.*, *2000 WL 130627* at *3 (Del. Ch. Jan. 16, 2000) ("In any case involving alter ego allegations, the *two separate entities* are at least holding themselves out to the public as separate") (emphasis added). *See also Butler v. Candlewood Road Partners, LLC (In re Raymond)*, 2014 WL 3534038 at *4–5 (D. Mass July 16, 2014).

[966] *See* Nev. Rev. Stat. §163.418; S.D. Codified Laws §55-1-32–§55-1-33.

This critical distinction, however, does not always keep U.S. courts from applying alter-ego theory to trusts.[967]

[967] *See, e.g., In re Schwarzkopf*, 626 F.3d 1032, 1040 (9th Cir. 2010) (California); *United States v. Nelson*, *2018 WL 2390128* at *6 (D.S.D. May 25, 2018 (South Dakota)); *United States. v. Williams*, 2017 WL 3700901 at *2 (M.D.N.C. Aug. 25, 2017) (North Carolina); *United States v. Scherer*, *2016 WL 1047139* at *5 (S.D. Ohio Mar. 16, 2016) (Ohio); *United States v. O'Shea*, *2015 WL 738135* at *5 (D.W.Va. Feb. 20, 2015) (West Virginia); *Acheff v. Lazare*, 2014 WL 894491 (D.N.M. Jan. 29, 2014) (New Mexico); *United States v. Smith*, 2012 WL 1977964 at *7 (W.D. Wash. June 1, 2012) (Washington); *In re Yerushalmi*, 487 B.R. 98, 112 (Bankr. E.D.N.Y. 2012) (New York). *See also* CC-2012-002, 2011 Tax Notes Today 235-14 (Dec. 2, 2011) (federal common law alter-ego analysis is most appropriate way for courts to resolve alter-ego claims in federal tax collection cases).

The flawed application of the alter-ego doctrine to trusts sharply differs from applying that doctrine to trustees. For instance, while a corporation, company, or other artificial entity "has no body to kick and no soul to damn,"[968] such an entity is nonetheless a separate juridical person,[969] and it, therefore, makes theoretical sense to talk of a corporation as potentially being somebody else's alter ego. It makes no sense, however, to describe a nonentity like a trust as potentially being someone else's alter ego. Still, U.S. courts and litigants persist in misapplying this doctrine to trusts; this unfortunately, is not surprising, since alter-ego theory generally suffers from "confused jurisprudence."[970] Its application to trusts is just one more unhappy example of this confusion.

[968] *Mason v. Network of Wilmington, Inc.*, 2005 WL 1653954 at *4 (Del. Ch. July 1, 2005) (footnote and internal quotation marks omitted). For the test under Minnesota law, see *In re Crabtree*, 554 B.R. 174, 192 (Bankr. D. Minn. 2016), *rev'd and rem'd*, 562 B.R. 749 (B.A.P. 8th Cir. 2017). For a case that applied conflict-of-laws principles in the corporate alter-ego setting, see *Lim v. Miller Parking Co.*, 560 B.R. 688, 703–05 (E.D. Mich. 2016).

[969] Numerous cases apply this analysis to LLCs. *See, e.g.*, *Gowin v. Granite Depot, LLC*, 634 S.E.2d 714, 719 (Va. 2006) ("A limited liability company is an entity that, like a corporation,

shields its members from personal liability based on actions of the entity"); *Elf Atochem N. Am., Inc. v. Jaffari*, 727 A.2d 286, 288 (Del. 1999) (noting that filing of certificate of formation "is the first statutory step in creating the LLC as a separate legal entity"); *Cortellesso v. Town of Smithfield Zoning Board*, 888 A.2d 979, 981 (R.I. 2005) ("a limited liability company is a legal entity distinct from its members"); *First Nat'l Bank of Chicago v. Maynard*, 815 A.2d 1244, 1248 (Conn. App. Ct. 2003) (similar); *Cleveland Bar Ass'n v. Pearlman*, 832 N.E.2d 1193, ¶36 (Ohio 2005) (similar); *Heartland v. McIntosh Racing Stable*, 632 S.E.2d 296, 299 (W. Va. 2006) (similar). For cases on corporations, see, for example, *In re Centaur Ins.*, 632 N.E.2d 1015, 1017 (Ill. 1994) ("A corporation is a legal entity separate and distinct from its shareholders, directors, and officers"); *Cheatle v. Rudd's Swimming Pool Supply Co.*, 360 S.E.2d 828, 831 (Va. 1987) ("The proposition is elementary that a corporation is a legal entity entirely separate and distinct from the shareholders or members who compose it"); *Bovee v. Gravel*, 811 A.2d 137, 140 (Vt. 2002) ("in Vermont, as elsewhere, a corporation is a legal entity distinct from its shareholders"); *New Light Co. v. Wells Fargo Alarm Servs.*, 567 N.W.2d 777, 782 (Neb. 1997) ("A corporation is a legal entity complete and separate from its shareholders and officers"); *Seagram Distillers Co. v. Alcoholic Beverages Control Comm'n*, 519 N.E.2d 276, 281 (Mass. 1988) ("It is a basic tenet that a corporation is a legal entity distinct from its shareholders").

[970] *Allied Capital v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1044 (Del. Ch. 2006).

4. **Trustees Can Be Alter Egos** —

Whereas applying alter-ego doctrine to trusts is conceptually unsound, applying the doctrine to trustees is a different proposition. Trustees are real persons, either natural or artificial, and as a conceptual matter it is entirely reasonable to ask whether a trustee is the alter ego of a defendant who made a transfer into trust. Alter-ego doctrine can, therefore, provide a viable legal theory for creditors vis-a‘-vis trustees. Accordingly, a federal district court in Washington state held in 2019 that an individual trustee was the debtor's alter ego.[971]

[971] *Saepoff v. N. Cascade Trustee Servs., Inc.*, *2019 WL 1759836* at *3 (W.D. Wash. Apr. 19, 2019).

Once properly framed, however, the question can cause significant fact problems for plaintiffs, particularly if the trustee is a professional trustee or trust company. Alter-ego theory typically requires proof that the wrongful actor has somehow gained overbearing control of the alleged alter ego, but it's hard to imagine how the settlor of a single trust has somehow acquired domineering control over a major trust company or a professional trustee that administers scores (perhaps thousands) of trusts with hundreds of millions (perhaps even billions) of dollars of trust assets under management.

When viewed in this context, it is little wonder that plaintiffs allege that trusts, rather than trustees, are alter egos—proving that a full-time professional trustee is the alter ego of a single settlor-transferor would be a daunting task. Even if the transfers in question were numerous or valuable from an individual settlor's perspective, they often amount to small change from a trustee's perspective—the relevant transfers will often be a very small percentage of the trustee's trusts, and the trustee will typically run its multi-faceted business without being subject to any controlling influence of the settlor-transferor. Sometimes, the trust may amount to a large percentage of a trustee's portfolio—perhaps even the trustee's sole trust in certain family or insider situations—and on these facts it may be plausible to claim that a trustee is a settlor-transferor's alter ego because of the disputed trust's alleged propensity to dominate and control the trustee's business. But, on the more typical facts involving a professional trustee, the notion that a professional trustee has somehow been wrongfully bent to the will of a single settlor will often be prima facie absurd.

5. **The Alter-Ego Theory and Trusts Around the Country**

a. **State Statutes** —

Some state statutes recognize the existence of the alter-ego theory for trusts. For example, a South Dakota statute, which took effect in 2007, provides as follows:[972]

[972] S.D. Codified Laws §55-1-33 (emphasis added).

> Factors which are insufficient evidence that settlor controls or is *alter ego* of trustee
>
> Absent clear and convincing evidence, no settlor of an irrevocable trust may be deemed to be the *alter ego* of a trustee. The following factors by themselves or in combination are not sufficient evidence for a court to conclude that the settlor controls a trustee or is the *alter ego* of a trustee:
>
> (1) Any combination of the factors listed in §55-1-32;
>
> (2) Isolated occurrences where the settlor has signed checks, made disbursements, or executed other documents related to the trust as a trustee, when in fact the settlor was not a trustee;
>
> (3) Making any requests for distributions on behalf of beneficiaries;
>
> (4) Making any requests to the trustee to hold, purchase, or sell any trust property.

A second South Dakota statute specifies the factors that are not to be considered as dominion and control over trusts.[973] Nevada (2009), Oklahoma (2010), Tennessee (2013), and Mississippi (2014) have comparable legislation.[974]

[973] S.D. Codified Laws §55-1-32.

[974] Nev. Rev. Stat. §163.418, §163.4177; Okla. Stat. §175.84; Tenn. Code Ann. §35-15-1104–§35-15-1105; Miss. Code Ann. §91-8-1107–§91-8-1108.

In a 2019 article, commentators contended that having anti-alter-ego legislation should be viewed as a plus in ranking domestic APT states.[975] The author disagrees. This is because, as will be seen below, it is unclear whether the alter-ego theory is available in many states. States possessing anti-alter-ego legislation have conceded by negative implication that the doctrine is available, though in restricted circumstances.

[975] *See* Mark Merric et al., *Best Situs for DAPTs in 2019*, 158 Tr. & Est. 60, 63 (Jan. 2019).

b. **Other Jurisdictions**

(1) **Introduction** —

In an unpublished opinion—*TransFirst Group, Inc. v. Magliarditi* (2017),[976] Judge Gordon of the U.S. District Court for the District of Nevada, in granting a motion for a preliminary injunction, but without noting the Nevada statute mentioned in IX.F.5.a., above, concluded, inter alia, that “I predict the Supreme Court of Nevada would apply alter ego to trusts if justice required it.”[977]

[976] 2017 WL 2294288 (D. Nev. May 25, 2017). The discussion of the *TransFirst* case is based on Nenno, *Dick Nenno on TransFirst Group Inc. v. Magliarditi: Using the Alter-Ego Doctrine to Reach Assets of Third-Party and Self-Settled Trusts—Setting the Record Straight*, LISI Asset Prot. Plan. Newsl #347 (Aug. 14, 2017), www.leimbergservices.com.

[977] 2017 WL 2294288 at *5.

In a commentary on the case (the "*TransFirst* Commentary"), the authors blithely asserted that:[978]

> This opinion shouldn't be unduly concerning regarding Nevada Law. *Even if the rationale of this opinion is followed by Nevada state courts, it simply would mean that Nevada alter ego law is the same as that of most other states*.

The authors of the *TransFirst* commentary based their contention that "Nevada alter ego law is the same as that of most other states" on a statement in another unpublished opinion—*Bash v. Williams* [979] —that the authors quote as follows:[980]

> [N]early every court to have addressed the issue … has concluded that alter ego liability should apply to trusts to the same it [sic] extent it applies to other legally created fictions.

Just 11 days before the *TransFirst* commentary was published, however, Judge Goldgar of the U.S. Bankruptcy Court for the Northern District of Illinois wrote in a published opinion—*In re Glick*:[981]

> A recent unpublished decision *incorrectly* declares that nearly every court to have addressed the issue … has concluded that alter ego liability should apply to trusts to the same extent it applies to other legally created fictions. *Bash v. Sydney Jackson Williams, Jr. Irrevocable Trust*, No. 5:16 CV 257, 2016 WL 1592445 at *3 (N.D. Ohio Apr. 20, 2016).

For this and the other reasons discussed below, practitioners should not concede that alter-ego theory is available to creditors in the trust context.

(2) **The TransFirst Case** —

When a state's highest court has not decided a question of the state's law, lower state courts and federal courts must "predict" what the highest court would conclude.[982] Judge Gordon was presented with this situation in the *TransFirst* case:[983]

> Because the Supreme Court of Nevada has not decided this issue of Nevada law, I must predict what it would do.

He reasoned:[984]

[978] Adkisson, Riser & Slenn, *Jay Adkisson, Chris Riser and David Slenn on TransFirst Group, Inc. v. Magliarditi—U.S. District Court Holds That Nevada Law Permits Piercing of Nevada LLCs, Nevada Partnerships, and Nevada Trusts*, LISI Asset Prot. Plan. Newsl. #344 (June 19, 2017), www.leimbergservices.com (emphasis added).

[979] 2016 WL 1592445 (N.D. Ohio Apr. 20, 2016).

[980] 2016 WL 1592445 at *3 (ellipses in *TransFirst* Commentary)

[981] 568 B.R. 634, 665 n.28 (Bankr. N.D. Ill. 2017) (internal quotation marks omitted; emphasis added).

[982] *Crystallex Int'l Corp. v. Petroleos De Venezuela, S.A.*, 879 F.3d 79, 84 (3d Cir. 2018); *United States v. Nassar*, 2014 WL 5822677 at *7 (S.D.N.Y. Nov. 10, 2014).

[983] *TransFirst*, 2017 WL 2294288 at *3.

[984] 2017 WL 2294288 at *5 (footnote omitted).

> The Supreme Court of Nevada has not addressed whether a trust can be an alter ego. As with LLCs and partnerships, I predict the Supreme Court of Nevada would apply alter ego to trusts if justice required it. Under California law, it is "well-settled that a trust created for the purpose of defrauding creditors or other persons is illegal and may be disregarded." *In re Schwarzkopf*, 626 F.3d 1032, 1037 (9th Cir. 2010) (quotation omitted) (citing California authority and finding trusts were alter egos); see also Wood, 572 P.2d at 762 ("If it were alleged and proven that the two trusts in question were themselves alter egos of the Wenckes, those trusts would essentially drop out as independent legal entities … ."). "Where Nevada law is lacking, its courts have looked to the law of other jurisdictions, particularly California, for guidance." *Eichacker v. Paul Revere Life Ins. Co.*, 354 F.3d 1142, 1145 (9th Cir. 2004) (quotation omitted). Moreover, the defendants have not given any reason why Nevada would countenance a sham, regardless of its form. For all the reasons discussed above with respect to LLCs and partnerships, and in light of California and Ninth Circuit authority, I will apply alter ego analysis to the trust defendants.

Subsequently, Judge Gordon granted a motion to reconsider this portion of the opinion and certified to the Supreme Court of Nevada "the question of whether the alter ego doctrine applies to spendthrift trusts."[985]

[985] *TransFirst Group, Inc. v. Magliarditi*, *2017 WL 3723652* at *2 (D. Nev. Aug. 29, 2017).

(3) **The TransFirst Commentary** —

The contention by the authors of the *TransFirst* commentary that "Nevada alter ego law is the same as that of most other states" is inaccurate in at least three respects.

> (a) First, it's curious that the authors excerpted language to support their assertion from an unpublished opinion that actually went the other way. The pertinent sentence from the *Bash* case, with the authors' deletion highlighted, reads:[986]

[986] *Bash*, 2016 WL 1592445 at *3 (emphasis added).

> [N]early every court to have addressed the issue *outside of Florida* has concluded that alter ego liability should apply to trusts to the same it [sic] extent it applies to other legally created fictions.
>
> In *Bash*, Judge Gaughan of the U.S. District Court for the Northern District of Ohio had to predict whether the veil of a Florida irrevocable trust could be pierced via the alter-ego doctrine under Florida law. After analyzing authorities, she concluded that "the Court finds that the bankruptcy court correctly predicted that Florida law—as it currently stands—would not recognize alter ego liability with respect to irrevocable trusts."[987]
>
> (b) Second, as noted above, Judge Goldgar observed in the *Glick* case that Judge Gaughan "incorrectly declares" that most states recognize the alter-ego theory as a means of accessing trust assets.[988] In *Glick* , Judge Goldgar considered whether the alter-ego doctrine was available in Illinois trusts. According to Judge Goldgar "[j]ust as Illinois has not yet recognized reverse piercing, it has yet to recognize piercing a trust's veil."[989] He continued:[990]

[987] 2016 WL 1592445 at *5 (footnote omitted).

[988] *In re Glick*, 568 B.R. at 665 n.28.

[989] 568 B.R. at 665.

[990] 568 B.R. (footnote omitted).

> Veil-piercing of trusts is as controversial as reverse-piercing of corporations—but without the extensive case law. The few courts to address the question have disagreed on the theory's validity. Compare, *e.g., Babitt v. Vebeliunas (In re Vebeliunas),* Nos. 01 CIV 1108, 1225, 1230; 2002 WL 115656 at *4–5 (S.D.N.Y. Jan. 28, 2002) (predicting New York would approve piercing of trusts), *rev'd on other grounds*, 332 F.3d 85 (2d Cir. 2003); *Gordon v. Harman (In re Harman)*, 512 B.R. 321, 341 Bankr. N.D. Ga. 2014) (finding reverse piercing of trusts under Georgia law not precluded at dismissal stage), with *Henkel v. Brothers Mill, Ltd. (In re Eddy)*, Nos 6:12-bk-04736-CCJ, 6:13-ap-00112-CCJ, 6:13-ap-00115-CCJ, 2015 WL 1585513 at *4 (Bankr. M.D. Fla. Apr. 3, 2015) (expressing "doubts that the alter ego doctrine applies to irrevocable trusts" and refusing to extend it); *Greenspan v. LADT, LLC*, 191 Cal. App. 4th 486, 521–22, 121 Cal. Rptr.3d 118, 145–46 (2010) (rejecting piercing of trusts).

Regarding Illinois law, Judge Goldgar observed:[991]

[991] 568 B.R. at 665–66.

> No Illinois decision has recognized the piercing of trusts as opposed to corporations. Two federal decisions, *Laborers' Pension Fund v. Lay-Com*, 580 F.3d 602, 615 (7th Cir. 2009), and *Dexia Credit Local v. Rogan*, No. 02 C 8288, 2008 WL 4543013 at *7 (N.D. Ill. Oct. 9, 2008), assume piercing of trusts is possible but do not decide the question. More recently, the Seventh Circuit observed that piercing in Illinois arises "most commonly, if not exclusively" in the context of corporations. *Wellness Int'l Network, Ltd. v. Sharif*, 727 F.3d 751, 774 (7th Cir. 2013), *rev'd on other grounds*, —U.S.—, 135 S. Ct. 1932, 191 L.Ed.2d 911 (2015). The court found it "unclear whether Illinois recognizes an analogous alter ego theory to disregard the separate legal identity of a trust." *Id.* There have been no decisions since *Wellness*.

He held:[992]

[992] 568 B.R. at 667.

> Because Illinois has not recognized the veil piercing of trusts (let alone the reverse veil piercing of trusts), and because Counts I and V do not allege facts that would justify ignoring the separate existence of either the JCG 1999 Trust or the JCG 2012 Trust in any case, the motion of the Glick defendants to dismiss Counts I and V will be granted.

(c) Third, with the exception of California, the highest court of no state of which the author is aware has held that the alter-ego doctrine may be used to reach the assets of third-party and self-settled trusts. The Supreme Court of California did hold in *Wood v. Elling Corporation* (1977) that:[993]

[993] 572 P.2d 755, 762 (Cal. 1977). *But see Diversified Funding Grp., LLC v. Hendon*, *2017 WL 3014492* at *7 (C.D. Cal. June 12, 2017), final report and recommendation of magistrate judge *adopted and* accepted, *2017 WL 3014494* (C.D. Cal. July 12, 2017) ("those cases and the alter ego doctrine are inapplicable because they arise in scenarios—unlike the present—where the trust settlor is also the trustee and/or beneficiary").

> If it were alleged and proven that the two trusts in question were themselves alter egos of the Wenckes, those trusts would essentially drop out as independent legal entities ….

The only authorities that the authors of the *TransFirst* commentary include to support their contention came from their footnote iii that reads:

> *Bash v. Williams*, No. 5:16 CV 257, 2016 WL 1592445 at *3 (N.D. Ohio Apr. 20, 2016). ("*See, Smith v. S.E.C.*, 432 Fed. Appx. 10 (2d 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.").")

Of *Bash* and the eight other cases cited above, not a single one is a decision of a state's highest court, and only one—*Bracken v. Early*—was decided by a state appellate court.

(4) **Other Authorities—Alter-Ego Theory Not Available**

(a) **Introduction** —

The author's research has produced additional cases—none decided by a state's highest court—that expressed doubt as to whether the alter-ego theory is available to creditors.

(b) **In re Huber (2013)** —

In *In re Huber*,[994] Judge Snyder of the U.S. Bankruptcy Court for the Western District of Washington considered whether the alter-ego doctrine was available for the bankruptcy trustee to reach the assets of an Alaska asset-protection trust ("APT"), in a controversy which the judge determined to be governed by Washington law.[995] He held:[996]

> Absent any Washington authority or argument to support Trustee's position, this Court will not speculate as to whether Washington courts would apply the alter ego doctrine in the trust context, and if so, whether they would limit application to trustees as in the *Greenspan* case.

[994] 493 B.R. 798 (Bankr. W.D. Wash. 2013).

[995] 493 B.R. 798, 809.

[996] 493 B.R. 798, 810.

(c) **In re Reuter (2013)** —

In *In re Reuter*,[997] Judge Dow of the U.S. Bankruptcy Court for the Western District of Missouri had to decide whether the bankruptcy trustee could employ the alter-ego theory to access the assets of a Missouri trust. He concluded:[998]

> [T]he Court rejects the Trustee's argument that the alter ego doctrine can be used to sweep the assets into the estate. The Court elects not to decide definitively whether the doctrine would be applicable to trusts as it is to corporations and whether Plaintiff has standing under the circumstances of this case.

(d) **In re Raymond (2014)** —

In *In re Raymond*,[999] Judge Feeney of the U.S. Bankruptcy Court for the District of Massachusetts considered whether the bankruptcy trustee could use the alter-ego doctrine to reach trust assets under Massachusetts law. She held:[1000]

> [T]he Chapter 7 Trustee failed to cite any Massachusetts case permitting creditors or bankruptcy trustees to “pierce trust veils,” as opposed to corporate veils, where the debtor is neither a trustee nor a beneficiary of the trust.

(e) **Church Joint Venture v. Blasingame (2016)** —

In *Church Joint Venture v. Blasingame*,[1001] a federal district court in Tennessee reported that “the Tennessee Supreme Court has never recognized reverse piercing … in a trust/beneficiary context.”[1002]

(5) **Other Authorities—Alter-Ego Theory Available**

(a) **Introduction** —

The author's research has produced additional cases—none decided by a state's highest court—that held the alter-ego theory is available to creditors.

(b) **United States v. O'Shea (2015)** —

In *United States v. O'Shea*,[1003] a federal district court in West Virginia held that trusts were alter egos.[1004] The court reasoned:[1005]

[997] 499 B.R. 655 (Bankr. W.D. Mo. 2013).

[998] 499 B.R. at 683.

[999] 2014 WL 3534038 (Bankr. D. Mass. July 16, 2014).

[1000] 2014 WL 3534038 at *5.

[1001] 2016 WL 3248044 (W.D. Tenn. Jan. 13, 2016).

[1002] 2016 WL 3248044 at *8.

[1003] *2015 WL 738135* (SD. W. Va. Feb. 20, 2015).

[1004] *2015 WL 738135* at *5.

[1005] *2015 WL 738135* at *4.

> The West Virginia Supreme Court has established a similar totality of the circumstances test, with a set of factors to be considered, for determining whether to pierce the corporate veil.

(c) **United States v. Scherer (2016)** —

In *United States v. Scherer*,[1006] a federal district court in Ohio held:[1007]

[1006] *2016 WL 1047139* (S.D. Ohio Mar. 16, 2016).

[1007] *2016 WL 1047139* at *5 (citation omitted).

> Under Ohio law, in deciding whether a company is the alter ego of an individual, Ohio courts consider the following factors: (1) grossly inadequate capitalization, (2) failure to observe corporate formalities, (3) insolvency of the debtor corporation at the time the debt is incurred, (4) shareholders holding themselves out as personally liable for certain corporate obligations, (5) diversion of funds or other property of the company property for personal use, (6) absence of corporate records, and (7) the fact that the corporation was a mere facade for the operations of the dominant shareholder(s).

Nearly all of these factors weigh in favor of a judgement that the Trust was Scherer's alter ego.

(d) **United States v. Williams (2017)** —

In *United States v. Williams*,[1008] a federal district court in North Carolina found that "Williams is declared the alter ego of the Foundation [a charitable trust]."[1009] In so doing, the court observed:[1010]

[1008] 2017 WL 3700901 (M.D.N.C. Aug. 25, 2017).

[1009] 2017 WL 3700901 at *3.

[1010] 2017 WL 3700901 at *2.

> In North Carolina, a party is the legal alter ego of an entity when (1) he had complete control of the entity, (2) he used that control to commit fraud or violate a statutory duty, and (3) the fraud or violation caused the injury at issue.

(e) **United States v. Nelson (2018)** —

In *United States v. Nelson*,[1011] a federal district court in South Dakota held that a trust was the alter ego of the settlor without adverting to the South Dakota statutes mentioned in IX.F.5.a., above.[1012] The court declared:[1013]

[1011] *2018 WL 2390128* (D.S.D. May 25, 2018).

[1012] *2018 WL 2390128* at *9.

[1013] *2018 WL 2390128* at *6.

> An alternative basis for holding that the property held in the name of the Trust is subject to a tax lien is that the admitted allegations in the Complaint also establish that the Trust is Nelson's alter ego.

(f) **Saepoff v. North Cascade Trustee Services, Inc. (2019)** —

In *Saepoff v. North Cascade Trustee Services, Inc.*,[1014] a federal district court in Washington state observed that "[t]he factors to be considered in determining whether an entity is an alter-ego of a taxpayer are similar to the nominee factors."[1015] The court concluded that "Randy Styer, Trustee of the 4003 92nd

Avenue SE Land Trust is plaintiff's … alter ego."[1016]

[1014] *2019 WL 1759836* (W.D. Wash. Apr. 19, 2019).

[1015] *2019 WL 1759836* at *2 (citations omitted).

[1016] *2019 WL 1759836* at *3.

6. **Applying the Alter-Ego Doctrine in the Trust Context** —

As noted above, the Supreme Court of California has held that the alter-ego theory is available to creditors in the trust context. In *Greenspan v. LDT, LLC*,[1017] Presiding Justice Mallano of the court of Appeal of California (Second District) explained how the doctrine should be applied:[1018]

[1017] 121 Cal. Rptr.3d 118 (Ct. App. 2010).

[1018] 121 Cal. Rptr.3d at 146. *See Glick*, 568 B.R. at 666 n.29 (internal quotation marks omitted). The author would like to thank John E. Sullivan, III, Esquire, Sullivan & Sullivan, Ltd., Beachwood, OH, for this insight.

> Because a trust is not an entity, it's impossible for a trust to be anybody's alter ego. That's because alter ego theory, which is simply one of the grounds to "pierce the corporate veil," is inescapably linked to the notion that one person or entity exercises undue control over another person or entity. However, a trust's status as a non-entity logically precludes a trust from being an alter ego. (Nenno & Sullivan, *Planning and Defending Domestic Asset-Protection Trusts*, Planning Techniques for Large Estates, supra, SR034 ALI-ABA at p. 1870, fn. omitted). But while applying alter ego doctrine to trusts is conceptually unsound, applying the doctrine to *trustees* is a different proposition. Trustees are real persons, either natural or artificial, and, as a conceptual matter, it's entirely reasonable to ask whether a trustee is the alter ego of a defendant who made a transfer into [the] trust. Alter-ego doctrine can therefore provide a viable legal theory for creditors vis-à-vis trustees. (Id. at p. 1871, italics added.)

He concluded:[1019]

[1019] 121 Cal. Rptr.3d at 146 (citations and internal quotation marks omitted).

> As recognized in California: Unlike a corporation, a trust is not a legal entity. Legal title to property owned by a trust is held by the trustee. A trust is simply a collection of assets and liabilities. As such, it has no capacity to sue or be sued, or to defend an action. The proper procedure for one who wishes to ensure that trust property will be available to satisfy a judgment is to sue the trustee in his or her representative capacity.

It should be noted that it will be hard for a creditor to prevail on the alter-ego theory if the trust being contested has a corporate trustee or a professional individual trustee.

7. **Protectiveness of Nevada and Delaware Entities** —

Nevada practitioners tout the protectiveness of Nevada entities. In light of the *TransFirst* case, one wonders if the protective features are as extensive as advertised. Thus, in *TransFirst*, Judge Gordon noted:[1020]

[1020] *TransFirst*, 2017 WL 2294288 at *2 (footnote, citations, and internal quotation marks omitted).

> Under Nevada law, corporations are generally to be treated as separate legal entities. But Nevada recognizes the equitable remedy of piercing the corporate veil in circumstances where it appears that the corporation is acting as the alter ego of a controlling individual. Nevada also recognizes reverse piercing where a creditor may reach a

> corporation's assets to satisfy the debt of a corporate insider based on a showing that the corporate entity is really the alter ego of the individual.

Later in the opinion, Judge Gordon considered whether the alter-ego doctrine could be applied to pierce the veil of Nevada LLCs notwithstanding that a Nevada statute—Nev. Rev. Stat. §86.401(2)(a)—provides that the charging order is a creditor's exclusive remedy and that other remedies are not available.[1021] He nevertheless said that "I predict that, despite this statute, the Supreme Court of Nevada would hold that LLCs are subject to alter ego under the appropriate circumstances."[1022]

[1021] Nev. Rev. Stat. §86.401(2)(a).

[1022] *TransFirst*, 2017 WL 2294288 at *4.

Next, Judge Gordon considered whether creditors could access the assets of Nevada FLPs under the alter-ego theory. He concluded that "I predict the Supreme Court of Nevada would apply alter ego to partnerships where justice required it."[1023]

[1023] 2017 WL 2294288 at *5.

In contrast, Delaware, the jurisdiction with which the author is most familiar, appears to offer more protection via corporations, LLCs, FLPs, and trusts. Hence, in *Glick*, Judge Goldgar—an Illinois judge—observed:[1024]

[1024] *Glick*, 568 B.R. at 661–62 (footnotes, citations, and some internal quotation marks omitted).

> In 2012, this court considered whether Delaware had acknowledged the validity of an inside reverse piercing theory. In an extensive discussion, the court found it highly problematic whether Delaware would accept that theory—or for that matter reverse piercing of any kind. Delaware, the court said, had never recognized any form of reverse piercing. Only four unpublished Delaware decisions had even mentioned the theory. Not only that, but Delaware's exceptionally strong policy of respecting the corporate form made its recognition doubtful. With no guidance from the Delaware courts, and with Delaware taking a conservative approach to veil piercing, this court declined to predict that Delaware would endorse a reverse piercing theory, moving Delaware law in a direction that Delaware's own courts have not yet gone. State courts, not federal courts, are the place for innovations in state law.

The Delaware courts still have not recognized reverse piercing. A single unpublished Delaware trial court decision from 2015 mentioned reverse piercing, commenting that the plaintiff was pursuing a reverse piercing theory, and that if the claim had been properly supported it might have prevailed. But that was the extent of the discussion. "Might have prevailed" is not an endorsement. Just last year, the district court in Delaware declared: whether Delaware law recognizes reverse veil piercing is an unsettled question. The Seventh Circuit has not retreated from its view that federal courts should be reluctant to expand state law when state law is unsettled.

Because Delaware law does not recognize reverse piercing, Gierum has no piercing remedy under Delaware law—and in his response, he actually concedes as much. Judge Goldgar, in *Glick*, also noted:[1025]

[1025] 568 B.R. at 662 n.24.

> No Delaware decision has addressed whether to recognize piercing of limited partnerships, and the only decision elsewhere to consider whether Delaware would recognize the theory concluded it would not.

8. **Practice Tip** —

It cannot be gainsaid that every trust should be assiduously designed, funded, and administered. At the same time, practitioners must not be lulled into giving up potential defenses needlessly when controversies, including creditor claims, inevitably arise. When state law is uncertain, Judge Goldgar counseled in the *Glick* case:[1026]

[1026] 568 B.R. at 666 (citations, footnote, and internal quotation marks omitted).

> With no Illinois authority on the subject and the law consequently unsettled, the correct course again is to refrain from offering an unfounded prediction—really no better than a shot in the dark—about the course of state law, making changes no Illinois court has thus far seen fit to make. To expand Illinois law on piercing, Gierum should have brought his action in an Illinois court. Nothing prevented him from doing so. He chose instead to sue in federal court, and it is not the role of a federal court to expand state law in ways not foreshadowed by state precedent.

The author encourages practitioners to heed Judge Goldgar's sage advice.

9. **Sham-Trust Theory** —

Courts and creditors can always invoke the “sham-trust” doctrine, which is much more doctrinally sound than the alter-ego doctrine because it does not treat a trust as an entity but instead asserts that a trust has been improperly used and should therefore be ignored so that creditors may attach trust assets. In the United States, though, this doctrine has not been very well developed, is the subject of limited caselaw, and is most commonly applied in tax cases for purposes of determining taxable income.[1027] Also, more generally, the meaning of the word “sham” is fuzzy and ill-defined, at best. The concept of sham transactions is widely accepted in many contexts. Accordingly, the following discussion details how this concept is applied in trust law.

[1027] *See, e.g.*, *United States v. Leveto*, 540 F.3d 200 (3d Cir. 2008); *United States v. Schmidt*, 935 F.2d 1440 (4th Cir. 1991); *Sandvall v. Commissioner*, 898 F.2d 455 (5th Cir. 1990); *Vlach v. Commissioner*, T.C. Memo 2013-116 at 17–26; *Balice v. Commissioner*, T.C. Memo 2009-196 at 15–16; *Ioane v. Commissioner*, T.C. Memo 2009-68 at 25–31, *aff'd*, *108 AFTR 2d 2011-5162* (9th Cir. 2011).

10. **Sham-Trust Theory—Limited Tax Holdings** —

In the tax setting, U.S. courts often examine whether a trust has “economic substance” and should be recognized as a valid and separate taxpayer, or whether a trust's lack of economic substance warrants disregarding the trust.[1028] For federal tax purposes “[a] sham transaction is one having no economic effect other than to create income tax losses.”[1029] In addition, a “transfer of the title of assets to a trust while retaining their use and enjoyment is a sham transaction that will not be recognized for tax purposes.”[1030] This doctrine has been more specifically refined into the following four-prong test:[1031]

[1028] *See*, *e.g.*, *United States v. Steele*, *2019 WL 2411422* at *11 (D. Nev. June 7, 2019) (“Under Ninth Circuit caselaw, a sham transaction is where there is no economic effect other than to create income tax losses”) (internal quotation marks omitted); *Sparkman v. Commissioner*, 509 F.3d 1149, 1156 n.6 (9th Cir. 2007) (“An entity without economic substance, whether a sham partnership or a sham trust, is a sham either way and hence is not recognized for federal tax law purposes”); *Sandvall v. Commissioner*, 898 F.2d 455, 458 (5th Cir. 1990) (“A fundamental principle of our income tax structure is the basic rubric that economic substance prevails over form,” and “sham transactions, having no economic effect other than the creation of income tax losses, cannot be recognized for tax purposes”) (citations and internal quotation marks omitted).

[1029] *Neely v. United States*, 775 F.2d 1092, 1094 (9th Cir. 1985).

[1030] 775 F.2d at 1094.

[1031] *Full-Circle Staffing, LLC v. Commissioner*, T.C. Memo 2018-66 at *10 (quoting *Markosian v. Commissioner*, 73 T.C. 1235, 1243–1244 (1980)). *Accord Wegbreit v. Commissioner*, T.C. Memo 2019-82; *Richardson v. Commissioner*, 509 F.3d 736, 741 (6th Cir. 2007); *United States v. Washington*, 2011 BL 227598, 2011 WL 3902737 at *17 (S.D. Tex. Sept. 6, 2011); *Close v. Commissioner,* T.C. Memo 2014-25 at *11.

> (1) Whether the taxpayer's relationship to the property transferred to the trust materially changed after the trust's creation; (2) whether the trust has an independent trustee; (3) whether an economic interest passed to other trust beneficiaries; and (4) whether the taxpayer feels bound by the restrictions imposed by the trust agreement or the law of trusts.

If these four prongs are satisfied, then a sham trust exists, at least for federal tax purposes. This federal test has been viewed favorably by at least two state tax courts.[1032]

[1032] *In the Matter of the Petition of Patrick Murphy,* DTA No. 825277, *2017 WL 677226* (N.Y. Div. Tax App. Feb. 9, 2017), www.dta.ny.gov/pdf/determinations/825277.det.pdf; *Lund v. Dep't Rev.*, *2004 WL 226273* (Or. Tax Magistrate Div. Jan. 14, 2004).

Note that the Tax Court opinion that first set forth these four factors also stated that their presence will justify a sham-trust finding only when they are combined with a fifth factor, specifically being “the lack of any valid purpose other than the avoidance of tax.”[1033] However, at least some of the subsequent rulings seemingly omit this fifth “valid purpose” consideration as an independent factor and have instead stated that the four-prong test is used to determine whether the challenged structure has economic substance or is justified by a valid nontax reason.[1034]

[1033] *Markosian v. Commissioner*, 73 T.C. 1235, 1244–1245 (1980). *Cf. Close v. Commissioner*, T.C. Memo 2014-25 (where IRS failed to include sham transaction theory in notice of deficiency and only raised issue in pre-trial memorandum and at trial, whereby burden then shifted to IRS, IRS failed to meet its burden of proof in alleging sham transaction despite fact that district court in taxpayer's criminal case had issued order of forfeiture with respect to part of property at issue).

[1034] *See Richardson v. Commissioner*, 509 F.3d 736, 741 (6th Cir. 2007); *Sparkman v. Commissioner*, 509 F.3d 1149, 1155 (9th Cir. 2007).

Practice Tip: As a general rule, all tax cases must be treated cautiously when applied in nontax settings. These cases involve enforcement of laws designed to collect revenue and tax holdings may have little relevance to nontax issues arising under state or federal law. This caution is especially warranted in connection with federal tax rulings because they expressly apply regardless of whether a transaction is valid for state-law purposes[1035] and because “[s]tate property law is not controlling as to who should pay the Federal tax on the income derived from such property.”[1036]

[1035] *See, e.g.*, *Edwards v. First Fed. Sav. & Loan Ass'n*, 696 P.2d 484, 489 (N.M. Ct. App. 1985) (“Whether the trust is or is not a valid and discrete entity for matters other than the federal tax involved in this suit is not an issue”); Rev. Rul. 2006-19 (“[e]ven if the taxpayer created a valid trust under state law, the trust would be ignored for federal tax purposes because it is a sham. When the form of the transaction has not, in fact, altered economic relationships, income is taxed according to the substance of the transaction. This rule applies regardless of whether the entity has a separate existence recognized under state law, and regardless of the form of the entity, such as a trust or common law business trust.”). As an aside, recall that the IRS treats trusts as entities, even though trusts are really relationships.

[1036] *Sampson v. Commissioner*, 81 T.C. 614, 618 (1983), *aff'd*, 829 F.2d 39 (6th Cir. 1987).

Nonetheless, these tax opinions give us some idea of what to look for when probing for a sham relationship.

11. **Sham-Trust Theory—Unrevealing State Law Holdings** —

At the state-law level, the sham-trust doctrine has received only cursory treatment in nontax opinions issued by state courts, and what little attention the doctrine has received has not been very illuminating.

For instance, an Oregon marital dissolution case considered various matters related to a disputed trust. As part of its ruling, the court gave very vague or downright meaningless guidance when the court stated that courts "have authority to deal with a trust and its assets directly under circumstances where the trust itself is a sham to conceal or distort the parties' interests in the property it contains."[1037] The court did not elaborate on what factors or elements might be relevant to such a determination. The court further muddied matters by inappropriately declaring that "[t]he trust *is* a separate legal entity,"[1038] even though trusts plainly are not entities, as discussed above.

[1037] *In re Jones*, 973 P.2d 361, 365–366 (Or. Ct. App. 1999).

[1038] 973 P.2d 361, 366 (emphasis in original).

A Massachusetts case discussing a Massachusetts nominee trust (akin to an Illinois land trust) suggests that a sham-trust would have existed if the beneficiaries, who had considerable power to direct the trust, also had an understanding that they would eventually return the property to the settlor who apparently arranged to entrust assets in the first place.[1039] However, the facts are not entirely clear and, in any event, it is a considerable stretch to say that this opinion's brief and superficial analysis is a comprehensive review of sham-trust doctrine by the Massachusetts courts.[1040] Note that the same court also stated in rather general terms:[1041]

[1039] *Shamrock, Inc. v. FDIC*, 629 N.E.2d 344, 349 (Mass. App. Ct. 1994) (noting that "[t]here was no showing that the [beneficiary] sisters had under-taken any obligation, in whole or in part, to return the property to their [settlor] brother" but also noting that "[i]n such a case the trust might be disregarded").

[1040] For other Massachusetts cases briefly dealing with sham trusts, see the following unilluminating cases: *Boynton v. Buchanan*, 429 N.E.2d 365 (Mass. App. Ct. 1981), and *Theodore v. Theodore*, 249 N.E.2d 3 (Mass. 1969).

[1041] *Shamrock, Inc.* 629 N.E.2d 344, 350.

> It is a perfectly usual employment of the trust device to place property in a safe harbor against the possibility of future rough financial seas, although the nominee trust would generally not be the form of choice for that purpose because of its susceptibility to penetration by creditors of the beneficiaries.

A Connecticut divorce case makes passing reference to sham trusts employed by one spouse to hide assets from the other spouse but then addresses the use of the trusts rather than the factors that made the trusts shams.[1042] A West Virginia case, in rather gratuitous dicta, expressly suggested that a self-settled trust would be a sham if the settlor was also the trustee and sole beneficiary.[1043] Such an off-the-cuff remark was plainly unwarranted because the court found that the trust in question was actually valid and doubly unwarranted because it was unnecessary to even consider sham issues in the court's hypothetical scenario: A simple application of the well-known rule regarding merger of legal and equitable title would have sufficed to extinguish such a trust in any event.[1044] More significantly, this West Virginia opinion also failed to identify the factors that would create a sham trust in cases involving multiple beneficiaries.

[1042] *LaBow v. LaBow*, 537 A.2d 157 (Conn. App. Ct. 1988) (noting that ex-husband "abused his skill and expertise in financial matters to insulate his assets from his creditors," including his ex-wife, and that his methods involved using many vehicles, including certain "sham trusts and …, a large variety of ever changing corporate entities and other devices to obscure his assets in order to shield them from the [ex-wife] and his other creditors").

[1043] *Davis v. KB&T Co.*, 309 S.E.2d 45 (W. Va. 1983) ("This is not a case involving a sham trust wherein the settlor names himself as trustee and sole beneficiary, thus retaining both legal and equitable title to the trust property with the right to control the disposition of the trust assets").

[1044] *See, e.g.*, *In re Baum*, 22 F.3d 1014, 1019 (10th Cir. 1994) ("If at any point all of the legal and equitable interests are held by one person or entity, the interests merge and the trust fails").

An older Minnesota case suggests that a trust is not a sham if the trust is "created and carried on in good faith" but failed to articulate what is a sham trust.[1045] Other state cases are even less revealing.

[1045] *In re Estate of Marshall*, 228 N.W. 920, 923 (Minn. 1930).

As a matter of state law, then, the sham trust doctrine is woefully underdeveloped in the United States, perhaps in large part because courts and litigants insist upon thinking in alter-ego terms even though a trust is not an entity.

12. **In re Baum—A Federal Attempt to Divine State Law** —

Perhaps the most revealing examination of state law on sham trusts came from *In re Baum* (1994),[1046] a Tenth Circuit bankruptcy case decided under Colorado law. At issue were two irrevocable trusts established by the debtor for the sake of his children. The trust corpus included the debtor's residence, and the debtor had retained a life estate in the realty. The bankruptcy trustee sought to recover the trust funds as property of the bankruptcy estate.

[1046] 22 F.3d 1014 (10th Cir. 1994).

After first acknowledging that neither the litigants nor the court could find any Colorado cases regarding sham trusts,[1047] the court stated that persuasive authority existed in the form of corporate and tax cases.[1048] Based on that authority, the court concluded that the irrevocable trusts would be deemed shams (and the debtor would be treated as the real owner of the trust funds) if the debtor: (1) retained too much control over the entrusted property, (2) ignored legal formalities, and (3) used trust property as his own.[1049]

[1047] 22 F.3d 1014, 1018.

[1048] 22 F.3d 1014, 1018.

[1049] 22 F.3d 1014, 1018.

Based on the facts, the court held that the trusts were not shams or nominee trusts and upheld the summary judgment in favor of the debtor. More importantly, *Baum* provided at least some limited insight into what constitutes a sham trust for nontax purposes.

In 2009, the U.S. Bankruptcy Court for the District of Colorado addressed, inter alia, whether a family trust was a sham in *In re Bryan*.[1050] Applying the *Baum* principles, the court concluded:[1051]

[1050] *In re Bryan*, 415 B.R. 454, 472–482 (Bankr. D. Colo. 2009), *aff'd in part, rev'd in part*, No. 09-cv-1366, 2010 BL 396215, *2010 WL 3894035* (D. Colo. Sept. 29, 2010), *aff'd*, 495 Fed. App'x 884 (10th Cir. 2012).

[1051] *In re Bryan*, 415 B.R. 454, 482.

> [T]hat the Trust is a sham trust because: (a) the Bryans exercised complete dominion and control over the Trust and the purported trust assets; (b) the Bryans ignored formalities; (c) the Bryans used Trust property as their own;

and (d) the integrity of the Trust was disregarded.

13. **The Nominee-Trust Theory** —

The third theory that planners must be aware of is the nominee-trust doctrine. As germane here, *Black's Law Dictionary* defines "nominee" as:[1052]

[1052] *Black's Law Dictionary* 1261 (11th ed. 2019).

> A party who holds bare legal title for the benefit of others or who receives and distributes funds for the benefit of others.

Tests have been developed in state and federal tax controversies.

14. **The Nominee-Trust Theory: State Authorities**

a. **Introduction** —

As with the alter-ego doctrine, states' highest courts have done little to clarify the requirements to establish a nominee trust.

b. **California** —

In 2015, a magistrate judge for the U.S. District Court for the Eastern District of California issued proposed findings and recommendations,[1053] which were adopted by the court,[1054] that reported:[1055]

[1053] *United States v. Molen*, *2015 WL 3407553* (E.D. Cal. May 26, 2015).

[1054] *2015 WL 3932548* at *1.

[1055] *2015 WL 3407553* at *5 (citations and internal quotation marks omitted). *Accord Fourth Inv. LP v. United States*, 720 F.3d 1058, 1069 (9th Cir. 2013) ("We thus confirm that California law recognizes a nominee theory of property ownership"); *United States v. Pflum*, *2017 WL 4038365* at *3 (E.D. Cal. Sept. 13, 2017) ("California courts, however, have not yet specified the factors relevant to determining whether a person or entity holds title as a nominee").

> California law recognizes the theory of nominee property ownership. However, California courts have not yet specified the factors relevant to determining whether a person or entity holds title as a nominee.

c. **Nevada** —

In *United States v. Shaw* (2018),[1056] the federal district court in Nevada considered whether a business trust held Nevada real property as the taxpayer's nominee. The court noted:[1057]

[1056] 2018 WL 4682333 (D. Nev. Sept. 28, 2018).

[1057] 2018 WL 4682333 at *8 (citations omitted). *Accord United States v. Steele*, *2019 WL 2411422* at *9 (D. Nev. June 7, 2019) ("However, although the state recognizes the nominee theory, it does not appear to address the factors necessary to determine whether an entity is the nominee of a taxpayer").

> In Nevada, courts weigh at least seven factors in determining whether a nominee situation exists: (1) the source of the funds used to purchase the property; (2) the taxpayer's continued use of the property without the

> payment of a fair rental value; (3) the taxpayer's continued payment of maintenance charges and real estate taxes; (4) the nominees' acquisition of the property without any consideration, or for inadequate consideration; (5) the taxpayer's acts of holding himself out as the owner of the property; (6) the transfer of the property in anticipation of suit or the incurrence of liabilities by the taxpayer; and (7) the relationship between the taxpayers and the nominee, that is, whether it is a close one, such as by blood or marriage.

The court applied the above factors and determined "that Saint Andrews Ivy owns the Nevada property as Richard Shaw's nominee or alter ego."[1058]

[1058] 2018 WL 4682333 at *12.

d. **New Jersey** —

The federal district court in New Jersey wrote in 2017 that:[1059]

[1059] *United States v. Balice*, 2017 WL 3420918 at *11 (D.N.J. Aug. 9, 2017) (citations omitted). *Accord United States v. Patras*, 544 Fed. App'x 137, 141 (3d Cir. Nov. 19, 2013); *United States v. Hovnanian*, No. 18-15099, 2019 BL 91135, 2019 WL 1233082 at *4 (D.N.J. Mar. 18, 2019). *See United States v. Sollenberger*, 150 F. Supp. 3d 393, 403 n.4 (M.D. Pa. 2015) ("*Klimek* factors correspond to those New Jersey courts use to determine if a third party is a 'nominee'").

> Under New Jersey law, the following factors are relevant in determining whether a person or entity to whom property has been transferred is a taxpayer's nominee: (1) whether adequate consideration was paid for the transferred property; (2) whether the transfer occurred in anticipation of a lawsuit or other liabilities; (3) the relationship between the taxpayer and transferee; (4) whether the parties failed to record the conveyance; (5) whether the property remained in the taxpayer's possession; and (6) whether the taxpayer continued to enjoy the property's benefits.

e. **New York** —

The Second Circuit noted in 2017 that:[1060]

[1060] *United States v. Nassar*, 699 Fed. App'x 46, 47 (2d Cir. 2017) (citations omitted). *See Hinerfeld v. Commissioner*, T.C. Memo 2019-47, *2019 WL 1959939* at *10 (May 2, 2019) ("New York State courts have not explicitly applied the nominee theory of ownership in tax cases").

> New York law recognizes a difference between a "beneficial owner" and a "bare legal title-holding nominee." The District Court employed a fact-specific six-factor nominee test to determine whether Nassar is the beneficial owner of the condominium apartment such that the Nassar Family Irrevocable Trust—the holder of legal title to the apartment—is merely his nominee.

f. **Pennsylvania** —

In 2017, a federal district court in Pennsylvania enumerated the nominee factors in the Commonwealth:[1061]

[1061] *United States v. Santana*, *2017 WL 4873515* at *4 (M.D. Pa. Oct. 27, 2017), citing *United States v. Klimek*, 952 F. Supp. 1100, 1113 (E.D. Pa. 1997) (internal quotation marks omitted). *Accord United States v. Bogart*, 715 Fed. App'x 161, 167 (3d Cir. 2017). *See United States v. Sollenberger*, 150 F. Supp. 3d 393, 403 n.4 (M.D. Pa. 2015) ("although the

Klimek factors do not derive directly from Pennsylvania state law, they are congruent with factors used by Pennsylvania courts to discern whether a property transfer was made to evade debts or other obligations").

In looking to Pennsylvania state law to determine the taxpayer's ownership interest in the property and whether the property's title owner is only a nominee, Courts have deemed the following factors to be relevant: (a) the amount of consideration, or lack thereof, paid by the nominee; (b) whether the property was placed in the name of the nominee in anticipation of a suit or occurrence of liabilities while the transferor continues to exercise control over the property; (c) whether a close relationship exists between the transferor and the nominee; (d) whether the conveyance was recorded; (e) whether the transferor retained possession of the property; and (f) whether the transferor had continued enjoyment of benefits of the transferred property. Courts may also consider whether the taxpayer used personal funds to purchase and maintain the property.

g. **Other States** —

Other states that recognize the nominee doctrine but have not developed a list of factors include Florida,[1062] Illinois,[1063] Montana,[1064] and Texas.[1065] Washington State employs factors comparable to those listed above for New Jersey;[1066] the Supreme Court of West Virginia has "established a … totality of the circumstances test."[1067] Guidance is also available for Maine[1068] and New Hampshire.[1069] It appears that the doctrine is not recognized in Connecticut.[1070]

[1062] *United States v. Hunter*, 2015 WL 4068374 at *8 (M.D. Fla. July 2, 2015) ("Florida does not have a bright-line test for determining nominee ownership"). *See United States v Shaw*, 2017 W: 2791512 at *6 (M.D. Fla. June 28, 2017) ("Saint Andrews Ivy, B.T. is the nominee … of Richard Shaw").

[1063] *United States v. Maier*, 2019 WL 1399983 at *8 (N.D. Ill. Mar. 28, 2019) ("Illinois courts have never articulated a detailed standard for what constitutes a nominee").

[1064] *United States v. Birdsong*, *2018 WL 6330112* at *5 (D. Mont. Dec. 4, 2018) ("Montana courts have not articulated a test for nominee status").

[1065] *Medina v. IRS*, 2017 WL 4227990 at *3 (S.D. Tex. Sept. 21, 2017) ("Texas courts have not delineated a nominee test").

[1066] *United States v. Kraus*, 2018 WL 1610225 at *5–6 (W.D. Wash. Apr. 3, 2018).

[1067] *United States v. O'Shea*, *2015 WL 738135* at *4 (SD. W. Va. Feb. 20, 2015).

[1068] *United States v. Kimball*, *2016 WL 3566199* at *6–7 (D. Maine June 24, 2016).

[1069] *United States v. Sullender*, 2018 WL 1368040 at *4 (D.N.H. Mar. 16, 2018).

[1070] *Campbell v. Commissioner*, T.C. Memo 2019-4, 2019 WL 453736 at *7 (Feb. 4, 2019) ("Respondent has not presented any evidence that Connecticut courts have applied or adopted nominee theory").

15. **The Nominee-Trust Theory: Federal Tax Authorities**

a. **Introduction** —

Not only does the federal tax lien apply to property owned by a debtor, but it also extends to property owned by a third party (including a trustee in some states)[1071] as the debtor's nominee.[1072] In 2015 proposed findings and recommendations,[1073] which were adopted by a federal district court in California,[1074] a magistrate judge described how to evaluate a purported nominee arrangement in the following way:[1075]

[1071] *United States v. Steele*, *2019 WL 2411422* at *9 (D. Nev. June 7, 2019) ("The use of the nominee doctrine to collect federal taxes has been approved where the nominee is a trust").

[1072] *United States v. Wilson*, *2016 WL 3198629* at *17 (E.D. Mich. June 9, 2016).

[1073] *United States v. Molen*, *2015 WL 3407553* (E.D. Cal. May 26, 2015).

[1074] *United States v. Molen*, *2015 WL 3932548* at *1 (E.D. Cal. June 25, 2015).

[1075] *2015 WL 3407553* at *5 (citations and internal quotation marks omitted).

> In determining whether a third party is a nominee of a taxpayer, the court looks to state law. California law recognizes the theory of nominee property ownership. However, California courts have not yet specified the factors relevant to determining whether a person or entity holds title as a nominee. In the absence of controlling California Supreme Court case law dictating what criteria courts are required to consider in assessing whether a person or entity holds title as a nominee of another person or entity, the federal courts must predict how the California Supreme Court would decide the issue.

b. **Popular Federal Test** —

The magistrate judge just mentioned summarizes the test that has emerged in the Ninth Circuit:[1076]

[1076] *2015 WL 3407553* at *5–6 (citation omitted). *Accord Fourth Inv. LP v. United States*, 720 F.3d 1058, 1069 n.6 (9th Cir. 2013); *United States v. Peacock*, *2018 WL 4468845* at *3 (S.D. Cal. Sept. 18, 2018); *United States v. Pflum*, *2017 WL 4038365* at *4 (E.D. Cal. Sept. 13, 2017).

> [T]he Ninth Circuit Court of Appeals has addressed the issue of how to determine whether a title holder is a nominee under California law and has devised a six-factor test in order to determine whether an individual or entity is a nominee based on what it predicts the California Supreme Court would adopt if it were to rule on the issue. The six factors that comprise this test are:
>
> (1) whether inadequate or no consideration was paid by the nominees;
>
> (2) whether the properties were placed in the nominees' names in anticipation of a law suit or other liability while the transferor remains in control of the property;
>
> (3) whether there is a close relationship between the nominees and the transferor;
>
> (4) failure to record the conveyances;
>
> (5) whether the transferor retained possession; and
>
> (6) whether the transferor continues to enjoy the benefits of the transferred property.

The same six-factor test applies in federal district courts in Colorado,[1077] Illinois,[1078] Kentucky,[1079] Michigan,[1080] Montana,[1081] New Hampshire,[1082] New Jersey,[1083] New York,[1084] Pennsylvania,[1085] Texas,[1086] Utah,[1087] Washington State,[1088] and Wyoming. [1089] Federal district courts in the Third Circuit and the Sixth Circuit sometimes add a seventh factor: "[w]hether the taxpayer expended personal funds to purchase and maintain the property."[1090]

[1077] *United States v. Martens*, 2016 WL 1212704 at *7 (D. Colo. Feb. 23, 2016), magistrate judges report and recommendation *adopted*, 2016 WL 1182754 (D. Colo. Mar. 28, 2016).

[1078] *United States v. Sanders, 2016 WL 6124931* at *10 (S.D. Ill. Oct. 20, 2016). *But see United States v. Maier*, 2019 WL 1399983 at *8 (N.D. Ill. Mar. 28, 2019) (applying a five-factor test).

[1079] *Spotts v. United States* 429 F.3d 248, 253 n.2 (6th Cir. 2005).

[1080] *United States v. Wilson*, *2016 WL 3198629* at *17 (E.D. Mich. June 9, 2016).

[1081] *United States v. Birdsong*, *2018 WL 6330112* at *5–6 (D. Mont. Dec. 4, 2018).

[1082] *United States v. Sullender*, 2018 WL 1368040 at *4 (D.N.H. Mar. 16, 2018).

[1083] *United States v. Patras*, 544 Fed. App'x 137, 141 (3d Cir. 2013). *Accord United States v. Wunder*, 2019 WL 2928842 at *4 (D.N.J. July 8, 2019).

[1084] *United States v. Nassar*, 699 Fed. App'x 46, 47 (2d Cir. 2017). *Accord Hinerfeld v. Commissioner*, T.C. Memo 2019-47, *2019 WL 1959939* at *10 (May 2, 2019).

[1085] *United States v. Sollenberger*, 150 F. Supp. 3d 393, 401–02 (M.D. Pa. Dec. 15, 2015).

[1086] *United States v. Orr*, *2018 WL 4134703* at *21 (W.D. Tex. Aug. 28, 2018); *United States v. Cobos*, 2017 WL 4422403 at *3 (N.D. Tex. Oct. 5, 2017); *Medina v. IRS*, 2017 WL 4227990 at *3 (S.D. Tex. Sept. 21, 2017).

[1087] *United States v. Fraughton*, *2015 WL 915434* at *6 (D. Utah Mar. 3, 2015).

[1088] *Saepoff v. N. Cascade Trustee Servs. Inc.*, *2019 WL 1759836* at *2 (W.D. Wash. Apr. 19, 2019); *United States v. Smith*, 2012 WL 1977964 at *6 (W.D. Wash. June 1, 2012).

[1089] *United States v. Lain*, 2019 WL 2051960 at *10 (D. Wyo. Feb. 5, 2019).

[1090] *United States v. Bogart*, 715 Fed. App'x 161, n.4 (3d Cir. 2017). *Accord United States v. Sollenberger*, 150 F. Supp. 3d 393, 402 (M.D. Pa. 2015).

Florida federal district courts employ the following five-factor assessment:[1091]

[1091] *United States v. Enright*, 2015 WL 5883166 at *4 (M.D. Fla. Oct. 6, 2015). *Accord United States v. Hunter*, 2015 WL 4068374 at *8 (M.D. Fla. July 2, 2015). *See United States v. Shaw*, 2017 WL 2791512 at *6 (M.D. Fla. June 28, 2017).

> When determining whether a taxpayer conveyed property to a nominee, district courts in Florida consider the following factors: (1) whether the taxpayer continues to exercise dominion and control over the property after transfer; (2) whether the property was transferred in anticipation of collection activity; (3) the amount of consideration, if any, paid for the transfer; (4) the relationship between the taxpayer and the new title holder; and (5) whether the taxpayer continues to pay for the property's expenses.

U.S. district courts in Arizona[1092] and West Virginia[1093] employ similar tests.

[1092] *United States v. Bigley*, *2017 WL 2417911* at *7 (D. Ariz. May 10, 2017), *aff'd*, *2018 WL 6722413* (9th Cir. Dec. 21, 2018).

[1093] *United States v. O'Shea*, *2015 WL 738135* at *4 (SD. W. Va. Feb. 20, 2015).

16. **Applicable Law** —

In *United States v. Hovnanian* (2019),[1094] the federal district court in New Jersey considered whether New York law or New Jersey law applied in a nominee-trust dispute involving New Jersey real property. The court decided for New Jersey for the following reasons:[1095]

[1094] *United States v. Hovnanian*, No. 18-15099, 2019 BL 91135, 2019 WL 1233082 (D.N.J. Mar. 18, 2019).

[1095] *United States v. Hovnanian*, No. 18-15099, 2019 BL 91135, 2019 WL 1233082 at *3–4 (internal quotation marks and citations omitted).

> As a threshold matter, New Jersey law governs whether the Pachava Trust or the VSHPHH Trust is a nominee of Defendant Shant. The Trusts contend that New York law governs because their formation documents contain choice-of-law provisions. The Court does not doubt that these choice-of-law provisions are valid, but the Government was not a settlor, trustee, beneficiary, nor was it otherwise involved in their formations. These provisions state that "matters of interpretation, validity and administration" are governed by New York law, but this dispute is outside the confines of these prescriptions; the Court is focused on the conduct of Defendant Shant and his exercise of control over the Trusts' properties, not on the interpretation of the Trusts' formation documents. These provisions cannot dictate the governing law in this action.

Moreover, the Third Circuit has counseled that state law … determines the taxpayer's ownership interest in the property and whether the title holder is merely a nominee, and then federal law determines whether that property interest is subject to a federal tax lien. Because both the Navesink Property and the Village Mall Property are located in New Jersey, the law of New Jersey governs the determinations at issue.

17. **Distributions Are Not Proof of an Alter-Ego, Sham, or Nominee Trust** —

Many APT critics contend that the alter-ego, sham, or nominee-trust doctrine should apply to APTs because trustees often make distributions back to settlor-beneficiaries whenever requested, make property available for use by settlors, or otherwise display friendly behavior toward settlors. The critics take this as proof positive that the trustee is under the settlor's thumb and is really his or her alter ego.

However, this criticism is seriously flawed. In addition to the basic reasons outlined above that preclude any alter-ego claim (i.e., trusts cannot be alter egos and it is often very hard to prove that a trustee is an alter ego), numerous other reasons debunk the notion that friendly relations between a settlor and trustee are, by themselves, proof of a sham or nominee, as follows:

- It is the very nature of a trust relationship that settlors will pick trustees they trust, and it should not be surprising that trustees will take care of a settlor-beneficiary. Indeed, any other conclusion seems to imply that a settlor-beneficiary is somehow obligated to pick a trustee that will ignore or act contrary to the settlor-beneficiary's best interests. In other words, the critics imply that settlor-beneficiaries are supposed to pick trustees the settlor-beneficiaries cannot trust. This, of course, is an absurd implication and is contrary to the well-established duties that trustees owe their beneficiaries.[1096]

- Trustees are supposed to carry out a settlor's intent.[1097] This is reflected in the most fundamental rule of trust construction: Courts are supposed to divine a settlor's intent and make trustees honor it.[1098] If distributions back or liberal use of trust property are what the settlor intended, then it seems rather bizarre to complain about trustees carrying out a settlor's intent when that is what trustees are duty-bound to do.

- Given that trustees are fiduciaries who must be solicitous of their beneficiaries' best interests, they often make distributions requested by beneficiaries—either settlors or nonsettlors.

- The need for a trustee to honor legal duties to a settlor-beneficiary will be most acute precisely when creditors press claims. Invariably, one of the overriding purposes of an APT is to shelter a settlor-beneficiary's assets during troubled times and to preserve those assets for the sake of a settlor and his or her family at just such moments. Seen in this light, a creditor's cry of "sham" is nothing more than a lament that a trustee is honoring its duty. If anything, a creditor's attempts to invade an APT fund simply underscores the trustee's need to fulfill its duty to take care of beneficiaries during a time of need.

- A trustee's failure to honor duties during the pendency of a creditor's claim could expose the trustee to claims for breach of duty; a beneficiary asserting such claims could seek money damages, a declaratory judgment for specific performance of those duties, or other remedies. All of this undoubtedly gives trustees extra impetus to administer and distribute trust funds in ways that keep assets working for beneficiaries rather than creditors, exactly as the settlor intended.

- An APT that functions exactly as required by the terms of the agreement is not a sham or nominee.

- As discussed above, precedent shows that proper trust administration involving an independent trustee and observing legal formalities will survive a sham or nominee challenge. This is shown above by the four-pronged tax law test for sham trusts (which considers the presence or absence of an independent trustee) and the three-pronged *In re Baum*[1099] test (which considers whether legal formalities were observed). In other words, the trust is not a sham so long as the trustee independently exercises its authority (whatever that authority might be under the trust agreement) and follows proper trust administration protocols.

- A rule or argument that says a sham or nominee trust exists simply because a trustee engages in a pattern of trust distributions or other friendly measures to or for a settlor-beneficiary could actually have an undue chilling effect on a trustee's independence. This would be paradoxical because such a rule or argument implies that a trustee has somehow lost its independence. Nonetheless, this paradox could arise because a trustee worried about such a rule or argument might sometimes deny legitimate beneficiary requests simply to create a record of “saying no” and, thereby, generate evidence to refute such a prospective application of such an argument or rule. In other words, a trustee may fear that granting a request would simply bolster a pattern that could be later used against the trust, no matter how meritorious the underlying distributions or other acts might have been, thus prompting a denial. This practice of “defensive trusteeship” could become particularly acute if trustees believe trust disputes might somehow wind up in front of a commercially unsophisticated jury and/or a harried and overworked trial court judge who has little or no experience in trust matters. Put simply, such a risk could deter trustees from accommodating many legitimate beneficiary requests because indulging beneficiaries today could expose the entire trust fund to dissipation. In such circumstances, the trustee might reason that even the most valid request for distributions should sometimes be denied today to advance the greater good of protecting the trust fund from potential attacks tomorrow. So, far from promoting trustee independence, a “distributions are proof of alter ego status” rule could undermine trustee independence, compromise a trustee's ability to properly discharge its fiduciary duty, and frustrate the settlor-beneficiary's intent.

[1096] *See, e.g.*, UTC §802(a) (2018) (“A trustee shall administer the trust solely in the interests of the beneficiaries”); *Saigh v. Saigh*, 218 S.W.3d 556, 561 (Mo. Ct. App. 2007) (similar); *Smith v. Baptist Found. of Okla.*, 50 P.3d 1132, 1144 (Okla. 2002) (“A trustee is a fiduciary of the highest order in whom the hope and confidence of the settlor are placed with the expectation that the trustee will exercise the obligations of the office for the exclusive benefit of those holding beneficial interests”).

[1097] *See, e.g., In re Peierls Family Inter Vivos Tr.*, 77 A.3d 249, 263 (Del. 2013); *Shelton v. Tamposi*, 62 A.3d 741, 746–47 (N.H. 2013); *Smith v. Hallum*, 691 S.E.2d 848, 849 (Ga. 2010); *In re Estate of Singer*, 920 N.E.2d 943, 946 (N.Y. 2009); *Harbour v. SunTrust Bank*, 685 S.E.2d 838 , 841 (Va. 2009); *In re Estate of Feinberg*, 919 N.E.2d 888, 896 (Ill. 2009).

[1098] *Domo v. McCarthy*, 612 N.E.2d 706, Syl. ¶1 (Ohio 1993) (“A court's purpose in interpreting a trust is to effectuate, within the legal parameters established by a court or by statute, the settlor's intent.”); *Central Trust Co. of N. Ohio v. Smith*, 553 N.E.2d 265, 270 (Ohio 1990) (“[I]t is axiomatic that the intent of the testator, grantor, or settlor will be ascertained and given effect wherever legally possible”); *Dickinson v. Wilmington Trust Co.*, 734 A.2d 605, 609 (Del. Ch. 1999), *aff'd*, 734 A.2d 642 (Del. 1999) (“The cardinal rule of law regarding construction of trust provisions is that the settlor's intent controls the interpretation of the language”); *Scharlin v. Super. Ct.*, 11 Cal. Rptr.2d 448, 451–52 (Cal. Ct. App. 1992) (similar).

[1099] 22 F.3d 1014 (10th Cir. 1994).

All in all, then, distributions to settlor-beneficiaries, letting settlors have liberal use of trust property, and generally friendly relations between trustees and settlors will not, by themselves, be enough to establish a sham trust. While these things may be factors to consider, creditors need to show much more to prove a sham, including serious defects in trust administration and a mutual intent on the part of the settlor and trustee to deviate from the terms of a lawful written trust.

18. **Retained Powers and Interests Don't Make a Sham or Nominee Trust** —

Some observers have erroneously contended that domestic APTs are rendered shams or nominees because settlors can retain significant interests in or powers over a trust fund. However, this is incorrect and contrary to established principles. In connection with domestic APTs, settlor-retained interests and powers are allowed by statute, as set forth elsewhere herein. It is hard to imagine how retention of statutorily approved interests or powers can be a sham or nominee unless there is a constitutional defect in the legislation authorizing such rights and interests. Any judicial declaration of a sham or nominee on these grounds would plainly be a judicial usurpation of the legislature's police power.

More generally, as noted by the Supreme Court of Colorado "[i]t is well established that the settlor may reserve extensive powers of control over the administration of the trust corpus."[1100] Indeed, according to the Tenth Circuit "even if [a] debtor acted as trustee, it does not follow that the trust is a sham."[1101] The same result accrues even if the settlor-trustee was a sole beneficiary with a power to revoke or amend a trust.[1102] In essence, a settlor's retained rights and benefits do not make a trust a sham or nominee so long as a trustee acts appropriately in connection with those matters that are subject to the trustee's authority.

[1100] *Exch. Nat'l Bank v. Sparkman*, 554 P.2d 1090, 1093 (Colo. 1976).

[1101] *In re Baum*, 22 F.3d 1014, 1018–19 (10th Cir. 1994).

[1102] 22 F.3d 1014, 1018–19, citing *Estate of Brenner*, 547 P.2d 938 (Colo. Ct. App. 1976). *Accord* UTC §602–§603 (amended 2018) (allowing revocable trusts and making other beneficiaries' interests presumptively subordinate to trustor's interests).

In sum, then, a settlor's "retainage" is hardly grounds to declare a domestic APT a sham or nominee.

Practice Tip: In concluding this survey of alter-ego trust, sham trust, and nominee-trust issues, the author expresses his hope that any U.S. courts that are considering these doctrines vis-a'-vis any trust (including domestic APTs) will tread warily, recognizing the complexity of the issues outlined here, and avoid the confusing jurisprudence that can arise if a court tries to apply alter ego doctrine to trusts (as opposed to trustees). Accordingly, courts should use the alter-ego trust, sham trust, and nominee-trust doctrine sparingly and only when clearly justified.

Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Detailed Analysis
IX. Defenses to Creditor Attacks on Domestic APTs

G. Obstacle 6: Non-DAPT Court Should Apply Domestic APT State Law

1. **Introduction** —

Choice of law issues can sometimes become mind-numbingly complex, particularly if courts or practitioners get too caught up in the details of a problem and lose sight of "big picture" issues. However, details can be very important, particularly in connection with trust matters, as different parts of trust operations can implicate very different choice-of-laws issues. Therefore, it is necessary to isolate the precise trust aspect that is being scrutinized. Is it a trust's administration, validity, or interpretation? Is it a trust's personalty or realty? If the relevant question deals with personalty, is the property in question a movable or immovable, a tangible or intangible, or something else altogether?

Ultimately, though, it seems that four key questions emerge from the various analyses set forth below and will apply to virtually all trust-related conflict of laws issues. Specifically:

- Which state's law did the settlor intend to apply?

- Is there a logical basis or justification for the settlor's choice of law? In other words, is there a meaningful nexus or relationship between the state that provides the settlor's chosen law (the "source state") and the trust issue in question?

- Even if the settlor's intent is clearly stated and logically justified, and notwithstanding the cardinal rule of construction that calls for honoring a settlor's intent, is there some sort of strong public policy articulated by another interested state (and that other state is usually the forum state) that is contrary to the policy embodied in the law of the source state?

- Finally, even if there is another interested state with such a strong public policy, is that other state's interest in the specific trust issue so much more significant than the interest of the source state that the other state's competing interest justifies a judicial override of the settlor's intended choice of law?

Whereas the answers to these questions may vary with the particular circumstances and perhaps even vary in connection with differing particulars of the same trust, these key questions provide a good overarching framework for discussion. Bearing these questions in mind, the following discussion turns to some of the gruesome details.

2. **Restatement Approach—Introduction**

a. **Background** —

To determine how much latitude a client who resides in a non-DAPT state has to select the law of a domestic APT state to govern his or her domestic APT, the attorney must analyze the conflict-of-laws principles that have been developed in trust matters. These matters are covered in Chapter 10 of the *Second Restatement of Conflict of Laws*,[1103] Chapters 44–46 of the Scott treatise,[1104] and Chapter 16 of the Bogert treatise.[1105] Significantly, the fundamental objective of the *Restatement* is to carry out—not to frustrate—the testator's or settlor's intent. Accordingly, the Introductory Note to Chapter 10 of the *Restatement* provides in pertinent part that:[1106]

[1103] *Restatement (Second) of Conflict of Laws* §267–§282 (1971). In 2019, a federal bankruptcy judge in Mississippi noted that courts in the state "look to the relevant section of the *Restatement (Second) of Conflict of Laws*" (*In re Delta Investments & Development, LLC*, No. 12-01160, 2019 BL 7900, 2019 WL 137578 at *16 (Bankr. S.D. Miss. Jan. 8, 2019), relying on *Zurich American Ins. Co. v. Goodwin*, 920 So.2d 427, 433 (Miss. 2006)). In 2018, a federal bankruptcy judge in Arizona observed that "[i]n a bankruptcy case, the court must apply federal choice of law rules … . which follow the approach of the *Restatement (Second) of Conflict of Laws.*" (*In re Bullseye Holdings, LLC*, 2018 BL 379908, *2018 WL 4998089* at *7 (Bankr. D. Ariz. Oct. 15, 2018) (citation omitted)). In 2013, the Supreme Court of Delaware confirmed that "when confronted with a choice-of-law issue, Delaware courts adhere to the *Restatement (Second) of Conflict of Laws"* (*In re Peierls Family Inter Vivos Tr.* , 77 A.3d 249, 255 (Del. 2013), and a federal bankruptcy judge in Washington state noted that "in applying federal choice of law rules, courts in the Ninth Circuit follow the approach of the *Restatement (Second) of Conflict of Laws*" (*In re Huber*, 493 B.R. 798, 807 (Bankr. W.D. Wash. 2013)). In 2012, the Bankruptcy Appellate Panel for the Ninth Circuit said that "federal courts in the Ninth Circuit and California state courts both look to the *Restatement (Second) of Conflict of Laws* (1971) (the "Restatement") for the choice of law rules" (*In re Zukerkorn*, 484 B.R. 182, 189 (B.A.P. 9th Cir. 2012)).

[1104] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §44.1–§46.9 (5th ed. 2010).

[1105] Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §291–§301 (3d ed. 2014).

[1106] *Restatement (Second) of Conflict of Laws* Ch. 10, Introductory Note (1971).

> The chief purpose in making decisions as to the applicable law is to carry out the intention of the creator of the trust in the disposal of the trust property. It is important that his intention, to the extent to which it can be ascertained, should not be defeated, unless this is required by the policy of a state which has such an interest in defeating his intention, as to the particular issue involved, that its local law should be applied. The policy may relate to the capacity of the testator or settlor to create the trust, to the formalities required for the creation of the trust, or to the validity of the trust in other respects.

Even though testator-settlor intent is supposed to reign this does not always happen in practice. A Florida practitioner therefore advises that trusts not be established in his state for the following reason:[1107]

[1107] Alan S. Gassman, *Florida Traps for the Unwary: a/k/a Runnin' Down a Dream*, 44 Est. Gifts & Tr. J. 19, 26 (Jan. 10, 2019).

> Florida case law has unfortunately provided that the beneficiaries and trustees of an irrevocable trust can agree to amend the terms of the trust, and completely ignore the grantor's intent. This is a good reason that significant trusts should be situated outside of Florida, or that there should be a beneficiary that will not agree to a Trust Amendment.

Under the *Restatement,* a client's freedom to select the law of a state other than his or her state of residence to govern a trust is a function of the following:

- *Type of Asset:* Whether the trust holds personal property or real property (the *Restatement* refers to them as "movables" and "land," respectively);

- *Type of Trust:* Whether the trust is created by will or inter vivos; and

- *Type of Question:* Whether the issue involves: (1) the "validity" of a trust provision; (2) the "administration" of the trust; (3) the "construction" of a trust provision; or (4) restraints on alienation of beneficiaries' interests.

b. **Framework** —

The above division of issues is evident from the Table of Contents of Chapter 10 of the *Restatement*, which lists its provisions as follows:[1108]

[1108] *Restatement (Second) of Conflict of Laws* Ch. 10, Table of Contents (emphasis added).

Topic 1 — Movables

§267 Court Supervision of Administration

§268 Construction of Trust Instrument

§269 Validity of Trust of Movables Created by Will

§270 Validity of Trust of Movables Created Inter Vivos

§271 Administration of Trust of Movables Created by Will

§272 Administration of Trust of Movables Created Inter Vivos

§273 Restraints on Alienation of Beneficiaries' Interests

§274 Exercise of Power Under a Trust to Appoint Interests in Movables

§275 What Constitutes Appointment by Will of Interests in Movables

Topic 2 — Land

§276 Court Supervision of Administration

§277 Construction of Trust Instrument

§278 Validity of Trust of Land

§279 Administration of Trust of Land

§280 Restraints on Alienation of Beneficiaries' Interests

§281 Exercise of a Power Under a Trust to Appoint Interests in Land

§282 What Constitutes Appointment by Will of Interests in Land

c. **Type of Asset** —

The *Restatement* contains one set of rules for trusts that hold movables and another set of rules for trusts that hold land. Regarding trusts of movables, the *Restatement* provides in pertinent part:[1109]

> The subject matter of the trust is ordinarily not a single movable but rather a group of movables which at the time of the creation of the trust may be situated in different states. It is desirable that a trust should be treated as a unit, and, to this end, that the same law should be applied to all the movables included in the trust.

Although the state in which a chattel or a right embodied in a document is situated has power, when it is the forum, to apply its local law to the validity and administration of a trust, insofar as it includes such chattel or document, it is generally accepted doctrine that it will apply the law selected in accordance with the rules stated in this Topic. Hence the location of the movables at the time of the creation of the trust, whether it is created inter vivos or by will, is ordinarily unimportant in determining issues as to the validity or the administration of the trust or the construction of the will or trust instrument.

[1109] *Restatement (Second) of Conflict of Laws* Ch. 10, Introductory Note to Topic 1—Movables (1971). *See* 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §44.2 at 3054–55 (5th ed. 2010).

Although the same law is applied to all of the movables included in a trust, no matter where they are located, the choice of the law to be applied to them may depend upon the particular issue involved. The local law of one state may be applied to an issue of validity and the local law of another state applied to an issue of administration or to an issue of construction. Moreover, the local law of different states may be applicable to different issues of validity, depending upon the particular ground for the claim that the trust or one of its provisions is invalid. So also, the local law of different states may be applied in determining different issues as to construction.

In determining the law applicable to a trust of movables created inter vivos, the settlor's domicil is ordinarily not of the first importance, whereas in the case of a trust of movables created by will the domicil of the testator is very important. It will be noted, however, that both in the case of inter vivos trusts and of trusts created by will the place of administration of the trust is of great importance.

Regarding trusts of interests in land, the *Restatement* states in relevant part:[1110]

[1110] *Restatement (Second) of Conflict of Laws* Ch. 10, Introductory Note to Topic 2—Land (1971).

> As has been stated, it is desirable that all of the movables included in a trust, although they may be situated in different states at the time of the creation of the trust, should be subject to the same law. As to trusts of interests in land, it has been felt that each parcel of land should be subject to the state in which it is situated, and that the law which would be applied by the courts of that state, whether its own local law or the local law of some other state, should be applied by the courts of all states. The courts of the state of the situs will usually apply its local law; but in some situations, as will appear hereafter, they may apply the local law of some other state. Whatever law is applied by the courts of the state of the situs will be applied by the courts of other states in which the question arises in litigation.

d. **Type of Trust** —

For each type of asset, the *Restatement* offers rules for trusts created by will and for trusts created inter vivos. Because an APT is an inter vivos trust, the following discussion focuses on the rules for inter vivos trusts.

e. **Type of Question—Definitions**

(1) **Validity** —

The *Restatement* defines questions relating to the “validity” of trust provisions as follows:[1111]

[1111] *Restatement (Second) of Conflict of Laws* §269 cmt. d (1971). *See id.* §270 cmt. d; 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.4 at 3181 (5th ed. 2010); Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §293 at 37 (3d ed. 2014).

> Some questions of validity relate only to the trust provisions and not to the will as a testamentary disposition. A trust may be invalid, in whole or in part, because it violates the rule against perpetuities or a rule against the suspension of the absolute ownership or of the power of alienation; because it violates a rule against accumulations; because the purpose is illegal; because of an illegal condition, such as one promoting divorce or restraining marriage. A trust may be invalid because there are no beneficiaries to enforce it, or because the purpose is merely capricious. A legacy for charitable purposes may be invalid, either on the ground that there is no beneficiary to enforce it or on the ground that it involves a perpetuity, as it was under the local law of New York and a few other States until changed by statute. A legacy to an

> unincorporated association may be invalid. A trust for charitable purposes may be invalid for indefiniteness. All trusts may be invalid as under the civil law which formerly prevailed in Louisiana.

Conspicuously absent from the list of issues that the *Restatement* says involve the validity of trust provisions is the issue regarding the ability of creditors to reach a beneficiary's interest in the trust or the trust assets themselves. Judges and commentators sometimes analyze the ability of creditors to defeat such trusts as a matter of trust validity. The author has found nothing in the *Restatement*, the Bogert treatise, or the Scott treatise that supports that view, which is not surprising because, as will be seen shortly, the *Restatement* treats this issue as a separate type of question.

The Bogert treatise discusses the issue as follows:[1112]

[1112] Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §293 at 44–45 (3d ed. 2014) (footnotes omitted).

> Another example of characterization relates to the question of the validity or application of a trust spendthrift clause. Such a clause denies creditors of a beneficiary the right to reach the beneficiary's interest and restricts the beneficiary's right to voluntarily assign his interest. In a few states, spendthrift clauses are not enforced. If the domicile of the settlor or testator and the situs of trust administration are in the same state, it is unlikely any question will arise as to the validity or invalidity of the spendthrift clause under the law of the state. If, however, two states are involved and their laws differ on the matter, the forum court can characterize the problem as one relating to validity of the restrictions under the law of the settlor or testator's domicile, especially if that state has a strong public policy against protecting trust beneficiaries, or under the law of the situs where real estate is involved. The question has usually been treated as one to be governed by the trust law of the state in which the trust is administered or the trust land has its situs, often the residence or domicile of the trustee, on the ground that the matter relates solely to trust administration rather than the validity of the clause or construction of the extent of the beneficiary's interests under the terms of the trust instrument.

The Scott treatise paraphrases with approval dictum in the 1892 New York case of *Cross v. U.S. Trust Co.* [1113] indicating that "the question here was not one of validity but one of reaching the beneficiary's interest."[1114]

[1113] 131 N.Y. 330 (1892).

[1114] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.7.1.1 at 3346 (5th ed. 2010).

(2) **Administration** —

The *Restatement (Second) Conflict of Laws* defines questions of trust "administration" as follows:[1115]

[1115] *Restatement (Second) of Conflict of Laws* §271 cmt. a (Am. Law Inst. 1971) (citations omitted). *See Restatement (Second) of Conflict of Laws* §272 cmt. a, §279 cmt. a (Am. Law Inst. 1971); 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.5 at 3265–3266 (5th ed. 2010); Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §293 at 36 (3d ed. 2014).

> The term "administration of a trust," as it is used in the Restatement of this Subject, includes those matters which relate to the management of the trust. Matters of administration include those relating to the duties owed by the trustee to the beneficiaries. They include the powers of a trustee, such as the power to lease, to sell and to pledge, the exercise of discretionary powers, the requirement of unanimity

> of the trustees in the exercise of powers, and the survival of powers. They include the liabilities which may be incurred by the trustee for breach of trust. They include questions as to what are proper trust investments. They include the trustee's right to compensation. They include the trustee's right to indemnity for expenses incurred by him in the administration of the trust. They include the removal of the trustee and the appointment of successor trustees. They include the terminability of the trust.

(3) **Construction** —

For purposes of the *Restatement (Second) Conflict of Laws*, "where the question is as to who are beneficiaries of the trust and as to the extent of their interests, the question is one of construction rather than of administration … ."[1116]

[1116] *Restatement (Second) of Conflict of Laws* §271 cmt. a (Am. Law Inst. 1971). *See* Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §293 at 35 (3d ed. 2014).

(4) **Restraints on Alienation of Beneficiaries' Interests** —

The *Restatement (Second) Conflict of Laws* contains no special definitions regarding a trust beneficiary's ability to assign his or her interest or creditors' ability to reach that interest. As discussed above, the *Restatement* addresses this subject separately and does not treat it as a matter of trust validity.

From the foregoing definitions, it is evident that the ability of creditors to reach the settlor-beneficiary's interest in a domestic APT is not a matter of construction or administration. The following discussion, therefore, focuses on issues of validity and restraints on alienation of beneficiaries' interests.

f. **Type of Question—Effectiveness of Designation**

(1) **Validity**

(a) **Trust of Movables Created Inter Vivos** —

Restatement (Second) Conflict of Laws §270 provides in pertinent part as follows:[1117]

[1117] *See Restatement (Second) of Conflict of Laws* §270 cmt. b (Am. Law Inst. 1971); 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.1 at 3060–3064, §45.4.2.1 at 3234–3242 (5th ed. 2010); Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §297 at 70–71 (3d ed. 2014).

> 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 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 ….

One of *Restatement (Second) Conflict of Laws* §270's comments notes that:[1118]

[1118] *Restatement (Second) of Conflict of Laws* §270 cmt. b (Am. Law Inst. 1971).

> Despite the absence of an express designation, it may otherwise be apparent from the language of the trust instrument or from other circumstances, such as the extent of the contacts with a particular

> state, that the settlor wished to have the local law of a particular state govern the validity of the trust.

Another comment gives the general principle underlying the section as follows:[1119]

[1119] *Restatement (Second) of Conflict of Laws* §270 cmt. a (Am. Law Inst. 1971) (cross-reference omitted).

> It is desirable that a trust should be treated as a unit and, to this end, that the trust as to all of the movables included therein, no matter where they happen to be at the time of the creation of the trust, should be governed by a single law. The creation of a trust is different from an outright conveyance, which is either valid or invalid at the outset. In the case of a trust there is something more. In the first place, the creation of a trust establishes a continuing relationship between the trustee and the beneficiaries, and the state in which the trust is to be administered or which is otherwise connected with the trust may be different from the state in which the trust property is situated when the trust is created. In the second place, the trust property is ordinarily not a single movable but includes a group of movables which may be situated in different states at the time of the creation of the trust. The validity of a trust of movables, therefore, should be governed by a single law and not held valid as to some of the movables included in the trust and invalid as to others. This is true whether the movables consist of chattels, rights embodied in a document or intangibles. The rule of this Section is applicable to all these types of movables, no matter where they are situated at the time of the creation of the trust. It does not follow, however, that all questions of validity are determined by the same law.

(b) **Substantial Relation to the Trust** —

As mentioned above, for the designation of a domestic APT state's law to govern the validity of the provisions of a domestic APT,[1120] the domestic APT state must have "a substantial relation to the trust."

[1120] *Restatement (Second) of Conflict of Laws* §270(a) (Am. Law Inst. 1971).

For an inter vivos trust, a comment under *Restatement (Second) Conflict of Laws* §270 provides in pertinent part:[1121]

[1121] *Restatement (Second) of Conflict of Laws* §270 cmt. b (Am. Law Inst. 1971). *See* 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.4.2.1 at 3234–3242 (5th ed. 2010).

> 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. There may be other contacts or groupings of contacts which will likewise suffice.

(c) **Strong Public Policies** —

As also mentioned above, the designation of a domestic APT state's law to govern the validity of a domestic APT that holds personal property will be honored unless the issue in question contravenes a "strong public policy" of the state with which, as to the matter at issue, the trust has its most significant relationship.[1122]

[1122] *Restatement (Second) of Conflict of Laws* §270(a) (Am. Law Inst. 1971).

The *Restatement (Second) Conflict of Laws*, the Scott treatise,[1123] and the Bogert treatise[1124] do not cover whether the designation of a domestic APT state's law to govern the ability of creditors to reach trust assets might offend a strong public policy of the non-DAPT state. As noted above, this is consistent with the *Restatement's* framework that addresses this issue separately rather than as an issue of validity.

[1123] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* (5th ed. 2010).

[1124] Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* (3d ed. 2014).

(d) **Most Significant Relationship** —

For domestic APTs, a designation of a domestic APT state's law to govern the validity of trust provisions will stand even if doing so will violate a strong public policy of a non-DAPT state if the domestic APT state rather than the non-DAPT state is “the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in [*Restatement (Second) of Conflict of Laws*] §6.”[1125] *Restatement (Second) Conflict of Laws* §6 provides that:[1126]

[1125] *Restatement (Second) of Conflict of Laws* §270(a) (Am. Law Inst. 1971).

[1126] *See also Restatement (Second) of Conflict of Laws* §6(2) cmts. d–j (Am. Law Inst. 1971).

> [T]he 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.

These factors are analyzed in IX.G.5.b., below. It must be emphasized here, though, that the settlor's domicile is only one factor that warrants consideration. Most of the other factors weigh in favor of honoring the designation of domestic APT state law even if doing so will offend a strong public policy of the non-DAPT state.

(e) **Trust of Land Created Inter Vivos** —

Restatement (Second) Conflict of Laws §278 provides that:[1127]

[1127] *See also Restatement (Second) of Conflict of Laws* §278 cmt. a (Am. Law Inst. 971); 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §46.1 at

3368–3371, § 46.4.1 at 3402, §46.4.1.2 at 3418–3422 (5th ed. 2010); Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §296 at 65–67 (3d ed. 2014).

> [T]he validity of a trust of an interest in land is determined by the law that would be applied by the courts of the situs.

A comment under the section provides in pertinent part that:[1128]

[1128] *Restatement (Second) of Conflict of Laws* §278 cmt. c (Am. Law Inst. 1971).

> If the trustee is to retain the land in the trust, the substantial validity of the trust is determined by the law that would be applied by the courts of the situs, and usually those courts would apply their local law. Thus, … the local law of the situs is applicable on the question whether the disposition of the land violates the rule against perpetuities, or a rule against accumulations, or a rule as to illegal conditions or purposes, or a rule precluding the creation of a trust, or a rule invalidating charitable trusts.

(2) **Restraints on Alienation of Beneficiaries' Interests**

(a) **Trust of Movables Created Inter Vivos** —

Restatement (Second) Conflict of Laws §273 reads in relevant part:[1129]

[1129] *See also Restatement (Second) of Conflict of Laws* §273 cmt. c, §273 cmt. d (Am. Law Inst.1971); 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.7 at 3337–3338, §45.7.1.2 at 3349–3355, §45.7.2 at 3359–3365, §45.7.3 at 3365–3366 (5th ed. 2010); Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §293 at 44–45 (3d ed. 2014).

> Whether the interest of a beneficiary of a trust of movables is assignable by him and can be reached by his creditors is determined…(b) in the case of an inter vivos trust, by the local law of the state, if any, in which the settlor has manifested an intention that the trust is to be administered ….

A comment continues:[1130]

[1130] *Restatement (Second) of Conflict of Laws* §273 cmt. d (Am. Law Inst. 1971).

> In the case of an inter vivos trust, if the settlor has fixed its administration in a particular state, the local law of that state is applicable to the assignability of a beneficiary's interest. Thus if the settlor domiciled in one state transfers property to a trust company of another state, the law applicable to the assignability of a beneficiary's interest is ordinarily the local law of the state in which the trust company was incorporated and does business.

(b) **Trust of Land Created Inter Vivos** —

Restatement (Second) Conflict of Laws §280 provides:[1131]

[1131] *See also Restatement (Second) of Conflict of Laws* §280 cmt. a (Am. Law Inst. 1971); 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §46.7 at

3457–3458 (5th ed. 2010); Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §293 at 44–45 (3d ed. 2014).

> Whether the interest of a beneficiary of a trust of an interest in land is assignable by him and can be reached by his creditors, is determined by the law that would be applied by the courts of the situs as long as the land remains subject to the trust.

The section's comment expands as follows:[1132]

[1132] *Restatement (Second) of Conflict of Laws* §280 cmt. a (Am. Law Inst. 1971).

> In the case of land the applicable law is the law that would be applied by the courts of the situs if it is to be retained in the trust. These courts would apply their own local law to determine this question.

3. **Restatement Approach—Application**

a. **Restatement Approach—Movables**

(1) **Introduction** —

In IX.G.2., above, the author quoted provisions of the *Restatement (Second) Conflict of Laws* regarding the effectiveness of a designation by a settlor of a law to govern the validity of a trust of movables as well as restraints on alienation of beneficiaries' interests.

(2) **Validity**

(a) **Introduction** —

Restatement (Second) Conflict of Laws §270 covers the law that is used to resolve questions involving the validity of provisions of a trust of movables created inter vivos.[1133] When analyzing the validity of a trust provision under *Restatement (Second) Conflict of Laws* §270, it is necessary to answer the following four questions:

[1133] *See Toledo Tr. Co. v. Nat'l Bank of Detroit*, 362 N.E.2d 273, 278–279 (Ohio Ct. App. 1976).

- Is the question one of validity?
- Does the domestic APT state have a substantial relation to the trust?
- Does the trust provision in question violate a strong public policy of the non-DAPT state?
- Does the domestic APT state or the non-DAPT state have the most significant relationship to the matter at issue?

As discussed below, a limited number of authorities hold that self-settled spendthrift trusts involve matters of "strong public policy," but the authorities do not impugn a trust's validity. Instead, those cases provided local-law reasons why spendthrift provisions should be overridden or not given effect but otherwise left the trust as valid. (And, significantly, none of those cases involved a self-settled spendthrift trust that was valid under the trust's governing law.)

(b) **Questions of Validity** —

The "validity" of trust clauses addresses matters such as whether the trust violates the rule against perpetuities or a rule against accumulations.[1134] The ability of creditors to reach trust assets is not a matter of validity but is addressed separately by the *Restatement (Second) Conflict of Laws*.

[1134] *Restatement (Second) of Conflict of Laws* §269 cmt. d (Am. Law Inst. 1971).

(c) **Substantial Relation to the Trust** —

The domestic APT state has a substantial relation to the trust if, among other things, the settlor designated the domestic APT state as the place of the trust's administration, the trustee lives or does business in the domestic APT state when the domestic APT is created, or the trust assets are located in the domestic APT state at that time.[1135]

[1135] *Restatement (Second) of Conflict of Laws* §270 cmt. b (Am. Law Inst. 1971). *See Annan v. Wilmington Tr. Co.*, 559 A.2d 1289, 1293 (Del. 1989) (Delaware court recognized trust agreement's designation of Quebec law because trust was created and initially administered in Quebec).

(d) **Strong Public Policy** —

According to the authorities, the strong public policy issues that justify departure from *Restatement (Second) Conflict of Laws* §270's general rule involve trust provisions designed to defeat a surviving spouse's right of election and that violate a state's restrictions on testamentary gifts to charity[1136] but do not include jurisdictional differences in the rule against perpetuities.[1137] Moreover, the spousal elective share exception is not always followed as a matter of common law. Courts have sometimes allowed deceased spouses from one state to establish inter vivos trusts under the law of another state to defeat surviving spouses' elective shares.

[1136] *See Restatement (Second) of Conflict of Laws* §269 cmt. c, §269 cmt. i, §270 cmt. b, §270 cmt. e (Am. Law Inst. 1971); 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.4.2.4 at 3254–60 (5th ed. 2010); Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §297 at 70 n.6, §301 at 113 (3d ed. 2014).

[1137] *Restatement (Second) of Conflict of Laws* §269 cmt. i (Am. Law Inst. 1971). *See 2002 Lawrence R. Buchalter Alaska Tr. v. Phila. Fin. Life Assurance Co.*, 96 F. Supp. 3d 182, 209 (S.D.N.Y. 2015) ("The party seeking to invoke the doctrine bears the 'heavy burden' of establishing that the foreign law is repugnant").

The *Restatement (Second) Conflict of Laws*, the Scott treatise, and the Bogert treatise do not cover whether the recognition of self-settled spendthrift trusts formed under the law of one state violates a strong public policy of another state, and, until 2013, there were no cases or rulings that address this point. However, a handful of cases or rulings have, in other contexts, found that the self-settled trusts (either spendthrift trusts or discretionary trusts with distributions subject to a third party's veto) violated a state's "strong" public policy. Examples include:

- *State v. Heneberry* (2003)[1138] —The Connecticut Superior Court held that using a self-settled spendthrift trust to maintain a successful tort plaintiff's eligibility for public assistance violated Connecticut's strong public policy. The court based its holding on prior caselaw.[1139]

- *Outwin v. Commissioner* (1981)—The Tax Court held that Massachusetts's strong public policy allowed creditors to reach assets in self-settled spendthrift trusts and, hence, this rendered the transfers to the trusts incomplete gifts.[1140]

- TAM 199917001—The National Office reached the same result as *Outwin*, but under California law.[1141]

- *Estate of German v. United States* (1985)[1142]—The Claims Court, under similar circumstances, held that there was no such strong public policy against self-settled spendthrift trusts under Maryland law.

[1138] *2003 WL 23149933* (Conn. Super. Ct. Dec. 16, 2003) ("Connecticut case law expresses the strong public policy that proscribes self-settled spendthrift trusts").

[1139] *2003 WL 23149933* (collecting cases).

[1140] *Outwin v. Commissioner,* 76 T.C. 153, 166 (1981), *acq.* recommended, *1981 WL 176209* (AOD Feb. 10, 1981), and *acq.*, 1981-2 C.B. 1 (Dec. 1, 1991) (caselaw "evidence[s] 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").

[1141] The National Office stated that "California law… evidences a strong public policy against persons placing property in trust for their own benefit while at the same time insulating such property from the claims of creditors" (internal quotation marks omitted).

[1142] *Estate of German v. United States*, 7 Cl. Ct. 641 (1985).

In invalidating a poorly designed Alaska APT in 2013, a federal bankruptcy judge in the state of Washington held that, "Washington State has a strong public policy against self-settled asset-protection trusts."[1143] However, the court didn't even consider the relevance of *Restatement (Second) Conflict of Laws* §273 that the author discusses shortly. It would seem that if differences between rules against perpetuities do not amount to differences in strong public policy, then differences as to the recognition of self-settled spendthrift trusts should not either.

[1143] *In re Huber*, 493 B.R. 798, 809 (Bankr. W.D. Wash. 2013).

(e) **Most Significant Relationship to the Matter at Issue** —

Restatement (Second) Conflict of Laws §270 refers to *Restatement (Second) Conflict of Laws* §6 quoted above on this issue. This subject is discussed in IX.G.5.b., below, with respect to the UTC.

(3) **Restatement (Second) of Conflict of Laws §273—Restraints on Alienation of Beneficiaries' Interests** —

Nevertheless, the "validity" of a domestic APT is not the real issue. After all, settlors routinely create valid self-settled trusts (e.g., revocable trusts and charitable-remainder trusts ("CRTs")),[1144] and concerns about APTs do not revolve around things like the rule against perpetuities or accumulations. The pertinent question is the extent, if any, to which creditors may reach the assets of such a trust. For trusts that hold personal property, the analytical starting point is *Restatement (Second) Conflict of Laws* §273 quoted above.[1145]

[1144] *See, e.g., Braunstein v. Beatrice (In re Beatrice)*, 277 B.R. 439, 447 (Bankr. D.

Mass. 2002) ("A trust in which the settlor has reserved to herself the power to alter, amend or revoke … is not invalid").

[1145] *See Estate of German v. United States,* 7 Cl. Ct. 641 (1985) (in suit to establish whether estate was entitled to estate tax refund, court, without discussion, applied Maryland law (law designated by trust) not Florida law (law of trustor's domicile) to determine whether creditors could reach trustor's interest). *See* 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.7–§45.7.3 (5th ed. 2010); Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §293 at 44–45, §301 at 114 (3d ed. 2014).

Further, "movables" include virtually any category or type of asset except real estate.[1146]

[1146] *Restatement (Second) of Conflict of Laws* Ch. 10, intro. n. (Am. Law Inst. 1971).

Restatement (Second) Conflict of Laws §273 and its comments specify that the law of the place of administration designated by the settlor is to be respected and, unlike *Restatement (Second) Conflict of Laws* §270 and its comments, do not contemplate that a different rule might apply if the law of the trust's situs violates a strong public policy of another state. Consequently, the law that governs a domestic APT should be determinative as to the ability of creditors to reach the APT's assets without further inquiry.

For inter vivos trusts, the Scott treatise suggests that there might be a strong public policy exception to the rule in *Restatement (Second) Conflict of Laws* §273. The treatise states:[1147]

[1147] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.7.1.2 at 3350 (5th ed. 2010).

> If the settlor creates a trust to be administered in a state other than that of the settlor's domicil, the law of the place of administration, rather than that of the settlor's domicil, should ordinarily apply. Thus, a settlor domiciled in one state may create an inter vivos trust by conveying property to a trust company of another state, as trustee, and delivering the property to it, for administration in the other state. In that case, the law of the other state ordinarily applies as to the rights of creditors to reach a beneficiary's interest.
>
> It is true that this permits a settlor who is domiciled in a jurisdiction in which restraints on alienation are not permitted, to create an inter vivos trust in another jurisdiction, in which they are permitted, and thereby to take advantage of the law of the latter jurisdiction. It would seem, however, that there is ordinarily nothing wrong with this, at least if there is no strong public policy against doing so in the state of the settlor's domicil.

The Scott treatise does not discuss whether a state's provision of greater protection from creditor claims for an inter vivos trust amounts to a violation of a forum state's strong public policy. However, in discussing the issue for testamentary trusts (where the law of the testator's domicile traditionally is given more weight than the law of the domicile of the settlor of an inter vivos trust), the treatise takes the position that a difference in the effectiveness of spendthrift clauses should not justify a departure from the general rule:[1148]

[1148] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.7.1.1 at 3345 (5th ed. 2010).

> [I]t would seem, such a policy, of whether to allow restrains on alienation, in order to protect beneficiaries or to permit alienation, in order to protect creditors and assignees, is not so strong as to preclude the

> application in another jurisdiction of its own law.

Indeed, the Scott treatise criticizes dictum in *Erdheim v. Mabee*,[1149] which suggested that forum courts should have more latitude, as follows:[1150]

> If this means that any court that acquires jurisdiction over the trust property can properly apply its own law as to the rights of creditors to reach the trust property, regardless of the law of the situs of the trust, we submit that the dictum is unsupportable.

The Scott treatise summarizes the applicable principles as follows:[1151]

> There are conflicting policies in the various states as to the rights of the creditors of a beneficiary of a trust of movables to reach the beneficial interest, and as to the rights of an assignee of such an interest. In some jurisdictions, the policy is to protect the beneficiary; in others, the policy is to protect creditors and assignees; and in yet others, the policy attempts, within limits, to protect all of them. When more than one jurisdiction is involved, the question is which jurisdiction's law should apply.
>
> Although the matter is not entirely clear, we submit that the applicable law should, ordinarily at least, be that of the situs of the trust. To the extent that under that law a beneficiary's interest cannot be reached by creditors or assignees, it ought not be possible to reach that interest ….
>
> If under the law of the situs of the trust a beneficiary's interest cannot be reached, it should ordinarily be immaterial that the plaintiff chooses to bring the proceeding in a jurisdiction in which the result would or might have differed. The law of the forum, merely because it is the law of the forum, should not apply. It should also generally be immaterial where the beneficiary is domiciled, where the creditor or assignee is domiciled, and where the debt was incurred or the assignment was made.

Practice Tip: Until very recently, the effectiveness of spendthrift clauses in third-party trusts was quite controversial. When the fourth edition of the Scott treatise was published in 1989, some states did not respect spendthrift trusts at all, whereas others did so to one degree or another. The treatise nevertheless suggested that differences between spendthrift laws did not constitute differences of “strong public policy.” Today, every U.S. jurisdiction respects some form of third-party spendthrift trust and the asset-protection effectiveness of a variety of self-settled vehicles. The extension of recognition to self-settled spendthrift trusts also should not justify departure from the general rule.

b. **Restatement Approach—Land** —

Many of the provisions of the *Restatement (Second) Conflict of Laws* regarding the effectiveness of a designation by a settlor of a law to govern the validity of a domestic APT of land as well as of restraints on alienation of beneficiaries’ interests are quoted in IX.G.2., above. The law that governs questions of validity[1152] or restraints on alienation[1153] for a domestic APT of land is the law that would be applied by the courts of the situs of the land.

[1149] *Erdheim v. Mabee*, 113 N.E.2d 433 (N.Y. 1953).

[1150] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.7.1.1 at 3347.

[1151] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.7.3 at 3365–3366 (5th ed. 2010).

[1152] *Restatement (Second) of Conflict of Laws* §278 (Am. Law Inst. 1971).

[1153] *Restatement (Second) of Conflict of Laws* §280 (Am. Law Inst. 1971).

4. **UTC Approach—Introduction** —

The UTC does not countenance APTs. Thus, UTC §505(a)(2), which is in Article 5, provides in relevant part as follows:

> (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.

The model UTC contains many "default" rules, which means that the trust instrument may change them. However, the model UTC also lists several "mandatory" terms from which the trust instrument may not depart.[1154] As relevant here, UTC §105(b) provides, "the terms of a trust prevail over any provisions of this [UTC] except…(5) the effect of a spendthrift provision and the rights of certain creditors and assignees to reach a trust as provided in [Article] 5… ." Therefore, a resident of a state that has enacted these provisions may not create an effective domestic APT in that state. Nevertheless, he or she may explore creating an APT in a domestic APT state.

[1154] UTC §105(b) (Unif. Law Comm'n amended 2018).

UTC §107 provides in relevant part that: "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… ." UTC §107's comment describes the general rule as follows:

> Paragraph (1) allows a settlor to select the law that will govern the meaning and effect of the terms of the trust. The jurisdiction selected need not have any other connection to the trust. The settlor is free to select the governing law regardless of where the trust property may be physically located, whether it consists of real or personal property, and whether the trust was created by will or during the settlor's lifetime. This section does not attempt to specify the strong public policies sufficient to invalidate a settlor's choice of governing law. These public policies will vary depending upon the locale and may change over time.

UTC §107 is concerned with matters of "meaning and effect," which seem to correspond most closely to matters of "construction" under the *Restatement (Second) Conflict of Laws* and which are not germane for present purposes. Regarding other matters, UTC §107's comment provides: "Usually, the law of the trust's principal place of administration will govern administrative matters and the law of the place having the most significant relationship to the trust's creation will govern the dispositive provisions."

To determine a trust's "principal place of administration," UTC §108(a) stipulates:

> Without precluding other means for establishing a sufficient connection with the designated jurisdiction, terms of a trust designating the principal place of administration are valid and controlling if: (1) a trustee's principal place of business is located in or a trustee is a resident of the designated jurisdiction; or (2) all or part of the administration occurs in the designated jurisdiction.

Regarding the governance of the trust's "dispositive provisions," which seems to correspond to "validity" under the *Restatement (Second) Conflict of Laws*, UTC §107's comment refers to "the law of the place having the most significant relationship to the trust's creation."

No UTC section or comment addresses what state's law governs the ability of creditors to reach a trust beneficiary's interest, but UTC §106 provides that matters not covered by the UTC are to be resolved under common law principles.

Thus, the above discussion of the *Restatement's* treatment of these issues remains relevant.

In 2016, an intermediate appellate court in Arizona, which is a UTC state, had to resolve a conflict-of-laws issue to determine whether creditors could reach the assets of self-settled charitable-remainder unitrusts.[1155] In choosing Washington state law, as designated by the trust, the court said:[1156]

> The CRUTs expressly provide that the operation of the [CRUTs] shall be governed by the laws of the State of Washington. As a result, we look to Washington state law to determine if the spendthrift provisions are valid.

When the relative interests of two jurisdictions are being weighed (e.g., to determine which state's law governs a trust's "dispositive provisions" or their "meaning and effect"), UTC §107's comment offers the following guidance:

> Factors to consider … include the place of the trust's creation, the location of the trust property, and the domicile of the settlor, the trustee, and the beneficiaries. Other more general factors that may be pertinent in particular cases include the relevant policies of the forum, the relevant policies of other interested jurisdictions and degree of their interest, the protection of justified expectations and certainty, and predictability and uniformity of result.

The above factors are based on and, therefore, are quite similar to the *Restatement (Second) Conflict of Laws* guidelines. The factors are analyzed in IX.G.5.b., below.

5. **UTC Approach—Application**

a. **Introduction** —

As noted above, UTC §505(a)(2) forbids self-settled spendthrift trusts and UTC §105(b)(5) does not permit a governing instrument to depart from that rule. (Nevertheless, of the states that have enacted some form of the UTC, eleven states—Connecticut, Michigan, Mississippi, Missouri, New Hampshire, Ohio, Tennessee, Utah, Virginia, West Virginia, and Wyoming—have rejected this approach and allowed APTs as of July 1, 2019.)[1157]

The UTC intentionally does not specify the strong public policies that will invalidate a designation of governing law.[1158] As noted in the Scott treatise,[1159] however, differences over spendthrift rules are probably not the sort of policy issues that justify deviation from a trust's designated choice of law, a conclusion bolstered by the fact that *Restatement (Second) Conflict of Laws* §273 (quoted above) does not qualify a settlor's right to designate the law governing restraints on alienation.

Further, under the UTC, another state's strong public policy may not bar application of the domestic APT state's law regarding the "meaning and effect" of a trust provision unless that other state has the "most significant relationship" to the trust.[1160] This can pose considerable difficulties for creditors who might challenge a trust's choice of law. More significantly for present purposes, a trust's "dispositive provisions" are governed by the law of "the place having the most significant relationship to the trust's creation."[1161]

[1155] *Wells Fargo Bank, N.A. v. Hoag*, No. 1-CA-CV-15-0559, 2016 BL 367346, *2016 WL 6436830* (Ariz. Ct. App. Nov. 1, 2016).

[1156] *Wells Fargo Bank, N.A. v. Hoag,* No. 1-CA-CV-15-0559, 2016 BL 367346, *2016 WL 6436830* at *2 (internal quotation marks and citation omitted).

[1157] For a list of states that have adopted the UTC, see www.uniformlaws.org.

[1158] UTC §107 cmt. (Unif. Law Comm'n amended 2018).

[1159] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* (5th ed. 2010).

[1160] UTC §107(1) (Unif. Law Comm'n amended 2018).

[1161] UTC §107(1) cmt. (Unif. Law Comm'n amended 2018).

To begin, as a general rule of trust law, the overriding principle of construction is that courts should discern and honor a settlor's intent whenever possible.[1162] This rule applies in choice of law issues as well,[1163] and, "[t]he jurisdiction selected need not have any other connection to the trust."[1164] Any other considerations are typically just factors used to divine a settlor's intent when it is not expressed.[1165] This rule honoring a settlor's intent is well established in Delaware.[1166]

[1162] *See, e.g., Hodges v. Johnson*, 177 A.3d 86 (N.H. 2017); *In re Peierls Family Inter Vivos Tr.*, 77 A.3d 249, 263 (Del. 2013); *Ladysmith Rescue Squad, Inc. v. Newlin*, 694 S.E.2d 604, 608 (Va. 2010); *In re Tr. Under Will of Flint for the Benefit of Shadek*, 118 A.3d 182, 194 (Del. Ch. 2015).

[1163] *Rudow v. Fogel*, 426 N.E.2d 155, 160 (Mass. App. Ct. 1981) ("In estate or commercial planning areas, the intentions of the settlor-testator or the contracting parties are significant both for local law and choice-of-law decisions"). *First Nat'l Bank v. Shawmut Bank of Boston* , 389 N.E.2d 1002, 1008 (Mass. 1979) ("In construing a trust instrument and rights and obligations under it, the law of the situs of the trust would often be given recognition, particularly when, as here, the trust expressly so directs."); *Nat'l Shawmut Bank of Boston v. Cumming*, 91 N.E.2d 337, 341 (Mass. 1950) (noting that Vermont trustor "had expressed an intent in the trust instrument that it should be construed and interpreted according to the laws of this Commonwealth [of Massachusetts]"). *See also* Annotation, *Conflict of Laws as to Trusts Inter Vivos*, *139 A.L.R. 1129*, 1130 (1942) ("There is also apparent in the more recent cases a tendency to give effect to any expressed or necessarily implied intention or desire of the creator of the trust to have the trust governed by the law of a particular jurisdiction with which one or more of the elements of the trust are connected").

[1164] *See* UTC §107 cmt. (Unif. Law Comm'n amended 2018).

[1165] Annotation, "Conflict of Laws as to Trusts Inter Vivos," *139 A.L.R. 1129*, 1130 (1942) ("Indeed, it may be said that any rule referring the validity, interpretation, or effect of the trust to the law of the situs of particular elements of the trust, such as the law of the donor's domicile or the law of the situs of the administration of the trust, is not an absolute or primary rule, but a secondary rule based upon the presumed intention of the donor, in the absence of indications to the contrary, that the law of that jurisdiction be the governing law of the trust").

[1166] *See, e.g., In re Peierls Family Inter Vivos Tr.*, 77 A.3d 249, 263 (Del. 2013) ("the settlor's intent controls the interpretation of the instrument"); *Annan v. Wilmington Trust Co.*, 559 A.2d 1289 (Del. 1989); *Dickinson v. Wilmington Tr. Co.*, 734 A.2d 605 (Del. Ch. 1999), *aff'd*, 734 A.2d 642 (Del. 1999); *Wilmington Tr. Co. v. Wilmington Tr. Co.*, 186 A. 903, 907–08 (Del. Ch. 1936), *modified* on rehearing on other grounds, 15 A.2d 153 (Del. Ch. 1940), *aff'd*, 24 A.2d 309 (Del. 1942); *In re Tr. Under Will of Flint for the Benefit of Shadek*, 118 A.3d 182, 194 (Del. Ch. 2015).

b. **Specifics** —

The UTC sets the guidelines quoted above for determining which state has the most significant relationship to a trust.[1167] These factors may be managed or addressed in ways that maximize the domestic APT state's relation to a trust and/or minimize a non-DAPT state's relation. Examples are described below.

[1167] UTC §107 cmt. (Unif. Law Comm'n amended 2018).

(1) **Place of Trust's Creation** —

A trust executed by a trustee inside a particular state is typically deemed to be created in that state.[1168] Accordingly, so long as a domestic APT trustee executes its trust in its home state, the "place of creation" test is satisfied. To be safe, the settlor could also execute the trust in the domestic APT state.[1169] Because a prudent client should meet with his or her trustee in any event, a trip to the trustee's place of business is hardly a serious burden. Additionally, a trust's situs, which arises from the creation of a trust, is based on the trustee's domicile and the trust's place of administration.[1170] Hence, accepting and administering a trust from inside the domestic APT state will also, in many cases, be the same as creating the trust in the domestic APT state.

[1168] *See, e.g., In re Gower*, 184 B.R. 163, 164 (Bankr. M.D. Fla. 1995) (noting that decedent "created and executed [trust] in Colorado"); *Nat'l Shawmut Bank of Boston v. Cumming*, 91 N.E.2d 337, 341 (Mass. 1950) (referring to "the completion of the trust agreement by final execution by the trustee").

[1169] *See, e.g.*, *Toledo Tr. Co. v. Nat'l Bank of Detroit*, 362 N.E.2d 273, 278–279 (Ohio Ct. App. 1976) (trustor's execution of trust in Toledo, Ohio, helped establish that trust had its "most significant contacts with … Ohio").

[1170] *Warner v. Fla. Bank & Tr. Co.*, 160 F.2d 766, 771 (5th Cir. 1947) ("Matters of administration are determined by the law of the situs or the seat of the trust, and the domicile of the trustee of intangible personal property including shares of stock is usually the seat of the trust"). *See also* 90 C.J.S. §221 (2002).

(2) **Location of Trust Property** —

"[T]he situs of intangibles is often a matter of controversy."[1171] The common-law maxim is that "movables follow the person"[1172] and, hence, personalty is situate where the legal title holder is located.[1173] Although this view has been somewhat displaced in recent years by the notion that property is situate where it is physically located,[1174] personal property is still often considered situate with the owner. In keeping with this rule, personalty can be situated in a domestic APT state simply by retitling the personalty in the name of a domestic APT trustee.[1175]

[1171] *Hanson v. Denckla*, 357 U.S. 235, 246–247 (1958).

[1172] *Delaware v. New York*, 507 U.S. 490, 503 (1993); *Appraisal Review Bd. of Galveston Cnty. v. Tex-Air Helicopters, Inc.*, 970 S.W.2d 530 (Tex. 1998).

[1173] *Zanes v. Mercantile Bank & Tr. Co. of Tex.*, 49 S.W.2d 922, 926 (Tex. Civ. App. 1932). *See also Sadler v. Industrial Tr. Co.*, 97 N.E.2d 169, 170 (Mass. 1951) (noting that trusts "consist[ed] entirely of personal property which was transferred to the trustee by the settlor at the times the trusts were executed" and that trust property was in Rhode Island).

[1174] *See, e.g.*, Abramson, Gary, Bogert & Bogert, *The Law of Trusts and Trustees* §291 at 8 (3d ed. 2014) ("The word 'situs' usually refers to the state in which trust assets are physically located … .").

[1175] *Cf. Nat'l Shawmut Bank of Boston v. Cumming*, 91 N.E.2d 337, 339 (Mass. 1950) (noting that trustor executed trust in Vermont while trustee executed trust in Massachusetts).

Situs selection can be reinforced by good planning. Certain tangible assets are easily located within the domestic APT state, such as valuables held in a safe deposit box. Cash, securities, and comparable assets can be placed into accounts maintained in the domestic APT state. Additionally, assets can be titled in a limited liability company (LLC) or family limited partnership (FLP), and the trust can then be funded with interests in the entity, further bolstering the situs argument (because the entity is organized in the domestic APT state) and the primary significance of the domestic APT state's relationship to the trust.

(3) **Trustee's Domicile** —

The fact that a trustee is located, incorporated, or organized in the domestic APT state will make this factor weigh in the domestic APT state's favor.[1176]

[1176] *See, e.g.*, *Toledo Tr. Co. v. Nat'l Bank of Detroit*, 362 N.E.2d 273, 278–79 (Ohio Ct. App. 1976) (trustee's incorporation in Ohio helped establish that trust had its "most significant contacts with … Ohio"); *Nat'l Shawmut Bank of Boston v. Cumming*, 91 N.E.2d 337, 339 (Mass. 1950) (trustee's domicile and place of business in Massachusetts supported application of Massachusetts law).

(4) **Settlor's Domicile** —

A settlor's domicile outside of the domestic APT state admittedly lessens the state's relation to a trust. However, in an increasingly mobile society, the weight accorded to a settlor's domicile, which may be transient, may often be considered a less important consideration and, hence, given less weight than the trustee's domicile, particularly that of an institutional trustee with a more-or-less permanent presence in the domestic APT state. The impact of a settlor's domicile may be further lessened by other considerations.

(5) **Beneficiaries' Domiciles** —

Not all beneficiaries will necessarily live in the same jurisdiction as the settlor (who presumably is also a domestic APT beneficiary). A scattered group of beneficiaries residing in multiple states dilutes the relationship of any one beneficiary's home state to the trust. And, if the non-settlor beneficiaries are also mobile (an especially likely case for the young, well-educated collegians often born to affluent settlors), then the permanency and primacy of the trustee's relationship is further heightened. This dilution effect is also manipulable to an extent. A settlor can always name charitable or institutional beneficiaries that reside outside his or her home state and perhaps even one or more who reside in the domestic APT trustee's home state. Such planning will reduce the impact of any one beneficiary's state.

(6) **Policies of Forum State—Domestic APT State Not the Forum** —

This factor's impact is clearly based on which state is the forum for a dispute. If someplace other than the domestic APT state is the forum for a suit to recover assets from a domestic APT, then the domestic APT state's relationship to the trust is arguably diminished, and a local judge may conclude that his or her state—and, hence, its policy, if any, against self-settled spendthrift trusts—has a greater relationship to the trust.[1177]

[1177] *See Waldron v. Huber (In re Huber)*, 493 B.R. 798, 809 (Bankr. W.D. Wash. 2013); *In re Smith*, 415 B.R. 222, 234–235 (Bankr. N.D. Tex. 2009); *Dexia Credit Local v. Rogan*, 624 F. Supp. 2d 970, 975–976 (Bankr. N.D. Ill. 2009); *In re Lawrence*, 227 B.R. 907, 917 (Bankr. S.D. Fla. 1998); *In re Brooks*, 217 B.R. 98, 101–102 (Bankr. D. Conn. 1998); *In re Portnoy*, 201 B.R. 685, 698 (Bankr. S.D.N.Y. 1996).

However, the policy bias against APTs is clearly eroding. For instance, a growing number of states are adopting APT laws and judges from inside those states can hardly complain about another domestic APT state's comparable statute. Likewise, judges from non-DAPT states will find it hard to vilify a domestic APT as aberrant and, thus, undeserving of respect when, as of July 1, 2019, a total of 19 states had some type of domestic APT law, and these difficulties mount with each new state that adopts domestic APT laws. Congress has approved various self-settled asset protection vehicles as a matter of federal law. For instance, in 2005, Congress approved generous bankruptcy exemptions for IRAs,[1178] which are a form of self-settled vehicle.[1179] (Broad state law exemptions also often make IRAs a form of sheltered self-settled vehicle.) Congress has long exempted most ERISA funds, which are yet another form of self-settled spendthrift trust, and these protections were expanded by the 2005 bankruptcy changes.[1180] In 2005, Congress also opted to respect domestic APTs in bankruptcy, provided that transfers in trust are not fraudulent.[1181] Accordingly, the policy argument against self-settled trusts and APTs has substantially eroded over the years and is likely to further diminish in the future. This conclusion is bolstered in the case of domestic APTs because the domestic APT statutes contain reasonable safeguards to protect against abusive transactions. For instance, under the Delaware statute, all creditors are protected from fraudulent transfers[1182] and particularly vulnerable claimants (i.e., current and former spouses holding support or divorce decrees and persons holding pre-transfer claims for death, personal injury, or property damage) are even protected from nonfraudulent transfers.[1183] Domestic APT states' efforts to respect legitimate interests of creditors from other states mean other states should be less anxious to disregard their policies.

[1178] *See* 11 U.S.C. §522(b)(3)(C) (making broad IRA exemptions available to debtors who “opt out” of federal exemption scheme), 11 U.S.C. §522(d)(12) (comparable exemptions under federal scheme). *But see* 11 U.S.C. §522(n) (placing $1 million cap on exemption for IRA funds other than SEPs, SIMPLEs, rollovers, and earnings on IRAs).

[1179] *See* §408(a) (defining IRA as “a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries”).

[1180] *See* 11 U.S.C. §522(b)(3)(C), §522(b)(4), §522(d)(12).

[1181] *See* 11 U.S.C. §548(e).

[1182] Del. Code Ann. tit. 12, §3572.

[1183] Del. Code tit. 12, §3573.

Additionally, some jurisdictions have very liberal exempt-property policies, including, in some cases, unlimited homestead exemptions, such as the District of Columbia, Florida, Iowa, Texas, and Kansas.[1184] These local laws further undermine policy arguments made against domestic APTs. After all, it is hard for judges in these states to say that sheltering wealth in a domestic APT somehow contravenes local public policy when their own citizens can do virtually the same thing via a different sheltering vehicle.

[1184] *See* D.C. Code §15-501(a)(14); Fla. Const. art. 10, §4; Iowa Code Ann. §561.2, §561.16; Kan. Const. art. 15, §9, Kan. Stat. Ann. §60-2301; Tex. Const. art. 16, §51, Tex. Prop. Code Ann. §41.001–§41.002. *See also* Jeffrey A. Baskies, *New Florida Homestead Laws Add Flexibility in Estate Planning*, 38 Est. Plan. 13 (Mar. 2011).

Taken together, the public interest of non-DAPT forum states simply is not as great as it might first appear.[1185]

[1185] For more details on exempt homesteads and other planning vehicles, see I.F., above.

As a federal court in New York explained in 2015:[1186]

[1186] *See 2002 Laurence R. Buchalter Alaska Tr. v. Phila. Fin. Life Assurance Co.*, 96 F. Supp. 3d 182, 208–209 (S.D.N.Y. 2015) (citations and internal quotation marks omitted).

> The public policy doctrine is an exception to implementing an otherwise applicable choice of law in which the forum refuses to apply a portion of foreign law because it is contrary or repugnant to its State's own public policy. This exception should only be used in instances in which the laws of the foreign state are 'truly obnoxious' to the public policy of the forum state.

The party seeking to invoke this doctrine bears the heavy burden of establishing that the foreign law is repugnant.

(7) **Policies of Forum State—Domestic APT State as the Forum** —

If the domestic APT state is the forum, then that state's relation to a trust and, hence, the interest in advancing its policies, is obviously enhanced. This, in turn, suggests that settlors expecting challenges to their domestic APTs might preemptively sue in that state. A preemptive suit could take the form of an action for a declaratory judgment that the domestic APT state's law applies (and could perhaps be joined with a count seeking a declaration as to whether a fraudulent transfer was made).

Preemptive suits might raise nettlesome questions of whether the prospective challenger (presumably a would-be judgment creditor) is a necessary or indispensable party to the suit, whether the domestic APT state had good jurisdiction over him or her, and whether a case has become ripe for adjudication. The answers may depend upon whether the plaintiff in the underlying action has commenced any form of pre- or post-judgment collection action, and settlors and trustees may want to have pleadings ready to file on very short notice. Nonetheless, if a preemptive suit can be filed in the domestic APT state, then it should be. This will plainly enhance the domestic APT state's relationship to the trust and give that state's law the legal advantage as to the forum state's policies.

A preemptive suit may also create a very practical advantage—a domestic APT state judge is likely to think long and hard before finding that his or her own state's relationship to a domestic APT is somehow displaced by another state's interest. This is evident in the following passage from the 1957 decision of the Supreme Court of Delaware in *Lewis v. Hanson*:[1187]

[1187] 128 A.2d 819, 835 (Del. 1957), *aff'd*, 357 U.S. 235 (1958). *See Sloan v. Segal*, No. 2319, 2008 BL 662, 2008 WL 81513 at *10 (Del. Ch. Jan. 3, 2008).

> [W]e think the public policy of Delaware precludes its courts from giving any effect at all to the Florida judgment of invalidity of the 1935 trust. We are dealing with a Delaware trust. The trust res and trustee are located in Delaware. The entire administration of the trust has been in Delaware. The attack on the validity of this trust raises a question of first impression in Delaware and one of great importance in our law of trusts. To give effect to the Florida judgment would be to permit a sister state to subject a Delaware trust and a Delaware trustee to a rule of law diametrically opposed to the Delaware law. It is our duty to apply Delaware law to controversies involving property located in Delaware, and not to relinquish that duty to the courts of a state having at best only a shadowy pretense of jurisdiction.

If the filing of a preemptive suit smacks of forum shopping, then so be it. Plaintiffs show no remorse over this practice; there is no reason why trustees or settlors should be less willing to use this tool to their advantage.[1188]

[1188] *See* Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?* 85 Cornell L. Rev. 1035, 1112–1114 (May 2000).

Courts in Delaware, Nevada, and South Dakota allow requests for declaratory judgments because they have statutes based on the 1922 Uniform Declaratory Judgments Act (UDJA).[1189] UDJA §4 provides that (emphasis added):

[1189] The text of the UDJA may be viewed at www.uniformlaws.org. *See* Del. Code Ann. tit. 10, §6504; Nev. Rev. Stat. §30.060; S.D. Codified Laws §21-24-5. *See also Bessemer Tr. Co. v. Wilson*, No. 6148-MA, 2011 BL 227167, *2011 WL 1938660* at *3–5 (Del. Ch. Apr. 18, 2011), *vac'd, Bessemer Trust Co. of Delaware, N.A. v. Wilson*, No. 6148-MA., 2011 BL 260317, 2011 WL 4484557 (Del. Ch. Sept. 28, 2011); *In re Farrell,* No. 3811-VCP., 2008 BL 289837, 2008 WL 5459270 at *4 (Del. Ch. Dec. 18, 2008).

> *Any person interested as or through an* executor, administrator, *trustee*, guardian *or other fiduciary, creditor*, devisee, legatee, heir, next of kin, *or cestui que trust, in the administration of a trust*, or of the estate of a decedent, an infant, lunatic, or insolvent, *may have a declaration of rights or legal relations in respect thereto*:
>
> (a) *To ascertain any class of creditors,* devisees, legatees, heirs, next of kin or others; or
>
> (b) *To direct the* executors, administrators, or *trustees to do or abstain from doing any particular act in their fiduciary capacity; or*
>
> (c) *To determine any question arising in the administration of the* estate or *trust*, including questions of construction of wills and other writings.

(8) **Policies of Non-Forum State** —

The court should consider the relevant policies of other interested jurisdictions and the degree of their interest. Thus, although a non-DAPT court may not feel any compunction about disregarding the law of a foreign jurisdiction (see below), it must consider the domestic APT state's policies and interests.[1190] The reverse, of course, is also true—a domestic APT court must consider the policies and interests of other states. As suggested above, there will sometimes be little conflict between the laws and policies of the domestic APT states and other states. In other instances, there might be. However, as also noted above, the Scott treatise [1191] and *Restatement* §273 both strongly indicate that conflicting spendthrift rules are not good grounds to invalidate a trust's choice of law. Further, such conflict merely means that the competing policies may cancel out each other as factors regarding which state has the most significant relationship to a trust, which leaves the outcome determined by other factors, most of which strongly cut in the domestic APT state's favor.

[1190] *See Bartlett v. Dumaine*, 523 A.2d 1, 14–15 (N.H. 1986).

[1191] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* (5th ed. 2010).

(9) **Justified Expectations, Certainty, Predictability, and Uniformity of Results** —

These final factors strongly weigh in favor of a domestic APT state being deemed the state with the most significant relationship to a domestic APT.

As noted above, the primary duty of a court is to discern and apply a settlor's intent. If a settlor intended a trust to be governed by a domestic APT state's law, to contain property legally situate in the domestic APT state, and to be administered by a domestic APT state trustee, then it seems probable that the settlor intended that the domestic APT state have the most significant relationship with the trust. Moreover, these factors also show that both the settlor and the trustee have an expectation that the law will govern. The justified nature of this expectation is shown by the fact that domestic APTs are statutorily authorized by domestic APT state legislatures and by the growing acceptance of domestic APTs and other self-settled devices at the state and federal level. Further justification is found in other authorities, such as the Scott treatise[1192] and the *Restatement (Second) Conflict of Laws,* which indicate that different spendthrift laws are not good grounds to ignore a trust's choice of law.

[1192] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* (5th ed. 2010).

Considerations of certainty, predictability, and uniformity also point to finding the domestic APT state's relationship more significant than other states. Although courts elsewhere may only occasionally deal with domestic APTs and, thus have limited need to address the laws governing trust funds held by such trusts, domestic APT state trustees and their many settlors and beneficiaries have a constant need to know which body of law governs their rights and duties. The knowledge that domestic APTs are governed by domestic APT state law will facilitate stability, predictability, and uniformity in connection with trust planning and administration. In contrast, an ad hoc, result-oriented approach will create much uncertainty, unpredictability, and inconsistency. Such chaos simply is not good for interstate commerce and transactions. As noted by a Massachusetts court, "the interests of our interstate system … are furthered by applying a single law in determining whether a given situation creates a fiduciary relationship. It is desirable that the same law apply to all property involved in the same transaction wherever situated."[1193]

[1193] *Rudow v. Fogel*, 426 N.E.2d 155, 160 (Mass. App. Ct. 1981).

In sum, then, it will be very hard to deny that the domestic APT state is the state with the most significant relationship to a domestic APT, even if another state has a strong public policy against self-settled trusts.

6. **Rules for Foreign APTs** —

Regarding foreign APTs, a commentator observed in a 2007 article that "[a]lmost without exception, American courts have chosen to apply the law of the forum instead of the law of the [foreign] trust situs (where self-settled spendthrift trusts are recognized), even though the trust instrument expressly provided that the law of the trust situs should be applied."[1194]

[1194] Richard C. Ausness, *The Offshore Asset Protection Trust: A Prudent Financial Planning Device or the Last Refuge of a Scoundrel?* 45 Duq. L. Rev. 147, 162 (Winter 2007).

Hence, in the following cases (all of which probably involved fraudulent transfers), U.S. courts applied their laws, rather than the laws of the foreign jurisdictions designated in the trust instruments, in determining whether creditors could reach assets of foreign APTs:

- *In re Portnoy* (1996)—a federal bankruptcy court in New York held that New York—not Jersey, Channel Islands—law applied.[1195]

- *In re Brooks* (1998)—a federal bankruptcy court in Connecticut held that Connecticut—not Jersey, Channel Islands, or Bermuda—law applied.[1196]

- *In re Lawrence* (1998)[1197]—a federal bankruptcy court in Florida held that Florida—not Mauritian—law applied.
- *Dexia Credit Local v. Rogan* (2009)—a federal district court in Illinois held that Illinois—not Bahamian—law applied.[1198]
- *In re Smith* (2009)—a federal bankruptcy court in Texas held that Texas—not Cook Islands—law applied.[1199]

[1195] *In re Portnoy,* 201 B.R. 685, 698–701 (Bankr. S.D.N.Y. 1996).

[1196] *In re Brooks,* 217 B.R. 98, 101–102 (Bankr. D. Conn. 1998).

[1197] *In re Lawrence*, 227 B.R. 907, 917 (Bankr. S.D. Fla. 1998).

[1198] *Dexia Credit Local v. Rogan,* 624 F. Supp. 2d 970, 975–976 (N.D. Ill. 2009).

[1199] *In re Smith*, 415 B.R. 222, 234–235 (Bankr. N.D. Tex. 2009).

The bankruptcy judge in *In re Lawrence* summarized *In re Portnoy* as follows:[1200]

[1200] *In re Lawrence*, 227 B.R. 907, 917 (Bankr. S.D. Fla. 1998) (citations, footnote, and internal quotation marks omitted).

> There is a growing body of case law surrounding debtors who have secreted their assets in distant jurisdictions with laws which would make the stereotypical Swiss banker proud. For example, in *In re Portnoy,* a case with strikingly similar facts, the court held that to apply the law of the chosen offshore trust situs, in that case the Jersey Channel Islands, would offend strong state and Federal bankruptcy policies if applied.

The *In re Portnoy* court further stated that while under normal circumstances parties are free to designate what state's or nation's law will govern their rights and duties, where another state or nation has a dominant interest in the transaction at issue, and the designated law offends a fundamental policy of that dominant state, the court may refuse to apply the foreign law. The court held that equity would not countenance a debtor unilaterally removing the characterization of property by incorporating a favorable choice of law provision into a self-settled trust of which he is the primary beneficiary.

Next, the judge in *In re Lawrence* summarized *In re Brooks* as follows:[1201]

[1201] *In re Lawrence,* 227 B.R. 907 n.17 (citation omitted).

> This issue was also recently addressed in *In re Brooks*. In *In re Brooks*, the court held that certain assets placed in an offshore trust in Bermuda and the Jersey Channel Islands were nevertheless assets of the bankruptcy estate and subject to the Court's jurisdiction, and refused to allow the laws of the foreign jurisdiction to control because these laws were repugnant to the public policy of Connecticut and the United States.

The judge concluded:[1202]

[1202] *In re Lawrence*, 227 B.R. 907, 917–918 (in addition to *In re Brooks* and *In re Portnoy*, court cites *In re Cameron*, 223 B.R. 20 (Bankr. S.D. Fla. 1998)) (footnote omitted).

> This Court is persuaded by the decisions of *In re Portnoy*, *In re Brooks* and *In re Cameron*. The Debtor's rights and obligations under the Mauritian Trust are governed by Florida and federal bankruptcy law, which have an overriding interest in the trust, and not the law of the Republic of Mauritius. Accordingly, the trust corpus is property of the estate under 11 U.S.C. §541.

The district judge in the *Dexia Credit Local* case considered the choice of law issue as follows:[1203]

[1203] *Dexia Credit Local v. Rogan,* 624 F. Supp. 2d 970, 976 (citations omitted).

> Dexia has conceded that Bahamian law would not permit it to seek turnover of the assets held by the PGR trust, because Bahamian law permits the use of self-settled spendthrift trusts to shield assets from a settlor's creditors. Dexia contends, however, that Bahamian law on this point is contrary to Illinois law and public policy and should therefore be disregarded.

Under Illinois law, spendthrift trusts are valid except when they have been created or funded by a judgment debtor. A self-settled spendthrift trust is "void as to existing or future creditors, and they can reach his or her interest under the trust." This rule reflects the law in most U.S. jurisdictions. Bahamian law to the contrary would violate Illinois' public policy. Accordingly, the court would not apply Bahamian law to the construction and operation of the PGR trust.

The bankruptcy judge in *In re Smith* applied Texas law without discussing Cook Islands law that the trust designated to govern its operation.[1204]

[1204] *In re Smith*, 415 B.R. 222, 234–235.

7. **Why the Rules Are Different** —

For conflict-of-laws purposes, the law designated in a domestic APT should be respected, whereas U.S. courts have more leeway to disregard the law designated in a foreign APT. Such a distinction is contemplated by *Restatement (Second) of Conflicts of Law* §10, which provides that:

> The rules in the Restatement of this Subject apply to cases with elements in one or more States of the United States and are generally applicable to cases with elements in one or more foreign nations. There may, however, be factors in a particular international case which call for a result different from that which would be reached in an interstate case.

Restatement (Second) of Conflicts of Law §10, comment d, amplifies the distinction in relevant part as follows:

> (2) Within the United States, there are safeguards under the Constitution of the United States, such as the due process clause of the Fourteenth Amendment, which give a large measure of legal assurance of fairness of official action within each State. The lack of such safeguards in an international conflicts case may call for closer scrutiny or different treatment.
>
> (3) Within the United States, there are authoritative constitutional rules … which do not bind courts of other nations and which may not apply to an international conflicts case in the United States. A court in the United States, in any event, should be guided by the policies of fairness and equality embodied in these constitutional rules in deciding an international case to which these rules are not strictly applicable.

Although the domestic APT and foreign APT statutes give effect to self-settled spendthrift trusts, foreign APTs, unlike domestic APTs, are sometimes seen as openly flouting this country's judicial system. Whether that is true in connection with any specific transfer to a foreign APT must be decided on the facts and circumstances of each case, but it is clear that foreign APTs often conjure up negative impressions and that abuses have apparently occurred in connection with a fair number of reported offshore cases.

Thus, foreign APTs frustrate the setting aside of fraudulent transfers, the enforcement of judgments obtained elsewhere, and the engagement of local counsel.

8. **Judicial Hostility to Domestic APTs Will Only Promote Foreign APTs** —

Ironically, the alleged evils of foreign APTs are an additional reason for U.S. courts to recognize the validity of domestic APTs.

Foreign APTs attract U.S. settlors for various reasons, many of which are quite legitimate, but prospective settlors should know that foreign APTs have drawbacks as well. On the "minus" side of the ledger are these considerations:

(1) worries about entrusting assets to a foreign trustee in a distant land;

(2) the need to file additional and potentially complex foreign trust reporting forms with the IRS,[1205] which can add thousands of dollars to annual tax compliance costs; and

(3) the risk of substantial penalties for late or incomplete filing of these forms, even if the lapse was due to a good faith error.[1206]

[1205] *See, e.g.*, Form 1040-NR, *U.S. Nonresident Alien Income Tax Return*; Form Link, *Annual Information Return of Foreign Trust With a U.S. Owner (Under section 6048(b))*; Form 3520, *Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts*. See also 854 T.M., *U.S. Taxation of Foreign Estates, Trusts and Beneficiaries*.

[1206] *See* §6048 (imposing reporting requirements), §6677 (imposing civil penalties). Under §6677(d), penalties can be waived if the reporting lapse was "due to reasonable cause and not due to willful neglect." Note that failing to file the required data is not excused merely because foreign law prohibits a trustee from disclosing any necessary data. §6677(d). Criminal penalties can also apply to willful failure to report. *See* §7203. Other criminal penalties can also apply. *See generally* §7201–§7208, §7212.

Additionally, foreign APTs can elicit fiery hostility from U.S. judges, who sometimes liberally apply contempt of court sanctions (including prolonged jail time) against foreign APT settlors who do not turn over trust assets to satisfy a judgment, even when settlors claim they lack the ability to turn over assets.[1207] These offshore contempt cases often contain egregious fact patterns that involved serious pre-transfer fraud by the settlor and/or reasonable grounds to believe that the settlor lied about his or her inability. However, judicial hostility to foreign APTs is not necessarily confined to the "bad fact" cases. Instead, foreign APT abuses have prompted some courts to take a skeptical view of all foreign APTs,[1208] which could understandably lead some clients to consider foreign APTs "too hot to handle."

[1207] *See, e.g.*, *Chadwick v. Janecka*, 302 F.3d 107 (3d Cir. 2002); *FTC v. Affordable Media, LLC*, 179 F.3d 1228 (9th Cir. 1999) (a/k/a *Anderson*); *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002); *SEC v. Bilzerian*, 131 F. Supp. 2d 10 (D.D.C. 2001); *SEC v. Bilzerian*, 112 F. Supp. 2d 12 (D.D.C. 2000).

[1208] *See, e.g.*, *SEC v. Bilzerian*, 112 F. Supp. 2d 12, 26 (D.D.C. 2000) ("Where assets are held in an offshore trust, the burden of proving impossibility as a defense to a contempt charge will be especially high") (quoting *FTC v. Affordable Media, LLC*, 179 F.3d 1228, 1241 (9th Cir. 1999)).

On the "plus" side, creditors find it very difficult to reach assets settled into foreign APTs. Among other things, many offshore jurisdictions:

(1) will not permit plaintiffs' attorneys to engage in contingent fee representation (a practice deemed unethical in much of the world);

(2) will follow the "English rule," which requires the loser to pay the winner's attorney fees and differs from the "American rule," wherein each side generally bears its own legal fees;[1209] and

(3) often will not recognize U.S. judgments (a statutory rule in key offshore jurisdictions).

[1209] *See Alyeska Pipeline Servs. Co. v. Wilderness Soc'y*, 421 U.S. 240 (1975).

Moreover, foreign courts will enforce a trust's "excluded person" clause, which bars a trustee from disbursing trust funds to the settlor's creditors and other persons who are expressly excluded from benefiting from the trust fund.[1210] Sometimes even U.S. federal judges must face reality and concede that they simply cannot force a settlor to turn over assets when the terms of the offshore APT do not empower the settlor to control distributions.[1211]

[1210] *Re the A Irrevocable Trust* (a/k/a *Anderson*) 2 ITELR 482 [Cook Island High Court (Civil Division) 1999].

[1211] *See United States v. Grant*, No. 9:00-cv-08986, 2008 BL 317381, 2008 WL 2894826 (S.D. Fla. May 27, 2008). *But see United States v. Grant*, No. 00-08986, 2013 BL 105975, 2013 WL 1729380 (S.D. Fla. Apr. 22, 2013). The author analyzes this case in XI.C.5.c.(6), below.

Whether prospective APT settlors go offshore or stay onshore depends upon their overall cost-benefit analysis of foreign APTs versus domestic APTs. For many clients, one of the most important factors is whether the clients may reliably count on their choice of law to truly protect their assets from future, unforeseen claims. Many clients and advisers worry that judges in non-DAPT states may try to circumvent domestic APT statutes by citing public policy grounds or other rationales to disregard a settlor's choice of law in connection with a domestic APT and, thereafter, enter a judgment that will bind the domestic APT trustee under the full faith and credit doctrine. The author believes that such worries are substantially unfounded, but nonetheless this concern is present and the caselaw has yet to evolve.

Consequently, future U.S. court decisions regarding domestic APTs and a settlor's choice of governing law will significantly affect future settlors' preference for domestic APTs or foreign APTs. If U.S. courts ignore a domestic APT settlor's choice of domestic APT law as governing, then settlors will be less inclined to use domestic APTs and will have greater incentive to go offshore, where the real or perceived whims of judges in non-DAPT states will simply be ignored because of nonrecognition statutes. This migration of capital will, in turn, make it much harder for U.S. creditors to pursue claims against trust funds and will be diametrically opposed to the pro-creditor motives that would presumably underlie the anti-domestic APT decisions of U.S. courts. In other words, the long-term adverse consequences to creditors as a class may easily outweigh any short-term benefits afforded to those specific creditors who rack up early success in suits challenging domestic APTs. In contrast, cases upholding a settlor's right to use domestic APTs, even if the settlor is from a non-DAPT state, will create confidence in domestic APTs, which will stem the flow of trust funds to foreign shores and encourage the use of domestic APTs that are ultimately subject to supervision by U.S. courts.

Granted, in accepting domestic APT law as governing, judges in non-DAPT states will substantially curtail creditors' rights under the old rule against self-settled spendthrift trusts. However, the alternative is to encourage trusts in offshore jurisdictions where creditors have even fewer rights. Wealthy settlors will use APTs in any event, so U.S. courts might as well recognize and honor domestic APTs. After all, U.S. courts will have greater powers over domestic trustees and trust funds and, hence, greater ability to guard against fraudulent transfers.

Paradoxically, then, courts that are interested in truly protecting the rights of U.S. plaintiffs and judgment creditors should be the ones most keen to recognize domestic APTs.

9. **Rules in Federal Court** —

The conflict-of-laws analysis essentially is the same if a controversy ends up in federal district court because of diversity of citizenship. The U.S. Supreme Court laid down the governing principles in *Klaxon Co. v. Stentor Electric Manufacturing Co.*as follows:[1212]

[1212] *Klaxon Co. v. Stentor Electric Manufacturing Co.*, 313 U.S. 487, 496–497 (1941) (footnote, citations, and internal quotation marks omitted). The case referred to within quote is *Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938). *Accord 2002 Lawrence R. Buchalter Alaska Tr. v. Phila. Fin. Life Assurance Co.*, 96 F. Supp. 3d 182, 199 (S.D.N.Y. 2015); *Wells Fargo Bank, N.A. v. Barber*, 85 F. Supp. 3d 1308, 1316 (M.D. Fla. 2015); *State Farm Mut. Auto. Ins. Co. v. Snyder*, No. 13-2172, 2013 BL 308898, *2013 WL 5948089*, *2 (E.D. Pa. Nov. 6, 2013); *Campbell v. Fawber*, 975 F. Supp. 2d 485, 504 (M.D. Pa. 2013); *Broaddus v. Shields*, No. 08-C-4420, 2012 BL 2275, 2012 WL 28694, *5 (N.D. Ill. Jan. 5, 2012).

> The conflict of laws rules to be applied by the federal court in Delaware must conform to those prevailing in Delaware's state courts. Otherwise, the accident of diversity of citizenship would constantly disturb equal administration of justice in coordinate state and federal courts sitting side by side. Any other ruling would do violence to the principle of uniformity within a state, upon which the *Tompkins* decision is based. Whatever lack of uniformity this may produce between federal courts in different states is attributable to our federal system, which leaves to a state, within the limits permitted by the Constitution, the right to pursue local policies diverging from those of its neighbors. It is not for the federal courts to thwart such local policies by enforcing an independent general law of conflict of laws. Subject only to review by this Court on any federal question that may arise, Delaware is free to determine whether a given matter is to be governed by the law of the forum or some other law. This Court's views are not the decisive factor in determining the applicable conflicts rule. And the proper function of the Delaware federal court is to ascertain what the state law is, not what it ought to be.

The author discusses choice of law principles in the bankruptcy context in IX.I.3., below.

Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Detailed Analysis
IX. Defenses to Creditor Attacks on Domestic APTs

H. Obstacle 7: Domestic APT Court Might Not Have to Give Full Faith and Credit to Non-DAPT Court Judgment

1. **Introduction** —

Under the U.S. Constitution "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State."[1213]

[1213] U.S. Const. art. IV, §1. *See also* 28 U.S.C. §1738. For a description of the Full Faith and Credit Clause, see *Franchise Tax Bd. of Calif. v. Hyatt*, 136 S. Ct. 1277, 1285–1286 (2016).

2. **Respect Due Statutes** —

The Full Faith and Credit Clause[1214] applies to statutes and to court judgments of another state, but it does not operate in the same manner with respect to them. In 2003, the U.S. Supreme Court considered the Full Faith and Credit Clause's application to state statutes in *Franchise Tax Board v. Hyatt*,[1215] in which the Court unanimously held that the Nevada Supreme Court's refusal to extend full faith and credit to California's statute immunizing California's tax collection agency from suit did not violate the Full Faith and Credit Clause. In contrasting the application of the Full Faith and Credit Clause to statutes and to judgments, the Court stated:[1216]

[1214] U.S. Const. art. IV, §1.

[1215] 538 U.S. 488 (2003). For a history of the quarter-century *Hyatt* controversy, see Hamilton, *The 'Horrible Quarter Century' of FTB v. Hyatt Ends*, 92 State Tax Notes 827 (June 3, 2019).

[1216] 538 U.S. at 494 (citations and internal quotation marks omitted).

> [O]ur precedent differentiates the credit owed to laws (legislative measures and common law) and to judgments. Whereas the full faith and credit command "is exacting" with respect to [a] final judgment … rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment, it is less demanding with respect to choice of laws. We have held that the Full Faith and Credit Clause does not compel a state to substitute the statutes of other states for its own statutes dealing with a subject matter concerning which it is competent to legislate.

Hyatt is consistent with comment d to the *Restatement (Second) of Conflict of Laws*, §145, which states "subject only to rare exceptions, the local law of the state where conduct and injury occurred will be applied to determine whether the actor satisfied minimum standards of acceptable conduct and whether the interest affected by the actor's conduct was entitled to legal protection."

Although the Full Faith and Credit Clause does not compel a court in one state to adopt the statute of another state, a court may not simply ignore a sister state's law and apply its own, and it must satisfy two criteria before its statute may constitutionally displace another state's statute. First, as noted above, the state must be "competent to legislate" regarding the subject matter in question. This criterion is usually easy to satisfy in the absence of some form of preemption or constitutional prohibition. Second, full faith and credit and due process require "that for a State's substantive law to be selected in a constitutionally permissible manner, that State must have a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair."[1217] It is often a close question whether, and to what extent, a state court may apply its own law to the exclusion of another state's law that is arguably more applicable. As a constitutional matter, states will be given significant leeway in developing local conflict-of-laws rules that satisfy the broad constitutional mandates.[1218] Nonetheless, one state cannot disregard another state's statutes when the other state had sufficiently significant contacts to the issues being litigated and the first state's interest was weak.[1219]

[1217] *Allstate Ins. Co. v. Hague*, 449 U.S. 302, 312–313 (1981). *Accord Hyatt*, 538 U.S. at 494.

[1218] *See, e.g.*, *Allstate*, 449 U.S. 302.

[1219] *See, e.g.*, *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985) (Kansas not allowed to apply its statutes to oil and gas lease controversies involving properties located in Texas, Oklahoma, and elsewhere).

3. **Implications** —

Although the forum court often will have constitutional discretion to apply or ignore a sister state's statute, the facts of some cases will strongly suggest (or perhaps require, as in *Phillips Petroleum Co. v. Shutts* [1220] (1985)), the application of another state's law rather than forum law. On the one hand, a forum court in a defendant's home state may have a strong argument for applying forum law because of the defendant's residence and because the plaintiff, whatever his or her residence, chose the forum. On the other hand, the argument for applying forum law is weaker when the defendant's contact with the forum is limited and the defendant's conduct took place outside the forum state. This observation has a potentially significant impact for out-of-state trustees with limited and minimal ties to the forum state.

[1220] 472 U.S. 797 (1985).

Thus, as to matters of statute, the Full Faith and Credit Clause[1221] may be more of a benefit than a burden to a domestic APT. Whereas there are no constitutional constraints on a court's right to ignore foreign APT law, the court may be constitutionally required to apply the domestic APT state's statute. Furthermore, even if the Constitution does not mandate adherence to a domestic APT act, a plaintiff arguing against application of domestic APT law must still satisfy the choice-of-laws rules that will often weigh in the domestic APT state's favor, as outlined above.

[1221] U.S. Const. art. IV, §1.

4. **Statutory Safeguard: Statutory Auto-Removal Rules and Related Tactics** —

Some of the domestic APT statutes provide a potential safeguard that may negate any attempt by a non-DAPT court to ignore domestic APT state law. For example, Delaware law provides that the trustee of a Delaware APT will cease to act if a court decides that Delaware law does not govern the validity, construction, or administration of the trust or the effect of its spendthrift clause. A new trustee will take over, pursuant to either a designation made in the trust instrument or an order by the Delaware Court of Chancery.[1222] If such a change of trustee occurs, then the non-DAPT court will need to determine whether it has personal jurisdiction over the newly appointed trustee, who presumably has little or no contact with the forum state and is from Delaware. However, at least one case, *Emberton v. Rutt*,[1223] dealt with more traditional trust matters and held that a change of trustee will not defeat a court's personal jurisdiction if the court had valid jurisdiction over the outgoing trustee. The court seemed to be heavily influenced by the fact that the incoming trustee, a Texas resident with no ties to New Mexico other than the trust, accepted the trusteeship while the trust was still administered in New Mexico, which was also the forum state, and while one of the New Mexico settlors was acting as co-trustee. The facts presented by an auto-removal case are likely to differ: an incoming Delaware trustee will assume the trusteeship of a trust that is domiciled in Delaware rather than in the non-DAPT court's home state, and many Delaware APTs will not have co-trustees from the non-DAPT state. It is unclear whether these distinctions will make a material difference to a court's personal-jurisdiction analysis, particularly given some of *Emberton's* sweeping language, but they might, and if they do, then the non-DAPT court will lack personal jurisdiction over the incoming trustee.

[1222] Del. Code Ann. tit. 12, §3572(g). *See also* S.D. Codified Laws Ann. §55-3-47.

[1223] No. 1:07-cv-01200, 2008 BL 348180, 2008 WL 4093714 (D.N.M. Mar. 31, 2008).

If the non-DAPT court lacks such jurisdiction, then the court simply cannot enter binding orders against the trustee. An interesting question is whether an attempted change of trustee pursuant to the Delaware or South Dakota statute would be effective if a non-DAPT court holds that Delaware law should not apply in the first place. Nonetheless, just sorting out this question could cause real difficulties for a plaintiff, particularly if a new trustee is appointed by a Chancery order. Thus, this mechanism creates another practical obstacle between creditors and the trust fund.

Moreover, there are at least two ways for settlors to increase the odds that an “auto-removal” will actually be enforced.

One is to strike first by filing a declaratory judgment action in Delaware or South Dakota the moment it becomes apparent that a creditor may challenge the Delaware or South Dakota APT. This suit could be filed by the settlor, the trustee, or other beneficiaries with an interest in preserving the trust fund from the settlor's creditors, and such actions are allowed under Delaware and South Dakota law.[1224] As part of that “dec. action,” as litigators often call them, the plaintiffs could expressly seek a ruling that Delaware or South Dakota law applies to the APT. Given that the matter would be before the APT trustee's home court, there could be a significant predisposition in favor of finding that Delaware law applies. However, this tactic may not always work because a declaratory judgment action cannot be prosecuted unless the controversy has become ripe for adjudication,[1225] and the trustee, settlor, and beneficiaries may not know that a controversy has ripened until after they have been sued in a non-DAPT court. At that point, the Delaware or South Dakota court may decline jurisdiction on the traditional grounds that comity requires the court to defer to the court that previously acquired jurisdiction.[1226] Hence, the declaratory judgment tactic involves a possible race to the court house that may be over before the APT's proponents even know that the race began. However, it is not entirely clear that a Delaware or South Dakota court would apply the traditional comity rule. Thus, the declaratory judgment option may be open even if an APT's proponents first learn of a challenge upon being served with a creditor's suit.

[1224] *See, e.g.,* Del. Ch. Ct. R. P. 57; *XO Commc'ns, Inc. v. Level 3 Commc'ns, Inc.*, 948 A.2d 1111, 1116 n.16 (Del. Ch. 2007) (noting that four elements that allow prosecution of declaratory judgment actions are as follows: "(1) the controversy must involve a claim of right or other legal interest of the party seeking declaratory relief; (2) the claim of right or other legal interest must be asserted against one who has an interest in contesting the claim; (3) the conflicting interest must be real and adverse; and (4) the issue must be ripe for judicial determination").

[1225] *See XO Commc'ns, LLC v. Level 3 Commc'ns, Inc.*, *948 A.2d 1111*, 1116 n.16 (Del. Ch. 2007) (ripeness is one of four criteria that must be satisfied to allow declaratory judgment action). "[A] ripe dispute is one where litigation sooner or later appears to be unavoidable, and one in which the material facts are static." *Bebchuk v. CA, Inc.*, 902 A.2d 737, 740 (Del. Ch. 2006) (citations and internal quotation marks omitted).

[1226] *See, e.g.*, *Orthmann v. Apple River Campground, Inc.*, 765 F.2d 119, 121 (8th Cir. 1985) ("courts follow a first to file rule that where two courts have concurrent jurisdiction, the first court in which jurisdiction attaches has priority to consider the case"); *Bjorklund v. Bjorklund Trucking Inc.*, 753 N.W.2d 312, 318 (Minn. Ct. App. 2008) ("comity requires that the first court to acquire jurisdiction has priority in considering the case") (citations and internal quotation marks omitted); *Joe Williamson Constr. Co. v. Raymondville Indep. Sch. Dist.*, 251 S.W.3d 800, 805 (Tex. Ct. App. 2008) ("The longstanding common law rule in Texas is that the first court to acquire jurisdiction over the subject matter and the parties of a controversy has dominant jurisdiction over all other courts") (internal quotation marks omitted).

The second tactic involves simply writing the auto-removal clause into the trust instrument so that the trust's choice-of-laws provisions expressly call for removing the old trustee and installing a new Delaware or South Dakota trustee if the non-DAPT court won't apply Delaware or South Dakota law. Tempting though it might be, a responsible non-DAPT court cannot simply ignore such a trust term. Accordingly, the non-DAPT court will be forced to either invalidate this clause or honor it. Invalidating the clause will give APT proponents another issue for appeal (hence adding to a creditor's litigation cost and uncertainty), whereas honoring this clause could trigger the same issues regarding personal jurisdiction and enforceability of orders that the statutory auto-removal clause creates.

Consequently, the statutory auto-removal rule, the ability to seek a declaratory judgment in Delaware or South Dakota, and the simple expedient of writing the auto-removal rule into the terms of the trust all combine to make this statutory safeguard a serious issue for creditors.

5. **Respect Due Judgments—Collateral Attack and Important Domestic APT Interests** —

As noted above, the U.S. Supreme Court declared in *Hyatt* that "the full faith and credit command is exacting with respect to a final judgment … rendered by a court with adjudicatory authority over the subject matter and persons covered by the judgment."[1227] However, this "exacting" requirement has its limits.

[1227] 538 U.S. 488, 494 (2003). *See also In re the Tr. of Vale ex rel. Asche*, No. 7662-VCP, 2015 BL 42112, 2015 WL 721038 at *3 (Del. Ch. Feb. 19, 2015).

To begin with, domestic APT courts may disregard judgments entered against domestic APT trustees by courts of other states if the judgment did not satisfy the requirements of due process.[1228] Hence, any failure to join a trustee to an action regarding a domestic APT, or any defect in service on or jurisdiction over a trustee, can open a non-DAPT court's judgment to collateral attack.

[1228] *Hanson v. Denckla*, 357 U.S. 235, 255–56 (1958). *See also Nastro v. D'Onofrio*, 822 A.2d 286, 292–94 (Conn. 2003).

Further, a domestic APT court might not have to give full faith and credit to a judgment rendered by a non-DAPT court. In this regard, *Restatement (Second) of Conflict of Laws* §103 states:[1229]

[1229] *Accord Bartlett v. Dumaine*, 523 A.2d 1, 14–15 (N.H. 1986).

> A judgment rendered in one State of the United States need not be recognized or enforced in a sister State if such recognition or enforcement is not required by the national policy of full faith and credit because it would involve an improper interference with important interests of the sister State.

Restatement (Second) of Conflict of Laws §103's comments emphasize that it has an extremely narrow scope of application[1230] and would probably include such things as one state refusing to respect a judgment from another state that "purport[s] to accomplish an official act within the exclusive province of that other State or interfere[s] with litigation over which the ordering State had no authority."[1231] Nevertheless, authorities indicate that §103 might apply if a domestic APT court is asked to give full faith and credit to a judgment rendered by a non-DAPT court.

[1230] *Restatement (Second) of Conflict of Laws* §103 cmts. a–b (1971).

[1231] *Baker v. Gen. Motors Corp.*, 522 U.S. 222, 235 (1998).

The Scott treatise frames the issue as follows:[1232]

[1232] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.2.2.6 at 3126 (5th ed. 2010).

> In some situations, however, the court that has primary supervision over the administration of the trust may regard the judgment as an undue interference with its power to control trust administration. It may take the position that the court rendering the judgment applied its own local law, though it should have applied the law of the state of primary supervision, or that it incorrectly applied the law of the state of primary supervision. The question then is whether the court of primary supervision is bound to give full faith and credit to the judgment. The final determination of this question rests, of course, with the Supreme Court of the United States.

It is unclear whether this trust administration exception applies to collection efforts aimed at a domestic APT. A creditor might argue that the issues presented are substantive matters of debtor-creditor law and, hence, that they have nothing to do with trust administration as that term is traditionally understood. In contrast, a trustee might argue that trust disbursements are matters of trust administration and, hence, that any attempt to compel a disbursement prohibited by a domestic APT state's law is subject to Scott's exception to full faith and credit. Thus, although the answer to the question may not be known, the fact remains that this debate creates yet another practical roadblock between a creditor and a trust fund. The realistic nature of this hurdle is shown by other considerations.

For instance, as noted above, *Hanson v. Denckla* [1233] held that Delaware did not have to give full faith and credit to a judgment of a Florida court that lacked jurisdiction over the trustee and the trust property. The Scott treatise states that "[i]t seems clear that the Florida court, in applying its own local law and holding that the Delaware trust and the exercise of the power of appointment were invalid, unduly interfered with the administration of the trust by the Delaware courts." [1234]

[1233] 357 U.S. 235 (1958).

[1234] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.2.2.6 at 3128 (5th ed. 2010).

The Scott treatise describes the implications of the above observation as follows:[1235]

[1235] 7 Scott, Fratcher & Ascher at 3128–29 (footnote omitted).

> Since the Delaware court could properly regard the judgment of the Florida court as unduly interfering with the administration of a trust that was fixed in Delaware, it was not bound by that judgment, notwithstanding the fact that the Florida court had jurisdiction over some or all of the beneficiaries. Indeed, it may well be argued that the Delaware court would not be bound by the Florida judgment even if the Florida court had jurisdiction over the trustee as well. A court might acquire jurisdiction over an individual trustee who happens to be in the state or over a corporate trustee that happens to have such a connection with the state as to give the state jurisdiction over it, or the trustee may appear in the action. We submit, however, that such a judgment would unduly interfere with the Delaware court's supervision of the administration of the trust. It might, indeed, be held that not only would the Delaware courts not be bound to give full faith and credit to the Florida judgment but that the Florida judgment would be such an interference with the administration of the trust that it would be invalid as a denial of due process of law.

The Scott treatise suggests that the same principle should apply in other contexts:[1236]

[1236] 7 Scott, Fratcher & Ascher at 3129.

> In *Hanson v. Denckla*, the issue was the validity of the disposition of the trust property. A similar question may arise as to the effect of a judgment rendered by a court, other than that which has primary supervision, instructing the trustee as to the trustee's powers and duties or authorizing or directing the trustee to deviate from the terms of the trust. These matters are ordinarily for determination by the court that has primary supervision over the administration of the trust. Certainly, in most cases the courts of other states would decline to exercise jurisdiction, though they happened to have jurisdiction over the trustee or some or all of the beneficiaries. If, however, such a court exercises jurisdiction, the Supreme Court might well hold that the court of primary supervision is not bound to give full faith and credit to the judgment. Indeed, it might hold that the judgment is invalid, even in the state in which it was rendered, on the ground that it unduly interferes with the administration of the trust and thus constitutes a denial of due process of law.

In the related case of *Lewis v. Hanson*,[1237] the Supreme Court of Delaware unequivocally stated that Delaware courts would not have been required to give full faith and credit to the Florida judgment even if the Florida courts had jurisdiction over the trustee and/or the trust property. The court declared:[1238]

[1237] 128 A.2d 819 (Del. 1957), *aff'd sub nom., Hanson v. Denckla*, 357 U.S. 235 (1958).

[1238] 128 A.2d at 835 (citation omitted).

> [W]e think the public policy of Delaware precludes its courts from giving any effect at all to the Florida judgment of invalidity of the 1935 trust. We are dealing with a Delaware trust. The trust *res* and trustee are located in Delaware. The entire administration of the trust has been in Delaware. The attack on the validity of this trust raises a question of first impression in Delaware and one of great importance in our law of trusts. To give effect to the Florida judgment would be to permit a sister state to subject a Delaware trust and a Delaware trustee to a rule of law diametrically opposed to the Delaware law. It is our duty to apply Delaware law to controversies involving property located in Delaware, and not to relinquish that duty to the courts of a state having at best only a shadowy pretense of jurisdiction.

The Supreme Court of New Hampshire applied the above principles in a 1986 case—*Bartlett v. Dumaine*.[1239] There, the beneficiaries of a New Hampshire trust (the Dumaine Trust) and a Massachusetts trust (the Dexter Trust) brought claims against the trustees of the two trusts. After affirming findings that the claims against the trustees of the New Hampshire trust were meritless,[1240] the court, citing *Restatement (Second) of Conflict of Laws* §103 and pertinent sections of a prior edition of the Scott treatise, dismissed the request for an accounting for the Massachusetts trust, even though the court had personal jurisdiction over all interested parties, for the following reasons:[1241]

[1239] 523 A.2d 1 (N.H. 1986).

[1240] 523 A.2d at 14.

[1241] 523 A.2d at 14–15 (citations omitted).

> In determining whether the superior court should have exercised or declined to exercise its jurisdiction in this case, we consider the relationships which New Hampshire and Massachusetts have with the Dexter Trust. New Hampshire's interest in the proper administration of Dexter is substantial because Dumaines, a New Hampshire trust, has the vested remainder interest in Dexter. Nevertheless, we cannot help but conclude that Massachusetts' interest in the administration of Dexter is greater. Both the petitioners and the respondents acknowledge that Dexter is a Massachusetts trust which is administered in Massachusetts, and which is governed by the trust law of that commonwealth. The question we are asked to decide is whether the Dexter trustees need only account to the Dumaines' trustees under the Massachusetts general rule that in matters involving the trust and the outside world the trustees represent the beneficiaries or whether the Dexter trustees must account directly to the Dumaines' beneficiaries under exceptions to the general rule which govern when certain conflicts of interest exist. It is our conclusion that the Massachusetts courts, and not those of New Hampshire, are the courts of "primary supervision" over the Dexter Trust and the satellite trusts, and that this question should be left to a Massachusetts court to decide.

Both New Hampshire and Massachusetts jealously seek to preserve jurisdiction over their own trusts. Both states also willingly decline jurisdiction over another State's trust. Both practices are sound. Although there is a strong policy favoring an end to litigation, there is an equally strong policy favoring the orderly administration of trusts.

The court concluded its discussion of this issue as follows:[1242]

[1242] 523 A.2d at 15 (citations and internal quotation marks omitted).

> A final consideration stays our hand from divining the law of Massachusetts in this area; namely, what effect that Commonwealth is likely to give any judgment we might render. A judgment rendered in one State of the United States need not be recognized or enforced in a sister State if such recognition or enforcement is not required by the national policy of full faith and credit because it would involve an improper interference with important interests of the sister State. There is ample evidence that the Massachusetts Supreme Judicial Court would consider a decision by this court regarding the Dexter trustees' duty to account as improper interference with the Commonwealth's important interests.

6. **The Role of Strong Public Policy** —

Throughout this Chapter IX., the author has adverted to situations in which a non-DAPT court might refuse to honor a domestic APT state's statute for the reason that it violated a strong public policy of the forum state. Not all scholars are of the mind that this strong-public policy exception should have any role in American jurisprudence. For example, in a 1992 Columbia Law Review article, Professor Laycock observed that:[1243]

[1243] Laycock, *Equal Citizens of Equal and Territorial States: The Constitutional Foundations*

> Traditional approaches to choice of law contain an even more offensive variation on better-law approaches. This is the rule that the forum can reject sister-state law on the ground that it too deeply offends the public policy of the forum. This is the extreme case of better-law rules. Texas would reject California law not just because Texas law is better, but because California law is so offensive that it cannot be tolerated in a Texas court. Texas can reject the law of Libya in this high-handed way, or even the law of Alberta, and it may occasionally need to do so. But it cannot so treat a sister state admitted to the Union on an equal footing with itself. The public policy exception is a relic carried over from international law without reflection on the changes in interstate relations wrought by the Constitution.

He continued “Texas has no authority to change California law, and no authority to deny faith and credit to California law on the ground that California ought to change its own law, or on the ground that California would not seriously object.”[1244]

He then pointed out that:[1245]

> If a Texas court genuinely believes that a California court would change California law if the case were presented there, the best solution is to certify the legal question to the Supreme Court of California. It is familiar practice for federal courts to certify questions to state supreme courts, and some fifteen states authorize their supreme courts to answer such questions from courts of other states. If no certification procedure is available, and if a Texas court genuinely believes that a California court would decide the case in a way that departs from prior California precedent, then perhaps the Texas court should follow its prediction of California law and not the old California precedent. Federal courts have a limited power to do this in diversity cases, and when properly done it gives full faith and credit to a more accurate statement of California law. It reduces an incentive to forum shop when one side is relying on a vulnerable precedent due for overruling.

But this practice would likely be abused. Unlike a federal trial judge sitting in California, Texas judges have no realistic experience of California law on which to base a judgment that a particular precedent is ripe for overruling. More important, Texas judges have a strong temptation to predict that California would now adopt the Texas rule that they consider more enlightened. This temptation may be especially strong if a Texas citizen would benefit. Even though the ideal is for a Texas court to decide the case as a California court would decide it, we may achieve that goal more often with a prophylactic rule that the courts of one state cannot predict change in the law of another state.

Professor Laycock concludes rather bluntly “[c]hoice-of-law methods that prefer local litigants, local law, or better law are unconstitutional. These unconstitutional preferences are central to some so-called modern choice-of-law methods and infect most other methods to some extent. The choice-of-law revolution has proceeded in disregard of the Constitution.”[1246]

of Choice of Law, 92 Colum. L. Rev. 249, 313 (Mar. 1992) (footnotes omitted).

[1244] Laycock at 314.

[1245] Laycock at 314–15 (footnotes omitted).

[1246] Laycock at 336.

I. Obstacle 8: Domestic APTs Should Survive Bankruptcy

1. **Introduction** —

If a creditor brings a collection effort against the settlor of a domestic asset protection trust (APT), it probably means that the settlor's nontrust assets are minimal and/or inadequate to satisfy his or her debts. If so, then a creditor's ability to reach the settlor's trust interest might be determined in bankruptcy court, either pursuant to a settlor's voluntary petition [1247] or to one or more creditors' involuntary petition against the settlor.[1248]

[1247] 11 U.S.C. §301. For a description of why a debtor should refrain from filing a voluntary bankruptcy petition, see Gideon Rothschild & Daniel S. Rubin, *Minimize Creditor Challenges to Self-Settled Spendthrift Trusts*, 157 Tr. & Est. 14, 19–20 (Nov. 2018).

[1248] 11 U.S.C. §303.

a. **General** —

The goals of bankruptcy have been described as follows:[1249]

[1249] *In re Garza*, 575 B.R. 736, 738 (Bankr. S.D. Tex. 2017) (footnote omitted).

> It is well known that bankruptcy has two primary public policy objectives. The first is to promote equality of distribution among similarly situated creditors. The second is to afford the debtor a fresh economic start. These goals of distribution and a fresh start are sometimes referred to as the twin pillars of bankruptcy.

According to the Seventh Circuit, the bankruptcy process works in the following manner:[1250]

[1250] *In re Veluchamy*, 879 F.3d 808, 815 (7th Cir. 2018) (citation omitted). For a description of the bankruptcy process in the 6th Circuit, see *In re Blasingame*, 920 F.3d 384, 388–389 (6th Cir. 2019); for a description of the process in the 10th Circuit, see *In re Chernushin*, 911 F.3d 1265, 1269–1270 (10th Cir. 2018). For the difference in treatment of pre- and post-bankruptcy assets, see *In re Ludkowski*, 587 B.R. 330, 338–339 (Bankr. N.D. Ill. 2018).

> A Chapter 7 bankruptcy is an exchange. The debtor surrenders his assets (subject to limited exemptions …) to his bankruptcy estate for equitable distribution to his creditors. In exchange he receives discharge from his debts and a fresh start.

The Ninth Circuit has summarized standing requirements in a bankruptcy proceeding as follows:[1251]

[1251] *In re Tower Park Properties, LLC*, 803 F.3d 450, 456 (9th Cir. 2015) (citation omitted). For standing considerations in the 3d Circuit, see *In re Marchese*, 2018 BL 253384, 2018 WL 3472823 at *10–11 (Bankr. E.D. Pa. July 16, 2018).

> In order to have standing in bankruptcy court, Hughes must satisfy three requirements. First, he must satisfy the statutory requirements of the Bankruptcy Code and qualify as a "party in interest" under 11 U.S.C. §1109(b). Second, because he seeks standing in federal court, he must satisfy the constitutional minimum required by Article III. Third, he must meet federal court prudential standing requirements.

b. **The Bankruptcy Estate** —

A bankruptcy proceeding works in the following way:[1252]

[1252] *In re Vess*, No. 17-31092, 2018 BL 38541, *2018 WL 722408* at *2 (Bankr. N.D. Ohio Feb. 5, 2018) (citations and internal quotation marks omitted).

> The filing of a Chapter 7 Petition creates a bankruptcy estate consisting of all legal or equitable interests of the debtor in property as of the commencement of the case. The Bankruptcy Code allows debtors to exempt certain property from the bankruptcy estate pursuant to 11 U.S.C. §522(b). Pursuant to §522(b)(2), a debtor may claim federal exemptions set forth in §522(d) so long as the applicable state has “opted-out” and enacted its own exemptions. Ohio has opted-out of the federal exemptions, and debtors’ bankruptcy exemptions are taken from the Ohio statute.
>
> Exemption claims are afforded a prima facie presumption that they are valid. The party objecting to a debtor's claimed exemption has the burden of rebutting the presumption by a preponderance of the evidence. Given their remedial nature, both federal and Ohio courts generally construe exemption statutes in favor of the debtor.

Powers that a debtor possesses may be implicated in a bankruptcy proceeding:[1253]

[1253] *In re Vess*, No. 17-31092, 2018 BL 38541, *2018 WL 722408* at *4 (footnote, citations, and internal quotation marks and brackets omitted). *Accord In re Johnson*, 513 B.R. 333, 343 (Bankr. S.D. Ill. 2014) (“[P]owers that a debtor may exercise for his own benefit are included in the bankruptcy estate”).

> Property of the bankruptcy estate does not include any power that the debtor may exercise solely for the benefit of an entity other than the debtor. It follows that, powers that a debtor may exercise for his or her own benefit are, therefore, included in the bankruptcy estate, or there would be no need for the §541(b)(1) exemption. Thus … the debtor's powers as trustee—which could be exercised for debtor's own benefit—also became property of the bankruptcy estate ….

Hence, the bankruptcy trustee succeeds to a debtor's power to revoke a trust[1254] or to disclaim an inheritance.[1255]

[1254] *White v. Gordon*, 558 B.R. 15, 21 (D.N.H. 2016) (“After he petitioned for bankruptcy, the bankruptcy estate assumed that power” to revoke the trust).

[1255] *In re Corse*, 486 B.R. 241, 247–248 (Bankr. D.R.I. 2013), *aff'd*, No. 13-282 S, 2014 BL 43776, 2014 WL 652268 (D.R.I. Feb. 19, 2014) (after filing of petition, right to disclaim belongs to bankruptcy trustee).

c. **Exclusions vs. Exemptions** —

The Bankruptcy Code allows exclusions and exemptions. A federal bankruptcy court in Florida has explained the distinction:[1256]

[1256] *In re Bos*, 561 B.R. 868, 892 (Bankr. N.D. Fla. 2016) (footnote and internal quotation marks omitted). See In re Yerian, 927 F.3d 1223 (11th Cir. 2019) (“Yerian failed to maintain his IRA in accordance with its governing instruments, which explicitly prohibited the acts of self-dealing he engaged in with his IRA funds. As a consequence, he is not entitled to claim a creditor exemption for his IRA under section 222.21(2)(a)(2)”).

> Exclusion and exemption do not mean the same thing. Property that is excluded from the bankruptcy estate never comes into the estate at all, by operation of law, while exempt property is estate property at all times but is protected from the reach of creditors and administration through the estate if the debtor exercises the statutory option.

As noted previously, "a bankruptcy trustee succeeds only to the title and rights in property that the debtor had at the time she filed the bankruptcy petition."[1257] Post-petition developments generally do not cause exempt assets to come into the bankruptcy estate. This applies to:

[1257] *In re Thorpe*, 881 F.3d 536, 539 (7th Cir. 2018) (citation omitted).

- proceeds of homestead property that the debtor sold shortly before she filed a bankruptcy petition;[1258]
- homestead property that was sold after a bankruptcy petition was filed;[1259]
- funds that a debtor withdrew but redeposited in an IRA before filing for bankruptcy;[1260]
- two post-petition withdrawals from an exempt IRA;[1261] and
- tenancy-by-the-entireties property where the husband died during the bankruptcy proceeding.[1262]

[1258] *In re Thomas*, No. BKY 17-43661-MER, 2018 BL 276316, *2018 WL 3655654* at *3 (Bankr. D. Minn. July 31, 2018) ("the debtor is entitled to claim her homestead proceeds as exempt under Minn. Stat. §510.07").

[1259] *In re Awayda*, 574 B.R. 692, 693–694 (Bankr. C.D. Ill. 2017) ("the Debtor is unconditionally entitled to the exemption regardless of any potential postpetition developments").

[1260] *In re Jones*, 2019 BL 134169, *2019 WL 1749219* at *1 (Bankr. S.D. Ill. Apr. 15, 2019) ("a Debtor may exempt funds that were withdrawn from an individual retirement account ("IRA"), deposited into a checking account and re-deposited into the IRA").

[1261] *In re Hawk*, 871 F.3d 287, 296 (5th Cir. 2017) ("the bankruptcy court erred in ordering the Hawks to turn over the liquidated funds to the Trustee") (footnote omitted).

[1262] *In re Chernushin*, 911 F.3d 1265, 1276 (10th Cir. 2018) ("No interest in the second home remains in the bankruptcy estate"); *Bellinger v. Buckley*, 577 B.R. 193, 201–202 (D. Md. 2017) ("Appellee's interest in the Property never reentered the bankruptcy estate").

Practice Tip: A debtor may prevent an interest in a domestic APT from being subjected to a bankruptcy proceeding simply by not filing a voluntary petition. As discussed in the next section, a creditor who believes that the assets of a domestic APT may be accessed via the filing of an involuntary petition is likely to be sorely disappointed.

2. **The Limited Nature of Bankruptcy Concerns**

a. **Involuntary Bankruptcies Are Rare** —

Any discussion of domestic APTs and bankruptcy must be prefaced with the important observation that the Bankruptcy Code only applies to debtors who are in bankruptcy. In addition, bankruptcy is normally a voluntary process. Although involuntary Chapter 7 and Chapter 11 bankruptcies may theoretically be commenced by a small handful of creditors owed a combined total of as little as $16,750 in minimal debt,[1263] such involuntaries are rare. In fact, data provided by table 7.2 on the U.S. Courts website[1264] shows that involuntaries are a miniscule percentage of all bankruptcies. During 2014–2018, inclusive, a total of 4,193,706 bankruptcy petitions were filed, of which only

1,679 were involuntary.[1265] Thus, over five years, involuntaries amounted to only 0.0004 of all filings.

[1263] *See* 11 U.S.C. §303(a)–§303(b). The statutory threshold is adjusted for inflation every three years pursuant to 11 U.S.C. §104. The $16,750 threshold amount became effective April 1, 2019. 84 Fed. Reg. 3488 (Feb. 5, 2019).

[1264] *See Judicial Facts and Figures*, published by the Administrative Office of the U.S. Courts ("AOUSC") available at www.uscourts.gov/statistics/table/72/judicial-facts-and-figures/2018/09/30. The website indicates that the AOUSC obtained its data from various sources.

[1265] *See Judicial Facts and Figures.*

b. **Why Involuntary Petitions Are Attractive to Creditors** —

Involuntary bankruptcies are tempting to creditors because bankruptcy court can offer significant procedural and jurisdictional advantages. As a general rule:

- the Bankruptcy Code and a related statute give the bankruptcy court exclusive jurisdiction over all of the debtor's legal and equitable interests, wherever situated;[1266]

- the Bankruptcy Rules provide for nationwide service of process in any adversary proceedings;[1267]

- the combined effect of the Bankruptcy Rules and Federal Rules of Civil Procedure is to allow bankruptcy trustees and creditors nationwide subpoena power;[1268]

- the Bankruptcy Rules contemplate a very liberal approach to discovery regarding any act or asset that might pertain to the debtor or the debtor's bankruptcy estate.[1269]

[1266] 28 U.S.C. §1334(e); 11 U.S.C. §541(a)(1). Venue in a bankruptcy proceeding is governed by 28 U.S.C. §1408–§1412. *See In re Blixseth*, 484 B.R. 360, 371 (B.A.P. 9th Cir. 2012) (venue in District of Nevada is appropriate); *In re Ruth Ann Hinzmann*, No. 15-10857-7, 2017 BL 5610, *2017 WL 83353* at *6 (Bankr. W.D. Wis. Jan. 9, 2017) (venue in Western District of Wisconsin is appropriate).

[1267] Fed. R. Bankr. P. 7004(d).

[1268] Fed. R. Bankr. P. 9016, incorporating by reference Fed. R. Civ. P. 45. *See also* Fed. R. Civ. P. 45(b) (allowing attorneys to serve subpoenas in any district provided that subpoena relates to matter pending in district in which attorney is authorized to practice).

[1269] 11 U.S.C. §341; Fed. R. Bankr. P. 2004; *In re Wilcher*, 56 B.R. 428, 433 (Bankr. N.D. Ill. 1985).

In 2017, a commentator described these advantages as follows:[1270]

[1270] Spero*, Recent Cases Show Need for Strict Compliance With DAPT Statutes*, 44 Est. Plan. 8, 11 (May 2017) (footnotes omitted).

> An additional creditor-friendly bankruptcy rule is the nationwide service of process available to the representative of the creditors (i.e., the bankruptcy trustee). Similarly, the bankruptcy court has authority to seize assets anywhere in the U.S. These rules effectively negate one of the primary tactical aspects of a DAPT relative to a debtor that resides in a non-DAPT state, namely, the difficulty of obtaining jurisdiction over the DAPT trustee.

Because of the foregoing, a debtor who has established a DAPT would normally avoid bankruptcy. But that debtor may not be able to do so if creditors successfully file an involuntary bankruptcy petition.

A debtor contested a bankruptcy court's jurisdiction in a 2018 case.[1271] In rejecting the argument, the court noted:[1272]

> In bankruptcy proceedings where jurisdiction is based on 28 U.S.C. §1334(b), a district court (and by reference a bankruptcy court) has original but not exclusive jurisdiction of all civil proceedings arising under, arising in, or related to cases under title 11. Because the sovereign exercising jurisdiction is the United States, not a particular state, minimum contacts with the United States is sufficient to satisfy the Fifth Amendment due process requirement, whether the claims asserted arise under federal, state or foreign law.

In *In re Celotex Corp.*,[1273] the court found that the question of whether the defendant had minimum contacts in the forum state was irrelevant, because when an action is in federal court on related to jurisdiction, the sovereign exercising authority is the United States, not the individual state where the federal court is sitting. Relying on these authorities, this court has personal jurisdiction over the Defendant.

c. **Why Involuntary Petitions Are Unattractive to Creditors**

(1) **Introduction** —

Nonetheless, as noted above, involuntary bankruptcy petitions are extremely rare. In 2014, the Fifth Circuit explained why:[1274]

> Recognizing that involuntary bankruptcy is a particularly severe remedy, Congress limited the circumstances in which creditors may force a debtor into such a proceeding. Section 303 of Title 11 permits creditors to file an involuntary petition against a debtor. Ordinarily, a case under §303 may be commenced only by three or more holders of qualifying claims; however, if the alleged debtor has fewer than twelve creditors, a single claimholder may file the petition. A claimholder does not have standing to file a petition under §303(b) if its claim is the subject of a bona fide dispute as to liability or amount.

A federal bankruptcy court in Georgia noted in 2018 that:[1275]

> There are few stronger provisions of the Bankruptcy Code than to involuntarily force a company into bankruptcy. As a safeguard, the Bankruptcy Code sets forth numerosity and claim status criteria that must be met for petitioning creditors to involuntarily place an entity into bankruptcy.

[1271] *In re Andrews*, 2018 BL 113647, *2018 WL 1614149* (Bankr. D. Conn. Mar. 30, 2018).

[1272] 2018 BL 113647, *2018 WL 1614149* at *2 (citations omitted).

[1273] 124 F.3d 619 (4th Cir. 1997).

[1274] *In re Green Hills Dev. Co., LLC*, 741 F.3d 651, 655 (5th Cir. 2014) (footnotes and internal quotation marks omitted). *See* Spero, *Recent Cases Show Need for Strict Compliance With DAPT Statutes*, 44 Est. Plan. 8, 12 (May 2017).

[1275] *In re Boudreaux*, No. 16-00101, 2017 BL 480334, *2018 WL 1532669* at *2 (Bankr. S.D. Ga. Aug. 22, 2017) (citation omitted). For application of the numerosity component, see *In re Bos*, 561 B.R. 868, 877–897 (Bankr. N.D. Fla. Mar. 11, 2011).

Creditors are therefore reluctant to bring involuntary petitions for several good reasons, most of which boil down to the near certainty of significant additional costs along with, in many cases, little or no prospect of a return to justify that investment.

(2) **Challenging an Involuntary Petition** —

Various persons, including debtors, parties-in-interest, and nonpetitioning partners in a partnership may challenge involuntary petitions.[1276] A contested involuntary results in a full trial on the merits,[1277] i.e., whether the debtor satisfies the criteria for an involuntary. Hence, creditors may need to fully litigate their right to bankrupt the debtor before they can even begin the normal bankruptcy process.

[1276] *See generally* Fed. R. Bankr. P. 1011; 11 U.S.C. §303(d).

[1277] *See* 11 U.S.C. §303(h).

(3) **Bond Requirement** —

After notice and a hearing, and for cause, the court may require the petitioner to file a bond to indemnify the debtor for damages.[1278]

[1278] 11 U.S.C. §303(e).

(4) **Pre-Trial Motion Practice and Discovery** —

Involuntary petitions are subject to motions to dismiss and motions for change of venue[1279] and, because a disputed involuntary petition is a contested matter, the case could prompt detailed pre-trial discovery.[1280]

[1279] *See* Fed. R. Bankr. P. 1011(b), 1014; Fed. R. Civ. P. 12.

[1280] *See* Fed. R. Bankr. P. 9014(c) (applying to contested matters most discovery rules of Fed. R. Bankr. P. 7026–7037).

(5) **Certain Creditors Do Not Count** —

Persons who transfer or acquire claims for the purpose of commencing an involuntary bankruptcy do not count as creditors when determining whether the $16,750 threshold has been satisfied.[1281] Creditors, therefore, cannot simply buy debt to control a bankruptcy filing but usually need to work together. Such a coalition is often hard to build because of a “free rider” problem—many creditors will not chip in their fair share towards defraying the cost of an involuntary, but they are nonetheless entitled to their pro rata share of payouts from a bankruptcy estate. This invariably means some creditors will bear a disproportionate share of the cost of prosecuting an involuntary.

[1281] Fed. R. Bankr. P. 1003(a). The $16,750 threshold amount became effective April 1, 2019. 84 Fed. Reg. 3488 (Feb. 12, 2019). *See In re Bos*, 561 B.R. 868, 877–897 (Bankr. N.D. Fla. 2016); *In re Smith*, 415 B.R. 222, 231–238 (Bankr. N.D. Tex. 2009).

(6) **Certain Claims Do Not Count** —

Certain claims simply do not count toward the $16,750 tally. Specifically, claims that are contingent or subject to a bona fide dispute are excluded from the count.[1282] As one court noted:[1283]

[1282] 11 U.S.C. §303(b)(1), §303(h)(1). The $16,750 threshold amount became effective

April 1, 2019. 84 Fed. Reg. 3488 (Feb. 12, 2019).

[1283] *In re Sims*, 994 F.2d 210, 220 (5th Cir. 1993). *See also* 2 *Collier on Bankruptcy* ¶303.08[11][a] (1993) ("When the duty to pay a claim does not rest upon the occurrence of a future event, the claim is not contingent").

> A claim is contingent as to liability if the debtor's legal duty to pay does not come into existence until triggered by the occurrence of a future event and such future occurrence was within the actual or presumed contemplation of the parties at the time the original relationship of the parties was created.

Involuntary debtors can contest whether a contingency existed or materialized. As to bona fide disputes "the bankruptcy court must determine whether there is an objective basis for either a factual or a legal dispute as to the validity of the debt."[1284] In some courts, this issue is jurisdictional, meaning that a debtor may not waive the defense and may bring it at any time.[1285] These criteria also create grounds for contesting a petition.

[1284] 994 F.2d at 221 (internal quotation marks omitted). *See In re Smith*, 415 B.R. 222, 229–231 (Bankr. N.D. Tex. 2009).

[1285] *See In re Green Hills Dev. Co., LLC*, 741 F.3d 651, 660 (5th Cir. 2014) ("CULS's claim was subject to a bona fide dispute").

Claims subject to *dispute as to amount,* as well as dispute as to liability, won't count toward the $16,750 threshold.[1286] Hence, debtors who admit that they owe but dispute how much can prevent many creditors from applying their claims towards the $16,750 tally, thus enabling debtors to hold certain creditors at bay for many years.

[1286] *See* 11 U.S.C. §303(b)(1), §303(h)(1). *See In re Clean Fuel Tech. II, LLC*, 544 BR 591, *603* (Bankr. W.D. Tex. 2016) ("a bona fide dispute as to the amount of a petitioning creditor's claim makes a petitioning creditor ineligible to file an involuntary petition").

(7) **"Generally" Failing to Pay Debts as They Become Due** —

Even if the $16,750 figure is reached by the requisite number of eligible claim holders, that still isn't enough. A debtor must "generally" fail to pay his or her debts as they become due.[1287] In determining whether this criterion is satisfied, courts often look to a number of factors, e.g.: "(1) the number of unpaid claims; (2) the amount of such claims; (3) the materiality of the non-payments; and (4) the debtor's overall conduct in [its] financial affairs."[1288] Thus, even a few big claims may not suffice to allow an involuntary if those claims amount to a small or manageable percentage of the debtor's overall debt load. Granted, even just one debt may suffice to establish a "general" failure if the debt is big enough.[1289] However, periodic lapses in payments will not, by themselves, add up to a general failure.

[1287] 11 U.S.C. §303(h)(1).

[1288] *In re Moss*, 249 B.R. 411, 422 (Bankr. N.D. Tex. 2000). *See In re Smith*, 415 B.R. 222, 231 (Bankr. N.D. Tex. 2009).

[1289] *See, e.g.*, *In re Moss,* 249 B.R. 411, 422 (and cases cited therein).

(8) **Sanctions for Unsuccessful Involuntaries: Damages, Fees, Expenses** —

If an involuntary bankruptcy petition is denied or dismissed other than by agreement of all parties, the court may make the petitioning creditors pay the debtor's costs and reasonable attorney fees,[1290] even if the petition was filed in good faith.[1291] Indeed, if an involuntary bankruptcy petition is dismissed, then a rebuttable presumption arises that the court should award attorney fees and/or costs to the debtor.[1292] Finally, if the involuntary petition was filed in bad faith, the court may also award compensatory damages for injuries proximately caused by the involuntary filing as well as punitive damages.[1293]

[1290] 11 U.S.C. §303(i)(1).

[1291] *See, e.g.*, *In re Advance Press & Litho, Inc.*, 46 B.R. 700, 702 (D. Colo. 1984).

[1292] *See, e.g., In re Clean Fuel Technologies II, LLC*, 554 B.R. 591, 601, 607 (Bankr. W.D. Tex. 2016) ("the Court finds that the Petitioning Creditors have overcome the rebuttable presumption that attorneys' fees and costs should be awarded to Clean Fuel2 on its Counterclaim under §303(i)(1) of the Bankruptcy Code. Based on the particular (and somewhat peculiar) facts and circumstances in this unsuccessful involuntary bankruptcy case").

[1293] 11 U.S.C. §303(i)(2). *See In re Green Hills Dev. Co., LLC*, 741 F.3d 651, 661 (5th Cir. 2014) ("Green Hill's motion for sanctions is denied").

(9) **Credit Counseling** —

The Bankruptcy Code's credit-counseling rules may have unwittingly outlawed involuntaries in most cases. In general, an involuntary petition may be filed only against someone who "may be a debtor under the chapter under which such [involuntary] case is commenced."[1294] This means the involuntary debtor must be eligible to voluntarily seek relief under the chapter of the Bankruptcy Code that is used for involuntary purposes. However, the Bankruptcy Code generally requires voluntary debtors to attend credit counseling at some point during the 180 days preceding the filing of a bankruptcy petition.[1295] It is unclear whether the credit-counseling requirement applies to debtors who are forced into involuntary bankruptcy. However, if it does, then very few debtors who are the target of an involuntary petition are likely to satisfy this requirement.

[1294] 11 U.S.C. §303(a).

[1295] 11 U.S.C. §109(h).

Practice Tip: For all of these reasons, domestic APT settlors are not likely to be involuntarily bankrupted. Moreover, even if creditors succeed in making an involuntary filing stick, they may find bankruptcy court less conducive to challenging a domestic APT than they thought thanks to 11 U.S.C. §541(c)(2).

3. **Bankruptcy Code §541's Trust Exclusion**

a. **Introduction** —

The filing of a bankruptcy petition creates a bankruptcy estate that includes "all legal or equitable interests of the debtor in property as of the commencement of the case."[1296] However, certain assets or interests are excluded[1297] or exempted[1298] from the debtor's estate. A federal bankruptcy judge in Florida has explained:[1299]

[1296] 11 U.S.C. §541(a)(1). For a summary of the treatment of trust interests in bankruptcy, see *In re Cutter*, 398 B.R. 6 (B.A.P. 9th Cir. 2008).

[1297] *See* 11 U.S.C. §541(b), §541(c)(2).

[1298] 11 U.S.C. §522.

[1299] *In re Bos*, 561 B.R. 868, 892 (Bankr. N.D. Fla. 2016) (footnote and internal quotation marks omitted).

> Exclusion and exemption do not mean the same thing. Property that is excluded from the bankruptcy estate never comes into the estate at all, by operation of law, while exempt property is estate property at all times but is protected from the reach of creditors and administration through the estate if the debtor exercises the statutory option.

For debtors with interests in domestic APTs, the most important exclusion is 11 U.S.C. §541(c)(2), which states: "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."

A federal district court in Illinois has described this exclusion in the following manner:[1300]

[1300] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *3 (N.D. Ill. Apr. 27, 2015). *Accord In re Upshaw*, 542 B.R. 619, 627 (Bankr. N.D. Ga. 2015).

> Property of the debtor that would otherwise be transferable is not transferred to the bankruptcy estate if: (1) it 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." *See* 11 U.S.C. §541(c)(2).

This exclusion means that a debtor's equitable interest in a valid spendthrift trust is not included in his or her bankruptcy estate,[1301] and there is nothing creditors can do about it.[1302]

[1301] 2 Cowans, *Bankruptcy Law and Practice* §5.9 at 86 (1998) ("Under the Code's concept of property the inclusion definition … for practical purposes includes as an estate asset everything other than a spendthrift trust").

[1302] Note also that creditors can do nothing about a debtor's nongeneral powers of appointment, either. 11 U.S.C. §541(b)(1) states that bankruptcy estate property does not include "any power that the debtor may exercise solely for the benefit of an entity other than the debtor." This means that nongeneral powers of appointment are not includible in the bankruptcy estate. *See* H.R. Rep. No. 95-595 at 367–369 (1977) (accompanying H.R. 8200); *In re Shurley*, 171 B.R. 769, 786–87 (Bankr. W.D. Tex 1994), *rev'd on other grounds*, 115 F.3d 333, 339, 343 (5th Cir. 1997). This is consistent with common law, which holds that nongeneral powers of appointment are not attachable by a debtor's creditors. *See, e.g.*, *Cooley v. Cooley*, 628 A.2d 608 (Conn. App. Ct. 1993) (nongeneral power of appointment "is not, itself, an asset of the donee" and "may be neither assigned nor delegated" by donee). Note, however, that some divorce courts will latch on to "equitable distribution" divorce statutes to justify taking a nongeneral power of appointment from a donee spouse and giving it (or other interests in the trust that is subject to the donee's power) to the other spouse. *See, e.g.*, *Ruml v. Ruml*, 738 N.E.2d 1131 (Mass. App. Ct. 2000). Further, a debtor who holds a general power of appointment (as opposed to a nongeneral power) can use that general power to confer assets unto himself or herself, which in turn makes that power includible in a debtor's bankruptcy estate. *See, e.g.*, *In re Gilroy*, 235 B.R. 512, 517 (Bankr. D. Mass 1999) (debtor held general power of appointment, and "[u]pon the filing of her bankruptcy petition, the power of appointment became an asset of the bankruptcy estate"); *Gilroy* at 518 ("The power of appointment is itself an asset of the estate" and "is not a beneficial interest in a trust, so it cannot be subject to a restriction that, pursuant to §541(c)(2), might keep it from the estate"). *See also In re Brown*, 303 F.3d 1261, 1269 (11th Cir. 2002) (citing Bogert & Bogert, *The Law of Trusts and Trustees* §223 (rev.2d ed. 1992), for view that trust interests subject to general power of appointment are attachable by creditors); *In re Shurley*, 171 B.R. 769, 786 (Bankr. W.D. Tex 1994), *rev'd on other grounds*, 115 F.3d 333, 339, 343 (5th Cir. 1997). Under the same logic, any power of withdrawal or direction that a debtor could exercise for his or her own benefit would be includible in his or her bankruptcy estate. *See, e.g.*, *In re Marrama*, 316 B.R. 418, 423 (B.A.P. 1st Cir. 2004) (noting in connection with debtor's power to revoke self-settled trust that "the bankruptcy estate includes a power that the debtor may exercise for his or her own benefit"). This rule was further set forth in *Askanase v. Livingwell, Inc.*, 45 F.3d 103, 106 (5th Cir. 1995), which stated the general rules as follows: "The bankruptcy estate succeeds to all legal or equitable interests of the debtor in property as of the commencement of the case, including those powers that the debtor may exercise for its own benefit. Any interest which a debtor retains in a trust is property of the estate, including the power to amend the trust and the power to revoke a revocable trust and recover the remaining funds in the trust for the benefit of the creditors. Thus, what comes to the bankruptcy estate is not only the property in which debtor has an interest, but also, the powers the debtor can exercise for its own benefit over property regardless of the title debtor may be acting under" (citations and internal quotation marks omitted).

Traditionally, 11 U.S.C. §541(c)(2) was used to exclude a debtor's beneficial interest in spendthrift trusts funded by third parties,[1303] to the extent provided by applicable state law.[1304] At one time, there was great controversy about whether 11 U.S.C. §541(c)(2) excluded from the bankruptcy estate a debtor's spendthrift interest in an ERISA trust.[1305] However, in *Patterson v. Shumate*,[1306] the U.S. Supreme Court held that a debtor's interest in an ERISA-qualified plan was excludible from his bankruptcy estate and that §541(c)(2) "entitles a debtor to exclude from property of the estate any interest in a plan or trust that contains a transfer restriction enforceable under any relevant nonbankruptcy law."[1307]

[1303] *See, e.g., First Northwestern Trust Co. v. IRS*, 622 F.2d 387 (8th Cir. 1980); *Safanda v. Castellano,* No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *8 (N.D. Ill. Apr. 27, 2015); *In re Glick,* 568 B.R. 634, 669 (Bankr. N.D. Ill. 2017); *In re Upshaw,* 542 B.R. 619, 627 (Bankr. N.D. Ga. 2015); *Murphy v. Felice (In re Felice),* 494 B.R. 160, 174 (Bankr. D. Mass. 2013); *Mann v. Kreiss*, 72 B.R. 933, 942 (Bankr. E.D.N.Y. 1987). *But see Carroll v. Takada*, 864 F.3d 512, 513 (7th Cir. 2017) ("Catherine's trust interest fully vested before the Carrolls filed for bankruptcy, so that property belongs to the bankruptcy estate"); *In re Werth* , No. CO-16-022, 2017 BL 152865, *2017 WL 1832210* at *8 (B.A.P. 10th Cir. May 8, 2017) ("For the exception to apply, property must be held by a valid spendthrift trust as of the commencement of the bankruptcy case") (footnote omitted); *Thompson-Rossbach v. Doeling (In re Thompson-Rossbach)*, 541 B.R. 451, 456 (B.A.P. 8th Cir. 2015) ("Thompson-Rossbach's interest in the Trust was fully alienable by her on the petition date, and her interest in the Trust was not excluded from the bankruptcy estate under §541(c) (2)"); *Heifner v. Rosen*, *2013 WL 12110254* at *4 (N.D. Ohio June 20, 2013) ("The Provisions Regarding the Trustee clause does not specifically bar the beneficiary [in this case, Appellant-Debtor] from naming himself as Trustee. Under Ohio law, this makes the spendthrift clause invalid"); *In re Dodart*, 577 B.R. 406, 414 (Bankr. D. Utah 2017) ("the restriction on the transfer of a beneficial interest was no longer enforceable under applicable nonbankruptcy law on the Petition Date").

[1304] *See, e.g., In re Reynolds*, 867 F.3d 1119, 1120 (9th Cir. 2017) ("The estate may also reach 25 percent of expected future payments from the spendthrift trust, reduced by the amount the beneficiary needs to support himself and his dependents") (citations omitted).

[1305] *See, e.g.*, *In re Meehan*, 102 F.3d 1209, 1212 n.7 (11th Cir. 1997) (collecting cases).

[1306] 504 U.S. 753 (1992). *See* 3 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §15.4.4 at 986–88 (5th ed. 2007).

[1307] 504 U.S. at 758.

Although *Patterson* said that the clarity of 11 U.S.C. §541(c)(2) obviated the need to consider the section's legislative history,[1308] the Court declared that:[1309]

[1308] 504 U.S. at 761.

[1309] 504 U.S. at 762 (emphasis in original).

> These meager [legislative history] excerpts reflect at best congressional intent to *include* state spendthrift trust law within the meaning of "applicable nonbankruptcy law." By no means do they provide a sufficient basis for concluding, in derogation of the statute's clear language, that Congress intended to *exclude* other state and federal law from the provision's scope.

Following *Patterson*, courts have held that a debtor's interest in a profit-sharing plan,[1310] a federal thrift savings plan,[1311] a municipal employees' retirement plan,[1312] a retirement plan that did not qualify under ERISA,[1313] a §401(k) plan,[1314] a Keogh Plan,[1315] a §403(b) plan,[1316] a §457 plan,[1317] a traditional IRA,[1318] an inherited IRA,[1319] an employee stock ownership plan,[1320] and a former spouse's retirement plan[1321] were not includible in the bankruptcy estate. Significantly, *Patterson* and its progeny apply to retirement and pension funds even though ERISA plans, IRAs, and similar plans are essentially self-settled spendthrift trusts for the benefit of the settlor-debtor.[1322] It should be noted, though, that ERISA does not prevent contributions to a pension plan from being recovered as fraudulent transfers;[1323] that the federal tax lien remains attached to an interest in a pension plan excluded under §541(c)(2);[1324] and that ERISA's anti-alienation provision does not bar the United States from collecting a criminal restitution judgement from a 401(k) plan.[1325]

[1310] *In re Swecker*, No. 15-14717-MKN, 2016 BL 217459, 2016 WL 3545052 at *4 (Bankr. D. Nev. Apr. 6, 2016).

[1311] *In re O'Neal*, 462 B.R. 324, 332 (Bankr. D. Mass. 2011).

[1312] *Taunt v. Gen. Retirement Sys. (In re Wilcox)*, 233 F.3d 899 (6th Cir. 2000).

[1313] *Traina v. Sewell (In re Sewell)*, 180 F.3d 707 (5th Cir. 1999); *In re Rogers*, 538 B.R. 158 , 162 (Bankr. N.D. Ga. 2015); *In re Hemmer*, *2011 WL 124278* at *3 (Bankr. S.D. Ind. 2011). *But see In re Bauman*, 2014 WL 816407 at *10 (Bankr. N.D. Ill. 2014) (single-member plan did not qualify).

[1314] *Shearer v. Oberdick (In re Oberdick)*, 490 B.R. 687, 718 (Bankr. W.D. Pa. 2013); *In re Bell*, 476 B.R. 168, 172 (Bankr. E.D. Pa. 2012): *IRS v. Wingfield (In re Wingfield)*, 284 B.R. 787 (E.D. Va. 2002). *But see In re White*, 2019 WL 2067360 at *4 (Bankr. E.D. Pa. Mar. 8, 2019) ("The $45,965 that Debtor withdrew from her 401(k) account [for hardship] pre-petition is property of the estate").

[1315] *In re Moses v. S. Calif. Permanente Med. Group*, 167 F.3d 470 (9th Cir. 1999).

[1316] *Skiba v. Laher (In re Laher)*, 496 F.3d 279 (3d Cir. 2007); *Rhiel v. OhioHealth Corp.* (*In re Hunter)*, 380 B.R. 753, 757 (Bankr. D. Ohio 2008); *In re Barnes*, 264 B.R. 415 (Bankr. E.D. Mich. 2001).

[1317] *In re Mueller*, 256 B.R. 445 (Bankr. D. Md. 2000).

[1318] *Orr v. Yuhas (In re Yuhas)*, 104 F.3d 612 (3d Cir. 1997); *Meehan v. Wallace* (*In re Meehan),* 102 F.3d 1209 (11th Cir. 1997); *In re McFarland*, 481 B.R. 242, 254–55 (Bankr. S.D. Ga. 2012). *But see In re Davis*, 108 Fed. App'x 717, 722 (3d Cir. 2004) ("the Bankruptcy and District Courts erred in holding that Davis's IRA was subject to exclusion under 11 U.S.C. §541(c)(2) without a thorough analysis of the applicable legal principles and the relevant facts").

[1319] *In re Norris*, 550 B.R. 271, 278 (Bankr. D.N.J. 2016); *In re Andolino*, 525 B.R. 588, 594 (Bankr. D.N.J. 2015). *But see In re Todd*, *2018 WL 1470526* at *6 (Bankr. N.D.N.Y. Mar. 23, 2018).

[1320] *In re Rose*, 563 B.R. 606, 614 (Bankr. E.D.N.C. 2016).

[1321] *Ostrander v. Lalchandani (In re Lalchandani)*, 279 B.R. 880, 886 (B.A.P. 1st Cir. 2002); *In re Chilson*, 2016 WL 1079149 at *6 (W.D.N.C. Mar. 18, 2016); *Walsh v. Dively*, 551 B.R. 570, 576 (W.D. Pa. 2016); *In re Warner*, 570 B.R. 582, *594*–96 (Bankr. N.D. Ohio 2017); *In re Lawson*, 570 B.R. 563, *581* (Bankr. N.D. Ohio 2017); *Dyckman v. Dyckman (In re Dyckman)*, *2012 WL 1302613* at *6 (Bankr. M.D. Pa. 2012); *In re Carter-Bland*, 382 B.R. 743 (Bankr. S.D. Ohio 2008); *Shodeen v. Woolley (In re Woolley)*, *2001 WL 36254575* at *7 (Bankr. S.D. Iowa 2001). *But see In re Woodyear*, 162 F.3d 1160 (5th Cir. 1998) (debtor's interest in former husband's qualified savings plan not excluded because has unrestricted right to withdraw); *Urmann v. Walsh*, 523 B.R. 472, *478* (W.D. Pa. 2014) (debtor's interest in estranged husband's 401(k) plan not excluded); *Walsh v. Burgeson (In re Burgeson)*, 504 B.R. 800, 805 (Bankr. W.D. Pa. 2014) (QDRO obtained after filing of bankruptcy petition).

[1322] *Taunt v. Gen. Retirement Sys. (In re Wilcox)*, 233 F.3d 899 (6th Cir. 2000).

[1323] *Wagner v. Galbreth*, 500 B.R. 42, 50 (D.N.M. 2013).

[1324] *Gross v. Commissioner*, 556 Fed. App'x 631, 632 (9th Cir. 2014).

[1325] *United States v. Young*, 325 F. Supp. 3d 830, 832 (W.D. Mich. 2018).

States vary on whether distributions made from a trust that is excluded from the bankruptcy estate under §541(c)(2) prior to the filing of the bankruptcy petition also are excluded.**[1326]** Debtors should also be aware that they may waive the exclusion**[1327]** and that it can be barred by res judicata.**[1328]**

[1326] *See In re Rogove*, 443 B.R. 182, 186 n.2 (Bankr. S.D. Fla. 2010).

[1327] *See, e.g., In re Amerson*, 839 F.3d 1290, 1300 (10th Cir. 2016) (“The exception outlined in §541(c)(2) is permissive rather than mandatory, and thus it is a debtor's choice whether or not to include such an interest in his or her bankruptcy estate”). *Accord In re Sann*, 2017 WL 4678196 at *4 (D. Mont. Oct. 17, 2017) (“§541(c)(2) is permissive, not mandatory”); *In re Tawil*, *2017 WL 3309693* at *3 (Bankr. D.N.J. Aug. 1, 2017) (same); *In re Bauman*, 2014 WL 816407 at *9 (Bankr. N.D. Ill. Mar. 4, 2014) (debtor waived the argument).

[1328] *In re McFarland*, 557 B.R. 256, 260 (S.D. Ga. 2016) (“The Court, therefore, Affirms the Bankruptcy Court on res judicata grounds”).

b. **Bankruptcy Code §541(c)(2) and Applicable Nonbankruptcy Law: A Three-Pronged Test and Two Key Questions** —

The test for determining whether 11 U.S.C. §541(c)(2) applies normally has three parts:**[1329]**

[1329] *In re Foster*, 556 B.R. 233, 237 (Bankr. E.D. Va. 2016) (citation and internal quotation marks omitted). *See, e.g., In re Sann,* 2017 WL 4678196 at *4 (D. Mont. Oct. 17, 2017) (Stipulated Preliminary Injunction “does not create a valid trust under state or federal law”); *In re McFarland*, 527 B.R. 256, 262 (S.D. Ga. 2016) (annuity not excluded because not trust); *In re Mohr*, 2016 WL 2869787 at *4 (S.D. Ga. May 16, 2016) (cash surrender value of life-insurance policy not excluded because not trust); *Carroll v. Berland*, *2014 WL 5461489* at *5 (N.D. Ill. Oct. 28, 2014) (distributable property not excluded because not covered by spendthrift clause); *In re Foster*, 556 B.R. 233, 238–39 (Bankr. E.D. Va. 2016) (deferred-compensation plan not excluded because not trust; nonassignability provision unenforceable); *Marchand v. Whittick (In re Whittick)*, 547 B.R. 628, *638* (Bankr. D.N.J. 2016) (proceeds of loan from pension plan not excluded); *Kohut v. Lewiston Living Tr. (In re Lewiston)*, 532 B.R. 36, 47–48 (Bankr. E.D. Mich. 2015) (interest in self-settled Michigan spendthrift trust not excluded because spendthrift clause unenforceable); *In re Gnadt*, 2015 WL 2194475 at *6, 8 (Bankr. E.D. Va. May 7, 2015) (interest in nonqualified deferred-compensation plan not excluded because not trust and anti-alienation provision unenforceable).

> First, the debtor must have a beneficial interest in a trust. Second, there must be a restriction on alienation of the debtor's beneficial interest. Third, the restriction on alienation must be enforceable under applicable non-bankruptcy law. This test is not stated in the alternative, and in order to satisfy it and successfully exclude property from the bankruptcy estate under §541(c)(2), a debtor must satisfy each of the three elements.

The settlor's interest in a domestic APT will meet the first two requirements because the settlor will have a beneficial interest in the trust and because, to qualify under a domestic APT statute, the trust must contain a spendthrift clause. Consequently, the focus of the inquiry will be the third prong of the test, which requires the spendthrift provision to be enforceable under applicable nonbankruptcy law. In the case of a domestic APT, the applicable law will be state law because bankruptcy courts look to state law to determine a debtor's—and, hence, the bankruptcy estate's—interest in property unless federal law requires otherwise.[1330] This, in turn, raises two related questions. First, which state's law applies? Second, what does applicable law provide?

[1330] 2 Cowans, *Bankruptcy Law and Practice* §9.2(a) at 339–40 (1998) ("property interests are created and defined by state law unless some federal interest requires a different result") (internal quotation marks omitted). *Accord In re McNeilly*, 249 B.R. 576, 580 (B.A.P. 1st Cir. 2000). *See also In re Schwen*, 240 B.R. 754, 757 (Bankr. D. Minn. 1999) ("The court must generally look to state law in determining whether property is excludible under §541(c)(2)").

In the case of domestic APTs, the answer to the second question is rather straightforward—a debtor's interest in a self-settled spendthrift trust is off-limits to the settlor's own creditors, subject to exceptions for a handful of preferred creditors and except to the extent funds were fraudulently transferred into trust.[1331] The real issue, then, is determining which state's law to apply.

[1331] *See, e.g.,* Del. Code Ann. tit. 12, §3572, §3573.

c. **Bankruptcy Code §541(c)(2) and Applicable Nonbankruptcy Law: Does the Law of the Debtor's Domicile Apply?** —

There is no uniform test for determining whether the law of a debtor's domicile or the law that governs a trust from which the debtor benefits is applicable under 11 U.S.C. §541(c)(2). The two most notable approaches for determining which state's law is applicable under §541(c)(2) are the *Klaxon* rule and the *Spindle* rule.

The *Klaxon* rule is based on *Klaxon v. Stentor Electric Manufacturing Company* (1941),[1332] which requires federal courts in diversity cases to apply the choice-of-laws rules of the forum state. *Klaxon* is an aspect of *Erie Railroad Company v. Tompkins* (1938)[1333] and, thus, strictly speaking, applies only to cases based on diversity jurisdiction under 28 U.S.C. §1332,[1334] whereas bankruptcy jurisdiction is based on 28 U.S.C.§1334. However, because "the operation of a double system of conflicting laws in the same State is plainly hostile to the reign of law,"[1335] it is second nature for federal courts to rely on *Klaxon.* This approach is bolstered by the Rules of Decision Act,[1336] which essentially requires federal courts to apply state law except when federal law or treaties require otherwise. Accordingly, when determining which state's law applies to a spendthrift trust, bankruptcy courts sometimes follow the forum's choice-of-laws rules.[1337] So far, though, courts have used the *Klaxon* rule only to disregard the designation of foreign law to govern a trust and, apparently, have never applied the rule to ignore the designation of a sister state's law to determine whether a debtor's interest in a domestic trust that holds personal property was excludible under Bankruptcy Code §541(c)(2). If a domestic APT holds real property in a non-DAPT state, however, the courts in the non-DAPT state are free to apply their law.[1338]

[1332] 313 U.S. 487 (1941).

[1333] 304 U.S. 64 (1938) ("The bankruptcy court applies the law of the state where the court sits, including the choice of law provisions") *Accord In re Irons*, 572 B.R. 877, 887 (Bankr. N.D. Ohio 2017); *Roeder v. Priscilla Avers Family Tr. (In re Avers)*, *2015 Bankr. Lexis 1623* at *11 (Bankr. W.D. Pa. May 13, 2015).

[1334] *See Klaxon*, 313 U.S. at 496–97 (discussing *Erie Railroad*).

[1335] *Guaranty Trust Co. v. York*, 326 U.S. 99, 112 (1945).

[1336] 28 U.S.C. §1652 ("The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply").

[1337] *See, e.g., In re Vess*, *2018 WL 722408* at *1 n.1 (Bankr. N.D. Ohio Feb. 5, 2018) ("the bankruptcy court applies the law of the state where the court sits, including the choice of law provisions"); *In re Dorsey*, 497 B.R. 374, 384 (Bankr. N.D. Ga. 2013); *In re Irons*, 572 B.R. 877, 887 (Bankr. N.D. Ohio 2017); *Roeder v. Priscilla Avers Family Tr. (In re Avers)*, *2015 Bankr. Lexis 1623* at *11 (Bankr. W.D. Pa. May 13, 2015).

[1338] *See Restatement (Second) of Conflict of Laws* §280. *See also In re Arney*, 35 B.R. 668, 670 (Bankr. N.D. Ill. 1983) (under Illinois law, Illinois courts look to Iowa law on whether future interest in Iowa trust holding Iowa real property is excludible under 11 U.S.C. §541(c)(2)).

Under the *Spindle* rule, many bankruptcy courts rely on the 1884 U.S. Supreme Court case of *Spindle v. Shreve* [1339] and simply declare that the law governing a trust is the law of the state in which the trust was created and/or is administered even if that law is not the law of the forum.[1340] At least one *Spindle* case also gave weight to the choice of law expressly stated in a trust agreement,[1341] which is consistent with the approach of other authorities cited above.[1342] However, *Spindle* and its rule predate *Erie Railroad* by more than half a century, are unmoored from any state conflict-of-laws doctrine, and arguably ignore the Rules of Decision Act because *Spindle* and its rule fail to heed state conflicts doctrine. The *Spindle* rule is, therefore, open to criticism as an unwelcome throwback to *Swift v. Tyson* (1842)[1343] and its discredited notions of overarching federal common law.[1344] On the other hand, the *Spindle* rule is defensible on the grounds that:

[1339] 111 U.S. 542 (1884).

[1340] A number of cases expressly cite *Spindle* (*see, e.g.*, *Horton v. Moore*, 110 F.2d 189, 191 (6th Cir. 1940) ("whether a particular future estate arising out of a trust is property which will pass to the trustee as an asset of the bankrupt depends upon the law of the state where the trust was created, and is being administered and in which the res is situated"); *In re Hunger*, 272 B.R. 792, 795 (Bankr. M.D. Fla. 2002) ("It is well established that the legal character of a trust under consideration must be determined with reference to the state where the trust was created"); *In re Hunter*, 261 B. R. 789, 791 (Bankr. M.D. Fla. 2001) ("The Trust was established and administered in the State of Missouri," and therefore "whether or not the Trust is qualified as a Spendthrift Trust must be determined with reference to the applicable law of the State of Missouri"); *In re Gower*, 184 B.R. 163, 165 (Bankr. M.D. Fla. 1995) ("Because the Frank H. Gower Trust was created and is administered in Colorado, this court must look to Colorado nonbankruptcy law to determine what protection is provided under section 541(c)(2) of the Code"); *McCauley v. Hersloff*, 147

B.R. 262, 264 (Bankr. M.D. Fla. 1992) (similar); *In re Graham*, *1989 WL 90534* at *2 (Bankr. D. Vt. May 25, 1989) ("The validity of a trust is governed in cases of personalty by the applicable non-bankruptcy law where the trust was created or is to be administered according to circumstances"); *In re Anselmi*, 52 B.R. 479, 490 (Bankr. D. Wyo. 1985) ("Where the subject property is a beneficial interest in a trust, the applicable law for determining exemption from process is the situs of the administration of the trust")). Other cases don't cite *Spindle* but nevertheless apply its rule (*see, e.g.*, *In re Amerson*, 839 F.3d 1290, 1299 (10th Cir. 2016) ("this is a spendthrift provision that is recognized as valid under Florida state law"); *Levin v. Wachovia Bank*, 436 Fed. App'x 175, 182 (4th Cir. 2011) (court in North Carolina bankruptcy proceeding held that "in this case, that means we apply Pennsylvania law"); *Matter of Newman*, 903 F.2d 1150, 1152 n.2 (7th Cir. 1990) ("The spendthrift trusts are enforceable under Missouri law," the "applicable nonbankruptcy law'"); *In re Kiesewetter*, *2011 WL 4527365* at *2 n.6 (W.D. Pa. Sept. 28, 2011) ("The parties have agreed that the applicable nonbankruptcy law is Florida law based on the settlor's citizenship and the place where the trust was established, recorded and administered"); *In re Trawick*, 497 B.R. 572, 577–78 (Bankr. C.D. Cal. 2013) ("As expressly provided in the Trust Instrument, the Trust is governed by North Carolina law"); *In re Hoopes*, *2010 WL 3724788* at *1 (Bankr. M.D. Ga. Sept. 17, 2010) ("The parties here agree Connecticut law governs the trust instrument"); *In re McDonald*, 430 B.R. 5, 11 n.9 (Bankr. D. Me. 2010) ("See S.C. Code Ann. §62-7-502 (2005) (establishing the requirements for a valid spendthrift trust under South Carolina law, which is applicable to the Trust at issue in this case"); *In re Allan*, 449 B.R. 628, 633 (Bankr. S.D. Ga. 2009), *aff'd*, 423 Fed. App'x 966 (11th Cir. 2011) ("The parties … agree Florida is the applicable non-bankruptcy law")).

[1341] *See In re Sanders*, 89 B.R. 266, 269 (Bankr. S.D. Ga. 1988) (citing *Spindle* and also stating "Where a trust specifically designates the state of controlling law and where such state is also the state where the trusts were created and are administered, such state law should be applied").

[1342] *See, e.g.*, IX.G., above (discussing impact of trustor's designation of governing law).

[1343] 41 U.S. 1 (1842) *overruled by Erie R.R. Co. v. Tompkins*, 304 U.S. 64 (1938).

[1344] *Erie Railroad*, 304 U.S. 64, discussing and overruling *Swift*.

- it merely establishes a federal standard to determine a federal question (i.e., what nonbankruptcy law is "applicable");

- it offers the advantage of relative simplicity;

- as shown by the citations in footnotes earlier in this paragraph, the rule is popular with many courts. A bankruptcy judge did use the *Spindle* rule rather than the *Klaxon* rule to determine whether a Wyoming debtor's interest in a foreign—Mexican—trust was excludible from his bankruptcy estate,[1345] and courts consistently have applied the *Spindle* rule to determine whether trust distributions received by a debtor after the filing of a bankruptcy petition were includible in the bankruptcy estate under Bankruptcy Code §541(a)(5)(A).[1346]

[1345] *In re Anselmi*, 52 B.R. 479, 490 (Bankr. D. Wyo. 1985).

[1346] *See, e.g., In re Newman*, 903 F.2d 1150, 1153 (7th Cir. 1990); *In re Hunter*, 261 B.R. 789, 791 (Bankr. M.D. Fla. 2001).

In 2017, a federal bankruptcy judge in Illinois noted the tension between the *Klaxon* rule and the *Spindle* rule:[1347]

[1347] *In re Glick*, 568 B.R. 634, 660 n.22 (Bankr. N.D. Ill. 2017) (citation and internal quotation marks omitted).

> The difficulty arises because a district court exercising diversity jurisdiction generally applies the choice-of-law rules of the state in which it sits but a bankruptcy court's jurisdiction does not arise from diversity, but from federal bankruptcy law. At the same time, state law typically governs property rights in bankruptcy cases. Thus, there is a tension as to whether bankruptcy courts follow federal common law choice-of-law principles or the forum state's choice-of-law principles.

In some cases, bankruptcy courts use another federal conflict-of-laws rule in lieu of state conflicts rules. However, this approach, which entails an "interest analysis,"[1348] is typically reserved for hard-core bankruptcy issues (e.g., questions relating to the federal law of adversary proceedings under 11 U.S.C. §523 or 11 U.S.C. §727),[1349] and any involvement of state-created property interests is purely coincidental. This federal conflicts approach is, therefore, inappropriate for determining which of several states' laws applies, for no federal interest is implicated in such cases.

[1348] *In re Portnoy*, 201 B.R. 685, 697 (Bankr. S.D.N.Y. 1996) ("federal common law choice of law rule is to apply the law of the jurisdiction having the greatest interest in the litigation").

[1349] 201 B.R. 685, 697 ("federal principles should guide consideration of which jurisdiction's substantive law applies in cases arising out of federal law"). *See also* 201 B.R. at 696 ("property interests are created and defined by state law").

Accordingly, the correct conflicts rule seems to be either the *Klaxon* rule or the *Spindle* rule. Whichever approach is selected, debtors who claim the benefit of §541(c)(2) bear the burden of showing that the rule applies,[1350] which means that settlors and trustees of domestic APTs must convince the court that domestic APT state law applies. This, though, is a burden that should be carried. In *Klaxon* cases, a debtor will often revisit the same factors and issues considered in IX.G., above, in connection with "Obstacle 6: Non-DAPT Court Should Apply Domestic APT State Law." For the same reasons outlined above, the domestic APT state's law should apply. The controlling nature of domestic APT state law is even clearer under the *Spindle* rule. All that must be shown is that the trust was created in and is administered in the domestic APT state and perhaps that there is an express choice of domestic APT state law in the trust instrument. These facts can be evidenced in virtually every case involving a domestic APT. Hence, whether the *Klaxon* rule or the *Spindle* rule is used, domestic APT state law should apply.

[1350] *See, e.g., In re Adams*, 302 B.R. 535, 540 (B.A.P. 6th Cir. 2003).

Creditors, of course, will argue that the "applicable nonbankruptcy law" for Bankruptcy Code §541(c)(2) purposes is the law of a jurisdiction that does not recognize self-settled spendthrift trusts, such as the law of the forum, which is almost always the same as a bankrupt debtor's domicile. The Scott treatise indicates that the creditor would be unsuccessful:[1351]

[1351] 7 Scott, Fratcher & Ascher, *Scott and Ascher on Trusts* §45.7.1.3 at 3355–56 (5th ed. 2010).

> We have already considered the question of what law applies in determining whether a beneficiary can transfer a beneficial interest, or whether a beneficiary's creditors can reach such a beneficial interest. We have seen that the law of the place of administration ordinarily determines whether a beneficial interest is assignable by the beneficiary or reachable by the beneficiary's creditors, and this is clearly so when the place of administration is also the settlor's domicil. It would seem, therefore, that the place of administration should also ordinarily determine whether a beneficiary's trustee in bankruptcy can reach the beneficial interest.

The author is not aware of any case in which a bankruptcy judge has considered whether Bankruptcy Code §541(c)(2) applies to a domestic APT. Nevertheless, courts that refused to extend §541(c)(2) to other self-settled spendthrift trusts did so because applicable state law held that these devices were ineffective against the settlor's own creditors.[1352] This, of course, returns to the question of which state's law would be applicable. More significantly, bankruptcy judges have plainly suggested during seminars that domestic APT laws will deserve recognition in various circumstances.

During a nationally televised program conducted on November 5, 2002, Chief Judge Mahoney of the U.S. Bankruptcy Court for the Southern District of Alabama opined that U.S. courts will honor the domestic APT statutes:[1353]

> The full faith and credit issue is going to be a really tough one for courts, and it is really hard to say we're not going to recognize a Delaware trust, we're not going to recognize another state's valid law even though it is offensive to our law. I can think of situations like that right now in different arenas where something that's a hotly contested or emotional issue in one state is dealt with differently in another state but we still recognize it and so I see some really interesting cases coming up.

Chief Judge Hyman of the U.S. Bankruptcy Court for the Southern District of Florida expressed a similar view during a panel discussion at the 2004 Joint Fall CLE Meeting of the Real Property, Probate and Trust Law Section and the Section of Taxation of the American Bar Association on October 1, 2004:[1354]

> Other than [section] 707, 727, or 548, the bankruptcy court looks to state law and is bound by state law. Before this legislation, we were asked to look at other types of trusts where the debtor was the settlor and beneficiary of a trust. We didn't look to federal law to determine whether the creditors could reach the assets. We looked to state law and the state where the trust is domiciled generally. So, this would be no different.

Regarding whether the Supremacy Clause would change the result, he stated: “Frankly, I do not understand that argument because … if there was a valid spendthrift clause and state law said creditors could not get to the assets, then the courts had to follow that state law.”[1355]

Lastly, several of the domestic APT statutes expressly provide that the spendthrift clause in an APT is to be considered a restriction described in Bankruptcy Code §541(c)(2).[1356] Although this statement of legislative intent may not prevent a bankruptcy court from undertaking a *Klaxon* or *Spindle* conflict-of-laws analysis, this provision will nonetheless be a significant factor to consider whenever a court assesses the relative importance that competing jurisdictions place on their respective policy interests. The states in question have made it plain that they intend their APTs to survive bankruptcy and, therefore, bankruptcy courts (and nonbankruptcy courts as well) must

[1352] *See, e.g., In re Brown*, 303 F.3d 1261, 1265–1270 (11th Cir. 2002); *In re Shurley*, 115 F.3d 333, 337–42 (5th Cir. 1997); *In re Mack*, 269 B.R. 392 (Bankr. D. Minn. 2001); *In re Landry*, 226 B.R. 507, 512 (Bankr. D. Mass. 1998).

[1353] Honorable Margaret A. Mahoney, Remarks at ALI-ABA, *Asset Protection Planning*, American Law Network (Nov. 5, 2002).

[1354] Honorable Paul G. Hyman, Jr., Remarks during panel discussion on Tax and Asset-Protection Issues Involved in Bankruptcy at the 2004 Joint Fall CLE Meeting of the Real Property, Probate and Trust Law Section and the Section of Taxation of the American Bar Association (Oct. 1, 2004).

[1355] Honorable Paul G. Hyman, Jr., Remarks (Oct. 1, 2004).

tread warily lest they show unconstitutional disregard for these interests.

[1356] *See, e.g.,* Alaska Stat. §34.40.110(a); Del. Code Ann. tit. 12, §3570(11)(c); S.D. Codified Laws Ann. §55-16-2(3).

d. **Implications for Foreign APTs** —

Under *Patterson v. Shumate* [1357] and subsequent cases, Bankruptcy Code §541(c)(2) excludes a trust interest from the debtor's bankruptcy estate if the interest is subject to a transfer restriction that is enforceable "under any relevant nonbankruptcy law."[1358] The word "any" obviously encompasses foreign law, and the Bankruptcy Rules plainly contemplate that a bankruptcy court will consider and apply foreign law when appropriate.[1359] However, apart from the possible implied or inferential holding of *In re Colburn*,[1360] research in this area has not revealed any Bankruptcy Code §541(c)(2) case in which a bankruptcy court has actually applied the choice of law specified in a foreign APT. This may happen at some time in the future, particularly if the court is not offended by the relevant transaction, but Bankruptcy Code §541(c)(2) has not helped debtors who tried to exclude foreign APTs from their bankruptcy estates.[1361]

[1357] 504 U.S. 753 (1992).

[1358] 504 U.S. at 758.

[1359] *See* Fed. R. Civ. P. 44.1 (incorporated by reference into Fed. R. Bankr. P. 9017).

[1360] 145 B.R. 851, 859–60 (Bankr. E.D. Va. 1992) (court denied discharge to trustor of Bermuda trust on grounds that debtor concealed assets, failed to preserve relevant financial records, and made false oath by submitting sworn bankruptcy schedules that were replete with omissions; in so holding, court refused to include trust fund (as opposed to reversionary interest) as property of estate because creditor did not show defect in transfer and failed to show that debtor had any trust interest other than his reversionary interest).

[1361] *See, e.g.*, *In re Rensin*, 600 B.R. 870, 885 (S.D. Fla. May 6, 2019); *In re Smith*, 415 B.R. 222, 234–35 (Bankr. N.D. Tex. 2009); *In re Lawrence*, 227 B.R. 907, 917 (Bankr. S.D. Fla. 1998); *In re Brooks*, 217 B.R. 98, 104 (Bankr. D. Conn. 1998); *In re Portnoy*, 201 B.R. 685, 701 (Bankr. S.D.N.Y. 1996).

4. **BAPCPA and Bankruptcy Code §548(e)'s 10-Year Look-Back Rule**

a. **Bankruptcy Code §548(a)(1)** —

As with the UFTA,[1362] the creation of an APT may be set aside for actual fraud[1363] or constructive fraud[1364] under the Bankruptcy Code. Hence, §548(a)(1) of the Bankruptcy Code provides in pertinent part:[1365]

[1362] *See* VIII.A., above.

[1363] *See, e.g., Matter of Wiggains*, 848 F.3d 655, 663 (5th Cir. 2017) ("by placing a portion of the homestead beyond the reach of his creditors on the eve of bankruptcy, he was seeking to hinder or delay"); *United States v. Wilhite*, 2016 WL 5720707 at *13 (D. Colo. June 23, 2016) ("the circumstances surrounding Mrs. Wilhite's creation of AFC, solely in her name, were sufficiently indicative of Mr. Wilhite's intent to defraud his past and future creditors"); *In re Johnson*, 579 B.R. 796, 802 (Bankr. W.D. Ky. 2017) ("The Trustee is entitled to judgment in his favor on Count II of the Complaint [actual fraud]"); *In re Dearmond, 2017 WL 4220396* at *1 (Bankr. E.D. Tenn. Sept. 21, 2017) ("the debtor made the three transfers with actual fraudulent intent"); *In re Maglione*, 559 B.R. 489, 496 (Bankr. N.D. Ohio 2016) ("the Debtor's transfer of $30,000 in cash to the Defendant, Debtor's mother, on the eve of the Debtor's divorce, and less than two years prior to the petition date, was made with the actual intent to hinder, delay, and defraud his now ex-wife, and also to hinder, delay, and defraud other creditors who have appeared in this case and whose debts date back to the time of that Transfer"); *In re Wolf*, 2016 WL 4940198 at *28 (Bankr. W.D. Tex. Sept. 15, 2016) ("Abie transferred the Subject Properties with actual intent to delay, hinder, or defraud creditors within the scope of §548(a)(1)(A) of the Bankruptcy Code"). *But see, e.g., In re Michel*, 573 B.R. 46, 68–69 (Bankr. E.D.N.Y. 2017) ("the School has shown that the Trustee does not state a plausible claim to recover the Transfers as fraudulent transfers under Bankruptcy Code Section 548(a)(1)(A)"); *In re Pollack*, *2016 WL 270012* at *6 (Bankr. D.N.H. Jan. 20, 2016) ("The Trustee has failed to establish that the Debtor's transfer of $60,741.84 was fraudulent under the Bankruptcy Code").

[1364] *See, e.g., In re Wierzbicki*, 830 F.3d 683, 686 (7th Cir. 2017) ("Wierzbicki gave up a $300,000 farm in which she had a $151,000 equity in exchange for very little value"); *Ronald A. Chorches*, *Trustee*, 2018 WL 3421318 at *3 (D. Conn. July 13, 2017) ("discharging a moral obligation or meeting a societal expectation is not "value" within the meaning of the statute"); *In re Sterman*, 594 B.R. 229, 239 (Bankr. S.D.N.Y. 2018) ("transfers to or for the benefit of Alexandra and Samantha after they reached the age of 21 for college tuition and related expenses are avoidable as constructive fraudulent transfers if the Debtors were insolvent at the times the transfers were made"); *In re Scarbrough*, *2018 WL 3218849* at *5 (Bankr. M.D. Tenn. June 29, 2018) ("The Transfers are avoided pursuant to 11 U.S.C. §548(a)(1)(B)"); *In re Orton*, 2018 WL 1577927 at *4 (Bankr. M.D. Fla. Mar. 28, 2018) ("the transfer of the Debtors' pro rata share of the insurance proceeds, equaling $2,860.03, is avoidable as constructively fraudulent"); *In re Johnson*, 579 B.R. 796, 802 (Bankr. W.D. Ky. 2017) ("the Trustee is also entitled to Judgment against Defendant for constructive fraud under 11 U.S.C. §548(a)(1)(B)"); *Matter of Dunston*, 566 B.R. 624, 637 (Bankr. S.D. Ga. 2017) ("By paying for her daughter's tuition, the Debtor did not discharge or satisfy any legal duty or obligation to do so, nor did she increase her assets in any way that could be used to pay her creditors"); *In re Fisher*, 575 B.R. 640, 648 (Bankr. M.D. Pa. 2017) ("the Trustee has pled a plausible cause of action to avoid some or all of the Tuition Payments as constructively fraudulent transfers"); *In re Wolf*, 2016 WL 4940198 at *30 (Bankr. W.D. Tex. Sept. 15, 2016) ("Transfers of these eight subject properties by Abie to Rema are also avoidable by the Trustee as constructive fraudulent transfers under §548(a)(1)(B) of the Bankruptcy Code"). *But see, e.g., In re Blixseth*, 679 Fed. App'x 611, 612 (9th Cir. 2017) ("Blixseth was solvent under all the relevant tests"); *In re Demauro*, *2018 WL 3064231* at *7 (Bankr. D. Conn. June 19, 2018) ("the Federal Direct PLUS Loan proceeds do not constitute an interest of the debtor in property subject to avoidance pursuant to §§544 and 548"); *In re Sterman*, 594 B.R. 229, 239 (Bankr. S.D.N.Y. 2018) ("transfers to or for the benefit of Samantha while she was a minor for college tuition and related expenses were supported by reasonably equivalent value and, therefore, are not avoidable"); *In re Demitrus*, 2018 WL 1121589 at *5 (Bankr. D. Conn. Feb. 27, 2018) ("Ultimately, the Trustee has failed to allege, and, given the federal statutory and regulatory scheme regulating DOE loans, is without the ability to demonstrate the requisite interest to support his avoidance claims under applicable non-bankruptcy law"); *In re Ladipo*, *2018 WL 1121590* at *1 (Bankr. D. Conn. Feb. 27, 2018) ("the transfer of the proceeds of Parent PLUS loan payments to Ithaca College do not constitute a transfer of property of the Debtor's estate, as defined in 11 U.S.C. §§548(a)(1)(B)"); *In re Libra*, 584 B.R. 550, 567 (Bankr. E.D. Mich. 2018) ("this transfer may not be avoided under §548"); *In re Lewis*, 574 B.R. 536, 538 (Bankr. E.D. Pa. 2017) ("I agree with Penn State that (1) neither Mr. Lewis nor his estate hold or ever held an interest in the proceeds of the Parent Plus loans and (2) Mr. Lewis received reasonably equivalent value in exchange for the transfers"); *In re Knight*, 2017 WL 4410455 at *2 (Bankr. D. Conn. Sept. 29, 2017 ("The court finds that the Debtor did not receive any legally cognizable value under these statutes in exchange for the Transfers and therefore could not have received reasonably equivalent value"); (*In re Michel*, 573 B.R. 46, 62 (Bankr. E.D.N.Y. 2017) ("the School has shown that the Trustee does not state a plausible claim to recover the Two-Year Transfers as constructive fraudulent transfers under Bankruptcy Code Section 548(a)(1)(B) "); *In re Gomez*, 560 B.R. 866, 874 (Bankr. S.D. Fla. 2016) ("The fact that the Debtor received reasonably equivalent value as a result of the Stock Payment transfer protects the transfer from being avoided as fraudulent"); *In re Pollack*, *2016 WL 270012* at *6 (Bankr. D.N.H. Jan. 20, 2016) ("The Trustee has failed to establish that the Debtor's transfer of $60, 741.84 was fraudulent under … the Bankruptcy Code …"); *In re Demauro*, *2018 WL 3064231* at *7 (Bankr. D. Conn. June 19, 2018) ("the Federal Direct PLUS Loan proceeds do not constitute an interest of the debtor in property subject to avoidance pursuant to §548 "). Effective October 1, 2017, college tuition payments no longer are recoverable under the Connecticut UFTA (Conn. Gen. Stat. §52-552i(f)).

[1365] 11 U.S.C. §548(a)(1). For pleading requirements for actual fraud, see *In re Anderson*, 2018 WL 3197746 at *5 (Bankr. D. Conn. June 26, 2018). For pleading requirements for constructive fraud, see *Ronald I. Chorches, Trustee*, 2018 WL 3421318 at *2 (D. Conn. July 13, 2018); *In re Anderson*, 2018 WL 3197746 at *5 (Bankr. D. Conn. June 26, 2018).

> (a)(1) The trustee may avoid any transfer…of an interest of the debtor in property…that was made…on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
>
> (A) 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; or
>
> (B)(i) received less than a reasonably equivalent value in exchange for such transfer…and
>
> (ii)(I) was insolvent on the date that such transfer was made…or became insolvent as a result of such transfer…
>
> (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;
>
> (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or
>
> (IV) made such transfer to or for the benefit of an insider…under an employment contract and not in the ordinary course of business.

A federal bankruptcy court in Colorado summarized §548(a)(1)'s history as follows:[1366]

[1366] *In re Kirst*, 559 B.R. 757, *759* (Bankr. D. Colo. 2016) (footnotes omitted).

> Fraudulent transfer law began as criminal and therefore intentional fraud law. However, since courts struggled reaching conclusions of the subjective intent of the transferor, the fraudulent transfer law was objectified. The courts began using badges of fraud beginning with *Twyne's* case in order to determine subjective fraudulent intent by reference to objective facts, and the law of fraudulent dispositions was extended to constructively fraudulent transfers.
>
> The Bankruptcy Code codifies the law of subjective and objective fraudulent transfers in 11 U.S.C. §§548(a)(1)(A) and (a)(1)(B). The subjective standard is whether there was actual intent to hinder, delay or

> defraud a creditor and the objective standard is whether the debtor-transferor received a reasonably equivalent value in exchange for such transfer and whether the debtor-transferor was insolvent or rendered insolvent by the transfer.

The test for actual fraud under §548(a)(1)(A) is:[1367]

> In order for the Trustee to succeed on a claim under 11 U.S.C. §548(A)(1)(A), he had to prove: (1) a transfer of an interest of the Debtor's property or the incurring of an obligation; (2) made on or within two years of the petition date; and (3) with actual fraudulent intent. The Trustee must prove actual intent to defraud by a preponderance of the evidence.

The test for constructive fraud under §548(a)(1)(B) is:[1368]

> The Supreme Court has ruled that in order to prevail on a claim of a constructive fraudulent transfer, the plaintiff must prove four elements: (1) the debtor had an interest in the property; (2) a transfer of that interest occurred within two years of the filing of the bankruptcy petition; (3) the debtor was insolvent or was rendered insolvent as a result of the transfer; and (4) the debtor received less than a reasonably equivalent value for the transfer.

As with the UFTA, a bankruptcy court considers badges of fraud in determining whether a fraudulent transfer has occurred:[1369]

> Since actual intent to defraud is difficult to prove, it may be proven by circumstances surrounding the transfer. This is what courts refer to as the “badges of fraud” which include such things as lack of or inadequate consideration, family or a close relationship between the parties, retention of possession, benefit or use of the property in question, the financial condition of the party sought to be charged both before and after the transaction, the existence or cumulative effect of the pattern or series of transactions or the course of conduct

[1367] *In re Johnson*, 579 B.R. 796, 801 (Bankr. W.D. Ky. 2017) (citation omitted). For other summaries of the provisions, see *In re Think Retail Solutions, LLC*, 2019 WL 2912717 at *11 (Bankr. N.D. Ga. July 5, 2019); *In re Noll*, *2018 WL 4693813* at *7–8 (Bankr. D. Minn. Sept. 27, 2018); *In re Dearmond*, *2017 WL 4220396* at *3 (Bankr. E.D. Tenn. Sept. 21, 2017); *In re Michel*, 573 B.R. 46, 66, 67 (Bankr. E.D.N.Y. 2017); *In re Loganbill*, 570 B.R. 810, 812 (Bankr. W.D. Mo. 2017).

[1368] *Kirst*, 559 B.R. 757 at 763. For other summaries of the provision, see *In re Blixseth*, 2017 WL 929206 at *1 (9th Cir. Mar. 9, 2017); *In re Henshaw*, *2016 WL 6575086* at *1 (9th Cir. Nov. 7, 2016); *In re Think Retail Solutions, LLC*, 2019 WL 2912717 at *15 (Bankr. N.D. Ga. July 5, 2019); *In re Cyr*, *2019 WL 1495137* at *10 (Bankr. W.D. Tex. Apr. 1, 2019); *In re Noll*, *2018 WL 4693813* at *4–7 (Bankr. D. Minn. Sept. 27, 2018); *In re Young*, 2018 WL 485957 at *2 (Bankr. M.D.N.C. Jan. 17, 2018); *In re Johnson*, 579 B.R. 796, 802 (Bankr. W.D. Ky. Dec. 21, 2017); *In re Fisher*, 575 B.R. 640, 644 (Bankr. M.D. Pa. 2017); *In re Michel*, 573 B.R. 46, 57–58 (Bankr. E.D.N.Y. 2017).

[1369] *Johnson*, 579 B.R. at 801 (citations omitted). For other summaries of badges of fraud, see *In re Think Retail Solutions, LLC*, 2019 WL 2912717 at *12 (Bankr. N.D. Ga. July 5, 2019); *In re Cyr*, *2019 WL 1495137* at *8 (Bankr. W.D. Tex. Apr. 1, 2019); *In re Esquibel*, *2018 WL 3570592* at *8 (Bankr. D.N.M. July 23, 2018); *In re Luciani*, *2018 WL 2077851* at *11 (Bankr. D. Mass. May 2, 2018); *In re Dearmond*, *2017 WL 4220396* at *5 (Bankr. E.D. Tenn. Sept. 21, 2017).

> after incurring of the debt and onset of financial difficulties or a pending or threat of lawsuits by creditors, as well as the general chronology of events and transactions under inquiry.

The Fifth Circuit has interpreted the "hinder, delay, or defraud" component of actual fraud in the following way:[1370]

[1370] *Matter of Wiggains*, 848 F.3d 655, 661 (5th Cir. 2017) (footnotes, citations, and internal quotation marks omitted). *Accord In re Michel*, 573 B.R. 46, 68 (Bankr. E.D.N.Y. 2017).

> The phrase intent to hinder, delay, or defraud is not defined in the Bankruptcy Code. We find relevant meaning in the fact that the phrase is stated in the disjunctive, which signifies that an intent to hinder or to delay or to defraud is sufficient. Ours is not a novel interpretation. The Supreme Court repudiated common misconceptions that surround a debtor's pre-bankruptcy activities by declaring that a conveyance is illegal if made with an intent to defraud the creditors of the grantor, but equally it is illegal if made with an intent to hinder and delay them. Other courts examining a debtor's intent when deciding whether to deny discharge under Section 727(a)(2)(A) also construe "hinder, delay, or defraud" as being three separate states of mind.

The federal district court in Connecticut has described the differences in the limitations periods in the UFTA and in §548 of the Bankruptcy Code in the following way:[1371]

[1371] *Ronald I. Chorches, Trustee*, 2018 WL 3421318 at *2 n.1 (D. Conn. July 13, 2018). *Accord In re Anderson*, 2018 WL 3197746 at *3 (Bankr. D. Conn. June 26, 2018) ("Other than the fact that Connecticut law affords the Trustee a four-year reach back period, as opposed to a shorter period under §548, the two are not materially different"); 2018 WL 3197746 at *4 ("the court notes that Florida fraudulent transfer law appears to share the same differences between it and the Bankruptcy Code as does Connecticut law and the Bankruptcy Code"). *See also Wolff v. Katz*, *2017 WL 2590757* at *4 (D. Md. June 14, 2017) ("The Trustee's complaint is untimely under the plain language of Section 546(a)"); *In re Walker*, *2017 WL 1239561* at *23 (Bankr. E.D. Tenn. Apr. 3, 2017) ("any claims made by the Trustee pursuant to this section for recovery of the 2007 or 2008 Transfers are time barred"). *See in re Hollaway*, 680 Fed. App'x 866, 868 (11th Cir. 2017) ("the date the executor assented—July 23, 2009—is the relevant date of the transfer"); *In re Esquibel*, *2018 WL 3570592* at *6 (Bankr. D.N.M. July 23, 2018) ("the transfer did not occur until recordation").

> The two years in the bankruptcy code provision are measured from the time of the filing of the petition; but the four years in the Connecticut statute are in most circumstances measured from the time of the transfer. Compare 11 U.S.C. §548(a)(1)(B) with Conn. Gen. Stat. §52-552j.

Bankruptcy courts approach fraudulent transfer claims under the UFTA and §548(a)(1) in a similar manner.[1372]

[1372] *See, e.g., Ronald I. Chorches*, *Trustee*, 2018 WL 3421318 at *2 (D. Conn. July 13, 2018) ("Connecticut courts analyze these two provisions together, as a single claim"); *In re Think Retail Solutions, LLC*, 2019 WL 2912717 at *11 (Bankr. N.D. Ga. July 5, 2019) ("The analysis of alleged fraudulent transfers under state law and bankruptcy law is substantially the same"); *In re Esquibel*, *2018 WL 3570592* at *8 n.8 (Bankr. D.N.M. July 23, 2018) (New Mexico state law mirrors the federal standard"); *In re Anderson*, 2018 WL 3197746 at *3 (Bankr. D. Conn. June 26, 2018) ("The standards of conduct for transfer avoidance under Connecticut law are not materially different than those under §548"); *In re Libra*, 584 B.R. 550, 558 (Bankr. E.D. Mich. 2018) ("The requirements for avoidance of a transfer as a constructive fraud on creditors are essentially the same under the Bankruptcy Code's avoidance provision and the Uniform Fraudulent Transfer Act"); *In re Orton*, 2018 WL

1577927 at *2 n.1 (Bankr. M.D. Fla. 2018) ("the Court focuses its analysis on §548(a)(1)(B) of the Bankruptcy Code but the same conclusions apply equally under section 726.105(1)(b), Florida Statutes").

b. **Bankruptcy Code §544(b)(1)** —

Section 548(a)(1) captures fraudulent transfers made within two years of the filing of the bankruptcy petition. A bankruptcy trustee may also set aside transfers pursuant to §544(b)(1) of the Bankruptcy Code, which provides:[1373]

[1373] 11 U.S.C. §544(b)(1). *See In re Ruvalcaba,* 2018 WL 2317682 at *5 (Bankr. N.D. Ill. May 18, 2018).

> 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.

A federal bankruptcy judge in Michigan has explained:[1374]

[1374] *In re Hatchett*, *2018 WL 1882914* at *2 (Bankr. E.D. Mich. Apr. 18, 2018). *See In re Grobner*, 2019 WL 2031060 at *2 (Bankr. C.D. Ill. May 8, 2019).

> Fraudulent transfers can be avoided under two different sections of the Bankruptcy Code: 11 U.S.C. §548, which creates a body of federal fraudulent transfer law, and 11 U.S.C. §544(b), which gives the trustee power to avoid a fraudulent transfer by the debtor if the transfer would be voidable by one of the debtor's creditors under state law. Specifically, §544(b)(1) permits a trustee to step into the shoes of an actual creditor who has a fraudulent transfer remedy under other "applicable law" (i.e., a state fraudulent transfer statute) and exercise that creditor's remedies on behalf of the bankruptcy estate. 11 U.S.C. §544(b)(1) provides, in relevant part, that a "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….
>
> The key difference between an action under §548 and an action under §544(b)(1) is the reach-back period. 548, captures only transfers made in the two years preceding the filing of the bankruptcy. Section §544(b)(1) looks to the specific state statute's reach-back period, which is generally longer than two years. Thus, a bankruptcy trustee seeking to recover transfers made more than two years prior to the filing of the bankruptcy must file an action under §544(b)(1).

Thus, §544(b)(1) allows a bankruptcy trustee to set aside transfers using longer limitations periods available under state fraudulent transfer law,[1375] including supplemental statutes such as Tenn. Code Ann. §66-3-101,[1376] and other federal laws.[1377]

[1375] *See, e.g., In re Huber*, 493 B.R. 798, 816 (Bankr. W.D. Wash. 2013); *In re Mastro*, 465 B.R. 576, 611–12 (Bankr. W.D. Wash. 2011).

[1376] Tenn. Code Ann. §66-3-101. *See In re Walker*, *2017 WL 1239561* at *24–27 (Bankr. E.D. Tenn. Apr. 3, 2017).

[1377] *See, e.g., In re Kipnis*, 555 B.R. 877, 883 (Bankr. S.D. Fla. 2016) ("The language in §544(b) is clear and allows the Trustee in this case to step into the shoes of the IRS to take advantage of the ten-year collection period in 26 U.S.C.§6502").

Hence, through a combination of §544(b)(1) and a state's version of UFTA, a bankruptcy trustee may set aside a transfer for actual fraud[1378] or constructive fraud.[1379] According to one court, it might also be possible to access trust assets via Bankruptcy Code §544(b)(1) and a state's rule against self-settled spendthrift trusts:[1380]

> [U]nder California law, Trustee (as a hypothetical lien creditor) can likewise recover those assets under section 544(a)(1).

In 2017, a federal bankruptcy judge in Illinois summarized many of the pertinent rules for fraudulent transfers:[1381]

> Fraudulent transfer claims under section 548(a) of the Code—for actual fraud under section 548(a)(I)(A) and constructive fraud under section 548(a)(1)(B)—share two elements. There must have been a “transfer,” and the transfer must have involved “an interest of the debtor in property.” 11 U.S.C. §548(a)(1). Fraudulent

[1378] *See, e.g., In re Think Retail Solutions, LLC,* 2019 WL 2912717 at *10 (Bankr. N.D. Ga. July 5, 2019) (“Transfers made with actual intent to hinder, delay, or defraud creditors are avoidable pursuant to 11 U.S.C. §548 or pursuant to 11 U.S.C. §544 and O.C.G.A. §18-2-74(a)”); *In re Chiang*, 562 B.R. 559, 577 (Bankr. D. Mass. 2016) (“the Debtor … conveyed his equity interest in the Property with actual intent to hinder, delay, and defraud an existing creditor”); *In re Xiang Yong Gao*, 560 B.R. 50, 64 (Bankr. E.D.N.Y. 2016) (“the Transfers were undertaken by the Debtor with actual fraudulent intent”). *But see, e.g., In re Michel*, 573 B.R. 46, 71 (Bankr. E.D.N.Y. 2017) (“the School has shown that the Trustee does not state a plausible claim to recover the Transfers as intentional fraudulent transfers under New York Debtor and Creditor Law Section 276”); *In re Michel*, 572 B.R. 463, 477 (Bankr. E.D.N.Y. 2017) (“the Trustee does not state a plausible claim to recover the Transfers as constructive fraudulent transfers under Bankruptcy Code Section 544 and New York Debtor and Creditor Law Sections 273, 274, or 275”); *In re Pollack*, *2016 WL 270012* at *1 (Bankr. D.N.H. Jan. 20, 2016) (“The Trustee has failed to establish that the Debtor's transfer of $60, 741.84 was fraudulent under either the Bankruptcy Code or New Hampshire state law”).

[1379] *See, e.g., Chorches v. Catholic Univ. of Am.*, 2018 WL 3421318 at *8 (D. Conn. July 13, 2018) (“the Franzeses did not receive reasonably equivalent value for their college tuition payments”); *In re Think Retail Solutions, LLC*, 2019 WL 2912717 at *11 (Bankr. N.D. Ga. July 5, 2019) (“Constructively fraudulent transfers are avoidable pursuant to 11 U.S.C. §548(a)(1)(B) or §544 and O.C.G.A. §§18-2-74(a)(2) and -75(a)”); *Chiang*, 562 B.R. at 578 (“the Trustee is entitled to summary judgment on Court III of his Complaint”); *Gao*, 560 B.R. at 62 (“the Trustee has presented sufficient evidence to meet this standard”); *In re Libra*, 584 B.R. 550, 567 (Bankr. E.D. Mich. May 9, 2018) (“Trustee may avoid the monetary transfer in the amount of $21,900 under M.C.L. §566.35(1), subject to §544”); *In re Rosich*, 570 B.R. 278, 281 (Bankr. W.D. Mich. 2017) (“the transfer of the Debtor's interest in the Property from the revocable trust to the Defendants is avoidable under §544(b) and the MUFTA”). *But see, e.g., Michel*, 573 B.R. at 64 (“Trustee does not state a plausible claim to recover the Transfers as fraudulent transfers under Bankruptcy Code Section 544 and New York Debtor and Creditor Law Sections 273, 274, or 275”); *Michel*, 572 B.R. at 482 (“the Trustee does not state a plausible claim to recover the Transfers as intentional fraudulent transfers under New York Debtor and Creditor Law Section 276”); *Pollack*, *2016 WL 270012* at *1 (“The Trustee has failed to establish that the Debtor's transfer of $60,741.84 was fraudulent under either the Bankruptcy Code or New Hampshire state law”); *In re DeMauro*, *2018 WL 3064231* at *7 (Bankr. D. Conn. June 19, 2018) (“the Federal Direct PLUS Loan proceeds do not constitute an interest of the debtor in property subject to avoidance pursuant to §§544 and 548”).

[1380] *In re Cutter*, 398 B.R. 6 (B.A.P. 9th Cir. 2008).

[1381] *In re Glick*, 568 B.R. 634, 671 (Bankr. N.D. Ill. 2017).

> transfer claims under section 544(b) are no different. Section 544(b) allows a trustee to avoid transfers that are voidable under "applicable law." 11 U.S.C. §544(b). "Applicable law" typically means a state's fraudulent transfer law. Under the IUFTA, the state fraudulent transfer law applicable here, a fraudulent transfer must involve a "transfer," 740 ILCS 160/5(a) (2014), and the transfer must be of an "asset or an interest in an asset," 740 ILCS 160/2(1) (2014), meaning "property of a debtor" or an interest in property of debtor, 740 ILCS 160/2(b) (2014).

In the case in question, the court found that there had been no transfer.[1382]

[1382] *In re Glick*, 568 B.R. at 673 ("Not only does Gierum fail to allege a claim involving an interest in Glick's property, but he also fails to allege a transfer") (quotation marks omitted).

Like the UFTA,[1383] the Bankruptcy Code does not contain a provision that embodies the common-law rule against self-settled spendthrift trusts. A federal bankruptcy judge in Washington State summarizes the pertinent options:[1384]

[1383] *See* VIII.E., above.

[1384] *In re Mastro*, 465 B.R. 576, 610–611 (Bankr. W.D. Wash. 2011).

> A transfer being deemed "void" under state law does not preclude the same transfer from being attacked as an avoidable fraudulent transfer under bankruptcy law. For example, in *Wiswall v. Wallaert*, 149 B.R. 665 (Bankr. W.D. Wash. 1992), the trustee sought to recover real property he alleged that the debtor had fraudulently transferred into a living self-settled trust. The debtors argued that "since the property remained subject to the claims of their then and future creditors [pursuant to RCW 19.36.020 (which codifies the common-law rule against self-settled spendthrift trusts)], nothing was conveyed." Id. at 667. The court granted partial summary judgment in favor of the trustee, unequivocally rejecting the debtors' argument that there had been no "transfer" for bankruptcy purposes. Id. at 668–69.
>
> Similarly, in *Menotte v. Champalanne (In re Champalanne)*, 425 B.R. 707, 713 (Bankr. S.D. Fla. 2010) the debtors alleged that a transfer to their family trust "was not fraudulent because under California law, the California Property remained subject to the claims of creditors after the transfer." The court held that "[e]ven if that is a correct statement of California law, the transfer may nevertheless be avoidable if the [d]ebtor acted with actual intent to hinder, delay, or defraud creditors." Id.; *see also In re Potter*, 2008 WL 5157877, *2008 Bankr. LEXIS 3351* (Bankr. D.N.M. 2009) (finding a transfer invalid under California self-settled trust law, but holding the same transfer to be a fraudulent transfer pursuant to §548(e)).
>
> To the extent a transfer is avoided as a fraudulent transfer under 11 U.S.C. §544, §548, and state law, the Trustee may recover the property transferred or the value of such property pursuant to 11 U.S.C. §550(a)(1) from the initial transferee of such property or from the entity for whose benefit the transfer was made, or pursuant to §550(a)(2) from any immediate or mediate transferee.

c. **Bankruptcy Code §548(e)(1)**

(1) **Introduction** —

Congress directed particular attention to self-settled spendthrift trusts when the Bankruptcy Code was revised in 2005. Under 11 U.S.C. §548(e)(1), which applies to bankruptcies commenced on or after April 20, 2005,[1385] bankruptcy trustees may sue to avoid a transfer to a "self-settled trust or similar device" made on or within 10 years before the date of the filing of a bankruptcy petition if, in addition to other technical criteria, the transfer was made "with actual intent to hinder, delay, or defraud" any creditor to which the debtor was or became indebted on or after the date that such transfer was made. The statute reads:[1386]

[1385] BAPCPA §1406.

[1386] 11 U.S.C. §548(e)(1). *See* John E. Sullivan, et al., Fraudulent Transfer Claims: Does the Bankruptcy Court's Decision in In re Mortensen Spell the End of the Asset Protection Trust? 150 Tr. & Est. 43, 48–49 (Dec. 2011).

> (e)(1) 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.

Transfers subject to 11 U.S.C. §548(e) also “include” those made to evade debts related to: (1) federal and state securities law violations; and (2) fraud, deceit, or manipulation involving the purchase or sale of registered securities.[1387]

[1387] 11 U.S.C. §548(e)(2).

Given that §548(e)(1) was drafted and passed at the last minute, its application is unclear. For example, in addition to a foreign or domestic APT, a “self-settled trust or similar device” conceivably might include a lifetime QTIP trust, a lifetime credit-shelter trust, a retirement plan, an IRA, a homestead, an FLP, an LLC, or tenancy-by-the-entireties property.

(2) **Caselaw Not Involving Domestic APTs**

(a) **In re Potter (2008)** —

A 2008 case applied 11 U.S.C. §548(e)(1) to a California spendthrift trust that was directly and indirectly self-settled by the debtor, who was also one of several trust beneficiaries.[1388] The court held “the Trustee has sufficiently established all elements required under 11 U.S.C. §548(e).”[1389]

[1388] *See In re Potter*, No. 7-05-14071, 2008 BL 158955, 2008 WL 5157877 (Bankr. D.N.M. July 29, 2008). *See also In re Mastro*, 465 B.R. 576, 611–612 (Bankr. W.D. Wash. 2011) (transfers to offshore trusts were set aside).

[1389] *In re Potter*, No. 7-05-14071, 2008 BL 158955, 2008 WL 5157877 at *8. *See In re Mastro*, 465 B.R. 576, 611 (Bankr.W.D. Wash. 2011 (“The transfers of various assets into the LCY Trust by placing ownership of the assets in the LCY LLC Entities are … avoidable by the Trustee as fraudulent transfers pursuant to 11 U.S.C. [§544, §548(a)(1)(A)–§548(a)(1)(B), §548(e)] and RCW 19.40.041(a)(1)-(2)”).

(b) **Safanda v. Castellano (2015)**

(i) **Introduction** —

In this case,[1390] a federal district judge in Illinois reversed a poorly reasoned bankruptcy court decision[1391] and held that a debtor's interest in a third-party trust was excluded from her bankruptcy estate under 11 U.S.C. §541(c)(2). At the outset, the court determined that the standard of proof in this fraudulent transfer case was a preponderance of the evidence not clear and convincing evidence.[1392]

[1390] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* (N.D. Ill. Apr. 27, 2015).

[1391] *Safanda v. Castellano (In re Castellano)*, 514 B.R. 555 (Bankr. N.D. Ill. 2014).

[1392] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *1–2.

(ii) **Facts** —

- February 18, 1997—Faith F. Campbell (“Settlor”) created Faith F. Campbell Living Trust (the “Trust”) naming herself trustee and her four children, including Linda K. Castellano (“Debtor”), as remainder beneficiaries;
- 2008—Debtor's and husband's business began experiencing financial problems;
- February 11, 2011—Settlor died and J.T. Del Alcazar (“Trustee”) subsequently was appointed Trustee;
- Summer 2011—Debtor's and husband's business closed;
- October 5, 2011—Debtor's attorney wrote Trustee suggesting that, due to her financial difficulties, he exercise discretion granted by Trust to hold her share in further trust rather than distributing it to her outright, which he subsequently did;
- November 18, 2011—Debtor and husband filed for bankruptcy;
- November 21, 2011—Debtor signed document releasing Trustee from liability for activities, including holding her share in further trust;
- December 2011—Trustee distributed trust shares to settlor's children other than Debtor;
- October 25, 2013—Bankruptcy trustee filed action to set aside transfer to debtor's trust under 11 U.S.C. §548(e)(1).[1393]

[1393] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *2–3.

Besides containing a spendthrift clause, the trust included the following provision:[1394]

[1394] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *2.

> [I]f by reason of bankruptcy or insolvency … 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 ….

(iii) **Issue** —

The issue was whether the Debtor's trust was includible in her bankruptcy estate.

(iv) **Bankruptcy Code §541(c)(2)** —

The court began its analysis by describing the exclusion provided by 11 U.S.C. §541(c)(2):[1395]

> Property of the debtor that would otherwise be transferable is not transferred to the bankruptcy estate if: (1) it 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.

Even though settlor died in February of 2011, the court concluded that the debtor had a beneficial interest in the trust when she and her husband filed their voluntary bankruptcy petition later that year, for the following reason:[1396]

> On the day Castellano filed for bankruptcy, Del Alcazar had not yet made any distributions. Consistent with the reading that best reflects Campbell's overall intent, the Living Trust was still in effect and Castellano had a beneficial interest in it.

Next, the court determined that the trust sought to restrict transfer of the debtor's interest twice—once through its spendthrift clause and also by the provision that converted her interest into a discretionary interest in the event of financial distress.[1397]

Finally, the court concluded that the trust's transfer restrictions were enforceable under the laws of the three states whose laws potentially might apply until distributions became mandatory.[1398] First, it held that the trust's spendthrift clause was enforceable under South Carolina, Illinois, and Wisconsin law.[1399] Second, it held that the protection provided to discretionary interests was effective in South Carolina, Illinois, and Wisconsin.[1400] The court, therefore, concluded:[1401]

[1395] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *3 (internal quotation marks omitted).

[1396] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *4.

[1397] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *5.

[1398] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *5.

[1399] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL*

1911130 at *6–7.

[1400] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *7–8.

[1401] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *8.

> Because on the day Castellano filed for bankruptcy the laws of South Carolina, Illinois, and Wisconsin all acknowledged the ability of discretionary trusts to restrict the transfer of a beneficiary's interest, §10.03's discretionary trust language also constituted a valid restriction on the transfer of Castellano's interest under applicable nonbankruptcy law.

Regardless of whether the Living Trust's conditional discretionary-trust language was triggered, Castellano had a beneficial interest in a trust subject to a valid nonbankruptcy restriction on transfer. Therefore, her interest in the Living Trust fell within the scope of 11 U.S.C. §541(c)(2) and is excluded from her bankruptcy estate.

(v) **Bankruptcy Code §548(e)(1)** —

The court also considered whether the bankruptcy trustee could reach the assets of the debtor's trust under 11 U.S.C. §548(e)(1), which provides:[1402]

[1402] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *8.

> The record does not support application of §548(e)[1] in this case. 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 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.

The court rejected this claim because:[1403]

[1403] *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *8.

> At all times, Castellano's potential share remained the property of the Living Trust in the custody of Merrill Lynch. Although Safanda segregated a portion of the Living Trust into a second account at Merrill Lynch earmarked for potential discretionary distributions to Castellano, that act did not end the Living Trust's ownership of those funds, constitute a distribution to Castellano, or create a new trust. It was simply a division of trust property as permitted by §4.02(b) of the Living Trust. Accordingly, because there was no transfer of an interest of the debtor, §548(e) does not apply.

Practice Tip: This case shows the importance of placing bequests in third-party trusts rather than giving them outright. It should be noted that the fact patterns in *Huber* and *Safanda* are quite similar. In *Huber*, the debtor's trust was included in the bankruptcy estate; in *Safanda*, the debtor's trust emerged unscathed.

(c) **In re Vorhes (2018)** —

A federal bankruptcy judge in Iowa decided a case in 2018 that involved §548(e)(1).[1404] The bankruptcy trustee sought to set aside a transfer of real property to a self-settled spendthrift trust, the terms of which were not disclosed. The parties contested whether there had been a "transfer" and whether there was intent to "hinder, delay, or defraud creditors."[1405] Regarding the first issue, the court found that "based on Blue Mountain's admission in its answer, that Debtor transferred his interest in the property to Blue Mountain. Blue Mountain is barred from arguing otherwise."[1406]

[1404] *In re Vorhes*, No. 16-1577, 2018 BL 111392, 2018 WL 1577980 (Bankr. N.D. Iowa Mar. 29, 2018).

[1405] *In re Vorhes*, No. 16-1577, 2018 BL 111392, 2018 WL 1577980 at *3.

[1406] *In re Vorhes*, No. 16-1577, 2018 BL 111392, 2018 WL 1577980 at *3.

Regarding the second issue, the court found that:[1407]

[1407] *In re Vorhes*, No. 16-1577, 2018 BL 111392, 2018 WL 1577980 at *5.

> The Court finds, that the undisputed evidence shows that Debtor transferred the real estate "with actual intent to hinder, delay, or defraud." As in those cases, the undisputed evidence here shows that Debtor transferred property to an insider trust, while a lawsuit was pending against him, without receiving anything in return, and retained possession or control over the property. Debtor used the services of a non-lawyer in establishing the trust. He and his family were again the beneficiaries of the trust. He transferred the real estate to the trust while a lawsuit was pending against him for no consideration. He made this transfer along with other transfers under almost exactly the same circumstances. This pattern of transferring property into insider trusts in an attempt to keep property out of the reach of a potential judgment creditor is precisely the kind of "clear pattern of purposeful conduct" that supports a finding of actual fraud.
>
> Looking at the record as a whole—especially in light of the many similar transfers which the Court has already found to be fraudulent—the Court must conclude that Debtor transferred the real estate at issue "with actual intent to hinder, delay, or defraud." There is no evidence to suggest otherwise."

The court made two other conclusions that are of interest. First, it declared that "clear and convincing evidence is the proper standard of proof for an action under §548."[1408] Second, the court held that "[t]rustee may avoid the transfer under §548(e) even if the real estate was exempt as Debtor's homestead at the time of the transfer."[1409]

[1408] *In re Vorhes*, No. 16-1577, 2018 BL 111392, 2018 WL 1577980 at *4.

[1409] *In re Vorhes*, No. 16-1577, 2018 BL 111392, 2018 WL 1577980 at *5.

(d) **In re Cyr (2019)** —

A federal bankruptcy judge in Texas gave a 11 U.S.C. §548(e)(1) primer in 2019.[1410] He first recited the statute's requirements:[1411]

[1410] *In re Cyr*, 602 B.R. 315 (Bankr. W.D. Tex. 2019).

[1411] *In re Cyr*, 602 B.R. 315, 335.

> The Trustee seeks to avoid transfers to the BHT under §548(e). To prevail on such claims, the Trustee must properly plead four elements: (1) a transfer to a self-settled trust or similar device made on or within 10 years before the date of the filing of the petition; (2) a transfer by the debtor; (3) debtor is a beneficiary; and (4) debtor made the transfer with the actual intent to hinder, delay or defraud creditors.

Regarding the first element, he observed:[1412]

> First, the plain language of §548(e)(1) does not look to whether assets transferred to a self-settled trust or similar device are self-settled under state law. Section 548(e)(1) is completely devoid of any reference to non-bankruptcy law. Therefore, the requirements contained in the statute itself, not state law, determine whether the transfer of a particular asset is subject to a trustee's avoidance power under §548(e)(1).
>
> Second, even if this Court were to define the term "self-settled trust" according to state law and the assets transferred by Debtor to the BHT are not self-settled under the Trust Code, the plain language of §548(e)(1) permits avoidance of transfers made to self-settled trusts or similar devices. The Court agrees with the *Avers* court that §548(e)(1) contemplates a broad application and applies to trusts or devices intended to shield assets from creditors, such as spendthrift trusts, where the debtor-beneficiary transfers assets to such device with an actual intent to hinder, delay, or defraud present or future creditors.

Besides proving element (2) (a transfer by the debtor) and element (3) (debtor is a beneficiary),[1413] the bankruptcy trustee must satisfy element (4) "[t]o prevail under §548(e)(1), a trustee must also prove an actual intent to hinder, delay, or defraud present and future creditors."[1414]

The judge noted that "[a]bsent such intent, whether a creditor can reach self-settled assets to satisfy their claims is determined by state law, and not the Bankruptcy Code."[1415] He pointed out that "§548(e)(1) respects the rights of states who choose to shield self-settled assets from creditors and those states which do not."[1416] Regarding Texas, he wrote:[1417]

> At common law, self-settled trusts were unlawful as a matter of public policy, and as the Fifth Circuit

[1412] *In re Cyr*, 602 B.R. 315, 335. *See Safanda v. Castellano*, *Safanda v. Castellano*, No. 14-CV-07094, 2015 BL 121731, *2015 WL 1911130* at *8 (N.D. Ill. Apr. 27, 2015), *rev'g* 514 B.R. 555 (Bankr. N.D. Ill. 2014) ("The record does not support application of §548(e) in this case"); *In re Porco, Inc.*, 447 B.R. 590, 597 (Bankr. S.D. Ill. 2011) ("Constructive and resulting trusts cannot be considered 'similar devices' to self-settled asset protection express trusts").

[1413] *See De Los Santos v.Commissioner*, T.C. Memo 2018-155 at 22 ("the S. Corp … was not a beneficiary of the Legacy or Flex Trust").

[1414] *In re Cyr*, 602 B.R. 315, 336. *See In re Combes*, 382 B.R. 186, 194 (Bankr. E.D.N.Y. 2008) ("the debtor did not purchase the Annuities with actual intent to hinder, delay, or defraud her creditors").

[1415] *In re Cyr*, 602 B.R. 315, 336.

[1416] *In re Cyr*, 602 B.R. 315, 335.

[1417] *In re Cyr*, 602 B.R. 315, 335.

recognized in *Shurley*, Texas has adopted such public policy:

> Public policy does not countenance devices by which one frees his own property from liability for his debts or restricts his power of alienation of it; and it is accordingly universally recognized that one cannot settle upon himself a spendthrift or other protective trust, or purchase such a trust from another, which will be effective to protect either the income or the corpus against the claims of his creditors, or to free it from his own power of alienation. The rule applies in respect of both present and future creditors and irrespective of any fraudulent intent in the settlement or purchase of a trust.

But the judge remarked upon the emergence of the domestic APT:[1418]

[1418] *In re Cyr*, 602 B.R. 315, 335–336 (citations omitted).

> Some states, however, have statutorily validated self-settled trusts such that creditors cannot look to self-settled assets to satisfy their claims. For example, in Alaska, self-settled assets are generally protected from claims of creditors except in limited circumstances, including clear and convincing evidence that the settlor's transfer was made with intent to defraud a creditor. Nevada and Delaware have similar protections for spendthrift trusts.

(3) **Caselaw Involving Domestic APTs** —

The first two cases involving domestic APTs under 11 U.S.C. §548(e)(1) are inconclusive because the trusts in question were structured improperly. Thus, in 2011, a federal bankruptcy judge in Alaska set aside a transfer of Alaska real property by an Alaska resident to an Alaska APT under 11 U.S.C. §548(e)(1).[1419] Similarly, in 2013, a federal bankruptcy court in Washington State set aside transfers by a Washington resident to an Alaska APT under the same provision.[1420] These cases demonstrate the importance of asset and trustee selection in developing a successful strategy.

[1419] *In re Mortensen*, *2011 WL 5025252* at *2 (Bankr. D. Alaska July 8, 2011) ("I found sufficient badges of fraud to determine that Mortensen intended to hinder, delay and defraud his creditors when he transferred the Seldovia property to the trust"). *See* IX.J.2.c., below. *See also* David G. Shaftel, *Court Finds Fraudulent Transfer to Alaska Asset Protection Trust*, 39 Est. Plan. 15 (Apr. 2012); John E. Sullivan, et al., *Fraudulent Transfer Claims: Does the Bankruptcy Court's Decision in Mortensen Spell the End of the Asset Protection Trust?* 15 Tr. & Est. 43 (Dec. 2011).

[1420] *In re Huber*, 493 B.R. 798, 814 (Bankr. W.D. Wash. 2013) ("The evidence presented by the Trustee supports an inference of actual fraudulent intent by the Debtor to hinder, delay, or defraud his current or future creditors, in violation of §548(e)(1)(D)"). *See* IX.J.2.d., below. *See also* Jonathan G. Blattmachr, et al., *Avoiding the Adverse Effects of Huber*, 152 Tr. & Est. 20 (July 2013).

(4) **Commentary** —

The author does not know how bankruptcy courts will interpret 11 U.S.C. §548(e)(1), but the worst-case scenario would be that the provision would merely create a 10-year limitations period for avoidance actions based on fraudulent transfers. In one sense, this is indeed significant because it is sometimes hard to defend old transfers because of the loss of critical evidence—memories fade, witnesses may die or move to points unknown, and relevant records can be lost or destroyed in the normal course of business. Moreover, the same factors might also make a stale case hard to prosecute. However, if 11 U.S.C. §548(e) is just a 10-year look-back rule, then any transfer that was defensible on substantive grounds before 11 U.S.C. §548(e)(1) is still defensible today. Consequently, any transactions that follow the guidelines discussed in IX.F., above, in connection with “Obstacle 5” and fraudulent transfers should survive scrutiny under this bankruptcy provision.

The best-case scenario is that 11 U.S.C. §548(e)(1) would require proof that a debtor-transferor had specific creditors in mind when making an alleged fraudulent transfer. In an analysis co-authored by a U.S. bankruptcy judge in the Western District of Tennessee, the authors note that 11 U.S.C. §548(e)(1):[1421]

> … is expressed in a way that seems to indicate that the trustee must prove that the debtor made the transfer to the self-settled trust with the intent to hinder, delay, or defraud a specific creditor or creditors to whom the debtor was indebted at the time of the transfer or to whom the debtor became indebted after the transfer… In other words, the trustee would need to show the existence of actual creditors and relate the debtor's intent to those creditors, rather than merely showing that the debtor created or transferred to an asset protection device.

If this view is indeed correct, then domestic APTs will benefit. As discussed above, normal fraudulent transfer law allows creditors to assert a theory of fraud on future creditors, even if the debtor made a transfer without a specific creditor in mind. These claims are difficult to prove, particularly if the debtor remained solvent after the transfer. Under the above reading, however, this type of theory moves from the realm of the difficult into that of the legally impossible—only claims involving specific, actual creditors could prevail under §548(e)(1) and cases that cannot link a transfer to such creditors will not be able to succeed.

Ultimately, transferors who intentionally retain post-transfer solvency, who disclose transfers whenever possible, who do not make transfers on the eve of risky new ventures, and who do not obtain credit under false pretenses will have plans that are defensible under either reading of Bankruptcy Code §548(e)(1). Put simply—careful, cautious planning will go a long way to legitimize a transfer under any scenario.

Section 548(e)(1) also carries offshore implications. Some clients may opt for foreign APTs rather than domestic APTs because offshore limitation periods are typically much shorter than 10 years and because it is harder for bankruptcy trustees to reach trust assets abroad than in the United States. Clients who follow conservative planning principles might craft an offshore plan that is substantively defensible and that also carries serious practical obstacles for a bankruptcy trustee. However, clients must balance this prospect against other factors, such as: (1) the additional out-of-pocket costs associated with maintaining an offshore structure; (2) tax compliance issues; (3) the greater risk of contempt-of-court sanctions associated with foreign APTs; and (4) the loss of a full faith and credit argument that might require bankruptcy courts to apply domestic APT law, whereas bankruptcy judges might find it legally easy to disregard foreign law.

It remains to be seen exactly how Bankruptcy Code §548(e)(1) affects client preferences. It seems likely that it will encourage at least some, and perhaps much, outflow of trust funds to overseas, particularly while the viability of domestic APTs in bankruptcy is still unsettled. However, if bankruptcy courts recognize and uphold domestic APTs (which the courts should), then, for many clients, the concerns over Bankruptcy Code §548(e)(1) and the incentive to go offshore will be significantly reduced.

d. **Bankruptcy Trustee's Remedies** —

A bankruptcy trustee's recovery is quite limited. Thus, §550(a) of the Bankruptcy Code provides:[1422]

[1421] Brown & Ahern, *2005 Bankruptcy Reform Legislation with Analysis* 77 (2005).

[1422] 11 U.S.C. §550(a). For applications of the provision, see, e.g., *In re Cynthia Noll*, *2018*

WL 4693813 at *8 (Bankr. D. Minn. Sept. 27, 2018); *In re Scarbrough*, *2018 WL 3218849* at *5 (Bankr. M.D. Tenn. June 29, 2018); *In re Anderson*, 2018 WL 3197746 at *9 (Bankr. D. Conn. June 26, 2018); *In re Dearmond*, *2017 WL 4220396* at *8 (Bankr. E.D. Tenn. Sept. 21, 2017); *In re Mastro*, 465 B.R. 576, 614–16 (Bankr. W.D. Wash. 2011). *But see In re Adamo*, 582 B.R. 267, 278 (Bankr. E.D.N.Y. 2018) ("The Defendants only received dominion and control over the funds once the students enrolled in classes and the funds were applied to the tuition bill").

> [T]o the extent that a transfer is avoided … the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.

Non-transferees rarely are exposed to potential liability for aiding and abetting or for participating in a conspiracy to commit a fraudulent transfer under the Bankruptcy Code. A federal bankruptcy judge in Delaware has explained why:**[1423]**

> The Court notes that a handful of courts have recognized a cause of action for either aiding and abetting a fraudulent conveyance or conspiracy to commit a fraudulent conveyance under state law, including the law of New Jersey. Whether any state law recognizes such a claim, even the law of a controlling state such as New Jersey or Delaware here, is irrelevant in bankruptcy proceedings, however.
>
> Even where a trustee (or party standing in a trustee's shoes, such as Plaintiff here) is given a lien creditor's rights under the law of a state that does recognize a claim such as aiding and abetting a fraudulent transfer or conspiracy to commit a fraudulent transfer, bankruptcy courts have refused to permit trustees to use section 544(b) to pursue such a claim. For example, the court in *In re Hamilton Taft & Co.* was presented with a trustee who attempted to use section 544(b) to pursue a claim for damages, premised on the theory that the defendant had aided and abetted a fraudulent transfer. The trustee was asserting a claim under the law of California, which is one of the few states that recognize non-beneficiary, non-transferee liability for helping execute a fraudulent transfer. Still, the court dismissed the trustee's claim for want of standing. The court held that a bankruptcy trustee is not authorized to pursue every state law action that creditors of the debtor might pursue, only those that the Code expressly allows the trustee to pursue. The trustee's only authority to assert a creditor's state law causes of action related to fraudulent conveyances is found in section 544(b) of the Code, the court held, and section 544(b) only permits the trustee *to avoid* a fraudulent transfer. This holding is consistent with other cases that have refused to allow trustees to use section 544(b) to assert claims for damages under state law, some of which even go so far as to call a trustee's argument that he is given such power by section 544(b) flatly wrong.
>
> Courts have also cited the language of Bankruptcy Code Section 550 as support for the idea that Congress did not intend to empower trustees to assert damage claims under state law for aiding and abetting a fraudulent transfer. The court in *In re Brentwood Lexford Partners LLC*, for instance, rejected a trustee's claim for damages arising from an alleged civil conspiracy to violate the Texas UFTA. The court reasoned that, under the Code, the trustee's remedy for an avoided transfer is addressed by a specific statutory provision, section

[1423] *In re Fedders N. Am., Inc.*, 405 B.R. 527, 548–49 (Bankr. D. Del. 2009) (emphasis in original; citations and internal quotation marks deleted). *Accord In re Madeoy*, 576 B.R. 484, 496–97 (Bankr. D. Md. 2017); *In re Pitt Holding Co.*, 484 B.R. 25, 48 (Bankr. D. Del. 2012).

> 550, and that provision only allows the trustee to recover up to the amount of the transfer from a transferee, or a party for whose benefit the transfer was made. The court held that to allow any other recovery could lead to a result that expands remedies beyond §550, and that the court cannot invoke state law remedies to circumvent or undermine the specific remedy legislated by Congress for the avoidance of a fraudulent transfer.
>
> Likewise, the authorities are also clear that there is no such thing as liability for aiding and abetting a fraudulent conveyance or conspiracy to commit a fraudulent transfer as a matter of federal law under the Code.
>
> The Court finds each of these lines of authority persuasive. Accordingly, Plaintiff cannot bring a state law claim for aiding and abetting a fraudulent transfer in this Court, and cannot bring a claim for aiding and abetting a fraudulent conveyance as a matter of federal law.

e. **Limitations Periods** —

The Bankruptcy Code includes statutes of limitations. Hence, §546(a) provides:[1424]

[1424] 11 U.S.C. §546(a).

> (a) An action or proceeding … may not be commenced after the earlier of—
>
> (1) the later of—
>
> (A) 2 years after the entry of the order for relief; or
>
> (B) 1 year after the appointment or election of the first trustee … if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or
>
> (2) the time the case is closed or dismissed.

5. **Post-Petition Distributions**

a. **Introduction** —

If a settlor's interest in a domestic APT is excluded from the bankruptcy estate under Bankruptcy Code §541(c)(2) and §548(e)(1), it may then be necessary to determine whether any trust distributions to the settlor after the filing of the bankruptcy petition will become part of the bankruptcy estate. This issue will arise if the settlor receives a discretionary or mandatory distribution of income or principal from the domestic APT.

b. **11 U.S.C. §541(a)(5)(A)** —

The only potentially relevant Bankruptcy Code provision is 11 U.S.C. §541(a)(5), which provides in pertinent part as follows:[1425]

[1425] 11 U.S.C. §541(a)(5). *See* 5 *Collier on Bankruptcy* P541.14 (Levin & Sommer eds., 16th ed. 2011). For situations in which the provision applied, see *In re Brown,* 2018 WL 2308267 at *4 (B.A.P. 9th Cir. May 21, 2018) (“Jason received the inheritance Proceeds in April 2014, within 180 days of filing the petition, making the funds property of the estate under section 541(a)(5)(A)”) (footnotes omitted); *In re Duran*, 2018 WL 989016 at *9 (Bankr. N.D. Ohio Feb. 16, 2018) (“The required funds are likely to come from an inheritance from Debtor's mother, in the estimated amount of $30,000, that she became entitled to acquire within 180 days of the filing of her Chapter 7 case") (citation omitted); *In re Ruth Ann Hinzmann*, *2017 WL 83353* at *2 (Bankr. W.D. Wis. Jan. 9, 2017) ("Debtor acquired or became entitled to an inheritance well within section 541(a)(5)'s time limit").

> Any 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—
>
> (A) by bequest, devise, or inheritance;

To be included in the bankruptcy estate under Bankruptcy Code §541(a)(5)(A), a domestic APT distribution must meet two requirements. First, the distribution must be received by the debtor within 180 days after the filing of the bankruptcy petition (not at all times thereafter).[1426] Second, it must result from a "bequest, devise, or inheritance."

[1426] *See, e.g., In re Massillon*, 2011 WL 1496101 at *7 (B.A.P. 1st Cir. Jan. 11, 2011) (distributions from testamentary trusts received within 180-day period included; distributions received thereafter excluded); *In re Gentry*, 2016 WL 4061248 at *7 (E.D. Mich. July 29, 2016) (trust interest not property of bankruptcy estate because, "Debtor Gentry's and Appellant Banfield's mother died on July 3, 2012. Debtor Gentry filed her bankruptcy petition under chapter 7 on December 3, 2009"); *In re Kiesewetter*, *2011 WL 4527365* at *13 (W.D. Pa. Sept. 28, 2011) (distributions from testamentary trusts received within 180-day period included; distributions received thereafter excluded).

Because the Bankruptcy Code does not define "bequest," "devise," or "inheritance,"[1427] courts considering Bankruptcy Code §541(a)(5)(A) look to applicable state law[1428] and, in the absence thereof, to the *Merriam-Webster Dictionary* [1429] or *Black's Law Dictionary*.[1430] The latter defines the terms as follows:[1431]

[1427] *In re Dayton*, *2018 WL 576748* at *3 (Bankr. W.D. Mo. Jan. 26, 2018).

[1428] *See Dayton*, *2018 WL 576748* at *3; *In re Weiser*, *2011 WL 1637945* at *2 (Bankr. S.D. Ind. 2011); *In re Blount*, 438 B.R. 98, 102 n.9 (Bankr. E.D. Tex. 2010); *In re Rogove*, 443 B.R. 182, 187 (Bankr. S.D. Fla. 2010); *In re Ciano*, 433 B.R. 431, 435 (Bankr. N.D. Fla. 2010).

[1429] *See In re Ciano*, 433 B.R. 431, 435 (Bankr. N.D. Fla. 2010).

[1430] *Black's Law Dictionary* (11th ed. 2019). *See Dayton*, *2018 WL 576748* at *3; *In re Rogove*, 443 B.R. 182, 187 (Bankr. S.D. Fla. 2010); *In re Mattern*, 2006 WL 3479016 at *3 (Bankr. D. Kan. Mar. 9, 2006); *In re Roth*, 289 BR. 161, 166 (Bankr. D. Kan. 2003).

[1431] *Black's Law Dictionary* (11th ed. 2019).

- a "bequest" is "[t]he act of giving property (usu[ally] personal property or money) by will."[1432]
- a "devise" is "[t]he act of giving property by will."[1433]
- an "inheritance" is "[p]roperty received from an ancestor under the laws of intestacy."[1434]

[1432] *Black's Law Dictionary* at 195.

[1433] *Black's Law Dictionary* at 567.

[1434] *Black's Law Dictionary* at 936.

It is hard to see how an interest in a domestic APT, which is an irrevocable inter vivos trust, fits into any of these categories, and courts agree. For instance, in *In re Newman*,[1435] income distributions received by the debtor from two irrevocable inter vivos spendthrift trusts within 180 days after the filing of the bankruptcy petition were not includible in his bankruptcy estate. Courts have also held that assets that were payable to a debtor from an inter vivos trust due to the death of a parent within 180 days after the filing of a bankruptcy petition did not come into the bankruptcy estate.[1436] Courts have exempted income and principal distributions to beneficiaries of inter vivos trusts within the 180-day period.[1437]

A Missouri bankruptcy judge handled a classic §541(a)(5) case early in 2018. At the outset, the court identified the issue and its resolution as follows:[1438]

> Debtor William Dayton received a distribution from an inter vivos spendthrift trust after the settlor died within 180 days after the petition date. Chapter 7 Trustee Patricia Brown contends the distribution constitutes property of William's bankruptcy estate, arguing that it qualifies as a “bequest, devise, or inheritance” within the meaning of §541(a)(5)(A), and seeks an order compelling William to turn over the distribution. William disagrees, arguing that he did not acquire his interest in the distribution by “bequest, devise, or inheritance” because he received the distribution by operation of an inter vivos spendthrift trust, rather than by will or intestacy.

For the reasons set forth below, the court determines that William did not acquire or become entitled to acquire the post-petition inter vivos spendthrift trust distribution by “bequest, devise, or inheritance.” Consequently, the distribution is not property of the bankruptcy estate, and the court denies Trustee Brown's motion to compel turnover.

The court then described the scope of §541(a)(5):[1439]

> Section 541(a)(5) provides that a property interest acquired by a debtor postpetition becomes part of the bankruptcy estate if it meets three requirements. First, the debtor must acquire or become entitled to acquire the interest within 180 days after the petition date. Second, the interest must be one that would have been property of the estate if the debtor had held the interest on the petition date. Third, the debtor must obtain the interest in one of three methods set forth in §541(a)(5)(A)–(C)—by “bequest, devise, or inheritance”; through a property settlement with a spouse or divorce decree; or as a beneficiary of a life insurance policy or a death benefit plan.

The parties agreed that the first test was met “because William first became entitled to receive the distribution from the inter vivos spendthrift trust upon Ms. Ault's death, which was less than 180 days after the petition date.”[1440]

[1435] 903 F.2d 1150 (7th Cir. 1990). *Accord In re Zuckerkorn*, 484 B.R. 182, 196 (B.A.P. 9th Cir. 2012); *In re Eley*, 331 B.R. 353, 357–58 (Bankr. S.D. Ohio 2005).

[1436] *In re Rowand*, 2012 WL 3070215 (Bankr. C.D. Ill. July 30, 2012); *In re Weiser*, *2011 WL 1637945* at *3 (Bankr. S.D. Ind. Apr. 29, 2011); *In re Ciano*, 433 B.R. 431, 435 (Bankr. N.D. Fla. 2010); *In re Mattern*, 2006 WL 3479016 (Bankr. D. Kan. Mar. 9, 2006); *In re Spencer*, 306 B.R. 328, 333–36 (Bankr. C.D. Cal. 2004); *In re Roth*, 289 B.R. 161, 169 (Bankr. D. Kan. 2003). *But see In re Dorsey*, 497 B.R. 374, 388 (Bankr. N.D. Ga. 2013).

[1437] *In re Blount*, 438 B.R. 98, 108 (Bankr. E.D. Tex. 2010); *In re Rogove*, 443 B.R. 182, 190 (Bankr. S.D. Fla. 2010).

[1438] *Dayton*, *2018 WL 576748* at *1.

[1439] *2018 WL 576748* at *2.

[1440] *2018 WL 576748* at *2.

Although the point was academic in the case, the court offered the following observations on the second test:[1441]

[1441] *2018 WL 576748* at *2 (citations omitted).

> It is less clear, however, whether William's interest in the distribution would have been property of the estate had Ms. Ault died just before the petition date, thus calling into question whether it meets the second requirement of §541(a)(5). The parties did not raise this issue in their papers or argue it at the hearing. Like so many things in life, timing here is everything. The parties agree that §541(c)(2) ordinarily excludes from the bankruptcy estate a debtor's interest in a spendthrift trust that remains undistributed at filing. If Ms. Ault had died prepetition and William had received the distribution prior to filing his bankruptcy petition and still held the funds on the petition date, those funds would be property of the estate under §541(a)(1). But what if Ms. Ault had died prepetition and William did not receive the distribution before filing bankruptcy? As stated above, §§541(a)(1) and (c)(2) operate to exclude from the bankruptcy estate a debtor's interest in post-petition distributions from an inter vivos spendthrift trust. So, if Ms. Ault had died prepetition and William had not yet received the distribution when he filed bankruptcy, it appears the post-petition distribution would not be part of William's bankruptcy estate, unless Ms. Ault's death somehow triggered the termination of the trust or invalidated the spendthrift protection under the terms of the trust agreement or applicable nonbankruptcy law. Neither party submitted any evidence—including any relevant provisions of the trust—or argument on this point. Consequently, the court is unable to determine whether the distribution meets the second requirement of §541(a)(5) for inclusion in the bankruptcy estate.

The court identified the central issue in the following way:[1442]

[1442] *2018 WL 576748* at *2 (emphasis in original).

> Trustee Brown contends in her briefing—perhaps using the “kitchen sink” approach—that William received the distribution by bequest, devise, *and* inheritance. That is unlikely, perhaps impossible, under the plain meaning of those terms—because two (bequest and devise) require a will and the other (inheritance) requires that the property pass under the laws of intestacy—and is wrong under the facts before the court.

The court explained:[1443]

[1443] *2018 WL 576748* at *3 (citations and internal quotation marks omitted).

> Neither the Bankruptcy Code nor any relevant state court decision defines the terms bequest, devise, or inheritance. *Black's Law Dictionary* defines an inheritance as property received from an ancestor under the laws of intestacy. Bequest means the act of giving personal property by will. Devise means the act of giving property by will. The Missouri and Colorado probate codes do not define inheritance or bequest, but both provide that the term devise when used as a noun, means a testamentary disposition of real or personal property and, when used as a verb, means to dispose of real or personal property or both by will. The term testamentary means created by will.

The court continued:[1444]

[1444] *2018 WL 576748* (citations omitted).

> By process of elimination, it becomes clear that William did not receive the distribution by bequest, devise, or

> inheritance according to the plain meanings of those terms. There is no evidence that Ms. Ault died intestate or that William somehow inherited the distribution under the laws of intestacy. This eliminates “inheritance.” There is also no evidence that Ms. Ault died testate (i.e., with a will) or that William's distribution from the trust came by way of a disposition under a will. This eliminates both “bequest” and “devise.” Other courts agree.

Whether a debtor's right to receive a post-petition trust distribution that arises during the 180-day period qualifies as a “bequest” or “devise” depends on the type of the underlying trust—testamentary or inter vivos. Unless excluded from the estate by §541(c)(2) because of an enforceable spendthrift provision, a distribution from a testamentary trust qualifies as a bequest or devise because testamentary trusts themselves necessarily arise by operation of a will—distributions from such trusts are quite literally property interests “created by will” and they therefore qualify as testamentary distributions. In contrast, distributions from inter vivos trusts do not qualify as bequests or devises because inter vivos trusts are not created by will. Here, William received the distribution by operation of an inter vivos trust. Consequently, he did not receive the distribution by bequest or devise under the plain meaning of those terms.

The court rejected a further argument by the bankruptcy trustee in the following manner:[1445]

> Though the distribution in this case does not qualify as a devise under the plain meaning of that term, Trustee Brown alternatively argues the distribution constitutes a devise in practical effect. She asks the court to ignore the plain meaning of “devise” and, instead, adopt a new, broader definition that includes will substitutes like an inter vivos trust when the settlor's death triggers the distribution. But her focus on Ms. Ault's death as the triggering event misses the point. By definition, testamentary trusts are created by the settlor's will. Inter vivos trusts are not. Testamentary trust distributions always follow the settlor's death—although the trigger might be something other than the settlor's death. Inter vivos trust distributions might occur before or after, and might or might not relate to, the settlor's death—for example, the beneficiary might receive the distribution upon reaching a certain age. Even if the settlor's death happens to trigger an inter vivos trust distribution, it is still not “by devise.” That is especially true here, where there is no evidence that Ms. Ault even had a will. Congress limited the types of interests that come into the bankruptcy estate pursuant to §541(a)(5) and did not introduce those interests with words like “includes” or “including.” This creates a presumption that §541(a)(5)(A) is limited to interests acquired “by bequest, devise, or inheritance” and does not include will substitutes such as inter vivos trusts. This court agrees with those who distinguish between testamentary and inter vivos trust distributions and declines Trustee Brown's invitation to expand the use of “devise” in §541(a)(5)(A) beyond its plain meaning.

For all of those reasons, the court held that “the court believes the plain meaning of bequest, devise, or inheritance compels it to conclude that the inter vivos spendthrift trust distribution to William does not qualify as a bequest, devise, or inheritance under §541(a)(5)(A).”[1446]

c. **11 U.S.C. §541(a)(7)** —

On its face, another provision of the Bankruptcy Code—§541(a)(7) [1447] —appears to cover our situation. This section provides:

[1445] *2018 WL 576748* at *4 (citation omitted).

[1446] *2018 WL 576748* at *4.

[1447] 11 U.S.C. §541(a)(7). *See* 5 *Collier on Bankruptcy* §541.16 (Levin & Sommer eds. 16th ed.).

> (a) The commencement of a case under section 301, 302, or 303 of this title creates an estate. Such estate is comprised of all of the following property, wherever located and by whomever held:
>
> ….
>
> (7) any interest in property that the estate acquires after the commencement of the case.

However, in 2018, the Bankruptcy Appellate Panel for the Ninth Circuit explained why it should not be of concern: [1448]

> Section 541(a)(7) "is confined to property interests that are themselves traceable to 'property of the estate' or generated in the normal course of a debtor's business."

[1448] *In re Brown*, No. SC-17-1068, *2018 BL 181352*, 2018 WL 2308267 at *9 n.4 (B.A.P. 9th Cir. May 21, 2018) (concurring opinion) (citations omitted). For another application of the provision, see *In re Adams*, 453 B.R. 774, 779–780 (Bankr. N.D. Ala. 2011) ("Because the §542 cause of action did not become property of the Chapter 7 estate, the Trustee is not permitted to bring the §542 cause of action on behalf of the estate") (footnote omitted).

Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Detailed Analysis
IX. Defenses to Creditor Attacks on Domestic APTs

J. Status of Domestic APTs

1. **Introduction** —

For an asset protection trust (APT) to have a chance to succeed, the trust must comply with all statutory requirements. The creators of the APTs in the following cases did not heed this advice.[1449]

- *Dahl v. Dahl* (2015)[1450]—The Supreme Court of Utah held that the trust was not a Nevada spendthrift trust because "the Trust is revocable as a matter of law."
- *In re Erskine* (2016)[1451]—A federal bankruptcy court in Tennessee held that a trust did not qualify as a Tennessee Asset Protection Trust because it was revocable, its spendthrift clause did not shield the settlor's interest, the trustee was not a qualified trustee, and the trust was not accompanied by a solvency affidavit.
- *Bertran v. Compton* (*In re Bertran*) (2017)—A federal district judge in Alaska held that a trust was not an Alaska APT because: [1452]

[1449] *See* Spero, *Recent Cases Show Need for Strict Compliance with DAPT Statutes*, 44 Est. Plan. 8, 10 (May 2017).

[1450] 345 P.3d 566 (Utah 2015). There clearly was a scrivener error. It's unfortunate that the Nevada trustee did not petition a Nevada court to reform the trust as the trustee successfully petitioned for reformation in the situation mentioned in II.F., above.

[1451] 550 B.R. 362, 367–368 (Bankr. W.D. Tenn. 2016).

[1452] *Bertran v. Compton* (*In re Bertran*), No. 4:16-cv-00022, 2017 BL 86453, *2017 WL 1051185* at *6 n.50 (D. Alaska Mar. 20, 2017).

There is some doubt whether the Toni 1 Trust was in existence at the time of the 2012 Judgment. Mr. Tangwall repeatedly failed to provide proof of the trust's existence during the Adversary Action, and the Bankruptcy Court found that Ms. Bertran had failed to submit the requisite settlor's affidavit as required by AS 34.40.110(j). In the absence of this affidavit, if a trust was established, it may be void and any transfers to the Toni 1 Trust would also be void.

2. **Unsuccessful Domestic APTs**

a. **Introduction** —

To date, no court has adjudicated whether a creditor may reach the assets of a properly designed and implemented domestic APT. Some poorly designed domestic APTs, however, have not fared well.

b. **FTC v. Ameridebt, Inc. (2005)** —

In this case,[1453] the federal district court for Maryland granted the FTC preliminary relief in a proceeding in which the FTC alleged, inter alia, that the debtor had sheltered assets in two foreign APTs and a Delaware APT after he learned that the FTC was investigating his business activities to determine whether he had defrauded customers. If the allegations had been proved, the debtor would have engaged in a fraudulent transfer. Accordingly, if the assets of his Delaware APT were reached, it would not have been fatal to Delaware APTs and domestic APTs because the domestic APT statutes are not designed to shield assets that were transferred fraudulently. The author understands that the case was settled.

[1453] 373 F. Supp. 2d 558 (D. Md. 2005).

c. **In re Mortensen (2011)**

(1) **Introduction** —

The next case was decided by the U.S. Bankruptcy Court for the District of Alaska. The bad facts, flawed judicial analysis, and misleading commentary about the case have hurt APTs in general and Alaska APTs in particular. The court issued three opinions in the case:

- Memorandum on Cross-Motions for Summary Judgment, dated January 14, 2011 ("*Mortensen I*")[1454]
- Memorandum Decision, dated May 26, 2011 ("*Mortensen II*")[1455]
- Memorandum on Defendant's Motion for Reconsideration, dated July 8, 2011 ("*Mortensen III*").[1456]

[1454] No. A09-90036, No. A-09-00565, 2011 BL 387653, *2011 WL 5025288* (Bankr. D. Alaska Jan. 14, 2011). *See* David G. Shaftel, *Court Finds Fraudulent Transfer to Alaska Asset Protection Trust*, 39 Est. Plan. 15 (Apr. 2012); Sullivan et al., *Fraudulent Transfer Claims: Does the Bankruptcy Court's Decision in In re Mortensen Spell the End of the Asset Protection Trust?* 150 Tr. & Est. 43 (Dec. 2011).

[1455] No. A09-90036, No. A-09-00565, 2011 BL 139744, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011).

[1456] No. A09-90036, 2011 BL 180087, *2011 WL 5025252* (Bankr. D. Alaska July 8, 2011).

(2) **Mortensen I (2011)** —

In *Mortensen I*, the court considered the bankruptcy trustee's Motion for Summary Judgment on whether the transfer of a parcel of Alaska real property (the Seldovia property), worth about $60,000, to an Alaska APT in 2005 could be set aside under §548(e)(1) of the Bankruptcy Code,**[1457]** quoted below. Going to the heart of the matter, he said that "[t]he determinative issue here is whether Mortensen transferred the Seldovia property to the trust with actual intent to hinder, delay, or defraud his creditors."**[1458]**

[1457] 11 U.S.C. §548(e)(1).

[1458] *Mortensen I*, No. A09-90036, No. A-09-00565, 2011 BL 387653, *2011 WL 5025288* at *2 (footnote and internal quotation marks omitted).

The court concluded:**[1459]**

[1459] No. A09-90036, No. A-09-00565, 2011 BL 387653, *2011 WL 5025288* at *3.

> Having read the debtor's deposition testimony and considered the entirety of the record which the parties have provided, I find that there is insufficient evidence for me to conclude whether Mortensen had the actual intent to hinder, delay or defraud his creditors when the trust was created.

The court's holding is significant because if, as some have claimed,**[1460]** Mortensen means that the creation of an Alaska APT is a fraudulent transfer per se under §548(e)(1), then the court would have had no choice but to grant the trustee's Motion for Summary Judgment.

[1460] *See* Adkisson & Riser, *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 Prot. Plan. Newsl. #185 (Oct. 20, 2011), www.leimbergservices.com.

(3) **Mortensen II (2011)** —

In *Mortensen II*, the court considered the trustee's two contentions as to why the Seldovia property should be included in the bankruptcy estate.

The trustee's first argument was that "[t]he trustee alleges that Mortensen failed to establish a valid asset protection trust under Alaska's governing statutes because Mortensen was insolvent when the trust was created on February 1, 2005."**[1461]**

[1461] *Mortensen II*, No. A09-90036, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 at *4.

After applying a balance-sheet test (in which a $100,000 gift from the debtor's mother was included as an asset) to determine whether the debtor was solvent when he transferred the Seldovia property to the Alaska APT, the court found that he indeed was solvent and that he, therefore, had established a valid Alaska APT.**[1462]** Although the judge reached the right result, it appears that his analysis was lacking because the Alaska Act requires the preparation of a solvency affidavit—not actual solvency—to establish a valid APT.**[1463]**

[1462] *Mortensen II*, No. A09-90036, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 at *5.

[1463] *See* Alaska Stat. §34.40.110(j)(2).

The trustee next argued that the debtor's transfer of the Seldovia property to an Alaska APT should be set aside under §548(e)(1) of the Bankruptcy Code,[1464] which provides:

[1464] 11 U.S.C. §548(e)(1). For a summary of §548(e)'s legislative history, see Sullivan, et al., *Fraudulent Transfer Claims: Does the Bankruptcy Court's Decision in In re Mortensen Spell the End of the Asset Protection Trust?* 150 Tr. & Est. 43, 48–49 (Dec. 2011).

> (e)(1) 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.

Regarding this contention, the court observed:[1465]

[1465] *Mortensen II*, No. A09-90036, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 at *6 (footnote and internal quotation marks omitted).

> Mortensen's trust, established under AS 34.40.110, satisfies the first three subsections of § 548(e)—the Seldovia property was transferred to a self-settled trust, Mortensen made the transfer, and he is a beneficiary of the trust. The determinative issue here is whether Mortensen transferred the Seldovia property to the trust with actual intent to hinder, delay, or defraud his creditors.

The court considered the weight to be given to a provision in the trust instrument that the trust's purpose 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."[1466]

[1466] No. A09-90036, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 at *6 (footnote omitted).

The court concluded "that a settlor's expressed intention to protect assets placed into a self-settled trust from a beneficiary's potential future creditors can be evidence of an intent to defraud."[1467]

[1467] No. A09-90036, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 at *7.

But, the court did not stop here and continued:[1468]

[1468] No. A09-90036, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 at *8 (footnotes and internal quotation marks omitted).

> [T]here is additional evidence which demonstrates that Mortensen's transfer of the Seldovia property to the trust was made with the intent to hinder, delay and defraud present and future creditors.
>
> First, Mortensen was coming off some very lean years at the time he created the trust in 2005. His earnings over the preceding four years averaged just $11,644.00 annually. He had burned through a $100,000.00 annuity which he had cashed out in 2000. He had also accumulated credit card debt of between $49,711.00 to $85,000.00 at the time the trust was created. He was experiencing financial carnage from his divorce. Comparing his low income to his estimated overhead of $5,000.00 per month (or $60,000.00 per year), Mortensen was well under water when he sought to put the Seldovia property out of reach of his creditors by placing it in the trust.
>
> Further, when Mortensen received the $100,000.00 from his mother he didn't pay off his credit cards. Rather, he transferred $80,000.00 into the trust after paying a few bills and began speculating in the stock market. He had a substantial credit card debt due to AT & T, approximately $15,200.00, which was not paid in 2005. This debt had increased to $19,096.00 by the time he filed his bankruptcy petition. In 2005, Mortensen also owed Capital 1 approximately $6,350.00 in credit card debt. This debt had bumped up to $7,525.00 when he filed for bankruptcy. He had a Discover card with a balance of $12,588.00 as of Feb. 1, 2005. He owed Discover $11,905.00 when he filed bankruptcy.
>
> Mortensen claims he paid these accounts off on a number of occasions and then re-borrowed against them. I can find no evidence of such payoffs in the documentary evidence and I don't believe Mortensen. Nor do I believe that the trust repaid Mortensen the $80,000 in 2006. If that had been the case, Mortensen wouldn't have needed to borrow another $29,000.00 on his credit cards. I conclude that Mortensen's transfer of the Seldovia property and the placement of $80,000.00 into the trust constitutes persuasive evidence of an intent to hinder, delay and defraud present and future creditors.

In civil matters, including cases involving Alaska APTs, Alaska state courts follow the English Rule, under which counsel fees generally are awarded to the prevailing party.[1469] But, in this federal case, the court honored the American Rule, under which each party generally bears its own counsel fees, as follows:[1470]

[1469] *See* Alaska R. Civ. P. 82(a); Alaska Stat. §13.36.310(b).

[1470] *Mortensen II*, No. A09-90036, No. A09-00565, 2011 BL 139744, 2011 WL 5025249 at *8 (footnote omitted).

> [U]nder the American Rule, attorney's fees are generally not recoverable for litigating federal issues absent an agreement or specific statutory authority. This avoidance action is brought under a provision of the Bankruptcy Code and raises federal issues. The trustee is not entitled an award of attorney's fees against the defendants.

(4) **Mortensen III (2011)** —

In *Mortensen III*, the court considered, inter alia, the debtor's motion to reconsider the holding that the transfer of the Seldovia property to the Alaska APT should be set aside under §548(e)(1). Initially, the court rejected the debtor's contention that the prior ruling meant that the transfer was a fraudulent transfer per se as follows: [1471]

[1471] *Mortensen III*, No. A09-90036, 2011 BL 180087, *2011 WL 5025252* at *1

> The defendants contend the essence of the court's ruling is that any transfer to a self-settled trust made within 10 years of the filing of a bankruptcy petition is a fraudulent conveyance. They base this contention on my finding that a settlor's expressed intention to protect assets placed into a self-settled trust from a beneficiary's potential future creditors can be evidence of an intent to defraud. I made this finding notwithstanding AS 34.30.110(b)(1)[sic], which specifies that a settlor's expressed intention to protect trust assets from a beneficiary's potential future creditors is not evidence of an intent to defraud.
>
> The defendants say the court should not use the creation of the trust itself as evidence of fraudulent intent, but should instead deal solely with the transfer of the property. However, when property is transferred to a self-settled trust with the intention of protecting it from creditors, and the trust's express purpose is to protect that asset from creditors, both the trust and the transfer manifest the same intent. In this case, I found that the trust's express purpose could provide evidence of fraudulent intent. However, it was not the only evidence upon which I based my decision.

Later, the court analyzed the available evidence as follows:[1472]

> The defendants contend there is scant evidence of Mortensen's actual intent to defraud his creditors. Mortensen's intent goes to the heart of this matter. Because this element is often difficult to prove with direct evidence, courts will look to circumstantial “badges of fraud” to determine fraudulent intent.
>
> Among the more common circumstantial indicia of fraudulent intent at the time of the transfer are: (1) actual or threatened litigation against the debtor; (2) a purported transfer of all or substantially all of the debtor's property; (3) insolvency or other unmanageable indebtedness on the part of the debtor; (4) a special relationship between the debtor and the transferee; and, after the transfer, (5) retention by the debtor of the property involved in the putative transfer.
>
> The defendants argue that when Mortensen placed the Seldovia property in trust he actually increased his vulnerability to creditors because he replaced an exempt homestead with non-exempt cash. I disagree. He placed most of the cash he received from his mother into the trust as well, insulating it from creditors’ claims. In other words, substantially all of his property was transferred to the trust. The defendants’ contention that Mortensen had to fund the trust in this manner is contradicted by Mortensen's own testimony. He said there was no expectation or requirement that he do this. His assertion that he lent these funds to the trust was not supported by the record. There was no promissory note. Nor was there evidence of repayment of the loan. Additionally, his investment of the funds, once placed into the trust, contradicted trust provisions which specified that the investment trustee would manage and invest trust assets. Mortensen, as a trust beneficiary, did not have this power.
>
> Further, evidence at trial refutes Mortensen's claim that he was making all required payments on his debts when the Seldovia property was transferred. He had burned through a $100,000.00 annuity, and his credit card debt was between $49,711.00 and $85,000.00 when the trust was created. It was difficult to determine the true nature of Mortensen's finances; he was not a credible witness. Even accepting the defendants’ contention that Mortensen's monthly expenses at that time were $3,000.00, rather than $5, 000.00, he was still under water when he put the realty (and then the cash) into the trust. His existing creditors were never paid off, and his debts were already unmanageable when the property was

(footnotes and internal quotation marks omitted).

[1472] No. A09-90036, 2011 BL 180087, *2011 WL 5025252* at *2 (footnotes and internal quotation marks omitted).

> transferred. The timeline provided by the plaintiff in his opposition highlights this point. Mortensen used the Seldovia property after he transferred it to the trust, but did not regularly pay rent to the trust. He also invested the funds he had transferred to the trust and lent funds to a friend for a vehicle purchase. Based on this evidence, I found sufficient badges of fraud to determine that Mortensen intended to hinder, delay and defraud his creditors when he transferred the Seldovia property to the trust.

(5) **Comment** —

Early commentators on *Mortensen* wrote:[1473]

[1473] Adkisson & Riser, *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 Prot. Plan. Newsl. #185 (Oct. 20, 2011), www.leimbergservices.com.

> Some planners have speculated that the only effect of 548(e) was to increase the Statute of Limitations in bankruptcy for transfers to a self-settled spendthrift trust to 10 years, while still requiring a battle to be fought over fraudulent intent. Others have speculated 548(e) effectively guts all self-settled spendthrift trusts within that 10-year battle where asset protection was a goal—no battle necessary.
>
> The *Mortensen* decision validates—at least for the moment—the speculation of the latter group of planners. The *Mortensen* decision says that the assets of a self-settled spendthrift trust are available to a bankruptcy Trustee who makes a fraudulent transfer claim where the bankruptcy filing occurs within 10 years of the trust's creation, if the trust was created for the purpose of asset protection.

It must be remembered that debtors must take account of existing and foreseeable future creditors but are free to protect assets from unknown future creditors. The court's failure to categorize the debtor's creditors along these lines is regrettable. But, nothing in the three opinions supports the above commentary.

Practice Tip: Nevertheless, *Mortensen* seems to be bad news for Alaska. Hence, a commentator opined in 2014:[1474]

[1474] Mann, *A Fresh Look at State Asset Protection Trust Statutes*, 67 Vand L. Rev. 1741, 1760 (Nov. 2014) (footnote omitted).

> In sum, if *Mortensen* stands for anything, it is the court's “bottom line” assessment that Mortensen's use of an APT was “a clever but fundamentally flawed scheme to avoid exposure to his creditors.” Importantly, because that decision came from the only bankruptcy jurisdiction in Alaska, the likelihood of successful reliance on that statute seems all but remote.

d. **Waldron v. Huber (In re Huber) (2013)**

(1) **Introduction** —

In this federal bankruptcy case,[1475] the bankruptcy trustee was able to access the assets of a poorly constructed Alaska APT under several theories. It offers lessons for practitioners designing APTs of any kind.

[1475] 493 B.R. 798 (Bankr. W.D. Wash. 2013). *See* Menton, *Domestic Asset Protection Trusts and Fraudulent Transfer Jurisdiction*, 43 Tax Mgmt. Est., Gifts & Tr. J. 263, 264–65 (Sept. 13, 2018).

(2) **Facts** —

- 1968—Huber founded United Western Development, Inc. (UWD), real estate development firm in the Pacific Northwest;
- 2007–2009—Several of Huber's projects encountered financial difficulty; Huber and his business partner each threatened to create an APT to protect assets from the other;
- August 19, 2008—Huber's son wrote to attorney inquiring about APT;
- September 4, 2008—Huber created DGH, LLC, and subsequently funded it with $10,000 cash and interests in over 25 entities (many holding Washington State residential or commercial real property);
- September 23, 2008—Huber established Donald Huber Family Trust, an Alaska APT, and subsequently funded it with a $10,000 Alaska certificate of deposit and 99% interest in DGH, LLC; two Washington State residents and Alaska USA Trust Company were appointed trustees;
- February 10, 2011—Huber filed voluntary bankruptcy petition.[1476]

(3) **Issues** —

The bankruptcy trustee moved for summary judgment that:

- Washington State rather than Alaska law applied and trust was invalid under Washington State law (motion granted);
- the trust was Huber's alter ego and therefore invalid (motion denied);
- transfers to trust could be set aside under §548(e)(1) of Bankruptcy Code (motion granted);
- transfers to trust could be set aside as fraudulent transfers (motion granted);
- Huber should not receive bankruptcy discharge (motion denied).

(4) **Applicable Law; Validity of Trust**

(a) **Choice of Law** —

On this issue, the court began:[1477]

> In federal question cases with exclusive jurisdiction in federal court, such as bankruptcy, the court should apply federal, not forum state, choice of law rules. In applying federal choice of law rules, courts in the Ninth Circuit follow the approach of the *Restatement (Second) of Conflict of Laws* (1971).

The court continued by quoting §270 of the *Restatement*, which provides:[1478]

[1476] 493 B.R. 798, 802–806.

[1477] 493 B.R. 798, 807.

[1478] *Restatement (Second) of Conflict of Laws* §270 (1971).

> 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 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.

It then elaborated by quoting Comment b under §270,[1479] which says:[1480]

> b. Law designated by the settlor to govern validity of the trust. Effect will be given to a provision in the trust instrument that the validity of the trust shall be governed by the local law of a particular state, provided that this state has a substantial relation to the trust and that the application of its local 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.
>
> 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. There may be other contacts or groupings of contacts which will likewise suffice ….
>
> Although as to most grounds for invalidity the local law of the designated state will be applied, provided that this state has a substantial relation to the trust, it will not be applied if this would violate a strong public policy of the state with which as to the matter in issue the trust has its most significant relationship. Thus, where the settlor creates a revocable trust in a state other than that of his domicil, in order to avoid the application of the local law of his domicil giving his surviving spouse a forced share of his estate, it may be held that the local law of his domicil is applicable, even though he has designated as controlling the local law of the state in which the trust is created and administered.

The court then applied the above principles to the case at hand:[1481]

> Under the *Restatement*, the Debtor's choice of Alaska law designated in the Trust should be upheld if Alaska has a substantial relation to the Trust. *Restatement* §270(a). Comment b 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. These contacts with the state are not exclusive. In the instant case, it is undisputed that at the time the Trust was created, the settlor was not domiciled in Alaska, the assets were not located in Alaska, and the beneficiaries were not domiciled in Alaska. The only relation to Alaska was that it was the location in which the Trust was to be administered and the location of one of the trustees, AUSA.
>
> Conversely, it is undisputed that at the time the Trust was created, the Debtor resided in Washington; all of the property placed into the Trust, except a $10,000 certificate of deposit, was transferred to the Trust from Washington; the creditors of the Debtor were located in Washington;

[1479] *Huber*, 493 B.R. 798, 808.

[1480] *Restatement (Second) of Conflict of Laws* §270 cmt. b (1971).

[1481] *Huber*, 493 B.R. 798, 808–809.

> the Trust beneficiaries were Washington residents; and the attorney who prepared the Trust documents and transferred the assets into the Trust was located in Washington. Accordingly, while Alaska had only a minimal relation to the Trust, using the test set forth in Comment b, Washington had a substantial relation to the Trust when the Trust was created.

Having determined that Washington State rather than Alaska had the most substantial relation, the court continued:[1482]

[1482] 493 B.R. 798, 809.

> Additionally, Washington State has a strong public policy against self-settled asset protection trusts. Specifically, pursuant to RCW 19.36.020, transfers made to self-settled trusts are void as against existing or future creditors. This statute has been in existence for well over a century, as it was first enacted in 1854. This policy is consistent with those in other states. For instance, in *Marine Midland Bank v. Portnoy (In re Portnoy),* the bankruptcy court considered the public policy of New York against self-settled trusts when determining a choice of law issue: *Portnoy* may not unilaterally remove the characterization of property as his simply by incorporating a favorable choice of law provision into a self-settled trust of which he is the primary beneficiary. Equity would not countenance such a practice. As with New York, Washington has a policy that a debtor should not be able to escape the claims of his creditors by utilizing a spendthrift trust.

The court concluded:[1483]

[1483] 493 B.R. 798.

> [I]n accordance with §270 of the *Restatement*, this Court will disregard the settlor's choice of Alaska law, which is obviously more favorable to him, and will apply Washington law in determining the Trustee's claim regarding validity of the Trust.

Practice Tip: The court misapplied the *Restatement*, under which issues are divided into matters of validity, construction, administration, and creditor rights. Under this framework, matters of “validity” are confined to issues such as whether the trust violates the rule against perpetuities or the rule against accumulations,[1484] and §270 is not a catch-all provision. Further, the matters that constitute strong public policy justifying departure from the settlor's intent involve things like efforts to defeat a surviving spouse's elective-share rights.[1485] Section 273 of the *Restatement* [1486] deals specifically with creditors’ ability to reach trust assets and provides that the law designated by the settlor governs without exception. Admittedly, APTs did not exist when the *Restatement* was issued in 1971, but, if §273 does not apply, Restatement §272,[1487] which covers matters of administration and, like §273, honors the settlor's designation without exception, might very well apply. Unfortunately, practitioners must plan on the assumption that courts will continue to misapply these rules so that APTs should be designed to make as strong a case as possible under §270.

[1484] *Restatement (Second) of Conflict of Laws* §269 cmt. d (1971).

[1485] *Restatement* §270 cmt. b.

[1486] *Restatement* §273 cmt. b.

[1487] *Restatement* §272 cmt. b.

(b) **Validity of Trust** —

Having found that Washington State law governed, the court turned to Wash. Rev. Code §19.36.020,[1488] which invalidates self-settled spendthrift trusts as follows:[1489]

[1488] *Huber*, 493 B.R. 798, 809.

[1489] Wash. Rev. Code §19.36.020.

> That all deeds of gift, all conveyances, and all transfers or assignments, verbal or written, of goods, chattels or things in action, made in trust for the use of the person making the same, shall be void as against the existing or subsequent creditors of such person.

The court concluded “[t]he Trust is admittedly a self-settled trust. In accordance with RCW 19.36.020, the Debtor's transfers of assets into the Trust were void as transfers made into a self-settled trust.”[1490]

[1490] *Huber*, 493 B.R. 798, 809.

(5) **Alter-Ego Doctrine** —

The bankruptcy trustee also sought summary judgment on the ground that he could reach the assets of the trust because it was Huber's alter ego. The court denied this motion, finding that it was unclear under Washington State law whether the alter-ego doctrine extended to the trust context.[1491]

[1491] 493 B.R. 798, 810.

(6) **Bankruptcy Code §548(e)(1)** —

Alternatively, the bankruptcy trustee sought summary judgment that transfers to the trust were voidable under §548(e)(1) of the Bankruptcy Code,[1492] which provides:[1493]

[1492] 493 B.R. 798, 811.

[1493] 11 U.S.C. §548(e)(1).

> 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.

The parties agreed that the first three elements were satisfied and that the controversy involved the fourth element.[1494] After analyzing various badges of fraud,[1495] the court determined that “[t]he evidence presented by the Trustee supports an inference of actual fraudulent intent by the Debtor to hinder, delay, or defraud his current or future creditors, in violation of §548(e)(1)(D). The Trustee is entitled to summary judgment on this claim as a matter of law.”[1496]

[1494] *Huber*, 493 B.R. 798, 811.

[1495] 493 B.R. 798, 812–14.

[1496] 493 B.R. 798, 814.

(7) **Fraudulent Transfer** —

The court next turned to the bankruptcy trustee's contention that summary judgment was warranted because transfers to the trust constituted fraudulent transfers under §544(b)(1) of the Bankruptcy Code and Wash. Rev. Code §19.40.041(a).[1497] Section 544(b)(1) provides in pertinent part that: "[t]he 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."[1498]

[1497] 493 B.R. 798, 814.

[1498] 11 U.S.C. §544(b)(1).

Under §544(b)(1) and applicable Washington State law, the bankruptcy trustee could set transfers to the trust aside under Wash. Rev. Code §19.40.041(a)(1),[1499] which provides:[1500]

[1499] *Huber*, 493 B.R. 798, 814.

[1500] Wash. Rev. Code §19.40.041(a)(1).

> (a) 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; ….

After analyzing badges of fraud,[1501] the court concluded:[1502]

[1501] *Huber*, 493 B.R. 798, 814–816.

[1502] 493 B.R. 798, 816 (footnote omitted).

> [V]iewing the evidence in the light most favorable to the Debtor, the Trustee has established that there is no genuine dispute as to any material fact, and the Trustee is entitled to summary judgment as a matter of law on its UFTA claim based on actual fraudulent intent.

Along the way, the court noted that "estate planning alone does not create an issue of fact as to intent."[1503]

[1503] 493 B.R. 798, 816.

(8) **Bankruptcy Discharge** —

Finally, the court considered the bankruptcy trustee's argument that the debtor should be denied a discharge in bankruptcy under §727(a)(2)(A) and (a)(4) of the Bankruptcy Code[1504] but concluded that the trustee had not carried his burden.[1505]

[1504] 11 U.S.C. §727(a)(2)(A), §727(a)(4).

[1505] *Huber*, 493 B.R. 798, 818.

Practice Tip: Huber demonstrates the importance of trust design. Huber's case would have been much stronger if he had appointed only Alaska trustees, funded the trust with Alaska assets, and minimized Washington State contacts. It should be noted that placing Washington State real property in LLCs and corporations did not work.

e. **Dahl v. Dahl (2015)**

(1) **Introduction** —

This case demonstrates how inartful drafting of a domestic APT can prove disastrous for a debtor.[1506] In it, the assets of what was intended to be a Nevada APT were reached by the settlor's former wife in a Utah divorce proceeding.

[1506] *Dahl v. Dahl*, 345 P.3d 566 (Utah 2015).

(2) **Facts** —

On an unspecified date, the husband created a trust that purported to be a Nevada APT. Both spouses contributed assets. Other pertinent facts are:

- October 24, 2006—Husband filed for divorce;
- July 31, 2009—Wife brought action seeking declaration of her rights in trust assets and requesting trust accounting and copy of agreement;
- July 20, 2010—Decree of divorce entered.[1507]

[1507] *Dahl v. Dahl*, 345 P.3d 566, 2015 WL 5098249 at *1–3.

(3) **Issues** —

For present purposes, the court considered the following issues:

- whether trust should be construed according to Nevada or Utah Law;
- whether wife had enforceable right in trust property.

(4) **Whether the Trust Should Be Construed According to Nevada or Utah Law** —

The court first noted that Utah's choice-of-law rules applied because it was the forum state.[1508] It continued that:[1509]

[1508] *Dahl v. Dahl*, 345 P.3d 566, 2015 WL 5098249 at *5.

[1509] *Dahl v. Dahl*, 345 P.3d 566, 2015 WL 5098249 at *5 (citations omitted).

> Under Utah choice-of-law rules, we will generally enforce a choice-of-law provision contained in a trust document, unless doing so would undermine a strong public policy of the State of Utah. Thus, we will refuse to enforce a settlor's choice-of-law provision if doing so would undermine strong public policy goals of this state.

The court then quoted the governing law provision of the governing instrument:[1510]

Section 5.4.6 of the Trust agreement provides:

> *Governing Law*. The validity, construction and effect of the provisions of this Agreement in all respects shall be governed and regulated according to and by the laws of the State of Nevada. The administration of each Trust shall be governed by the laws of the state in which the Trust is being administered.

It continued:[1511]

> Issues concerning the meaning of trust terms, the legal effect of those terms, and the status of individuals vis-à-vis the Trust are all matters of trust construction. Conversely, questions related to the performance of the trustee's duties and the management of trust assets are issues of trust administration. The central dispute between the parties in this case concerns the revocability of the Trust. This is an issue of trust construction to which we would ordinarily apply Nevada law. But we cannot apply Nevada law without violating Utah public policy.

The court then noted that Utah has a long-established policy in favor of equitable distribution of marital assets in divorce cases, that Utah has a strong interest in ensuring that trust property is equitably divided in the parties' divorce action to the extent it contains marital property, and that at least some of the trust assets originated as marital property.[1512]

The court concluded:[1513]

> Because Utah has a strong public policy of equitable division of marital assets, we will not enforce the choice-of-law provision contained in the Trust. Instead, we construe the Trust according to Utah law.

(5) **Whether Wife Had an Enforceable Right in the Trust Property** —

Near the beginning of this part of the opinion, the court quoted Section 5.5 of the Trust agreement, which provides: "*Trust Irrevocable*. The Trust hereby established is irrevocable. Settlor reserves *any power whatsoever* to alter or amend *any* of the terms or provisions thereof."[1514]

In the author's view, there was a drafting error—the first "any" should have been "no."

Based on the above provision, the court determined:[1515]

[1510] *Dahl v. Dahl*, 345 P.3d 566, 2015 WL 5098249 at *5.

[1511] *Dahl v. Dahl*, 345 P.3d 566, 2015 WL 5098249 at *5 (citations omitted). The *Restatement* agrees that whether a trustor may revoke an inter vivos trust is a matter of construction (*Restatement (Second) of Conflict of Laws* §268 cmt. g (1971)).

[1512] *Dahl v. Dahl*, 345 P.3d 566, 2015 WL 5098249 at *6.

[1513] *Dahl v. Dahl*, 345 P.3d 566, 2015 WL 5098249 at *3.

[1514] *Dahl v. Dahl*, 345 P.3d 566, 2015 WL 5098249 at *6 (emphasis in original).

[1515] *Dahl v. Dahl*, 345 P.3d 566, 2015 WL 5098249 at *7.

- the husband had reserved an unrestricted power to amend the trust;
- the trust was revocable under Utah law;
- the wife is a "settlor" because she contributed assets to the trust;
- being a settlor, the wife could revoke her contributions to the trust.

(6) **Conclusion** —

The court summarized its decisions on the wife's trust claims as follows:[1516]

> [W]e construe the trust agreement according to Utah law based on Utah's long-standing public policy interest in the equitable division of marital assets upon divorce. We conclude that Dr. Dahl reserved an unrestricted power to amend the Trust in the Trust agreement. Under Utah law, this unrestricted power to amend gave Dr. Dahl the power to revoke the Trust, thereby rendering the Trust revocable. Because Ms. Dahl contributed marital property to the Trust, she retains the status of settlor and may revoke the Trust as to her contribution of both her separate property and any marital assets.

It is interesting that the court did not even mention that Utah recognizes APTs.

3. **Successful Domestic APTs**

a. **Introduction** —

At this writing, domestic APTs have been successful in two reported cases—one in Delaware; the other in Nevada.

b. **TrustCo Bank v. Mathews (2015)**

(1) **Introduction** —

In this case,[1517] the Delaware Court of Chancery held that creditors' attempts to reach the assets of two Delaware APTs were time-barred. Accordingly, even though its scope was narrow, *TrustCo* represents the first reported case in which a domestic APT "worked." At the outset, the court summarized the controversy as follows:[1518]

> This action involves allegedly fraudulent transfers. The parties dispute which state's law and, more importantly, which state's statute of limitations applies. The plaintiffs assert that New York's six-year or two-years-from-discovery statute of limitations governs the plaintiffs' claims. The defendants argue that either Delaware or Florida law controls and that most of the plaintiffs' claims are barred by the identical four-year or one-year–from—notice statutes of limitations adopted by both of those states. Before the Court is the defendants' motion for partial summary judgment on the statute of limitations issue. For the reasons that follow, I conclude that New York's statute of limitations does not apply to this case and grant the defendants' motion for partial summary judgment. Even if New York law did apply, however, the defendants still would be entitled to summary judgment. The plaintiffs' primary fraudulent transfer claims,

[1516] *Dahl v. Dahl*, 345 P.3d 566, 2015 WL 5098249 at *10.

[1517] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 (Del. Ch. Jan. 22, 2015).

[1518] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *1.

therefore, are time barred.

(2) **Facts** —

- July 2006—TrustCo Bank (TrustCo), federal savings bank with principal place of business in Glenville, New York, made $9,300,000 construction loan to StoreSmart of North Ft. Pierce, LLC (StoreSmart), Florida LLC; Mathews guaranteed loan;
- December 21, 2006—Mathews established two Delaware APTs;
- January 2007—Mathews transferred ITRAX stock to two Delaware APTs;
- June 2008—Loan was modified;
- March 2009—Loan was modified again;
- April 2011—StoreSmart defaulted on loan;
- April 25, 2011—TrustCo filed foreclosure action against StoreSmart and Mathews in Florida;
- July 12, 2011—Florida court granted judgment to TrustCo against StoreSmart and Mathews for $8.2 million plus interest;
- August 2012—TrustCo assigned its interest in loan and judgment to ORE Property Two, Inc. (ORE), Florida corporation;
- February 2013—Florida court approved entry of $2.3 million deficiency judgment;
- March 1, 2013—Plaintiffs filed initial complaint in Delaware contending January 2007 transfers to Delaware APTs were fraudulent transfers.[1519]

[1519] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *2–3.

(3) **Issues** —

In analyzing defendants' motion for summary judgment, the court addressed the following issues:

- laches versus statute of limitations;
- Delaware borrowing statute;
- most significant relationship test;
- qualified Dispositions in Trust Act;
- analysis under New York's statute of limitations.

(4) **Laches vs. Statute of Limitations** —

The Court of Chancery observed that, as a court of equity, the court is not bound by statutes of limitations. Instead, the court follows the doctrine of laches, which was described as follows:[1520]

[1520] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *5 (footnote and internal quotation marks omitted).

> Laches is the equitable analog of the statute of limitations defense. Laches will prevent someone who slumbers on her rights and delays unreasonably in filing suit from being permitted to prosecute her claims. To prevail on a laches defense, a defendant must prove that: (1) the plaintiff had knowledge of his claim; (2) he delayed unreasonably in bringing that claim; and (3) the defendant suffered resulting prejudice.

Although statutes of limitations are not binding in courts of equity, the court found the applicable statute of limitations to apply in this case for the following reason:[1521]

[1521] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *5 (footnotes and internal quotation marks omitted).

> Generally, this Court will look to the analogous statute of limitations to determine whether a plaintiff's delay was unreasonable. As the Delaware Supreme Court has stated, absent a tolling of the limitations period, a party's failure to file within the analogous period of limitations will be given great weight in deciding whether the claims are barred by laches. Indeed, a filing after the expiration of the analogous limitations period is presumptively an unreasonable delay for purposes of laches. In this case, Plaintiffs presented no persuasive justification as to why the relevant statute of limitations period should not guide the laches analysis. As such, and because I am unable to articulate any independent reason for concluding otherwise, I find that the applicable statute of limitations here should be determinative as to whether Plaintiffs delayed unreasonably in filing suit more than six years after the allegedly fraudulent transfers took place.

The court continued that Delaware's statute of limitations should apply as follows:[1522]

[1522] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *5 (footnotes and internal quotation marks omitted).

> Even if another state's substantive law may govern the parties' rights in a given case, the general rule is that the forum state's statute of limitations applies. This is consistent with the general principle that the procedural law of the forum state (here, Delaware) usually applies. One exception to this rule arises when the procedural law of the foreign state is so inseparably interwoven with substantive rights as to render a modification of the foregoing rule necessary, lest a party be thereby deprived of his legal rights… . This exception is inapplicable in this case, however. The statute of limitations for fraudulent transfers in New York is merely New York's general statute of limitations for fraud. Nor is there any evidence that New York's statute of limitations for fraud claims has any special connection to that state's fraudulent transfer law, or that the two are so inseparably interwoven as to warrant an exception to the general rule of applying the forum state's procedural law.

But, the court noted that the general rule of following the forum state's statute of limitations might be modified by:

- Delaware's borrowing statute; or
- Delaware's Qualified Dispositions in Trust Act.[1523]

[1523] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *5.

(5) **The Delaware Borrowing Statute** —

The court indicated that the general rule that the forum state's statute of limitations applies might be changed by Delaware's borrowing statute,[1524] which provides:[1525]

[1524] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *6–7.

[1525] Del. Code Ann. tit. 10, §8121.

> 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.

After extensive analysis, the court concluded that no improper forum shopping justified departing from the borrowing statute.[1526]

[1526] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *8.

(6) **The Most Significant Relationship Test** —

The court wrote that Delaware's borrowing statute would apply only if plaintiffs’ cause of action arose outside Delaware and that Delaware courts look to the *Restatement (Second) of Conflict of Laws* to make such a determination.[1527] The plaintiffs contended that New York law, which required a fraudulent-conveyance claim to be brought within the later of six years after the conveyance or two years after its discovery,[1528] was applicable. However, the defendants argued that either Delaware or Florida law, both of which required a fraudulent transfer claim to be brought within the later of four years after the transfer or one year after its discovery,[1529] was applicable.[1530] Observing that it's unclear whether a fraudulent transfer claim sounds in tort or in contract, the court summarized and applied the rules for both theories.

[1527] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *9.

[1528] N.Y. C.P.L.R. §213(8)

[1529] Del. Code Ann. tit. 6, §1309; Fla. Stat. Ann. §726.110.

[1530] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *11.

The court noted that the factors for torts under *Restatement (Second) of Conflict of Laws* §145 are:[1531]

[1531] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *9.

> (a) [T]he place where the injury occurred, (b) the place where the conduct causing the injury occurred, (c) the domicil, residence, nationality, place of incorporation and place of business of the parties, and (d) the place where the relationship, if any, between the parties is centered.

After analyzing the above factors, he concluded that:[1532]

[1532] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *10.

> Overall, I conclude that the tort factors from the *Restatement* moderately favor Florida. Delaware has the next strongest connection to this case, with New York having the weakest relationship to it.

The court listed the factors for contracts from *Restatement (Second) of Conflict of Laws* §188 as follows:[1533]

> (a) [T]he place of contracting, (b) the place of negotiation of the contract, (c) the place of performance, (d) the location of the subject matter of the contract, and (e) the domicil, residence, nationality, place of incorporation and place of business of the parties.

After applying these factors, he opined that "[t]he contract factors therefore are either in equipoise between New York and Florida or only weakly favor New York."[1534]

The court held:[1535]

> Florida likely has the most significant relationship to this case and its four-year statute of limitations should apply. Alternatively, Delaware has the next most significant relationship and has essentially an identical statute of limitations. Under either of those scenarios, the Borrowing Statute is not applicable. As a third alternative, even if New York did have the most significant relationship, its contacts are 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, then the Borrowing Statute would be triggered and Delaware's statute of limitations nevertheless would apply. Regardless of which of these three states has the most significant relationship with this case, therefore, I conclude that Plaintiffs still 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 is longer. Because Plaintiffs did not file this action relating to the ITRAX Transfers until after the expiration of that time period, I hold that their claims regarding the ITRAX Transfers are barred by laches.

(7) **The Qualified Dispositions in Trust Act** —

The court then turned to the defendants' contention that Delaware's Qualified Dispositions in Trust Act required him to apply Delaware's statute of limitations[1536] but found it unnecessary to resolve this issue because:[1537]

> I concluded [above] that Plaintiffs' claims relating to the ITRAX Transfers are barred because of either the most significant relationship choice of law analysis, which points to the use of Florida or, perhaps, Delaware law, or Delaware's Borrowing Statute, which requires the application of Delaware's statute of limitations even if New York had been found to have the most significant relationship to this case. As a result, I find it unnecessary to resolve the question of whether in this case the QDTA requires application

[1533] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *10.

[1534] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *11.

[1535] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *11 (footnote omitted).

[1536] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *11–12.

[1537] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *12.

> of Delaware's fraudulent transfer statute of limitations without regard to the normal choice of law analysis or the Borrowing Statute.

(8) **Analysis Under New York's Statute of Limitations** —

The court stated:[1538]

> Summary judgment also is appropriate for the independent reason that Plaintiffs' claims are untimely even if New York's statute of limitations applies. 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.

The court then summarized situations in which plaintiffs had been given notice of Mathews's transfers and held that:[1539]

> I conclude that Plaintiffs were on inquiry notice by July 2010 at the latest and that the statute of limitations began running at that time. Because Plaintiffs filed suit in March 2013, their claims relating to the ITRAX Transfers are untimely even under New York's statute of limitations. Thus, for this second, independent reason, partial summary judgment in favor of Defendants is appropriate as to those transfers.

At this writing, the status of a claim involving a transfer to a third Delaware APT remains unresolved.

Practice Tip: Florida practitioners have observed:[1540]

> The old adage "good facts make good law" is on display in this case. Practitioners should consult this thorough, well-written opinion as a roadmap for the proper establishment and administration of domestic asset protection trusts in order to best situate their clients' use of such trusts as a creditor protection tool.

c. **Klabacka v. Nelson (2017)**

(1) **Introduction** —

This case arose in the all-too common divorce context. At the beginning of the opinion, the court summarized the controversy as follows:[1541]

> These appeals involve a divorce and a division of assets held in self-settled spendthrift trusts owned by the former husband and wife… . Ten years into their marriage, Eric and Lynita Nelson signed a separate property agreement (the SPA) that transmuted their property into separate property and placed that property into the parties' respective separate property trusts. Later, the parties converted those trusts into self-settled spendthrift trusts (SSSTs) and funded them with their respective separate property… . In

[1538] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *12 (footnote and internal quotation marks omitted).

[1539] *TrustCo Bank v. Mathews,* No. 8374, 2015 BL 15306, 2015 WL 295373 at *14.

[1540] Alan S. Gassman et al., *Debtor Wins in Court With Self-Settled Spendthrift Trust*, 42 Est. Plan. 26, 29 (Sept. 2015).

[1541] *Klabacka v. Nelson*, 394 P.3d 940, 942–943 (Nev. 2017).

> 2009, the parties began divorce proceedings and subsequently added the SSSTs as necessary parties. Issues presented within the divorce proceedings bring us to the instant appeals.

(2) **Facts** —

- 1993—After consulting separate counsel, husband and wife, Nevada residents, entered into separate property agreement by which they transmuted their community property into equal separate property trusts;
- 2001—Husband and wife converted their separate property trusts into Nevada APTs, naming Nevada resident distribution trustee; each settlor retained power to veto distributions and named settlor investment trustee of his or her respective trust.
- 2009—Husband filed for divorce.
- June 3, 2013—District court ordered, inter alia, that Nevada APTs be equalized
  - – Husband's Nevada APT pay wife $800,000 in spousal support
  - – Husband's APT pay wife's child support arrears[1542]

[1542] 394 P.3d at 943–945.

(3) **Issues** —

For present purposes, the relevant issues are whether the district court erred in ordering the equalization of the APTs and the payment of alimony and child support from husband's Nevada APT.

(4) **Wife's Remedy** —

The Supreme Court of Nevada reversed the district court's decision that husband's APT was invalid for the following reason:[1543]

[1543] 394 P.3d at 947–948 (citation omitted).

> The validity of the trusts brings into question many of the district court's findings in the decree. As discussed below, the district court found that it could have invalidated the SSSTs based on Eric's purported breach of trust formalities. Breaching trust formalities of an otherwise validly created SSST does not invalidate a spendthrift trust; rather, it creates liability upon the trustee(s) for that breach. Indeed, if, after an SSST is validly formed, the trust formalities are breached by a trustee, the proper remedy is a civil suit against the trustee—not an invalidation of the trust itself.

(5) **District Court's Errors** —

As relevant here, the supreme court held that:[1544]

[1544] 394 P.3d at 948.

> Despite recognizing the validity of the SPA and SSSTs in the decree, the district court made several missteps in fashioning the ultimate distribution of property, namely: … (2) equalizing assets held within the valid SSSTs; and (3) ordering Eric's personal obligations to be paid by a trust for which he is a

> beneficiary.

(6) **Equalization of APTs** —

The supreme court reversed the district court's determination that the APTs be equalized on the following bases:[1545]

[1545] 394 P.3d at 950.

> We conclude the statutory framework governing SSSTs does not allow a court to equalize spendthrift trust assets between or among different SSSTs. Such an equalization would require the district court to order the exercise of a trustee's discretion to distribute some discretionary interest, in contravention of NRS 163.417(1)(c)(1). Additionally, such a court order would require the trustee to make a distribution outside the scope of the trust agreement and, perhaps more importantly, would run afoul of NRS 166.120(2), which prohibits payments made pursuant to or by virtue of any legal process. Finally, pursuant to NRS 166.120(3), Eric, as the beneficiary of Eric's Trust, has no power to make any disposition of any of Eric's Trust income upon order of the district court. Thus, we conclude the district court erred in ordering trust assets to be equalized between Eric's Trust and Lynita's Trust.

(7) **Alimony and Child Support** —

The supreme court also reversed the district court's order that alimony and child support be paid from Husband's APT. To buttress that determination, the supreme court noted:[1546]

[1546] 394 P.3d at 951 (citation omitted).

> [I]n 2013, the Legislature proposed changes to NRS Chapter 166 that would have allowed a spouse or child to collect spousal support or child support from otherwise-protected spendthrift trust assets. However, the proposed changes to NRS Chapter 166 did not pass, and, as a result, the Nevada spendthrift trust statutes were not amended to allow for an exception for child- and spousal-support orders of a beneficiary to be enforced against a spendthrift trust.

The supreme court therefore held:[1547]

[1547] 394 P.3d (footnote omitted).

> We conclude Nevada SSSTs are protected against the court-ordered child-support or spousal-support obligations of the settlor/beneficiary that are not known at the time the trust is created. Here, Eric's child- and spousal-support obligations were not known at the time the trust was created. Accordingly, the district court abused its discretion in ordering Eric's Trust to pay Eric's child- and spousal-support arrears. We further conclude the child- and spousal-support exception articulated in section 59 of the *Third Restatement of Trusts* is inconsistent with Nevada's statutory framework and the legislative history of NRS Chapter 166, and we expressly reject that exception here.

(8) **Comments** —

Several observations regarding *Klabacka v. Nelson* are in order.

First, it should be noted that this dispute over the assets of a Nevada APT involved Nevada residents in a divorce proceeding. Although the APT worked here, the Nevada APT at issue in the *Dahl* case,[1548] which involved a divorce proceeding between Utah residents in Utah court, was unsuccessful.

[1548] *See* IX.J.2.e above.

Second, given that the dispute in *Klabacka* was between Nevada residents in Nevada court over a Nevada statute, it's surprising that the district court got so many issues wrong, requiring the supreme court to reverse on many points.

Third, as covered in V.F., above, the Supreme Court of Nevada has decided a series of cases in which it created a judicial exception for child-support payments from real property otherwise protected by Nevada's homestead exemption. It would have been helpful for the Supreme Court to disavow those authorities explicitly in the APT trust context.

Fourth, the supreme court noted that "[m]any transfers of property occurred between the trusts between 2001 and 2009, most of which were gifts from one trust to the other."[1549] That court also observed that the district court had found evidence that:[1550]

[1549] 394 P.3d at 944.

[1550] 394 P.3d at 944–945.

> (1) the parties intended to occasionally "level off the trusts," (2) the trust assets had become community property through Eric's comingling, (3) Lynita had delegated her role as investment trustee to Eric, and (4) an oral transmutation agreement occurred between the parties to transmute the separate property back into community property.

The above attributes certainly suggest that husband's APT (or its trustees), was his alter ego, sham, or nominee. This is of particular concern in Nevada for two reasons.

The first reason is that, in a 2017 case, the federal district court in Nevada declared "I predict the Supreme Court of Nevada would apply alter ego to trusts if justice required it."[1551]

[1551] *TransFirst Grp., Inc. v. Magliarditi*, No. 2:17-cv-00487, 2017 BL 176549, 2017 WL 2294288 at *5 (D. Nev. May 25, 2017).

Although that court subsequently reconsidered that determination and certified the question to the Supreme Court of Nevada,[1552] the latter court has yet to rule on the issue.

[1552] *TransFirst Grp., Inc. v. Magliarditi*, No. 2:17-cv-00487, 2017 BL 304288, *2017 WL 3723652* at *3 (D. Nev. Aug. 29, 2017).

The second reason is that, unlike almost every other state, Nevada has a statute that provides that a settlor may be treated as a trustee's alter ego in certain circumstances.[1553] The supreme court did not mention this legislation.

[1553] Nev. Rev. Stat. §163.418.

Clarification of the applicability of the alter-ego trust, sham-trust, and nominee-trust doctrines to Nevada APTs would have been helpful.

4. **Commentary** —

Commentators increasingly recognize the viability of domestic APTs.

A 2009 article summarizes the state of the law regarding domestic APTs as follows:[1554]

[1554] Fogel, *Scylla and Charybdis Attack: Using Trusts for Medicaid Planning and Non-Medicaid Asset Protection*, 35 ACTEC J. 45, 47 (Summer 2009) (footnotes omitted).

> The long and short of this discussion is two-fold. First, a self-settled trust created in an asset protection jurisdiction provides an enormous amount of protection against non-Medicaid creditors. Second, for most non-Medicaid creditors, the only means of enforcing a judgment against such a domestic asset protection trust may be to attack the creation of the trust as a fraudulent transfer. Whether or not the post-transfer creditor will be successful will likely depend on whether the particular creditor was a contemplated creditor at the time of the transfer.

In a 2014 article, Florida practitioners observed that "it should be possible to design an APT in Delaware that should withstand scrutiny from litigation occurring in other states and judgments issued against settlors of Delaware trusts by courts in other states."[1555]

[1555] Ruben & Gopman, Delaware Statutory Tenancy by the Entireties Trusts: Potentially Powerful Asset Protection for Couples Across the Country, 39 Tax Mgmt. Est., Gifts & Tr. J. 123, 126 (May 8, 2014).

Also in 2014, a Boston practitioner wrote that a properly constructed Delaware APT should work for a Massachusetts settlor because a settlor from that state "has an arguable claim against a creditor when the settlor properly creates a DAPT by placing in trust either real property or movable assets originating in Delaware by a transfer free of fraudulent intent and outside the scope of bankruptcy."[1556]

[1556] Dow, *The Hide and Seek of Creditors & Debtors: Examining the Effectiveness of Domestic Asset Protection Trusts for the Massachusetts Settlor*, *27* Quinnipiac Prob. L.J. 170, 182 (2014).

Similarly, a 2015 article in the *Connecticut Law Review* reported:[1557]

[1557] Cain*, Judgment Proof: Can Connecticut Residents Insulate Assets From Creditors Using a Delaware Domestic Asset Protection Trust?* 47 Conn. L. Rev. 1463, 1490 (July 2015). Connecticut since has enacted domestic APT legislation (see Worksheet 1).

> Provided that the DAPT was not funded via a fraudulent transfer, the trust was not established with the intention of defrauding creditors, or the creditor is not an exemption creditor, the Delaware DAPT will be effective in preventing a creditor from reaching the trust assets.

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X. A Comparison of the Leading Domestic APT States

A. Introduction

In the author's experience, Alaska, Delaware, Nevada, and South Dakota are recognized as leading domestic APT jurisdictions in the United States. The author acknowledges his Delaware bias and admonishes readers to view his claims—as well as the views and "rankings" of Alaska, Nevada, and South Dakota proponents—with a critical eye.[1558] He nevertheless will offer some observations in this Section X with the hope of assisting practitioners to make informed decisions. Wherever possible, the author will cite authorities to substantiate his views.

[1558] *See* I.E., above.

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B. Infrastructure

1. **Introduction** —

When attorneys are working with clients to develop estate plans that involve the use of domestic APTs, they should help clients find states where the clients' APTs will be more likely to accomplish what the clients want to achieve. Such a state should have a well-thought-out body of trust statutes; an ongoing commitment to update those statutes to respond to changing federal tax laws, financial conditions, and other circumstances; a competent judiciary; a supportive legislature, executive branch, and legal and banking community; and numerous financial institutions that compete for trust business. The state also must be committed to updating trust laws regularly.

2. **Population** —

The 2010 census shows that the leading trust states can draw on the following talent pools for their trust industries.[1559]

[1559] 2010 U.S. Census. The population figures for Las Vegas, Nevada, are 1,992,016 within 50 miles; 2,177,630 within 100 miles; and 2,505,505 within 150 miles.

Population…	Anchorage, AK	Wilmington, DE	Reno, NV	Sioux Falls, SD
…within 50 miles	298,695	7,151,472	588,804	335,369
…within 100 miles	457,849	20,464,043	1,690,519	908,084
…within 150 miles	457,849	40,244,858	4,942,483	1,656,250

Staff members commute to Wilmington from Maryland, New Jersey, and Pennsylvania (including Philadelphia) as well as from Delaware. Many came with relevant prior experience in Baltimore, New York City, Philadelphia, Washington, and elsewhere.

3. **Trust Climate** —

The following table shows the year in which a leading trust state first developed attractive trust laws.

	AK	DE	NV	SD
Year State Became Trust	1997[1560] [1560]	1903[1561] [1561]	1999[1562] [1562]	1983[1563] [1563]

Friendly	Alaska Spendthrift Trust Act amended to permit self-settled spendthrift trusts (1997 Alaska Laws 6, §8).	Wilmington Trust Company founded by members of du Pont family.	Nevada Spendthrift Trust Act amended to permit self-settled spendthrift trusts (1999 Nev. Laws 299).	South Dakota rule against perpetuities amended to permit perpetual trusts (1983 S.D. Sess. Laws 304).

Delaware's long-standing leadership in the trust field has been verified empirically. Professor Sitkoff of Harvard Law School and Professor Schanzenbach of Northwestern University School of Law reported in a 2006 empirical study (which analyzed pertinent data beginning in 1969) that "Delaware was clearly attracting trust funds from out of state in the early 1970s"[1564] and that "in 1986 Delaware had a disproportionate share of the nation's trust funds."[1565]

In 2010, a coalition of Delaware law firms and financial institutions commissioned Professor Schanzenbach to assess the impact of personal trusts created by non-Delaware residents on the state's economy. Professor Schanzenbach's report,[1566] dated May 25, 2011, quantified Delaware's past and present success in the personal-trust field. Highlights of the report included the following:

- personal trusts created by nonresidents contributed as much as $1,100,000,000 (2% of economic output) to Delaware's economy annually;
- such trusts generated at least $300,000,000 of trustee fees in Delaware each year;
- as much as $33,000,000 in annual Delaware income-tax revenue was attributable to the state's excess trust business;
- Delaware's personal-trust business had grown substantially over the past decade, taking an increasingly larger share of a growing national market; the state was in a good position to continue to grow this business.

Given that South Dakota, Alaska, and Nevada did not begin their efforts to attract trust business until 1983, 1997, and 1999, respectively, time will tell whether these efforts will continue.

4. **Liability System** —

The author is not aware of a national ranking of probate court systems. Since 2002, however, the U.S. Chamber of Commerce has issued eleven rankings of state liability systems. The ratings for Alaska, Delaware, Nevada, and South

[1564] Schanzenbach & Sitkoff, *Perpetuities or Taxes*? *Explaining the Rise of the Perpetual Trust*, 27 Cardozo L. Rev. 2465, 2495–96 (Apr. 2006).

[1565] Schanzenbach & Sitkoff at 2479. *See* Sitkoff & Schanzenbach, *Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds*, 42 Heckerling Inst. on Est. Plan. ¶1400 (2008); Sitkoff & Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 Yale L.J. 356, 375 n.62, 393–94 (Nov. 2005).

[1566] To view Professor Schanzenbach's report, go to www.leimbergservices.com/docs/report-5-25-11b.pdf.

Dakota in each of those studies are shown below.[1567]

[1567] www.instituteforlegalreform.com/states.

Year	AK	DE	NV	SD
2017	#6	#11	#37	#1
2015	#12	#1	#35	#9
2012	#13	#1	#37	#11
2010	#33	#1	#28	#10
2008	#20	#1	#40	#12
2007	#43	#1	#28	#11
2006	#36	#1	#37	#7
2005	#33	#1	#29	#8
2004	#33	#1	#34	#17
2003	#32	#1	#34	#4
2002	#37	#1	#30	#9

5. **ACTEC Fellows** —

The American College of Trust and Estate Counsel ("ACTEC") is widely viewed as containing the foremost trusts and estates attorneys in the United States. The following table shows the number of ACTEC fellows from Alaska, Delaware, Nevada, and South Dakota.

	AK	DE	NV	SD
Estimated 2018 population[1568] [1568] U.S. Census Bureau, www.census.gov/quickfacts.	737,438	967,171	3,034,392	882,235
No. of ACTEC fellows (July 1, 2019)[1569] [1569] American College of Trust and Estate Counsel, www.actec.org.	8	21	7	12

6. **Trust Conference** —

The Delaware Bankers Association holds an annual Delaware Trust Conference in Wilmington on October 23 and 24, 2018.[1570] The most recent annual, one-of-a-kind program drew 485 attendees from throughout the country. The sessions included:

[1570] www.debankers.com/DE_trust_conf_18.html.

- Federal Tax Update
- How to Administer a Directed Trust Right From the Start
- International Tax Planning Basics

- Preparing and Surviving Internal and External Audits
- LLCs/FLPS/Closely Held Stock Issues with Trusts
- Changing Residency/Domicile in Light of the Effective Repeal of the SALT Deduction
- Why Are the U.S. and Delaware Attractive to International Clients?
- Wealth Transfer and Income Tax Planning Opportunities Under the 2017 Tax Act
- Litigation Update—Delaware Trust Cases and National Trust Cases—Lessons Learned
- What Dead Celebrities Can Teach Us About Estate Planning
- Trustee Breakup and Resignation
- Deep Dive on Saudi Arabia, China, and Argentina—Why Delaware?
- Promissory Notes, Loans, Guarantees, Pledges From Irrevocable Trusts—Directed vs. Full Trustee
- Onboarding a New International Client
- Creative Solutions for Complex Situations—How Delaware Helped
- Not your Father's Investment Portfolio: Sustainable Investing and Cryptocurrency
- TCJA Enacted Section 199A—The Qualified Business Income Deduction
- Best Charitable Planning Ideas for the 2018 Planning Environment
- What Really Happens With Trust Cases in Court

Twenty-six of the 65 presenters were from outside Delaware. Nineteen speakers were practicing Delaware attorneys or CPAs; 18 others were Delaware representatives of 14 different trust institutions; two were Delaware government officials and other Delaware personnel. The author is not aware of a similar program in Alaska, Nevada, or South Dakota (let alone one that has been held for the over 13 years).

7. **Trust Management Minor** —

In the Fall of 2017, the University of Delaware instituted the following academic program:[1571]

[1571] *See* Press Release, Delaware Bankers Association, *Delaware Financial Education Alliance and Alfred Lerner College of Business and Economics Announce the Approval of the Trust Management Minor* (Mar. 23, 2017), www.debankers.com/communication.html.

> The Delaware Financial Education Alliance (DFEA) and the Alfred Lerner College of Business and Economics at the University of Delaware are pleased to announce approval by the University of Delaware Faculty Senate for the Trust Management Minor. The Trust Management Minor is designed to provide a comprehensive skillset in trust management as well as a foundation in taxation and estate planning.
>
> The Trust Management Minor will enable students to understand the legal relationships between trustees and beneficiaries; manage the legal, tax, financial and non-financial aspects of efficient conservation and transfer of wealth; understand individual, corporate, estate and trust tax issues; and, moderate conflicting desires of current

> income beneficiaries and residual owners.
>
> The program will educate students seeking an academic focus in the field of Trust Management. The Trust Management Minor is available to all University of Delaware students. Every student enrolled in the program will have the opportunity to work with a mentor in the trust field and will be required to complete an internship with a financial institution. Other goals of the program include: promoting trust management as a career choice, meeting the needs of employers seeking trust management experts and strengthening the bonds between the University of Delaware and the numerous trust management firms in Delaware.
>
> Unique to Delaware, this first-of-a-kind Trust Management Minor will be an accredited program that provides students with comprehensive skills grounded in taxation and estate planning. Some courses will be taught as early as this fall. The program will provide a pipeline of experienced candidates for employment by trust companies and law firms in Delaware. The program was made possible thanks to the generous support of corporate sponsors and individual donors who represent some of the top trust companies and law firms in the First State.

The initial class, which entered the program in the fall of 2017, consisted of 16 participants, one-third of whom were Delaware residents; two-thirds of whom were Delaware nonresidents. Each participant had a mentor and an internship for the summer of 2018. Of the 13 students who graduated in the spring of 2019, seven were placed in the Delaware trust industry, two found jobs elsewhere in financial services, one started law school, and the others sought work in the trust industry outside Delaware.

Through this program, students from throughout the country are able to come to Delaware for training in the trust field. The author is not aware of a comparable program in Alaska, Nevada, or South Dakota.

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C. Critical Issues

1. **Introduction** —

Before turning to a direct comparison of the leading domestic APT states, the author will cover the status of some issues that are relevant to that comparison.

2. **Exclusive Jurisdiction**

a. **Background** —

In IX.C., above, the author emphasized the importance of structuring a domestic APT so that controversies involving it will be adjudicated by a court in a domestic APT state rather than by a court in a non-DAPT state. With that in mind, some of the leading domestic APT states have statutes that confer exclusive jurisdiction on its courts. Caselaw to date suggests that practitioners should not rely on such statutes.

b. **Delaware** —

A Delaware statute, which took effect in 2000,[1572] provides that "the Court of Chancery shall have exclusive jurisdiction over any action brought with respect to a qualified disposition."[1573] In a 2014 case, the Delaware Court of Chancery declared that "[i]n my view, Delaware has not sought through the Qualified Dispositions Act to arrogate exclusive jurisdiction for itself, nor could it."[1574] At the same time, the court noted:[1575]

[1572] 72 Del. Laws 341, §6 (2000).

[1573] Del. Code Ann. tit. 12, §3572(a).

[1574] *IMO Daniel Kloiber Dynasty Tr.*, 98 A.3d 924, 941 (Del. Ch. 2014).

[1575] 98 A.3d at 953.

> The potential Delaware law issues regarding the enforcement of a judgment against the Dynasty Trust may never arise. If they do, they can and should be addressed after the Kentucky Divorce Proceeding has reached a final judgment that is no longer subject to appeal.

c. **Alaska** —

Similarly, an Alaska statute, which was passed in 2004,[1576] provides that "[a] court of this state has exclusive jurisdiction over an action brought under a cause of action or claim for relief that is based on a transfer of property to a trust that is the subject of this section."[1577]

[1576] 2004 Alaska Sess. Laws 82, §11 (2004).

[1577] Alaska Stat. §34.40.110(k).

In 2018, the Supreme Court of Alaska held that "this statute cannot unilaterally deprive other state and federal courts of jurisdiction."[1578]

[1578] *Toni 1 Trust, by Tangwall v. Wacker*, 413 P.3d 1199, 1201 (Alaska 2018). *See* Gideon Rothschild & Daniel S. Rubin, *Alaska Supreme Court Invalidates Exclusive Jurisdiction Provision*, 157 Tr. & Est. 23 (May 2018).

d. **South Dakota** —

A South Dakota statute, which became effective in 2007,[1579] provides that "[a] court of this state 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 this section."[1580] To the author's knowledge, no case has interpreted the foregoing language.

[1579] 2007 S.D. Sess. Laws 247, §12 (2007).

[1580] S.D. Codified Laws §55-16-13.

e. **Nevada** —

A Nevada statute, effective in 2009,[1581] says that "[a] court has exclusive jurisdiction over any proceeding pursuant to this section."[1582] The author is not aware of a case that construes the language in question.

[1581] 2009 Nev. Stat. 215, §59 (2009).

[1582] Nev. Rev. Stat. §166.120(2).

3. **Limitations Periods**

a. **Introduction** —

The limitations periods for bringing actions to contest APTs are half as long under the Nevada Act and the South Dakota Act as they are under the Alaska Act and the Delaware Act. Specifically, Nevada and South Dakota require present creditors to sue within two years of a transfer or six months after the date on which a transfer was discovered (or reasonably should have been discovered), whichever is later, while future creditors must sue within two years of a transfer.[1583] Alaska's and Delaware's time spans are double that: four years/one year for present creditors, and four years for future creditors.[1584] Thus, the difference is the "added time" that is available to plaintiffs under Alaska and Delaware law. This supposed advantage is more apparent than real for several reasons.

[1583] *See* Nev. Rev. Stat. §166.170(1); S.D. Codified Laws §55-16-10(1)–(2).

[1584] *See* Alaska Stat. §34.40.110(d); Del. Code Ann. tit. 12, §3572(b), Del. Code Ann. tit. 6, §1309.

b. **Fraudulent Transfer Claims** —

Given that the determination as to whether the creation of an APT is a fraudulent transfer is made as of the time the trust was created, not when a creditor brings a challenge, the statute of limitations really doesn't matter. If an APT is properly constructed at the outset, then a creditor will lose no matter when the suit is brought.

c. **Offshore Option** —

If settlors really are concerned about limitations periods, they likely will not go to Nevada or South Dakota. Instead, they will go to offshore jurisdictions where limitations periods are even shorter and claims are even harder to prove than in Nevada or South Dakota.

d. **Bankruptcy** —

Nevada's or South Dakota's shorter limitations periods will not apply if the debtor ends up in bankruptcy.[1585]

[1585] *See* 11 U.S.C. §546, §548(a), (e).

e. **Other States** —

Conflict-of-laws rules will allow the courts of other states to apply their longer limitations periods in many instances. A commentator explained why in 2017:[1586]

[1586] Spero, *Recent Cases Show Need for Strict Compliance With DAPT Statutes*, 44 Est. Plan. 8, 10 (May 2017) (footnote omitted).

> In this regard, a limitations period is considered "procedural," and governed by the state of the forum. Consequently, the short limitations period relative to certain DAPT state laws do not apply if the forum of the litigation is elsewhere.

4. **Judicially Created Exceptions**

a. **Introduction** —

The planner must be conscious of the possibility that a court in a domestic APT jurisdiction might create judicial exceptions to the protection given by domestic APTs in sympathetic cases. Courts have looked to create such exceptions but not have usually, though not always, concluded it was not possible.

b. **Delaware**

(1) **Garretson v. Garretson (1973)** —

The Supreme Court of Delaware created an extremely narrow common-law exception to the protection provided by Delaware's third-party spendthrift statute[1587] in the 1973 case of *Garretson v. Garretson* [1588] by concluding that a wife who sought support from her husband was not a "creditor," as the term is used in the statute. In *Garretson*, the wife, having been unable to obtain personal jurisdiction over her husband, filed an action in the Court of Chancery:[1589]

[1587] Del. Code Ann. tit. 12, §3536.

[1588] 306 A.2d 737 (Del. 1973).

[1589] 306 A.2d at 739.

> In order to obtain jurisdiction over the husband, now a resident of the State of Florida, the plaintiff obtained a sequestration order under which the income from the testamentary trust, payable to the husband, was seized in order to coerce his appearance in the Court of Chancery.

The court held that:[1590]

[1590] 306 A.2d at 740–41.

> It is to be noted that both s 3536 and Item II of the will provide in terms that the trust property shall "not be subject to the rights of the creditors of (such) beneficiary, (and) shall be exempt from execution, attachment, distress for rent, on behalf of such creditors." The question thus presented is whether or not a wife, seeking support from her husband, is a creditor within the meaning of the word as it is used in s 3536 and in Item II of the will. If the wife is a creditor, then seizure of any of the trust assets on her behalf is prohibited by the terms of s 3536 and of Item II of the will. The Chancellor concluded that the wife was not a creditor in that meaning of the word, and we agree with that conclusion.
>
> An action brought by a wife seeking separate maintenance from her husband who has deserted her is an attempt on her part to compel the performance of a duty imposed by law upon the husband to support his wife and dependents.
>
> The weight of authority is to the effect that a wife seeking such relief is not a creditor and is not bound by the spendthrift provisions of a trust from reaching the trust assets. A wife, under such circumstances, can hardly be a creditor who is defined as "one to whom a debt is owing by another person who is the debtor….

Practitioners in other states often misrepresent this advantage. Typical is the following statement: "Delaware provides that spouses who are beneficiaries of discretionary trusts do not receive protection of their trust assets from alimony claims of a divorced spouse."[1591]

[1591] Oshins & Siegel, *The Anatomy of the Perfect Modern Trust—Part I,* 43 Est. Plan. 3, 12 (Jan. 2016) (footnote omitted).

But, in its opinion, the court stressed that "[w]e … consider that, for the purposes of the appeals before us, the record discloses solely that the individual parties are still husband and wife."[1592] The court concluded its opinion as follows:[1593]

[1592] *Garretson*, 306 A.2d at 739.

[1593] 306 A.2d at 742.

> It … remains to be seen, if the husband appears generally in this litigation and subjects himself to the jurisdiction of the Court of Chancery, whether, on final hearing, his contentions with regard to his Mexican divorce will be ultimately upheld, in which event we assume that the wife would lose her status as wife, and there may be an entirely different situation then facing the Chancellor. This question, however, is not before us, and we make no ruling upon the future outcome of the course of the litigation.

In *Garretson*, the Supreme Court of Delaware found that a wife who seeks support from a husband who has deserted her is not a "creditor" under 12 Del. C. §3536. Subsequently, three plaintiffs asked the Court of Chancery to create new judicial exceptions to the statute. All three efforts were unsuccessful.

(2) **Gibson v. Speegle (1984)** —

In the 1984 case of *Gibson v. Speegle*,[1594] the Court of Chancery set the stage as follows:[1595]

[1594] 184 Del. Ch. Lexis 475 (Del. Ch. May 30, 1984), *rem'd*, 494 A.2d 165 (Del. 1984).

[1595] 184 Del. Ch. Lexis 475 at *1.

> This is the decision on the petition and proof of claim filed by Aetna Casualty and Surety Company of America ("Aetna") seeking an order requiring the payment of Aetna's outstanding judgment against Gary Barwick ("Barwick") from the proceeds of a partition sale. One-half of those proceeds, or the sum of $12, 799.20, is the share allocated to Arlene B. Gibson ("Gibson"), trustee of a testamentary trust created for the benefit of Barwick by his mother, Virginia Barwick. Gibson contends that Virginia Barwick's will created a spendthrift trust and that Aetna, as a "creditor" within the meaning of 12 Del. C. § 3536, is not entitled to satisfy its judgment from the trust assets.

The court first rejected the plaintiff's public policy argument:[1596]

[1596] 184 Del. Ch. Lexis 475 at *5 (citations omitted).

> Aetna contends that ours would be a sorry system of justice if the spendthrift statute were applied to allow a criminal such as Barwick to avoid having to pay for his crimes. Aetna suggests that its position is not unlike that of a wife suing her husband for support and attempting to reach her husband's interest in a spendthrift trust. This Court has concluded that a husband in those circumstances should not be allowed to enjoy the benefits of the trust while neglecting his legal obligation to support his dependents. The husband-wife situation, however, is distinguishable because a spouse has a statutory duty to support the other spouse and their children. Aetna has not cited any authority indicating that a tort-feasor owes a similar duty to a tort claimant.

The court then considered—and expressed sympathy for—the plaintiff's contention that a tort victim should not be a "creditor" under the statute:[1597]

[1597] 184 Del. Ch. Lexis 475 at *6 (citations omitted).

> The term "creditor" is not defined in the statute and has not been construed in Delaware other than in the context of the husband and wife support situation described above. However, the authors of several respected treatises on trusts have concluded that tort claimants should not be considered "creditors" for purposes of a spendthrift trust provision. Their reasoning is sound. If a business extends credit to a

> spendthrift trust beneficiary, it does so at its own risk. A person who is injured by a tort-feasor, by contrast, did not choose to do business with the tort-feasor and should not be prevented from receiving compensation for his injuries by the terms of a spendthrift trust.

Nonetheless, the court, deferring to the decision of the General Assembly, dismissed this argument as well:[1598]

[1598] 184 Del. Ch. Lexis 475 at *6–7 (citations omitted).

> In the absence of a statute, I would not hesitate to adopt this view and allow Aetna's claim. I am not at all comfortable with the fact that Virginia Barwick, by use of a spendthrift trust, assisted her son in avoiding his obligation to pay for his crimes. However, it is not the Court's function to write the law but only to interpret it. The statute enacted by the General Assemble [sic] contains no exceptions, Dean Griswold proposed a form of statute which, he believed, should retain the desirable elements of spendthrift trusts while eliminating most of the levels which accompany such trusts in their unrestrained form as early as 1947. The proposed statute, which contained an exception for tort claimants, among others, was available to the General Assembly in 1959 when *§3536* was amended. The fact that such a modification was not enacted leaves me no choice but to conclude that the General Assembly intended *§3536* to be an "unrestrained" form of spendthrift provision. As a result, I reluctantly conclude that Aetna is a creditor within the meaning of *§3536* and its proof of claim must be denied.

(3) **Parsons v. Mumford (1989)** —

The next case was the Court of Chancery's 1989 decision in *Parsons v. Mumford*,[1599] in which the court described the controversy as follows:[1600]

[1599] *1989 WL 63899* (Del. Ch. June 14, 1989).

[1600] *1989 WL 63899* at *1.

> Plaintiffs are judgment creditors of the individual defendant. The corporate defendant is trustee of a trust in which the judgment debtor has a remainder interest. The suit seeks, among other relief, an order directing the trustee, upon termination of the trust, to pay over a portion of the remainder interest, if then due to the judgment debtor, to plaintiffs in satisfaction of their judgments.

Following *Gibson*, the court concluded that "while there are strong equities in favor of the limited remedy sought, the provisions of *Section 3536* of Title 12 prohibit it in these circumstances."[1601]

[1601] *1989 WL 63899* at *5.

(4) **Mennen v. Wilmington Trust Company (2017)** —

The latest controversy involves trusts created by George S. Mennen in 1970. In this case, the beneficiaries of one trust attempted unsuccessfully to reach the assets of a second trust to remedy investment losses caused by the principal beneficiary of the second trust in his capacity as trustee of the first trust. In the 2015 Final Report,[1602] the master observed that "whatever my personal views regarding the policy supporting spendthrift clauses, I am bound by state statute and controlling precedent to conclude that the spendthrift clause bars the plaintiffs from satisfying the judgment against the individual trustee from the assets in the individual trustee's trust."[1603] The master therefore recommended that the Court of Chancery hold that:

[1602] *2015 WL 1897828* (Del. Ch. Apr. 24, 2015).

[1603] *2015 WL 1897828* at *1.

- a person with a tort claim is a "creditor" under *§3536*;[1604]
- a public policy exception to *§3536* should not be created for tort claims;[1605]
- a public policy exception to *§3536* should not be created for claims against a "persistent wrongdoer";[1606] and
- the theory of "impoundment" is not available.[1607]

[1604] *2015 WL 1897828* at *6.

[1605] *2015 WL 1897828* at *7.

[1606] *2015 WL 1897828* at *8.

[1607] *2015 WL 1897828* at *12.

After procedural issues were resolved,[1608] the Court of Chancery adopted the master's final report as written early in 2017.[1609] In affirming three months later, the Supreme Court of Delaware declared that "we have determined that the Court of Chancery's … February 27, 2017 Report Pursuant to Delaware Supreme Court Rule 19(c) should be affirmed for the reasons stated by the Court of Chancery and by the Master in Chancery in her well-reasoned April 24, 2015 final report on the motion for summary judgment."[1610]

[1608] *Mennen v. Wilmington Trust Co.*, *2017 WL 751201* at *1 (Del. Ch. Feb. 27, 2017).

[1609] *2017 WL 751201* at *2 ("I would like to think that I could improve on then-Master LeGrow's decision, but I know that I cannot").

[1610] *Mennen v. Fiduciary Tr. Int'l of Del.*, 166 A.3d 102 (Del. 2017).

Practice Tip: Delaware third-party spendthrift trusts provide beneficiaries with formidable protection from the claims of their creditors. Based on recent caselaw, it appears unlikely that Delaware courts will create common-law exceptions to the protection offered by the Delaware Act.

c. **Nevada**

(1) **Introduction** —

In cases that were decided before and after the passage of the Nevada Act, the Supreme Court of Nevada and Nevada federal courts have demonstrated a propensity to establish nonstatutory exceptions to the state's homestead exemption,[1611] and its annuity exemption,[1612] which are other state-created protections from creditor claims. It is possible that these courts will recognize comparable exceptions to the Nevada Act. The cases are summarized below:

[1611] Nev. Rev. Stat. §115.005–§115.090.

[1612] Nev. Rev. Stat. §687B.290(1).

(2) **Breedlove v. Breedlove (1984)** —

In *Breedlove v. Breedlove*,[1613] the Supreme Court of Nevada held that public policy required that there be "an exception to the homestead laws in cases where a party is seeking to enforce a child support award against the homesteader."[1614] The court concluded that "respondent [homesteader] is not the type of debtor whom the legislature sought to protect, and appellant [the custodial parent seeking child support], in turn, is not the type of creditor from whom the legislature intended to protect homesteaders."[1615]

[1613] 691 P.2d 426 (Nev. 1984).

[1614] 691 P.2d at 427.

[1615] 691 P.2d at 428.

(3) **Phillips v. Morrow (1988)** —

Following *Breedlove*, in *Phillips v. Morrow*,[1616] the Supreme Court of Nevada held that a second divorced wife's house could be sold to satisfy a first divorced wife's child-support order, saying "Laura's [second wife] residence is subject to Linda's [first wife] judgment lien."[1617]

[1616] 760 P.2d 115 (Nev. 1988).

[1617] 760 P.2d at 117.

(4) **Maki v. Chong (2003)** —

In *Maki v. Chong*,[1618] the Supreme Court of Nevada expanded the public policy exception to the homestead exemption. The court held:[1619]

[1618] 75 P.3d 376 (Nev. 2003).

[1619] 75 P.3d at 379–80 (footnote and internal quotation marks omitted).

> Under equitable lien principles, the homestead exemption is inapplicable when the proceeds used to purchase real property can be traced directly to funds obtained through fraud or similar tortious conduct. We conclude that, as in the case of a debtor owing child support obligations, debtors who fraudulently acquire funds are not the type of debtor whom the legislature sought to protect. Chong's homestead exemption cannot apply to prevent a forced sale on execution of Maki's judgment. We reverse the district court's order and remand with instructions for the district court to enter an order consistent with this opinion that Chong's homestead exemption is invalid against Maki's default judgment.

(5) **In re Graziadei (1994)** —

In *In re Graziadei*,[1620] the Ninth Circuit refused to extend the *Breedlove* analysis to a divorcing spouse's counsel fees and costs.[1621] The court distinguished the case from *Breedlove* as follows:[1622]

[1620] 32 F.3d 1408 (9th Cir. 1994).

[1621] 32 F.3d at 1411.

[1622] 32 F.3d at 1411 n.4 (citation omitted; emphasis in original).

> On cross-appeal, Marlys' lawyer argues that George is barred from using the homestead exemption as a defense under the doctrine announced in *Breedlove v. Breedlove*. We reject this argument. In *Breedlove*, the Nevada Supreme Court held that a debtor is barred from using the homestead exemption as a defense against making support payments to an ex-spouse (The court reasoned that the homestead exemption's very purpose was to support *family members* of the debtor.) By contrast, this case does not involve payments to an ex-spouse, but rather to her attorney for attorney's fees and costs.

(6) **Henry v. Rizzolo (2012)** —

In *Henry v. Rizzolo*,[1623] a federal magistrate judge determined that “there is no reason to believe that the Nevada Supreme Court would have reached a different conclusion if the defendant in *Maki* had deposited the misappropriated funds into an annuity account.”[1624]

[1623] 2012 WL 4092604 (D. Nev. Sept. 17, 2012), *order clarified*, 2012 WL 4867725 (D. Nev. Oct. 12, 2012).

[1624] 2012 WL 4092604 at *6.

He therefore held: “$617,513.81 of the Metlife annuity, and the full surrender values of the Prudential and Transamerica annuities are not exempt from execution pursuant to the exception set forth in NRS §687B.290.1 and pursuant to the equitable lien principles set forth in *Maki v. Chong*.”[1625]

[1625] 2012 WL 4092604 at *8.

(7) **In re Tarkanian (2014)** —

In *In re Tarkanian*,[1626] a federal bankruptcy court in Nevada declined to create a public policy exception to the homestead exemption when the homestead was acquired with the debtor's funds.[1627] He concluded:[1628]

[1626] 562 B.R. 424 (Bankr. D. Nev. 2014).

[1627] *562 B.R. at 468*.

[1628] *562 B.R. at 451*.

> The salient fact is that the assets which enabled the Debtors to claim a homestead exemption in the Residence were the Debtors’ assets, not those of a third party. Under these circumstances, the court concludes that the decision in *Maki* does not prohibit the Debtors from claiming a homestead in their Residence under Nevada law.

(8) **Klabacka v. Nelson (2017)** —

Without acknowledging the *Breedlove* line of cases or Nevada's statute recognizing that a settlor may be treated as a trustee's alter ego, the Supreme Court of Nevada held in 2017 in *Klabacka v. Nelson*,[1629] — that a Nevada APT created by a Nevada settlor could not be breached to satisfy alimony and child-support claims in *Klabacka*. Reversing the district court which would have allowed the exceptions, the supreme court held that “[w]e conclude Nevada SSSTs are protected against the court-ordered child-support or spousal-support obligations of the settlor/beneficiary that are not known at the time the trust is created.”[1630]

[1629] 394 P.3d 940 (Nev. 2017).

[1630] 394 P.3d at 951 (footnote omitted).

d. **South Dakota** —

The Supreme Court of South Dakota recognized a common-law exception to a state-law protection in *Gunn v. Gunn* (1993).[1631] The court held that “[a] divorce court, being a court of equity, possesses the power to impose a lien upon a homestead for purposes of spousal or child support.”[1632]

[1631] 505 N.W.2d 772 (S.D. 1993).

[1632] 505 N.W.2d at 775 (citations omitted).

The author is not aware of an instance in which a state or federal court in South Dakota has been asked to create a comparable exception to the South Dakota Act.

e. **Alaska** —

To the author's knowledge, no Alaska state or federal court has been asked to create a common-law exception to the Alaska Act or any other state-law protection.

5. **Availability of Alter-Ego and Nominee Theories**

a. **Introduction** —

The leading domestic APT states differ on the availability of the alter-ego and nominee doctrines for creditors to use in attempting to access the assets of APTs.

b. **South Dakota**

(1) **Introduction** —

South Dakota has a statute and caselaw regarding these theories.

(2) **2007 Statute** —

Effective in 2007,[1633] South Dakota enacted a statute that limits the availability of the alter-ego doctrine for creditors but does not prohibit it.[1634] It reads:[1635]

> Absent clear and convincing evidence, no settlor of an irrevocable trust may be deemed to be the alter ego of a trustee. The following factors by themselves or in combination are not sufficient evidence for a court to conclude that the settlor controls a trustee or is the alter ego of a trustee:
>
> (1) Any combination of the factors listed in §55-1-32;
>
> (2) Isolated occurrences where the settlor has signed checks, made disbursements, or executed other documents related to the trust as a trustee, when in fact the settlor was not a trustee;
>
> (3) Making any requests for distributions on behalf of beneficiaries;
>
> (4) Making any requests to the trustee to hold, purchase, or sell any trust property.

Hence, a creditor that proves that the settlor is the trustee's alter ego by clear and convincing evidence will be able to reach the assets of a South Dakota APT.

(3) **United States v. Nelson (2018)** —

In *United States v. Nelson*,[1636] a federal tax case, the federal government contended that a trust was the taxpayer's nominee or alter ego. Regarding the nominee theory, the South Dakota federal district court observed that:[1637]

[1633] 2007 S.D. Sess. Laws 280, §10.

[1634] S.D. Codified Laws §55-1-33.

[1635] S.D. Codified Laws §55-1-33.

[1636] *2018 WL 2390128* (D.S.D. May 25, 2018).

[1637] *2018 WL 2390128* at *5 (footnote omitted).

> Neither party cites South Dakota cases providing guidance on the nominee theory, and this Court found none. With the lack of South Dakota law regarding whether an entity holds title to property as a nominee, this Court must predict how the South Dakota Supreme Court would decide the issue.

After summarizing the typical framework for analyzing the nominee theory in federal court,[1638] the court declared "that faced with a similar situation a South Dakota court would likely apply these factors to determine whether Nelson exercises substantial control over the subject property."[1639]

[1638] *2018 WL 2390128* at *5. *See* IX.F.15., above.

[1639] *2018 WL 2390128* at *5.

Without mentioning the statute discussed above, the court then found that the alter-ego doctrine applied as well by stating "[a]n alternative basis for holding that the property held in the name of the Trust is subject to a tax lien is that the admitted allegations in the Complaint also establish that the Trust is Nelson's alter ego."[1640]

[1640] *2018 WL 2390128* at 6 (citation omitted).

As relevant here, the court concluded that "[t]he J.A. Nelson Irrevocable Trust is the nominee and/or alter ego of Jeffrey A. Nelson with respect to the Property identified in paragraph 4(b) above."[1641]

[1641] *2018 WL 2390128* at 9.

c. **Nevada**

(1) **Introduction** —

Nevada also has relevant statutes and caselaw.

(2) **2009 Legislation** —

Nevada has two statutes, which were passed in 2009,[1642] that make the alter-ego theory available to creditors.[1643] One of them provides that:[1644]

[1642] 2009 Nev. Stat. 215, §15–§16 (2009).

[1643] Nev. Rev. Stat. §163.4177, §163.418.

[1644] Nev. Rev. Stat. §163.418. Nev. Rev. Stat. §163.4177, which is referred to in subsection 4, is entitled, "Factors which must not be considered exercising improper dominion or control over trust."

> Absent clear and convincing evidence, a settlor of an irrevocable trust shall not be deemed to be the alter ego of a trustee of an irrevocable trust. If a party asserts that a settlor of an irrevocable trust is the alter ego of a trustee of the trust, the following factors, alone or in combination, are not sufficient evidence for a court to find that the settlor controls or is the alter ego of a trustee:
>
> > 1. The settlor has signed checks, made disbursements or executed other documents related to the trust as the trustee and the settlor is not a trustee, if the settlor has done so in isolated incidents.

2. The settlor has made requests for distributions on behalf of a beneficiary.

3. The settlor has made requests for the trustee to hold, purchase or sell any trust property.

4. The settlor has engaged in any one of the activities, alone or in combination, listed in NRS 163.4177.

Again, the statute does not completely bar the alter-ego theory; hence, a creditor has the opportunity to show that the settlor was the trustee's alter ego by clear and convincing evidence.

(3) **TransFirst Group, Inc. v. Magliarditi (2017)** —

In *TransFirst Group, Inc. v. Magliarditi*,[1645] the federal district court in Nevada considered whether creditors could reach the assets of a trust using the alter-ego theory in that state. The court opined:[1646]

> The Supreme Court of Nevada has not addressed whether a trust can be an alter ego. As with LLCs and partnerships, I predict the Supreme Court of Nevada would apply alter ego to trusts if justice required it.

The court did not acknowledge the existence of the above statutes in this opinion, but it subsequently issued an opinion by which the court vacated the alter-ego portion of the first opinion and certified the question of whether the theory was available for trusts to the Supreme Court of Nevada.[1647] The rationale for the latter action was:[1648]

> The defendants have identified an intervening change in the law with respect to spendthrift trusts. The same day I entered the preliminary injunction order, the Supreme Court of Nevada issued *Klabacka v. Nelson*, 394 P.3d 940 (Nev. 2017) (*en banc*). In *Klabacka*, the Supreme Court of Nevada addressed self-settled spendthrift trusts ("SSSTs") in the context of a divorce proceeding. Although *Klabacka* did not address alter ego, the opinion casts doubt on my ruling that the alter ego doctrine applies to spendthrift trusts, at least in the context of someone other than the settlor being the alter ego. *See* Nev. Rev. Stat. 163.418 (setting forth clear and convincing standard to show settlor is alter ego of a trustee of an irrevocable trust).

(4) **Klabacka v. Nelson (2017)** —

In *Klabacka v. Nelson*,[1649] summarized above, the Supreme Court of Nevada did not consider the Nevada statutes in question in assessing the validity of a Nevada APT.[1650] This is unfortunate because there were suggestions that the husband had ignored trust formalities.

d. **Delaware** —

The author is not aware of a Delaware state or federal court decision that considered whether creditors can resort

[1645] *TransFirst Grp., Inc. v. Magliarditi*, 2017 WL 2294288 (D. Nev. May 25, 2017).

[1646] 2017 WL 2294288 at *5 (footnote omitted).

[1647] *TransFirst Grp., Inc. v. Magliarditi*, *2017 WL 3723652* (D. Nev. Aug. 29, 2017).

[1648] *2017 WL 3723652* at *2 (some citations omitted).

[1649] 394 P.3d 940 (Nev. 2017).

[1650] *TransFirst*, *2017 WL 3723652* at *2.

to the alter-ego doctrine to access the assets of trusts. In a 2017 bankruptcy court decision in Illinois, though, the judge noted that "[t]he Delaware courts still have not recognized reverse piercing."[1651]

[1651] *In re Glick*, 568 B.R. 634, 661 (Bankr. N.D. Ill. 2017).

e. **Alaska** —

The author has not come across a federal or state decision that indicates whether the alter-ego doctrine is available to creditors in Alaska.

6. **Model for Other States** —

At this writing, 19 states—Alaska, Connecticut, Delaware, Hawaii, Indiana, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming—have some form of domestic APT legislation.[1652] Although Alaska enacted the first domestic APT statute—effective April 2, 1997,[1653] no other state used that statute in designing its domestic APT legislation. Delaware was the second state to enact such legislation—effective July 2, 1997,[1654] and 11 states—Connecticut, Hawaii, Indiana, Michigan, Mississippi, New Hampshire, Ohio, Rhode Island, South Dakota, Tennessee, and Wyoming—consciously modeled their domestic APT laws on Delaware's Qualified Dispositions in Trust Act.[1655] No state based its domestic APT legislation on Nevada's law, which was the fourth domestic APT legislation to take effect—on October 1, 1999.[1656] As just noted, South Dakota based its 2005 legislation on the Delaware Act.[1657]

[1652] For a compilation of the provisions of most of the statutes, see David G. Shaftel, *Eleventh Annual ACTEC Comparison of the Domestic Asset Protection Trust Statutes* (Aug. 2017), www.actec.org/assets/1/6/Shaftel-Comparison-of-the Domestic-Asset-Protection-Trust-Statutes.pdf. Colorado commentators now agree that Colo. Rev. Stat. §38-10-111 is not a domestic APT statute. Shaffel (Aug. 2017).

[1653] Alaska Stat. §34.40.110, 1997 Alaska Laws 6, §8 (Apr. 2, 1997).

[1654] Del. Code Ann. tit. 12, §3570–§3576, 71 Del. Laws 159, §1 (July 9, 1997).

[1655] *See* 2019 Conn. H.B. 7104, §99–§108 (July 12, 2019) (Connecticut Qualified Dispositions in Trust Act); *Haw. Rev. Stat. §554–G-1*–§554G-12, 2010 Haw. Laws 182, §2 (July 1, 2010) (Permitted Transfers in Trust Act); Ind. Code §30-4-8-1–§30-4-8-17, 2019 Ind. S.B. 265, §9 (July 1, 2019) (Legacy Trusts); Mich. Comp. Laws §700.1041–§700.1050, 2016 Mich. Pub. Acts 330, §1 (March 8, 2017) (Qualified Dispositions in Trust Act); Miss. Code Ann. §91-9-701–§91-9-723, 2014 Miss. Laws 513, §1 (July 1, 2014) (Mississippi Qualified Dispositions in Trust Act); N.H. Rev. Stat. Ann. §564-D:1–§564-D:18, 2008 N.H. Laws 374 (Jan. 2, 2009) (New Hampshire Qualified Dispositions in Trust Act); Ohio Rev. Code Ann. §5816.01–§5816.14, 2012 Ohio Laws 201 (Mar. 27, 2013) (Ohio Legacy Trust Act); R.I. Gen. Laws §18-9.2-1–§18-9.2-7, 1999 R.I. Pub. Laws 402, §1 (July 1, 1999) (Qualified Dispositions in Trust Act); S.D. Codified Laws §55-16-1–§55-16-16, 2005 S.D. Sess. Laws 261, §1 (Mar. 2, 2005) (Qualified Dispositions in Trust Act); Tenn. Code Ann. §35-16-101–§35-16-112, 2007 Tenn. Pub. Acts 144, §1 (July 1, 2007) (Tennessee Investment Services Act of 2007); Wyo. Stat. §4-10-510–§4-10-523, 2007 Wyo. Sess. Laws 155, §1 (July 1, 2007) (Qualified Spendthrift Trust). Subsequently, New Hampshire replaced its Delaware-based legislation with a stand-alone statute (N.H. Rev. Stat. Ann. §564-B:5-505A, 2017 N.H. Sess. Laws 257 (Sept. 16, 2017)).

[1656] Nev. Rev. Stat. §166.010–§166.170, 1999 Nev. Laws 299 (Oct. 1, 1999).

[1657] S.D. Codified Laws §55-16-1–§55-16-16, 2005 Sess. Laws 261, §1 (Mar. 2, 2005).

Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Detailed Analysis
X. A Comparison of the Leading Domestic APT States

D. Alaska vs. Delaware

1. **Introduction** —

In X.B., above, the author describes differences between Delaware's and Alaska's trust infrastructures. Delaware's favorable personal-trust structure has withstood the test of time. Given that Alaska's first beneficial-trust laws were only enacted in 1997, time will tell whether the state's efforts to attract trust business will continue into the future. As also discussed in X.B., above, Delaware has long been successful in attracting a disproportionate share of national trust business. A 2012 article in the *Alaska Law Review* found that Alaska's efforts to attract such business have been disappointing so far:[1658]

[1658] Lee, Note: Alaska on the Asset Protection Trust Map: Not Far Enough for a Regulatory Advantage, But Too Far for Convenience, 29 Alaska L. Rev. 149, 173 (June 2012).

> It appears, at least based on what little evidence is available, that Alaska is still far from reaching its goal of becoming a financial hub for asset protection. This goal may simply be unattainable due to the increase in competition from its sister states, all of which have closer access points for their residents to [set up] asset protection trusts than Alaska. Additionally, Alaska is unable to compete with offshore jurisdictions which are not bound by US federal law.

2. **APTs**

a. **Background** —

To the author's knowledge, Alaska provides the following advantages.

b. **Advantages of Alaska**

(1) **Constructive vs. Actual Fraud** —

Unlike the Delaware Act,[1659] the Alaska APT statute (the “Alaska Act”)[1660] does not permit a creditor to set aside an APT based on constructive fraud: that is, if the settlor (1) was engaged in (or was about to engage in) a business or transaction for which the settlor's remaining assets were unreasonably small or (2) intended to incur (or believed or reasonably should have believed that the settlor would incur) debts beyond the settlor's ability to pay as they became due.[1661] A commentator has explained that this difference is probably not significant for the following reasons:[1662]

[1659] Del. Code Ann. tit. 12, §3570–§3576.

[1660] Alaska Stat. §34.40.110.

[1661] Del. Code Ann. tit. 12, §3572(a); Del. Code Ann. tit. 6, §1304(a)(2).

[1662] Sullivan, Gutting the Rule Against Self-Settled Trusts, 23 Del. J. Corp. L. 423, 455 n.83 (1998) (citations omitted).

The distinction between the Alaska and Delaware remedies is potentially significant, but probably only in a handful of cases, particularly if good planning is followed. Many instances of constructive fraud are also cases of actual fraud: transfers that result in insolvency and which also lack an exchange of reasonably equivalent value are often exchanges that were meant to hinder, delay, or defraud creditors. Indeed, insolvency or lack of reasonably equivalent value are often signs of fraudulent intent, thus showing the potential for considerable overlap between the two species of fraud. When overlap occurs, the adverse economic effects associated with constructive fraud often arise by design. Thus, the distinction between Alaska and Delaware is limited to only the remaining cases of constructive fraud, i.e., those cases that are not also instances of actual fraud. Fortunately, transferors can avoid constructive fraud if they do not render themselves insolvent or if they receive reasonably equivalent value in exchange for property. Note, however, that reasonably equivalent value exists only if the interest received in exchange for the transferred property has utility or value to the transferor's creditors. Since the purpose of a qualified disposition is to put assets beyond the reach of creditors, it is highly unlikely that a settlor's retained interest in a Delaware trust will count as reasonably equivalent value. This means the settlor of a qualified disposition must remain solvent in order to avoid constructive fraud. This, however, is something the settlor of an Alaska trust should also strive for, as staying solvent will avoid an inference of fraudulent intent under Alaska law whereas post-transfer insolvency would jeopardize the safety of an Alaska structure. Thus, this difference between the Alaska and Delaware statutes is really more theoretical than practical.

(2) **Spousal Claims** —

Although the Alaska Act has no explicit exception for spousal claims, the Delaware Act permits a person who was married to the settlor at or before the time that the trust was created[1663] to reach the assets of a Delaware APT under limited circumstances.[1664] This Alaska advantage might not be as great as it first appears, however, because the surviving spouse of a nonresident settlor of an Alaska[1665] (but not a Delaware) APT might be able to reach trust assets if he or she elects against the settlor's will.[1666]

[1663] Del. Code Ann. tit. 12, §3570(9).

[1664] Del. Code Ann. tit. 12, §3573(1).

[1665] Alaska Stat. §13.12.202(d).

[1666] Del. Code Ann. tit. 12, §3573, flush language at end.

(3) **Child Support** —

With respect to claims by minor children, an Alaska APT is defeated only if the settlor was 30 or more days behind in making child-support payments when he or she created the trust,[1667] whereas such a claim relating to a judicial proceeding with respect to a separation or divorce may be brought against a Delaware APT at any time.[1668] Federal legislation and state court decisions might override Alaska's narrow exception for family claims. For example, as described in I.F., above, minor children are supercreditors. Thus, a federal statute not only requires states to give full faith and credit to child-support orders, but it also requires the application of the limitations period of the forum state or the state that issued the support order, whichever is longer.[1669] In addition, from a policy standpoint, the claims of spouses and children may be held as enforceable against self-settled spendthrift trusts. As discussed in VII., above, Delaware's broader exception for family claims should have no bearing on the federal transfer-tax consequences of Delaware APTs.

[1667] Alaska Stat. §34.40.110(b)(4).

[1668] Del. Code Ann. tit. 12, §3573(1).

[1669] 28 U.S.C. §1738B(a) (full faith and credit rule), §1738B(h)(3) (limitations rule).

(4) **Tort Claims** —

Unlike Alaska, Delaware permits a person who has a tort claim against the settlor when the settlor creates a Delaware APT to reach the assets of the trust at any time.[1670] Nevertheless, creditors who avail themselves of this exception in Delaware's law will almost certainly pursue their claims within the time limits imposed by the Alaska[1671] and Delaware Acts[1672] for preexisting claims (that is, within four years after the trust was created or, if later, within one year after the creditor discovered—or should have discovered—the trust).

[1670] Del. Code Ann. tit. 12, §3573(2).

[1671] Alaska Stat. §34.40.110(d)(1).

[1672] Del. Code Ann. tit. 12, §3572(b)(1); Del. Code Ann. tit. 6, §1309.

(5) **Validation of Claims** —

To reach the assets of an Alaska APT, a creditor whose claim existed when the trust was created must take steps to validate the claim[1673] and must show by clear and convincing evidence that creation of the trust was intended to defraud (not to hinder or to delay) a creditor.[1674]

[1673] Alaska Stat. §34.40.110(d)(1)(B).

[1674] Alaska Stat. §34.40.110(b)(1).

c. **Advantages of Delaware**

(1) **Infrastructure** —

Unlike Alaska, whose favorable trust laws date from 1997, Delaware has been a leader in the trust field since early in the 20th century.[1675]

[1675] *See* X.D.1., above.

(2) **Court System** —

The highly regarded Delaware courts have demonstrated their willingness to enforce Delaware statutes in difficult cases, such as those that might arise if creditors were to challenge Delaware APTs.[1676]

[1676] *See* X.C.4.b., above.

(3) **Fraudulent Transfer Claims** —

It might be harder to establish that the creation of an APT was a fraudulent transfer in Delaware, which has adopted the UFTA,[1677] than in Alaska, which has not.[1678] In particular, commentators have criticized Alaska's failure to define the term “creditor” for fraudulent transfer purposes as follows: “Unlike the two uniform laws, the Alaska law makes no attempt to define the term ‘creditor,’ leaving the class of plaintiffs as broad as the courts wish to make it, potentially including unknown future creditors, a class of creditors that neither the UFCA nor the UFTA includes in its definition of ‘creditor.’”[1679]

[1677] Del. Code Ann. tit. 6, §1301–§1311.

[1678] Alaska Stat. §34.40.090, §34.40.010.

[1679] Osborne, Giordani & Catterall, Asset Protection and Jurisdiction Selection, 33 Heckerling Inst. on Est. Plan. ¶1404.7B1 at 14-29–14-30 (1999).

(4) **Distribution Options** —

A Delaware APT gives the settlor two additional distribution options. Accordingly, settlors may obtain creditor protection if they create a grantor retained income trust or a trust from which they receive current income that meets the requirements of the Delaware Act.[1680] In addition, the settlor of a Delaware APT may provide for the payment of debts, expenses, and taxes from the trust after death.[1681]

[1680] Del. Code Ann. tit. 12, §3570(11)(b)(3).

[1681] Del. Code Ann. tit. 12, §3570(11)(b)(10).

(5) **Basis Planning** —

The Delaware Act allows creators of Delaware APTs to keep a power to reacquire trust assets in a nonfiduciary capacity under §675(4)(C).[1682] This power would enable such individuals to swap high-basis assets for low-basis assets in Delaware APTs that were structured to be excluded from the gross estate to obtain a step-up for the low-basis assets at death. Delaware also requires fiduciaries to verify the equivalent value of swapped assets as required by federal tax law.[1683] Alaska does not offer this option.

[1682] Del. Code Ann. tit. 12, §3570(11)(b)(8).

[1683] Del. Code Ann. tit. 12, §3316.

(6) **Automatic Resignation** —

One danger to a domestic APT is that a court that has jurisdiction over the trustee or trust assets will decide that the law of that court governs the trust or the effectiveness of the trust's spendthrift provision. The Delaware Act (but not the Alaska Act) provides that the trustee of an APT will automatically cease to serve if a court makes such a determination.[1684]

[1684] Del. Code Ann. tit. 12, §3572(g).

(7) **Elective-Share Claims** —

The surviving spouse of a nonresident settlor of an Alaska APT might be able to reach trust assets by electing against the will,[1685] but the surviving spouse of a resident or nonresident settlor of a Delaware APT may not do so.[1686]

[1685] Alaska Stat. §13.12.202(d).

[1686] Del. Code Ann. tit. 12, §3573, flush language at end.

(8) **Tenancy-by-the-Entireties Property** —

Delaware law gives protection from creditor claims to tenancy-by-the-entireties personal property contributed to a Delaware APT.[1687]

[1687] *See* III.G., above.

(9) **Public Policy** —

The Delaware Act is arguably less aggressive than the Alaska Act. For example, unlike Alaska, Delaware does not seek to frustrate claims by existing and former spouses. In addition, Delaware is far more solicitous of child-support claims, lacking as it does Alaska's rule that seems to bar claims by holders of child-support orders that are more than 30 days old.[1688] Accordingly, the more restrained Delaware Act may be more palatable to judges in non-DAPT states, especially if the settlor is trying to use a domestic APT to dodge child-support claims. In such cases, the non-DAPT court may be more likely to find that Alaska's statute offends a strong public policy of the non-DAPT state, which in turn will mean that the Delaware Act may be more likely to withstand a challenge.

[1688] *Cf.* Del. Code Ann. tit. 12, §3573(1) with Alaska Stat. §34.40.110(b)(4).

(10) **Court Decisions and Commentary** —

In two instances[1689] (both of which had bad facts for the debtor), federal bankruptcy judges in Alaska and Washington State set aside transfers to Alaska APTs. More recently, the federal district court in Alaska held than an Alaska APT was ineffective because the settlor did not satisfy the solvency-affidavit and other requirements.[1690] Professor Mann wrote about the *Mortensen* decision late in 2014: “If *Mortensen* stands for anything, it is the court's ‘bottom line’ assessment that Mortensen's use of an APT was ‘a clever but fundamentally flawed scheme to avoid exposure to his creditors.’ Importantly, because that decision came from the only bankruptcy jurisdiction in Alaska, the likelihood of successful reliance on that statute seems all but remote.”[1691] To date, the only published decision involving a Delaware APT had a favorable result for the settlor.[1692]

[1689] *In re Mortensen*, *2011 WL 5025288* (Bankr. D. Alaska Jan. 14, 2011); *In re Mortensen*, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011); *In re Mortensen*, *2011 WL 5025252* (Bankr. D. Alaska July 8, 2011); *In re Huber*, 493 B.R. 798, 817–18 (Bankr. W.D. Wash. 2013). *See* IX.J.2.c., above.

[1690] *In re Bertran*, No. 4:16-cv-00022, 2017 BL 86453, *2017 WL 1051185* at *6 n.50 (D. Alaska Mar. 20, 2017).

[1691] Mann, *The Role of Federal Law in Private Wealth Transfer: A Fresh Look at State Asset Protection Trust Statutes*, 67 Vand. L. Rev. 1741, 1760 (Nov. 2014) (footnote omitted).

[1692] *TrustCo Bank v. Mathews*, 2015 WL 295373 (Del. Ch. Jan. 22, 2015). *See* IX.J.3.b ., above.

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E. Nevada vs. Delaware

1. **Introduction** —

As shown in X.B., above, there are several differences between Delaware's and Nevada's trust infrastructures. Delaware has maintained a trust-friendly climate for over a century. Given that Nevada's efforts to attract trust business only began in 1999, time will tell whether these efforts will continue.

Delaware also has state-of-the-art trust laws that it refines almost every year. Because the Nevada legislature ordinarily convenes only in odd years, that state is unable to enact badly needed legislation in 2020 and other even years. In addition, in the past, Nevada has not passed certain key provisions until long after the state's competitors have acted. For example, the state did not enact a directed-trust or decanting statute until 2009,[1693] and it did not pass crucial updates to its APT statute until 2009 and even 2011.[1694] As noted in IX.J.3.b., above, the Delaware Court of Chancery held in 2015 that creditors' claims that transfers to two Delaware APTs were fraudulent transfers to be time-barred.[1695] As also covered in IX.J.3.b., above, the Supreme Court of Nevada held in 2017 that a Nevada APT was immune from claims by a surviving spouse in a Nevada divorce proceeding,[1696] but the Supreme Court of Utah reached the assets of a purported Nevada APT in 2015.[1697]

[1693] 2009 Nev. Stat. 215, §20–§35 (directed trust); 2009 Nev. Stat. 215, §37 (decanting).

[1694] 2009 Nev. Stat. 215, §58–§60; 2011 Nev. Stat. 270, §201–§206.

[1695] *TrustCo Bank v. Mathews*, 2015 WL 295373 (Del. Ch. Jan. 22, 2015).

[1696] *Klabacka v. Nelson*, 394 P.3d 940 (Nev. 2017).

[1697] *Dahl v. Dahl*, 2015 WL 5098249 (Utah Aug. 27, 2015).

2. **APTs**

a. **Advantages of Nevada**

(1) **Shorter Limitations Periods** —

As described in X.C.3., above, the limitations periods for bringing actions to contest APTs are half as long under the Nevada Act as they are under the Delaware Act. As also detailed in X.C.3., above, this supposed advantage is more apparent than real for several reasons, as has been conceded by a Nevada practitioner.

(2) **Family Claims** —

Unlike the Delaware Act,[1698] the Nevada Act contains no specific exception for claims by spouses, former spouses, and minor children that relate to separation or divorce proceedings. Delaware's exception for spousal claims is far narrower than might appear to be the case, because the exception does not extend to future spouses and because it limits the rights of current and former spouses.[1699] In addition, this **supposed Nevada** advantage might not exist at all for the following reasons.

[1698] Del. Code Ann. tit. 12, §3573(1).

[1699] Del. Code Ann. tit. 12, §3570(9), Del. Code Ann tit. 12, §3573, flush language at end.

(a) **Statutory Exception** —

A Nevada statute[1700] (as amended in 2011)[1701] provides that "a creditor may not bring an action with respect to a transfer of property to a spendthrift trust unless a creditor can prove by clear and convincing evidence that the transfer of property was a fraudulent transfer pursuant to chapter 112 of NRS or that *the transfer violates a legal obligation owed to the creditor under a contract or a valid court order that is legally enforceable by that creditor*." It certainly appears that the emphasized language will give spouses with alimony and child-support claims an opportunity to reach the assets of Nevada APTs.

[1700] Nev. Rev. Stat. §166.170(3) (emphasis added).

[1701] 2011 Nev. Stat. 270, §206.

(b) **Federal Exception** —

Federal law might enable persons with child-support claims to reach the assets of Nevada APTs.[1702]

[1702] 28 U.S.C. §1738B.

(c) **Judicially Created Exception** —

Even if these exceptions are not already in the Nevada Act, Nevada courts might add them. As discussed in X.C.4., above, in cases that were decided before and after the passage of the Nevada Act, the Supreme Court of Nevada and federal courts have demonstrated a propensity to establish nonstatutory exceptions to the state's homestead exemption,[1703] and its annuity exemption,[1704] which are other state-created protections from creditor claims.

[1703] Nev. Rev. Stat. §115.005–§115.090.

[1704] Nev. Rev. Stat. §687B.290(1).

(d) **Comment** —

In the author's experience, this advantage is not important to clients. According to a 2019 article, “[a]s not paying child support, and in some states, not paying maintenance, is a ‘go directly to jail’ offense, we don't find that preventing these exception creditors does much to enhance the asset protection of Nevada DAPTs for non-Nevada clients.”[1705]

[1705] Merric, Worthington, MacArthur & Sullivan, *Best Situs for DAPTs in 2019*, 158 Tr. & Est. 60, 69 (Jan. 2019)

(3) **Tort Claims** —

Nevada does not have Delaware's exception for tort claims that predate a transfer into an APT,[1706] but the holder of such a claim might fall within the highlighted exception in the Nevada statute quoted above.

[1706] Del. Code. Ann. tit. 12, §3573(2).

b. **Advantages of Delaware**

(1) **Basis Planning** —

Effective in 2015, the Delaware Act has allowed creators of APTs to have a power to reacquire trust assets in a nonfiduciary capacity within the meaning of §675(4)(C).[1707] That provision gives such individuals the planning option described in X.D.2.c.(5), above. Nevada does not have a comparable statute.

[1707] Del. Code Ann. tit. 12, §3570(11)(b)(8).

(2) **Spendthrift Clauses** —

Unlike the Delaware Act,[1708] the Nevada Act does not require an APT to have any particular spendthrift clause and does not provide that a spendthrift trust is to fall within the trust exclusion under the federal bankruptcy code. This deficiency might expose trust assets to creditor claims in poorly drafted instruments, particularly if (as is permitted by the Nevada Act)[1709] the trustee has minimal ties to the state.

[1708] Del. Code Ann. tit. 12, §3570(11)(c).

[1709] Nev. Rev. Stat. §166.015(2).

(3) **Automatic Resignation** —

Unlike the Nevada Act, the Delaware Act[1710] provides that the trustee of an APT will cease to act if a court determines that Delaware law does not govern the trust or the effect of its spendthrift clause.

[1710] Del. Code Ann. tit. 12, §3572(g).

(4) **Consequences of Successful Challenge** —

Unlike the Nevada Act, the Delaware Act[1711] describes the implications for the trust, the trustee, and the beneficiaries if a creditor brings a claim that may be paid from the trust. The inclusion of these provisions in the Delaware Act greatly increases its asset-protection effectiveness.[1712]

[1711] Del. Code Ann. tit. 12, §3574.

[1712] Sullivan, Gutting the Rule Against Self-Settled Trusts, 23 Del. J. Corp. L. 423, 464, 475 (1998).

(5) **Distribution Options** —

A Delaware APT gives the settlor additional distribution options. Thus, a settlor may obtain creditor protection if he or she creates a self-settled spendthrift trust that is a grantor retained income trust (GRIT) that meets the requirements of the Delaware Act.[1713] A Delaware APT may also provide for the payment of debts, expenses, and taxes following the settlor's death.[1714] This latter option might be particularly helpful when the settlor structures the APT as an incomplete gift and the APT's value appreciates relative to the size of the settlor's gross estate.

[1713] Del. Code Ann. tit. 12, §3570(11)(b).

[1714] Del. Code Ann. tit. 12, §3570(11)(b)(10).

(6) **Tenancy-by-the-Entireties Property** —

Delaware law offers protection to tenancy-by-the-entireties personal property contributed to a Delaware APT.[1715]

[1715] Del. Code Ann. tit. 12, §3574(f).

(7) **Public Policy** —

The Delaware Act is less aggressive than the Nevada Act. A court in a state that does not have domestic APT legislation that is adjudicating the ability of a creditor to reach the assets of a domestic APT therefore might be less likely to disregard Delaware law than Nevada law.

(8) **Other Self-Settled Vehicles** —

Unlike Nevada, Delaware does not permit creditors to reach a settlor's contingent interest in a lifetime marital-deduction trust, credit-shelter trust, or other trust.[1716]

[1716] Del. Code Ann. tit. 12, §3536(c)(1).

(9) **Judicial Decisions** —

In 2015, the Delaware Court of Chancery held creditors' claims that transfers to Delaware APTs by a non-Delaware resident were fraudulent transfers to be time-barred.[1717] Nevada courts have not yet rendered decisions involving Nevada APTs and Nevada nonresidents.

[1717] *TrustCo v. Mathews*, 2015 WL 295373 (Del. Ch. Jan. 22, 2015).

(10) **Trust Legislation** —

Delaware frequently revises its APT legislation. As noted above, the Nevada legislature generally convenes only in odd years. Nevada did not add crucial provisions to its APT legislation until 2009 or even 2011—long after other states.[1718]

[1718] 2009 Nev. Stat. 215, §58–§60; 2011 Nev. Stat. 270, §201–§206.

(11) **Alter-Ego Trusts** —

Unlike Delaware, Nevada has caselaw and legislation indicating that Nevada APTs can be set aside under the alter-ego doctrine in certain circumstances.[1719]

[1719] *See* X.C.5.c., above.

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F. South Dakota vs. Delaware

1. Introduction

a. **Background** —

Some differences between Delaware's and South Dakota's trust infrastructure are summarized in X.B., above. Delaware has offered favorable trust laws for over a century. Given that South Dakota has only done so since 1983, time will tell whether South Dakota will become and remain an attractive option.

b. **Worrisome Caselaw**

(1) **Introduction** —

Readers should be aware that two enormous South Dakota trusts—one a $150 million dynasty trust; the other a $1 billion charitable trust—have gone breathtakingly wrong. In both instances, South Dakota law might leave those attempting to right the wrong without a remedy.

(2) **McDevitt v. Wellin (2016)** —

The first case is the ongoing litigation involving the Wellin Family 2009 Irrevocable Trust, which the settlor, Keith Wellin, intended to be a South Dakota dynasty trust. In January of 2016, the U.S. District Court for the District of South Carolina summarized the sad saga as follows:[1720]

[1720] *McDevitt v. Wellin*, *2016 WL 199626* at *1–2 (D.S.C. Dec. 15, 2016) (citations omitted).

> On November 2, 2009, Keith Wellin ("Keith") created the Wellin Family 2009 Irrevocable Trust (the "Trust") for the benefit of his children and grandchildren. In late 2013, defendants Peter J. Wellin, Cynthia W. Plum, and Marjorie W. King (the "Wellin children"), acting as co-trustees, liquidated and distributed over $95.6 million of the Trust's estimated $154 million in assets to themselves. On December 17, 2013, then-plaintiff Schwartz, acting as trust protector, initiated the present action, claiming that the Wellin children's liquidation of the Trust assets was both tortious and in violation of the Trust. The action also seeks to remove the Wellin children from their positions as co-trustees. Notably, at the time Schwartz was hired by Keith as trust protector, and at all times since, Keith has pursued a separate action—*Wellin v. Wellin* et. al.—seeking to declare the Trust void ab initio. Recognizing this conflict, Keith released any claims he may have against Schwartz for reimbursement of Schwartz's fees and attorney fees in the event Keith's separate action is successful.
>
> In May 2014, after this court found that Schwartz did not qualify as a real party in interest and dismissed the instant action, Schwartz exercised his powers under the Trust and appointed McDevitt as an additional trustee. McDevitt quickly ratified the commencement of this action. On October 10, 2014, McDevitt filed a new complaint seeking actual and punitive damages from the Wellin children and asserting a cause of action for the recovery of attorney's fees. The Wellin children counterclaimed that Schwartz was not properly appointed trust protector because Keith lacked capacity at the time of his appointment, and that Schwarz was "subordinate" to Keith in violation of the Trust requirements. The Wellin children also seek to have the trust plaintiffs removed from their fiduciary positions based on various actions taken in bad faith and against the best interests of the Trust.
>
> The Wellin children are currently holding the distributed Trust assets in certain UBS accounts, and have used millions of dollars in Trust assets to pay their own attorneys, experts, and consultants in this litigation. The trust plaintiffs and their attorneys have not been paid or reimbursed by the Trust. However, the trust plaintiffs and their attorneys are being paid, pursuant to letter agreements between Keith and the trust plaintiffs, which provide that Keith will pay the trust plaintiffs' fees and expenses, and their attorneys' fees. The letter agreements further state that these advances must only be repaid to the extent the trust plaintiffs are able to recover such fees from the Trust assets or the Wellin children.

Hence, the salient facts of this case are as follows:

- settlor created enormous dynasty trust for his children and their issue in 2009;
- four years later, children, as co-trustees, liquidated trust assets and distributed bulk of proceeds to themselves;

- settlor spent the last few years of his life suing his children to restore or revoke trust;
- children are paying their litigation costs from proceeds of trust assets; settlor and his widow are bearing litigation costs of protector and trustee appointed by protector;
- South Dakota corporate co-trustee made no attempt to intervene.

(3) **In re Marvin M. Schwan Charitable Foundation (2016)** —

The second case is the ongoing litigation involving the Marvin M. Schwan Charitable Foundation. There, the settlor, Marvin M. Schwan, created the foregoing trust in 1992 for seven named charitable institutions and died the following year.[1721] After the settlor's death, the trust was funded with nearly $1 billion, but "[t]he parties do not dispute that certain investments made by the Trustees over several years caused approximately $600 million in losses to the Foundation."[1722] At all relevant times, the trust had five individual trustees and a Trust Succession Committee, which consisted of seven members, two of whom are sons of the settlor.[1723]

[1721] *In re Marvin M. Schwan Charitable Found.*, 880 N.W.2d 88, 89–90 (S.D. 2016).

[1722] 880 N.W.2d at 90.

[1723] 880 N.W.2d at 90.

In June of 2014, the settlor's sons, as members of the Trust Succession Committee, petitioned a circuit court for court supervision of the trust pursuant to South Dakota Codified Laws §21-22-9.[1724] Thereafter, the trustees, the beneficiaries, and the South Dakota Attorney General entered into a settlement agreement and disingenuously asked the court to dismiss the petition, inter alia, because court supervision "would needlessly waste additional assets."[1725] The court subsequently dismissed the petition for lack of standing, finding that the petitioners were neither fiduciaries nor beneficiaries for purposes of the statute.[1726] The Supreme Court of South Dakota reversed because it found that the petitioners in fact were "beneficiaries" within the meaning of the statute.[1727]

[1724] 880 N.W.2d at 91.

[1725] 880 N.W.2d at 91.

[1726] 880 N.W.2d at 92.

[1727] 880 N.W.2d at 95.

All of this means that, in a case in which the trustees admitted to $600 million of investment losses, the settlor's representatives had to go all the way to the Supreme Court of South Dakota even to be allowed to petition for court supervision, which petition might very well be denied.

2. **APTs**

a. **Advantages of South Dakota**

(1) **Shorter Limitations Periods** —

Whereas the general limitations rule in Delaware is four years,[1728] South Dakota's general limitations rule is two years. For reasons discussed in X.C.3., above, this advantage might be more apparent than real.

[1728] Del. Code Ann. tit. 12, §3572; Del. Code Ann. tit. 6, §1309.

(2) **Validating Claims** —

Unlike the Delaware Act, the South Dakota Act specifies methods to commence the date-of-discovery period.[1729]

[1729] S.D. Codified Laws §55-16-10.

(3) **Actual Fraud Test** —

Delaware requires that future creditors prove an intent to defraud and does not allow them to prevail based on a showing of intent to hinder or delay. Existing creditors can still prevail, however, by proving an intent to hinder or delay.[1730] South Dakota, on the other hand, has eliminated the "hinder or delay" theory for all creditors.[1731]

[1730] Del. Code Ann. tit. 12, §3572(a); Del. Code Ann. tit. 6, §1304–§1305.

[1731] S.D. Codified Laws §55-16-9.

(4) **Tort Claims** —

Unlike South Dakota, Delaware permits a person who has a tort claim against the settlor when the settlor creates a Delaware APT to reach the assets of the trust at any time.[1732] Nevertheless, creditors who avail themselves of this exception in Delaware's law will almost always pursue their claims within the time limits imposed by the South Dakota Act for preexisting claims: within two years after the trust was created or, if later, within six months after the creditor discovered (or should have discovered) the transfer.

[1732] Del. Code Ann. tit. 12, §3573(2).

b. **Advantages of Delaware**

(1) **Additional Distribution Option** —

In Delaware,[1733] a settlor may keep an interest in a GRAT or GRUT, while in South Dakota, a settlor may retain only up to a 5% interest in such a trust.[1734]

[1733] Del. Code Ann. tit. 12, §3570(11)(b)(5).

[1734] S.D. Codified Laws §55-16-2(2)(f).

(2) **Basis Planning** —

Delaware specifically allows the settlor to retain a power to reacquire trust assets in a nonfiduciary capacity within the meaning of §675(4)(C).[1735] Having this option will enable the settlor to make sure that assets receive a stepped-up income-tax basis at death. At present, this power is not available in South Dakota.

[1735] Del. Code Ann. tit. 12, §3570(11)(b)(8).

(3) **Family Claims** —

In Delaware[1736] (but not in South Dakota),[1737] a spouse or former spouse may reach the assets of an APT for property division and other actions only if such an action is "incident to a judicial proceeding with respect to a separation or divorce."

[1736] Del. Code Ann. tit. 12, §3573(1).

[1737] S.D. Codified Laws §55-16-15(1).

(4) **Elective-Share Rights** —

In South Dakota[1738] (but not in Delaware),[1739] a surviving spouse may reach the assets of a South Dakota APT by electing against the will of a South Dakota resident or nonresident decedent.

[1738] S.D. Codified Laws §29A-2-202(d), §29A-2-205(2)(i).

[1739] Del. Code Ann tit. 12, §3573, flush language at end.

(5) **Tenancy-by-the-Entireties Property** —

Unlike South Dakota, Delaware provides protection for tenancy-by-the-entireties personal property that is contributed to an APT.[1740]

[1740] Del. Code Ann. tit. 12, §3574(f).

(6) **Other Self-Settled Vehicles** —

Delaware allows creditor protection for a donor's contingent interest in a lifetime marital-deduction trust, credit-shelter trust, or other trust.[1741] To date, South Dakota does not have such legislation.

[1741] Del. Code Ann. tit. 12, §3536(c)(1).

(7) **Caselaw** —

In 2015, the Delaware Court of Chancery held that creditors' claims that transfers to Delaware APTs by a nonresident were fraudulent transfers to be time-barred.[1742] South Dakota courts have not yet ruled on the viability of South Dakota APTs.

[1742] *TrustCo v. Mathews*, 2015 WL 295373 (Del. Ch. Jan. 22, 2015).

(8) **Trust Legislation** —

Delaware updates its APT legislation more promptly than South Dakota does.

(9) **Alter-Ego Remedy** —

South Dakota legislation and caselaw indicate that a South Dakota APT might be set aside as the settlor's alter ego in certain circumstances.[1743] This appears to be less of a concern in Delaware.

[1743] *See* X.C.5.b., above.

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A. Introduction

Although they are described as APTs, domestic APTs (sometimes referred to as DAPTs) serve other purposes. As discussed in II., above, domestic APTs may be used to reduce federal transfer taxes, to protect self-settled estate planning vehicles, to save state income taxes, to assist nonresident aliens, and to provide protection to trusts that are moved from domestic or foreign jurisdictions. None of these ends requires a foreign APT. Even when asset protection is the sole objective, domestic APTs offer advantages over foreign APTs.

B. Advantages of Foreign APTs

1. **Offer Protective Features** —

Like domestic APTs, foreign APTs are governed by the laws of jurisdictions that provide creditor protection for settlors' retained interests in self-settled spendthrift trusts, but the similarity of the two vehicles stops there. Foreign APTs usually go on to provide protective features that domestic APTs do not or cannot offer.[1744] These features include:

[1744] For general descriptions of foreign APTs, see Stowell, Johanson & Pacini, *The Use of Wills and Asset Protection Trusts in Fraud and Other Financial Crimes*, 65 Drake L. Rev. 509, 529–41 (2017); Duggan, *The Prudence of Offshore Planning for Affluent Clients*, 40 Est. Plan. 18 (Feb. 2013); Russell et al., *Practical Asset Protection Planning Concepts and Ideas,* 39 Est. Plan. 7, 13–14 (Nov. 2012); Bove, *Offshore Asset Protection Trusts*, 149 Tr. & Est. 67 (Nov. 2010).

- narrow definitions of fraudulent transfer claims that may defeat APT;
- very short limitations periods for bringing such claims;
- very high burdens of proof (e.g., beyond a reasonable doubt) for proving fraudulent transfer claims;
- no recognition of U.S. judgments, meaning that creditor may not levy on trust assets to enforce claim but must relitigate claim;
- trust provisions (flight clauses) that permit trustee or protector to change governing law or move trust assets if settlor encounters creditor claims;
- trust provisions (duress clauses) that instruct trustee or protector to ignore orders of settlor or U.S. courts if settlor develops creditor problems;[1745]
- "excluded person" clauses that cut off rights of disfavored creditors;
- difficulty and/or significant expense for U.S. creditors to engage local counsel;
- inability of U.S. courts to obtain personal jurisdiction over trustee; and

- involvement of protector in distribution and administrative duties.

The difficulties for a U.S. court to obtain personal jurisdiction over the offshore trustee of a foreign APT are illustrated by a 2019 federal bankruptcy case in Florida.[1746]

In that case, after holding that the assets of an APT in Belize were includible in the debtor's bankruptcy estate, the court pointed out that "because the Joren Trustee is not a party to this action, the plaintiff cannot obtain enforceable relief regarding the assets of the Joren Trust."[1747]

The court elaborated:[1748]

> The Joren Trustee is located in Belize. Rule 4(f) of the Federal Rules of Civil Procedure governs service on an individual in a foreign country. Rule 4(f)(1)-(2) requires service by any internationally agreed means reasonably calculated to give notice, such as those authorized by the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents, or, if there is no internationally agreed means or if an international agreement allows but does not specify other means, by a method reasonably calculated to give notice by certain other methods in accordance with the foreign country's law. The Court may also order other means of service not prohibited by international agreement where necessary. At a minimum, citizens of Belize may be served under The Hague Convention. The Joren Trustee is thus subject to service of process. Joining the Joren Trustee would have no impact on subject matter jurisdiction in this case.

Regarding joinder, the court noted:[1749]

> Rule 19(a)(1) then provides two alternative tests for determining whether the party must be joined. If either (a) the Court cannot accord complete relief without the party, or (b) the party claims an interest in the subject of the case and ruling without it may impair its ability to protect that interest or subject an existing party to multiple or inconsistent obligations, then the party must be added to the suit. The Joren Trustee satisfies both standards. Because the Joren Trust is the sole owner of certain rights under the annuity contracts, the Court cannot grant the declaratory relief requested unless the Joren Trustee is a party. In addition, the Joren Trustee has a fiduciary obligation to all beneficiaries of the trust. Mr. Rensin is not the only beneficiary. A ruling in favor of the plaintiff on claims affecting property rights of the Joren Trust would impair the Joren Trustee's ability to protect the interests of the other stakeholders. As a result, under Rule 19(a)(1), in order to obtain the relief requested with regard to property owned by the Joren Trust the plaintiff must seek to add the Joren Trustee as a defendant.

The court continued:[1750]

[1745] *See* Reynolds, *Defending Offshore Trusts From Foreign Attack*, 150 Tr. & Est. 63 (Nov. 2011).

[1746] *In re Rensin*, *2019 WL 2004000* (Bankr. S.D. Fla. May 6, 2019). The district court has held the debtor to be in contempt, but collection activity has been stayed for the time being (*Rensin* at *4).

[1747] *2019 WL 2004000* at *8.

[1748] *2019 WL 2004000* at *13 (footnote and citations omitted).

[1749] *2019 WL 2004000* at *13.

[1750] *2019 WL 2004000* at *14 (citations and internal quotation marks omitted).

The parties agree that it is not feasible to join the Joren Trustee, as contemplated in Rule 19(b). But the Court need not heed that agreement as the law and circumstances obviously negate it. There are two issues relevant to this question: (a) whether the Court could obtain personal jurisdiction over the Joren Trustee, and (b) whether the order of the Supreme Court of Belize, directing the Joren Trustee to ignore orders of other courts, means that joining the Joren Trustee would be futile.

This Court looks to the Due Process Clause of the Fifth Amendment to the United States Constitution to determine whether it has personal jurisdiction over a defendant. Personal jurisdiction may be either general, meaning the defendant has continuous and systematic affiliation with the forum, or specific, meaning the controversy arises out of the defendant's contacts with the forum with regard to the underlying controversy. There is not sufficient evidence now before the Court to determine whether the Court would or would not have personal jurisdiction over the Joren Trustee. It is certainly possible that personal jurisdiction would attach. In any case, the lack of personal jurisdiction is a defense to be raised by the Joren Trustee if it is served. Unless it is obvious that there would be no personal jurisdiction over a proposed defendant, and that is not the case here, the potential lack of personal jurisdiction does not make joinder infeasible within the meaning of Rule 19(b).

The order of the Supreme Court of Belize, directing the Joren Trustee not to comply with certain orders, is not dispositive on the feasibility of joining the Joren Trustee. The order addresses potential rulings of the District Court, specifically in reference to the FTC action discussed above. The Supreme Court of Belize directed the Joren Trustee to look only to the Supreme Court itself for direction, thereby retaining ultimate control of the Joren Trust. This does not necessarily mean that the Supreme Court of Belize will refuse to direct the Joren Trustee to comply with a final judgment of this Court entered after the Joren Trustee is duly joined.

But even if joinder of the Joren Trustee was not feasible, the Court would nonetheless rule that the plaintiff's request for a declaratory judgment regarding property of the Joren Trust must be dismissed. Under Rule 19(B), if joinder of a necessary party is not feasible, the Court must determine whether, in equity and good conscience, the action should proceed among the existing parties. The Court considers, among other things: (a) whether the non-joined party and existing parties would be prejudiced; (b) whether the relief could be tailored to ameliorate that prejudice; (c) whether judgment in absence of the non-joined party would be adequate; and (d) whether the plaintiff would have an adequate remedy if the matter is dismissed. In this case, the plaintiff seeks a ruling that all assets owned by the Joren Trust are property of the bankruptcy estate subject to administration here. Only an order binding on the Joren Trustee can achieve that relief. There is no way to tailor the relief to make this Court's ruling binding on the Joren Trust without actually adding the Joren Trustee as a defendant. As an alternative, the plaintiff may seek relief against the Joren Trust in Belize.

Because the Joren Trustee is not a party defendant in the adversary proceeding the plaintiff's request in count I of the complaint for a declaratory judgment that all assets in the Joren Trust are property of the bankruptcy estate must be dismissed, without prejudice.

2. **Might Be Superior**

a. **Introduction** —

Foreign APTs are not always impregnable, however. Thus, the settlor's asset protection objectives might be thwarted if he or she appoints a trustee over which a U.S. court has personal jurisdiction,[1751] if the trust is funded with real property in the United States,[1752] the trust is funded with securities that are subject to the court's control,[1753] or the court has personal jurisdiction over a trustee that holds assets in another jurisdiction that the court cannot reach.[1754] In addition, as discussed below, the settlor might risk fine or imprisonment for creating a foreign APT and his or her attorney might face disciplinary action and personal liability for participating in the transaction.

[1751] *See Rush Univ. Med. Ctr. v. Sessions*, 980 N.E.2d 45 (Ill. 2012) (see below); *Beaubien v. Cambridge Consol., Ltd.*, 652 So.2d 936 (Fla. Dist. Ct. App. 1995) (finding personal jurisdiction over Florida agent of foreign corporate trustee); *Weitz v. Weitz*, *2012 WL 1079203* (N.Y. Sup. Ct. Mar. 22, 2012) (New York trial court ruled that it had personal jurisdiction over Cook Island corporate trustee).

[1752] *See Rush*, 980 N.E.2d at 48; *Bank of Am. v. Weese*, *2002 WL 33957429* (Md. Cir. Ct. Jan. 14, 2002); *Estate of Waitzman*, 507 So.2d 24, 25 (Miss. 1987).

[1753] *See Nastro v. D'Onofrio*, 263 F. Supp. 2d 446 (D. Conn. 2003). *But see Sargeant v. Al-saleh*, 137 So.3d 432, 435 (Fla. Dist. Ct. App. 2014) ("The trial court did not have the authority to order the debtors to turn the foreign stock certificates over to their counsel").

[1754] *See Koehler v. Bank of Bermuda Ltd.*, 911 N.E.2d 825, 827 (N.Y. 2009). *But see Livingston v. Naylor*, 920 A.2d 34 (Md. Ct. Spec. App. 2007).

b. **Rush University Medical Center v. Sessions (2012)**

(1) **Introduction** —

In this case,[1755] the Supreme Court of Illinois set aside transfers to an offshore trust pursuant to the common-law rule against self-settled spendthrift trusts (the "common-law rule"). The decision is instructive on the distinction between this common-law rule and the common-law prohibition of fraudulent conveyances as well as on trust design.

[1755] *Rush Univ. Med. Ctr. v. Sessions*, 980 N.E.2d 45.

(2) **Facts** —

- February 1, 1994—Sessions created offshore (Cook Islands) APT and funded it with 99% limited partnership interest in Colorado limited partnership (assets of which were worth $16.2 million at his death) and parcel of Illinois real property (worth $2.7 million at his death); he was discretionary beneficiary and trust protector;

- Fall 1995—Sessions made $1.5 million pledge to Rush to construct president's house and revised his will to provide for fulfillment of pledge at his death;

- February 2005—Sessions diagnosed as having late-stage lung cancer;

- March 10, 2005—Blaming Rush for not diagnosing his cancer sooner, Sessions signed new will making no provision for satisfaction of pledge;

- April 19, 2005—Sessions created revocable trust and funded it with 1% general partnership interest (worth $164,205) and subsequently made $200,000 of gifts that reduced his estate;

- April 25, 2005—Sessions died;

- December 15, 2005—Rush filed claim against Sessions's estate to collect $1.5 million pledge (no payments were made during life);

- April 4, 2006—Given that Sessions's probate estate was minimal, Rush sued trustees of 1994 trust to

> collect pledge.[1756]

(3) **Issue** —

The issue was whether Sessions's offshore trust was invalid vis-à-vis Rush's claim under the common-law rule or whether Illinois's adoption of the Uniform Fraudulent Transfer Act ("UFTA") supplanted that rule, in which event Rush would have had to show that transfers to the trust were fraudulent transfers.

(4) **Analysis** —

The court first noted that Illinois's adoption of the UFTA generally supplemented and did not supplant common-law principles and found no irreconcilable difference between the common-law rule and the UFTA.[1757] It then contrasted the purposes of the UFTA and the common-law rule. Regarding the UFTA, it said:[1758]

> It has been stated that the general purpose of the Act is to protect a debtor's unsecured creditors from unfair reductions in the debtor's estate to which creditors usually look to security.

By contrast, it described the purpose of the common-law rule:[1759]

> The common law rule also has a general purpose of protecting creditors, but it addresses the specific situation where an interest is retained in a self-settled trust with a spendthrift provision. Traditional law is that if a settlor creates a trust for the settlor's own benefit and inserts a spendthrift clause, the clause is void as to the then-existing and future creditors, and creditors can reach the settlor's interest under the trust. And the 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 reconciled the two doctrines as follows:[1760]

> Both laws have a general purpose of protecting creditors. But the common law 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. Additionally, the Act and the common law rule each operate in some circumstances where the other does not, thus negating any inference that the common law rule would render the Act superfluous. The Act is effective, but the common law rule is not, in a much larger sphere, which includes both situations that do not involve trusts and in connection with transfers into trusts that are not for the settlor's benefit because they permit distributions only to other persons.

It continued:[1761]

[1756] *Rush Univ. Med. Ctr. v. Sessions,* 980 N.E.2d 45, 48–49.

[1757] 980 N.E.2d 45, 51–52.

[1758] 980 N.E.2d 45, 52 (citation and internal quotation marks omitted).

[1759] 980 N.E.2d 45, 52 (footnote, citation, and internal quotation marks omitted).

[1760] 980 N.E.2d 45, 52 (emphasis in original).

[1761] 980 N.E.2d at 53 (emphasis in original).

> We also do not find any displacement of the common law rule by the language in section 5 of the Act, as it is not a fraudulent *transfer* of funds that renders the trust void as to creditors under the common law, but rather it is the spendthrift provision in the self-settled trust and the settlor's *retention* of the benefits that renders the trust void as to creditors.

The court summarized the history of fraudulent-conveyance law in Illinois as follows:[1762]

[1762] 980 N.E.2d at 53–54 (citations and internal quotation marks omitted).

> The appellate court concluded that count III could not survive because it did not allege, consistent with section 5 of the Fraudulent Transfer Act, that decedent made a transfer to the trusts with actual intent to hinder, delay, or defraud plaintiff. Ironically, the very statutory language that the appellate court quotes and finds inconsistent with the common law rule has itself coexisted in complete harmony with the common law trust rule for centuries. Our state's law on fraudulent conveyances, like that of many jurisdictions in the United States, traces back to the Statute of 13 Elizabeth, enacted in the sixteenth century, which declared invalid covinous and fraudulent transfers designed to delay, hinder or defraud creditors and others. That statute itself codified the common law. Shortly after Illinois became a state, our legislature first codified the substance of the common law that invalidates fraudulent conveyances. It then condensed it into section 4 of the 1874 Act to revise the law in relation to frauds and perjuries. That law remained in effect until January 1, 1990, when the legislature repealed it and enacted the Uniform Fraudulent Transfer Act. Thus, Illinois statutory law for well over 100 years before 1990 provided in relevant part that every transfer made with the intent to disturb, delay, hinder or defraud creditors shall be void as against such creditors. Similarly, from 1990 to the present, the Uniform Fraudulent Transfer Act has read in relevant part that a transfer made by a debtor is fraudulent as to a creditor if the debtor made the transfer with actual intent to hinder, delay, or defraud any creditor of the debtor. Given the longstanding coexistence of the common law trust rule and the statutory provisions against fraudulent conveyances that have remained essentially consistent in terms of the relevant language, we do not believe that the legislature intended to abrogate the common law rule by implication when it enacted the Uniform Fraudulent Transfer Act.

Next, the court observed:[1763]

[1763] 980 N.E.2d at 53–54 (citations and internal quotation marks omitted).

> Further support for our conclusion that the legislature intended to preserve rather than abrogate the common law rule with respect to self-settled spendthrift trusts is found in section 2-1403 of the Code of Civil Procedure. That section provides for a general exclusion from postjudgment execution on property held in trust for the judgment debtor, but it expressly limits that exclusion to trusts that are not self-settled. No court shall order the satisfaction of a judgment out of any property held in trust for the judgment debtor if such trust has, in good faith, been created by, or the fund so held in trust has proceeded from, a person other than the judgment debtor. The clear corollary is that Illinois law allows execution by a creditor against assets held in a self-settled trust and that the General Assembly thereby intended to preserve the common law trust rule. We also note that during nearly all of the many years that Illinois has had a fraudulent conveyance statute, it has also had a statute like current section 2-1403 of the Code that specifically withholds any protection from execution on assets held in trust for a judgment debtor who created or funded the trust. Yet, section 2-1403 and its predecessors have existed harmoniously alongside the Illinois statutes directed specifically at fraudulent conveyances without a hint of any inconsistency between them for more than a century. Nothing in the language of the Uniform Fraudulent

> Transfer Act convinces us that the legislature intended to change the status quo.

After reviewing relevant authorities,[1764] the court held that Sessions's estate was responsible for paying the pledge notwithstanding his death.[1765] It then concluded:[1766]

> [W]e hold that the Uniform Fraudulent Transfer Act did not displace or abrogate the common law trust rule with respect to self-settled trusts. We also conclude that under the undisputed facts of this case, plaintiff was a “creditor” of Sessions for purposes of the common law rule.

(5) **Observation** —

Rush shows that the common-law rule is alive and well in many states. It means that statutes of limitations, fraudulent transfer rules, and burdens of proof will be of no avail to a trustee defending an APT in such a state. But, if the law of an APT state applies, a creditor probably will have to prove a fraudulent transfer, which will be difficult for a properly designed and administered APT. Court jurisdiction was not at issue in *Rush* because the trust had resident individual trustees and held Illinois real property.

Practice Tip: If clients and their attorneys are willing to assume the risks, then a well-designed and implemented foreign APT may offer effective protection from creditor claims, particularly if the transactions are not fraudulent transfers.[1767]

3. **Full Faith and Credit Not Due U.S. Judgments** —

Unlike courts in the domestic APT states, courts of foreign jurisdictions do not have to give full faith and credit to judgments of U.S. courts. Nevertheless, the mere invocation of the Full Faith and Credit Clause does not, ipso facto, mean that the trustee of a domestic APT must pay a creditor's claim.[1768]

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Detailed Analysis
XI. A Comparison of Foreign and Domestic APTs

C. Advantages of Domestic APTs

1. **Constitutional Issues Might Favor** —

As discussed in IX., above, the Full Faith and Credit Clause and §541(c)(2) of the Bankruptcy Code are likely to favor domestic APTs. More specifically, U.S. courts have less leeway to ignore the laws of sister states[1769] and more leeway

[1764] 980 N.E.2d at 54–58.

[1765] 980 N.E.2d at 58.

[1766] 980 N.E.2d at 58.

[1767] *See* Gideon Rothschild & Daniel S. Rubin, *Minimize Creditor Challenges to Self-Settled Spendthrift Trusts*, 157 Tr. & Est. 14, 20 (Nov. 2018).

[1768] *See* IX.H., above.

under comity principles to ignore the laws of foreign jurisdictions.[1770]

[1769] See generally IX.G.–IX.I., above. For a general description of domestic APTs, see Stowell, Johanson & Pacini, *The Use of Wills and Asset Protection Trusts in Fraud and Other Financial Crimes*, 65 Drake L. Rev. 509, 541–47 (2017).

[1770] *See, e.g.*, *Taveras v. Taveraz*, 477 F.3d 767, 783 (6th Cir. 2007) ("Comity is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protection of its laws," but "Comity is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other") (citations and internal quotation marks omitted); 477 F.3d 767, 783 ("it is well-settled that, unlike the recognition and enforcement of judgments due to sister states, a foreign country's judgments are not subject to the Full Faith and Credit Clause"); *Daewoo Motor Am. v. Gen. Motors*, 459 F.3d 1249, 1258 (11th Cir. 2006) ("To determine whether comity is appropriate, we evaluate three factors: (1) whether the foreign court was competent and used proceedings consistent with civilized jurisprudence, (2) whether the judgment was rendered by fraud, and (3) whether the foreign judgment was prejudicial because it violated American public policy notions of what is decent and just") (citations and internal quotation marks omitted); *Bigio v. Coca-Cola Co.*, 448 F.3d 176, 178 (2d Cir. 2006) ("As to international comity… application of this doctrine ordinarily lies within the discretion of the district court"); *Aleem v. Aleem*, 947 A.2d 489, 498 (Md. 2008) (noting that comity rules apply to both interstate and international comity questions and that comity "is nevertheless subject to proper limitation to the effect that if a foreign law directly violates some recognized principle of public policy, or some established standard of morality prevailing in the forum exercising jurisdiction, the rules of comity, will not compel such forum to enforce the foreign law rather than its own, if to do so would be hurtful or detrimental to the interest and welfare of its own citizens") (citations and internal quotation marks omitted; emphasis deleted); *In re Marriage of Kosmond*, 830 N.E.2d 596, 600 (Ill. App. Ct. 2005) (while "failure to consider the nature and effect of a foreign law, and its compatibility with the interests and policies of Illinois, is an abuse of discretion," the ultimate "decision to acknowledge or defer to foreign law under the principles of comity lies within the discretion of the court and may be reversed only if we find an abuse of that discretion") (citations and internal quotation marks omitted).

2. **Less Financial Risk for Settlor and Beneficiaries** —

The factors that make assets of foreign APTs hard for creditors to reach also render the assets difficult to reach by the settlor and beneficiaries of a foreign APT in the event of political change or the misconduct or insolvency of the foreign trustee. The perils for the U.S. beneficiaries of a foreign APT are illustrated by *Beaubien v. Cambridge* (1995).[1771] There, the beneficiaries attempted to obtain an accounting from an Isle of Man corporation, as successor trustee of a Cayman Islands trust that originally was funded with $500,000 in 1984. By the time of the litigation, the trustee had been dissolved, so that the beneficiaries were without recourse in the Cayman Islands. The beneficiaries' last-ditch attempt was to try to convince Florida courts to compel the trustee's Florida attorney to account on the ground that he was the trustee's managing agent.[1772]

[1771] 652 So.2d 936 (Fla. Dist. Ct. App. 1995).

[1772] *652 So. 2*.

Along the same lines, changing the trustee of a trust (which may seem daunting within the United States) might be cumbersome, costly, and time consuming for an offshore trust.[1773]

[1773] *See* Harris, *Change in Trustees*, 151 Tr. & Est. 52 (July 2012).

3. **Tax Treatment More Favorable** —

A foreign APT is more likely than a domestic APT to be classified as a foreign trust for U.S. tax purposes. This carries various consequences.

For example, being so classified will subject a trust to special U.S. tax rules[1774] as well as onerous reporting requirements[1775] and penalty provisions for noncompliance with those rules.[1776] Moreover, while these foreign trust tax rules are primarily reporting rules and do not add to a client's actual tax bill, the cost of complying with these rules can be high and, as noted, noncompliance can be even costlier in terms of penalties. Regarding the reporting requirements, the author of a 2014 article concludes that "[t]he reporting obligations for foreign trusts are complex and can be quite onerous and time consuming. In addition, the penalties for failing to comply with the reporting requirements can be substantial."[1777]

[1774] *See* §679, §684. *See* 854 T.M., *U.S. Taxation of Foreign Estates, Trusts and Beneficiaries*.

[1775] Sheppard, *Appellate Court Jeopardizes First Holding of Non-Willfulness in FBAR Penalty Case: Round Three of the Bedrosian Battle*, 130 J. Tax'n 20 (Apr. 2019); Sheppard, *Pursuing FBAR Penalties of Deceased Taxpayers*, 130 J. Tax'n 16 (Mar. 2019); Sheppard, *What Constitutes a "Willful" FBAR Violation?* 129 J. Tax'n 24 (Nov. 2018); Gopman, et al., *Foreign Trust Reporting: You Can Run But You Can't Hide*, LISI Int'l Tax Plan. Newsl. #26 (July 26, 2018), www.leimbergservices.com; Angkatavanich, et al., *Foreign Affairs: A Primer on International Tax and Estate Planning (Part 3)*, 42 Tax Mgmt. Est., Gifts & Tr. J. 299 (Nov. 9, 2017); Brodsky & Zhang, *International Information Reporting for U.S. Individuals*, 127 J. Tax'n 16 (July 2017); Meltzer, Schwartz & Weissbart, *International Estate Planning for the Domestic Lawyer*, 43 Est. Plan. 13 (Apr. 2016); Bay, *Offshore Trust: The SEC Is Looking: Not Just the SEC* , 39 Tax Mgmt. Est., Gifts & Tr. J. 275 (Nov. 13, 2014).

[1776] *See* §6048, §6677; 31 U.S.C. §5321(a)(5). *See also United States v. Flume*, *2019 WL 2807386* at *9 (S.D. Tex. June 11, 2019) ("Defendant Edward Flume willfully failed to disclose his interest in a foreign [Swiss] bank account in tax years 2007 and 2008. The IRS's assessment of $456,509.00 in penalties is therefore proper"); *United States v. Garrity*, *2019 WL 1004585* at *9 (D. Conn. Feb. 28, 2019) ("The Clerk shall enter judgment for the Plaintiff in the total amount of $1,330,460.50, consisting of the civil penalty of $936,691, interest of $56,252.78, and a late payment penalty of $337,516.72)"; *United States v. Horowitz*, *2019 WL 265107* at *16 (D. Md. Jan. 18, 2019) ($750,000 of FBAR penalties plus interest assessed for failure to report $2 million Swiss bank account); *United States v. Bohanec*, 263 F. Supp. 3d 881, 890 (C.D. Cal. 2016) ("Defendants' failure to timely file an FBAR for 2007 was willful. The maximum penalty is therefore increased to the greater of $100,000 or fifty percent of the balance in the foreign accounts on June 30, 2008"); *Moore v. United States*, 2015 WL 1510007 at *13 (W.D. Wash. Apr. 1, 2015) (plaintiff was subject to civil penalty because he "violated the Bank Secrecy Act by failing to file FBARs for 2005 through 2008, and that he had no reasonable cause for that violation"); *Rahall v. Commissioner*, 101 TCM (CCH) 1486 at *12 (2011) (Taxpayer was liable for fraud penalties because he "intended to avoid taxes by concealing income in foreign accounts, deducting expenses he knew to be improper, and failing to comply with his reporting and documentation requirements"); ILM 201208028 (executors liable for decedent's failure-to-report penalties); FAA 20062701F (owner of and transferor to foreign trust subject to reporting requirements and therefore to failure-to-file and report penalties). *See also* Adler, *Questionable IRS Penalties for the Late Filing of Form 3520*, 42 Tax Mgmt. Est., Gifts & Tr. J. 343 (Nov. 9, 2017); Sheppard, *Government Wins Fourth Straight FBAR Penalty Case: Analyzing Bohanec and the Evolution of 'Willfulness*,' 126 J. Tax'n 110 (Mar. 2017).

[1777] Bowers, *U.S. Tax Reporting Obligations of Foreign Trusts*, 39 Tax Mgmt. Est., Gifts & Tr. J. 136, 139 (May 8, 2014). *See* Bowers, *U.S. Tax Reporting Obligations of Foreign Trusts*, 55 Tax

Mgmt. Memo. 215 (June 16, 2014); Heimos, *Reporting Requirements for Foreign Accounts*, 39 Tax Mgmt. Est., Gifts & Tr. J. 140 (May 8, 2014).

There is also an "exit tax" concern. In general, under §684, transfers to foreign trusts are treated as if the transferor sold or exchanged the assets in question, thereby triggering tax on any embedded gain that may have existed at the time of transfer. Note, however, that §684 exempts grantor trusts from this "exit tax," so this can be planned around but usually only with the assistance of expensive tax advisers.

There are also estate tax considerations. The assets of a foreign trust (including one deemed to become foreign due to the grantor's death) receive a stepped-up basis at the settlor's death only if the basis of the trust's assets is determined under §1014(a) (e.g., because they are included in the settlor's gross estate).[1778] Many foreign APTs are intentionally drafted to be included in a settlor's estate, thus side-stepping this basis issue, but this basis rule could easily be a trap for the unwary.

[1778] Reg. §1.684-3(c)(1), §1.684-3(g) *Exs.* 2–3.

These special tax and reporting rules will rarely apply to a domestic APT, which reduces the cost of tax compliance, minimizes the adverse consequences of noncompliance, simplifies tax planning, and generally reduces the cost of a domestic APT.

4. **Less Expensive** —

It usually is less expensive to establish and administer a domestic APT than a foreign APT. Whereas many variables can affect pricing and can result in significant case-by-case departures from the norm, the legal fees for preparing a typical domestic APT will often run about 50% of the legal fees for a foreign APT. These fees do not necessarily include legal fees for the funding of a trust, accountant fees, trustee fees, or other items that are in addition to drafting fees. For comparison, a Florida attorney charged $45,000 to prepare an unsuccessful Cook Islands APT.[1779]

[1779] *In re Niroomand*, 493 Fed. App'x 11, 12 (11th Cir. 2012).

5. **Less Risk of Fine or Imprisonment**

a. **Introduction** —

Even if the trustee and the assets of a foreign APT are beyond the reach of a U.S. court, that court might have potent remedial powers at hand. For example, a U.S. bankruptcy court might deny the debtor a discharge under §727 of the Bankruptcy Code,[1780] or a court might be able to compel the reregistration of trust assets.[1781] Courts have also fined or imprisoned settlors of foreign APTs for civil contempt in several notorious cases. Indeed, as reported in a 2012 case,[1782] "the Debtor repatriated the trust funds for fear of being held in contempt of the judgment against her."[1783] The author suspects that those fears are not unique.

[1780] 11 U.S.C. §727. *See In re Clark,* 2018 WL 4940799 at *14 (Bankr. E.D. Pa. Oct. 10, 2018) ("the Debtor's bankruptcy discharge must be denied under 11 U.S.C. §727(a)(4)(A)"); *In re Young*, 578 B.R. 312, 324 (Bankr. M.D.N.C. 2017) ("Defendants conduct shows a pattern of concealment and nondisclosure sufficient to support the conclusion that … Defendants acted with the intent to hinder, delay, and defraud the Trustee"); *In re Ellison*, *2016 WL 5349715* at *24 (Bankr. C.D. Cal. Sept. 23, 2016) ("Defendant made prepetition transfers to preferred parties with actual intent to hinder or delay non-preferred creditors"); *In re Wolf*, 2016 WL 4940198 at *51 (Bankr. W.D. Tex. Sept. 15, 2016) ("Abie has made numerous false oaths throughout this Bankruptcy Case that were knowingly false and material to this Bankruptcy Case"); *In re Crawford*, 531 B.R. 275, 309 (Bankr. D. Mass. 2015) ("Premier has met its burden by a preponderance of the evidence as to one count under §727(a)(2)(A), for concealment of the antique automobiles titled in Mrs. Crawford's name, and one count under §727(a)(4)(A), for omission of the Cash Balance Plan, and thus has established cause for denial of discharge"); *In re Hymas*, *2010 WL 3932042* at *15 (Bankr. D. Idaho Sept. 30, 2010) ("Debtor's discharge will be denied … based on their transfer of assets [to Nevada entities, including a self-settled spendthrift trust] within a year of filing bankruptcy with the intent to hinder, delay or defraud their creditors and their knowing and fraudulent false oaths in connection with their case"). *See generally In re Jeffery*, *2019 WL 2056688* at *2–9 (Bankr. E.D. Pa. May 7, 2019).

[1781] *See Nastro v. D'Onofrio*, 263 F. Supp. 2d 446 (D. Conn. 2003).

[1782] *In re Niroomand*, 493 Fed. App'x 11 (11th Cir. 2012).

[1783] 493 Fed. App'x at 12.

b. **Some General Principles Regarding Civil Contempt Law** —

U.S. courts have turned to civil contempt remedies as tools to force debtors and their transferees to repatriate assets held by foreign APTs. In so doing, U.S. courts have merely applied well-established principles of contempt law to new circumstances involving APTs. These basic principles have been spelled out over the years in many cases covering a myriad of fact patterns. For example, in 2009, the U.S. District Court for the District of Hawaii described civil contempt as follows:[1784]

[1784] *United States v. Bright*, *105 AFTR 2d 2010-669* at 2010-672 (D. Haw. Dec. 22, 2009) (citations and internal quotation marks omitted). For the test for criminal contempt, see *United States v. Shariati*, 694 Fed. App'x 893, 894–95 (4th Cir. 2017).

> Civil contempt occurs when a party disobeys a specific and definite court order by failing to take all reasonable steps within his power to comply. He may purge his contempt by demonstrating that he has substantially complied with the order or by producing evidence of a present inability to comply. The latter showing is known as the "impossibility" defense.
>
> In order to establish the defense, a contemnor must come forward with evidence that he has taken all reasonable steps within his power to comply. Such evidence must be credible under the circumstances, for a contemnor cannot satisfy his burden of production by evidence or by his own denials which the court finds incredible in context. He is not worthy of belief unless he can show categorically and in detail why he is unable to comply. In other words, his explanation must be sufficiently specific such that his inability clearly appears.

That court summarized the sanctions that may be imposed upon a finding of civil contempt as follows:[1785]

[1785] 105 AFTR 2d at 2010-677 (citations and internal quotation marks omitted).

> [C]ivil contempt sanctions, or those penalties designed to compel future compliance with a court order, are considered to be coercive and avoidable through obedience. To determine the size and duration of coercive sanctions, the court must consider the character and magnitude of the harm threatened by continued contumacy, and the probable effectiveness of any suggested sanction in bringing about the result desired. One of the paradigmatic civil contempt sanctions is a per diem fine imposed for each day a contemnor fails to comply with an affirmative court order. Courts also have the authority to order a contemnor's imprisonment to coerce compliance. Generally, the minimum sanction necessary to obtain compliance is to be imposed.

When confronted with a challenge, the debtor-settlor typically will contend that it is "impossible" to comply with a court's order to repatriate assets in a foreign trust. However, this assertion is disingenuous at best because debtors-settlors or their trustees seem to be able to repatriate assets when push comes to shove. Here are examples:

- *In re Mastro* [1786] (2011)—a federal bankruptcy court in Washington noted:[1787]

[1786] 465 B.R. 576, 599 (Bankr. W.D. Wash. 2011).

[1787] Nevertheless, discovery sanctions of $402,000 were assessed against the offshore trustee (465 B.R. at 618).

> [T]he Belizean Entities produced documents purporting to show that Compass Trust Corporation and Compass S.A. had resigned their positions relating to The LCY Trust, terminated The LCY Trust, and transferred the assets of The LCY Trust to Mastro and Linda.

- *In re Niroomand* (2012)—The Eleventh Circuit reported that "[a]t a later point, the Debtor repatriated the trust funds for fear of being held in contempt of the judgment against her."[1788]

- *In re Olson* (2018)—A federal district court in California stated that "Debtor agreed to repatriate the Cook Islands trust money, and a stipulated order was entered by the Bankruptcy Court ordering Debtor to do so."[1789]

[1788] 493 Fed. App'x at 12.

[1789] *2018 WL 2059648* at *1 (C.D. Cal. Apr. 30, 2018).

In any event, the mere assertion of this defense is insufficient to justify a motion for summary judgment. The Ninth Circuit explained in 2014 that "[o]nce an alleged contemnor's noncompliance with a court order is established, the burden shifts to the alleged contemnor to produce sufficient evidence of its inability to comply to raise a question of fact."[1790]

[1790] *In re Icenhower*, 755 F.3d 1130, 1139 (9th Cir. 2014).

The following discussion reviews some of the relevant cases.

c. **The Cases**

(1) **The Anderson Case** —

In *FTC v. Affordable Media, LLC* (1999)[1791] (commonly known as the *Anderson* case), the FTC sought to recover funds that Denyse and Michael Anderson raised through a fraudulent telemarketing scheme. The court described the Andersons' efforts as "a classic Ponzi scheme"[1792] and noted that the Andersons had retained an estimated $6.3 million in wrongful sales commissions.[1793] The Ninth Circuit affirmed the district court's finding that the Andersons were in civil contempt for failing to repatriate assets in a Cook Islands trust and the court order that the Andersons be incarcerated.

[1791] 179 F.3d 1228 (9th Cir. 1999).

[1792] 179 F.3d at 1232.

[1793] 179 F.3d at 1232.

The Ninth Circuit noted that:[1794]

[1794] 179 F.3d at 1239 (citation omitted).

The standard for finding a party in civil contempt is well settled:

> The moving party has the burden of showing by clear and convincing evidence that the contemnors violated a specific and definite order of the court. The burden then shifts to the contemnors to demonstrate why they were unable to comply.

The Andersons conceded that they had not complied with the district court's order to repatriate the assets of the Cook Islands trust but contended that it was impossible to comply because the trustee would not return the assets to the United States. The court continued that:[1795]

[1795] 179 F.3d at 1241.

> With foreign laws designed to frustrate the operation of domestic courts and foreign trustees acting in concert with domestic persons to thwart the United States courts, the domestic courts will have to be especially chary of accepting a defendant's assertions that repatriation or other compliance with a court's order concerning a foreign trust is impossible. Consequently, the burden on the defendant of proving impossibility as a defense to a contempt charge will be especially high.

The Ninth Circuit agreed with the district court that it was not impossible for the Andersons to repatriate the trust assets because the Andersons still were in control of the trust. In reaching this conclusion, the court noted that the Andersons were protectors of the trust and that they had obtained a distribution to pay their taxes. The court summarized its analysis as follows:[1796]

[1796] 179 F.3d at 1241 (citation and internal quotation marks omitted).

> The Andersons claim that they have demonstrated to the district court categorically and in detail that they can not comply with the repatriation section of the preliminary injunction. The district court was not convinced and neither are we. While it is possible that a rational person would send millions of dollars overseas and retain absolutely no control over the assets, we share the district court's skepticism.

The court suggested that the Andersons might have been in control of the trust even if they were not the protectors as follows:[1797]

[1797] 179 F.3d at 1243 n.11.

> Although we have concentrated on the Andersons' capacity as protectors of the trust to support the district court's finding that the Andersons remain in control of the trust, we have not considered whether other facts might support the Andersons' continuing control over the trust, regardless of who is the protector of the trust. The Andersons attempted to resign their position as protectors and that attempt appears to have failed. If the Andersons have in fact resigned their position as protectors, they may still remain in control of the trust. We have not resolved this issue at this time because the Andersons have conceded that they are the protectors of the trust.

The Andersons had contended that their inability to repatriate the assets of the Cook Islands trust would be a complete defense to civil contempt. The Ninth Circuit addressed this assertion as follows:[1798]

[1798] 179 F.3d at 1240.

> Given that these offshore trusts operate by means of frustrating domestic courts' jurisdiction, we are unsure that we would find that the Andersons' inability to comply with the district court's order is a defense to a civil contempt charge. We leave for another day the resolution of this more difficult question because we find that the Andersons have not satisfied their burden of proving that compliance with the district court's repatriation order was impossible.

The Andersons spent several months in jail, and the trustee ultimately turned over $1.2 million to the FTC.

Whether this amounts to a victory for the Andersons or the FTC is ultimately a question of perspective. Even exercises in perspective are difficult because certain facts are unknown. It is clear that the FTC sought $6.3 million but obviously settled for considerably less. Along the way, the FTC was classified as an "excluded person" and told by a Cook Islands court that the FTC had no right to the Anderson's trust fund.[1799] Further, unconfirmed reports indicate that the Andersons retained the overwhelming majority of their trust fund assets. On the other hand, because the rumors about the amount retained by the Andersons are unconfirmed, it is impossible to tell whether the rumors reflect real fact or "spin doctoring" designed to put a brave face on a bad result. And, in any event, the Andersons were sent to jail, a harsh fate that probably would not have befallen them had they used a domestic planning vehicle and left the assets subject to U.S. court supervision and jurisdiction.

[1799] *Re the A Irrevocable Trust* (a/k/a *Anderson*), 2 ITELR 482 [Cook Island High Court (Civil Division) 1999].

(2) **The Lawrence Case** —

In *In re Lawrence* (2002),[1800] the Eleventh Circuit affirmed the bankruptcy court's and district court's findings that Lawrence was in civil contempt for failing to repatriate the assets of a Mauritian trust that he created two months before a $20.4 million arbitration judgment was issued against him and the lower courts' orders for imprisoning him until he purged his contempt. The Eleventh Circuit agreed with the lower courts that Lawrence still was in control of the trust (he could remove and appoint trustees and add and exclude beneficiaries) and affirmed the lower courts' rejection of his impossibility defense. The court noted that:[1801]

[1800] 279 F.3d 1294 (11th Cir. 2002), *aff'g* 251 B.R. 630 (S.D. Fla. 2000), *aff'g* 238 B.R. 498 (Bankr. S.D. Fla. 1999).

[1801] 279 F.3d at 1300 (footnote and internal quotation marks omitted).

> Even if we were to find that Lawrence had set forth sufficient evidence of impossibility, we must agree with the trial court that Lawrence's claimed defense is invalid because the asserted impossibility was self-created. We previously have held that, where the person charged with contempt is responsible for the inability to comply, impossibility is not a defense to the contempt proceedings. Lawrence insists that his impossibility is distinguishable from other cases finding that self-created impossibility is not a defense because his actions, if any, creating the impossibility occurred prior to the instant action. This contention clearly lacks merit. We agree with the district court that Lawrence created this Trust in an obvious attempt to shelter his funds from an expected adverse arbitration award.

Lawrence was imprisoned in 2000 and was not released until December 12, 2006.[1802]

[1802] Omnibus Order, dated Dec. 12, 2006, in *In re Lawrence* (S.D. Fla. 2006).

(3) **The Bilzerian Case** —

In *SEC v. Bilzerian* (2001),[1803] the federal district court for the District of Columbia summarized the case's history as follows:[1804]

[1803] 131 F. Supp. 2d 10 (D.D.C. 2001). For developments in the Bilzerian family, see Rothfeld & Reagan, *A 1980s Corporate Raider Keeps the SEC at Bay*, Wall St. J., Sept. 17, 2014 at A1.

[1804] *131 F. Supp. 2*d at 12–13 (footnote and citation omitted).

> In 1991, the Court found Bilzerian liable for securities fraud. In connection with that liability, the Court ordered Bilzerian to disgorge $33,140,787.07 in profits from the fraud on January 28, 1993, and on June 23, 1993, ordered him to disgorge an additional $29,196,812.46 in prejudgment interest … . The SEC did not seek to enforce the roughly $62 million disgorgement judgment for over five years due to protracted litigation over the possible dischargeability of the judgment in a bankruptcy proceeding in Florida. In 1998, the Eleventh Circuit affirmed the ruling of the United States District Court for the Middle District of Florida that the disgorgement judgment against Bilzerian was not dischargeable in bankruptcy.
>
> In November 1998, the SEC moved this Court to hold Bilzerian in civil contempt of the 1993 disgorgement orders because he had not made any payments on the $62 million judgment. Bilzerian argued that he was unable to comply with the disgorgement orders essentially because he had no financial resources. On August 21, 2000, after receiving substantial briefing from the parties and holding a hearing, the Court found Bilzerian in contempt of its 1993 disgorgement orders. The Court found that (1) Bilzerian had not demonstrated his financial inability to comply “categorically and in detail” as required by case law; (2) Bilzerian had not made all reasonable efforts to comply with the orders; and (3) any financial inability to comply was self-created because Bilzerian had separated his assets from himself and funneled them to shell companies, partnerships, and trust entities … through outright transfers as well as payment arrangements made with his employer, Cimetrix. The Court set a number of conditions which Bilzerian had to meet in order to purge the contempt. These purgation conditions were set without prejudice and were only temporary because Bilzerian had not complied with the Court's order for a full accounting of his assets; without the accounting of his assets, the Court could not ascertain the precise amount of the $62 million judgment Bilzerian is capable of paying. These temporary conditions required Bilzerian to (1) pay $5,000 on the first day of each month until further order of the Court, and (2) submit an additional accounting by October 2, 2000 as detailed in PP 1-10 of the August 21 Order.

The court found that Bilzerian had failed to purge the temporary contempt order because he did not provide documentation for trusts and other entities and details of his personal finances. The court was particularly troubled by his failure to provide information for the trust that he created in the Cook Islands in 1995 because that trust was “at the apex of the structure comprising the Bilzerian-related entities, and—directly or indirectly—holds almost every other asset described in the Court's August 21 Opinion.”[1805]

[1805] *131 F. Supp. 2*d at 16.

As a result, the court held that “[g]iven Bilzerian's facially deficient accounting, the only remedy is to incarcerate Bilzerian until he provides the information covered by the Court's order or, at a minimum, until he demonstrates a credible and good faith effort to do so.”[1806]

[1806] *131 F. Supp. 2*d at 18.

The resolution of the case has been described as follows:[1807]

> Corporate raider Paul Bilzerian recently was reported to have given up half his assets, including a home owned by his wife that should have been protected under Florida law, after spending several months in prison. Mr. Bilzerian was quoted as follows in the *St. Petersburg Times* of 2/5/02: “People do not understand how awful those places are. There were weeks upon weeks that I wasn't able to see the sunlight or brush my teeth.”

(4) **The Eulich Case** —

In *Eulich v. United States* (2014),[1808] the court considered the government's motion to hold Eulich in civil contempt for failure to provide documents regarding a Bahamian trust (worth $75–$100 million) in connection with the IRS's review of the settlor's and his wife's 1995, 1996, and 1997 income tax returns. The court held as follows:[1809]

> For the reasons previously stated, the court determines that clear and convincing evidence establishes that John F. Eulich failed to comply with the court's Order of Enforcement dated September 17, 2002, and did not make all reasonable efforts to comply with it. Accordingly, court hereby holds John F. Eulich in civil contempt of court and, to obtain compliance with its enforcement order, the court imposes a civil fine in the amount of $5,000 per day for the first 30 days from the entry date of this order. If John F. Eulich has not complied by the 31st day, the fine is hereby increased to $10,000 per day until he produces, or causes to be produced, the documents of the Mallion Trust Fund No. 16 to IRS representative(s), or the court orders otherwise. If by the 45th day after entry of this order, Eulich has not complied with the enforcement order, the attorney for the Government shall notify the court of his noncompliance. If the court receives such notice, it will set the matter for a hearing to determine whether Eulich is 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.

To the settlor's contention that efforts to obtain the documents would be unavailing because the efforts would be thwarted by the confidentiality rules of Bahamian law, the court declared:[1810]

> 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 the new members of the Advisory Committee, which is in dispute, Eulich cannot benefit from a situation that he himself created.

The court's skepticism regarding the settlor's inability to provide the documents requested by the IRS was born out by subsequent events. Within 43 days after the court entered its contempt order and despite being delayed by hurricanes and legal hurdles, the settlor produced 9,501 pages of photocopied documents.[1811]

Shortly after the settlor provided the above documents, he filed a motion in the same court to abate the

[1807] Alan S. Gassman, *Common Mistakes Planners Make Regarding Asset Protection*, 29 Est. Plan. 518, 523 (Oct. 2002).

[1808] 2004 WL 1844821 (N.D. Tex. Aug. 18, 2004)

[1809] 2004 WL 1844821 at *6.

[1810] 2004 WL 1844821 at *3 (citations omitted).

[1811] *Eulich v. United States*, 2006 WL 176543 (N.D. Tex. Jan. 23, 2006).

penalties and to purge his contempt.[1812] The court described its task as follows:[1813]

[1812] 2006 WL 176543

[1813] 2006 WL 176543 at *3–4 (citations and internal quotation marks omitted).

> A movant seeking a civil contempt order must establish, by clear and convincing evidence, (1) that a court order was in effect; (2) that the order required certain conduct by the respondent; and (3) that the respondent failed to comply with the court's order. Willfulness is not an element of civil contempt. Once the movant has shown a prima facie case, the respondent can defend against it by showing a present inability to comply with the subpoena or order. 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 the civil contempt action. It is settled, however, that in raising this defense, the defendant has a burden of production.

A party under court order to produce documents has a duty to make in good faith all reasonable efforts to comply. A contemnor is able to purge the contempt and obtain his release by committing an affirmative act, and thus carries the keys of his prison in his own pocket. At the purgation stage, a court finding that a contemnor has not purged himself of contempt amounts to a second contempt finding.

The court concluded by upholding $135,000 of fines for the 27 days that it found that Eulich had not been in substantial compliance with the court's prior order and purged Eulich of contempt because he ultimately, if belatedly, complied with the court's order by producing documents.[1814]

[1814] 2006 WL 176543 at *8.

The *Eulich* saga continued as, on September 4, 2009, Judge Lindsay of the U.S. District Court for the Northern District of Texas issued two decisions in the matter. In the first opinion,[1815] he refused to hold Eulich in civil contempt, at least for the moment, on procedural grounds. In the second decision,[1816] Judge Lindsay ordered Eulich to produce nonprivileged documents and concluded rather testily:[1817]

[1815] *Eulich v. United States*, 2009 WL 2870004 (N.D. Tex. Sept. 4, 2009).

[1816] *Eulich v. United States*, 2009 WL 2870007 (N.D. Tex. Sept. 4, 2009).

[1817] 2009 WL 2870007 at *2.

> This review has placed an undue, and in many instances unjustified, burden on the court and its staff. It has stretched scarce judicial resources in a way never contemplated by the court. In many instances, the court does not believe that the claim of privilege was made in good faith. Petitioner is put on notice that the court will not tolerate such blanket claims of privilege and will impose sanctions as appropriate if such conduct recurs.

(5) **The Solow Case** —

In *SEC v. Solow* (2010),[1818] the SEC sought to hold the debtor in civil contempt for failing to turn over assets (including assets in a multimillion-dollar Cook Islands trust established in the course of the litigation) in violation of the court's $3,424,788.90 disgorgement order involving an alleged fraudulent trading scheme. The court summarized the civil contempt rules in the Eleventh Circuit as follows:[1819]

[1818] 682 F. Supp. 2d 1312 (S.D. Fla. 2010), *aff'd*, 396 Fed. App'x 635 (11th Cir. 2010). *See* Rubin*, Securities and Exchange Commission v. Jamie L. Solow*, 35 Tax Mgmt.

Est., Gifts & Tr. J. 271 (Nov./Dec. 2010).

[1819] 682 F. Supp. 2d at 1324–25 (citations and internal quotation marks omitted).

> Courts have inherent power to enforce compliance with their lawful orders through civil contempt. Civil contempt is remedial; the penalty serves to enforce compliance with a Court order or to compensate an injured party. In a civil contempt proceeding, the petitioning party bears the burden of establishing by "clear and convincing" proof that the underlying order was violated. However, once the moving party makes a prima facie showing that the court order was violated, the burden of production shifts to the alleged contemnor to show a present inability to comply that goes beyond a mere assertion of inability.
>
> Therefore, the focus of the court's inquiry in civil contempt proceedings is not on the subjective beliefs or intent of the alleged contemnors in complying with the order, but whether in fact their conduct complied with the order at issue. Conduct that evinces substantial, but not complete, compliance with the court order may be excused if it was made as part of a good faith effort at compliance. Therefore, under the Eleventh Circuit's case law, the alleged contemnor may avoid a contempt finding by showing an inability to comply or a good faith effort to comply. While inability to pay is a defense to civil contempt, inability to pay is not a defense if the contemnor created the inability.

Finding that the debtor's failure to obey the court's disgorgement order in a timely fashion constituted civil contempt[1820] and that he had failed to make in good faith all reasonable efforts to comply with the judgment,[1821] the court ordered, inter alia, that "Mr. Solow shall surrender to the custody of the U.S. Marshal's Office for the Southern District of Florida … by 2:00 p.m. on Monday, January 25, 2010,"[1822] and that "Mr. Solow shall remain incarcerated until such time that he has complied with the conditions set forth in this Court's May 14, 2008 Order."[1823]

[1820] 682 F. Supp. 2d at 1326–27.

[1821] 682 F. Supp. 2d at 1327–33.

[1822] 682 F. Supp. 2d at 1334.

[1823] 682 F. Supp. 2d at 1335.

In the wake of *Solow,* a long-time advocate of foreign APTs warned that "planning with offshore trusts should only be considered when there are no clouds on the horizon, since the risk of a contempt order may be significant when the clouds have thickened."[1824]

[1824] Gideon Rothschild, *Staying Out of Reach*, 150 Tr. & Est. 33, 35 (Jan. 2011).

(6) **The Grant Case** —

In *United States v. Grant* (2005),[1825] a U.S. magistrate judge in Florida recommended that the court order the settlor's surviving spouse to repatriate the assets of two foreign APTs to satisfy a federal tax lien. The court adopted the magistrate's report and recommendations,[1826] and the order was not appealed. However, in 2008, the court denied the government's motion to hold the surviving spouse in contempt for failure to comply with the court's earlier order because the court found that she was not able to do so.[1827] Subsequent events proved the court's conclusion that the surviving spouse was unable to obtain funds from the foreign trust to be incorrect: "Since … December 22, 2005, the offshore trusts transferred $506,630 in principal and income … into the bank accounts of Mrs. Grant's children," which she controlled.[1828] Accordingly, in 2013, the court found the surviving spouse to be in contempt and ordered her to take a number of steps to obtain funds from the foreign trusts to satisfy outstanding tax liabilities.[1829]

[1825] *2005 WL 2671479* (S.D. Fla. Sept. 2, 2005). *See* Covey & Hastings, *Foreign Asset Protection Trust*, Prac. Drafting 8399–8401 (Jan. 2006).

[1826] Order Adopting Report and Recommendations, Dec. 22, 2005.

[1827] *United States v. Grant*, 2008 WL 2894826 (S.D. Fla. May 27, 2008).

[1828] *United States v. Grant*, 2013 WL 1729380 at *1 n.2 (S.D. Fla. Apr. 22, 2013).

[1829] 2013 WL 1729380.

(7) **The Wyly Case** —

In *SEC v. Wyly* (2014),[1830] a federal district court in New York held Samuel Wyly and his deceased brother, Charles Wyly, liable for civil fraud in failing to report stock sales by four offshore trusts and subsidiary entities located in the Isle of Man ("IOM"). In the underlying case, the SEC had alleged ten securities violations arising from a scheme in which the Wyly brothers had established a group of offshore trusts and subsidiary entities in the IOM. The brothers used those offshore entities to trade in shares of four public companies ("Issuers") on whose boards the Wylys sat and failed to properly disclose their beneficial ownership of that stock.

[1830] 56 F. Supp. 3d 394 (S.D.N.Y. 2014). *See* Bay, *Off Shore Trust: The SEC Is Looking; Not Just the FTC*, 39 Tax Mgmt. Est., Gifts & Tr. J. 275 (Nov./Dec. 2014).

A jury found that the Wylys were beneficial owners of the Issuers securities transferred to, held, and sold by the IOM trusts because the Wylys, directly or indirectly, had or shared voting and/or investment powers over these securities. Thus, the jury found that the Wylys failed to accurately disclose their ownership under the Securities Exchange Act. In addition, the Wylys were found liable for securities fraud and for selling unregistered securities.

The court held that the SEC was entitled to disgorgement based upon the unpaid taxes and 25% of the total profits made by the Wylys. The court also awarded prejudgment interest. In total, the court held that Sam Wyly was required to disgorge $123.8 million and Charles Wyly was required to disgorge $63.4 million.

Approximately two weeks later, the SEC requested, among other things, that the court enter an order for a temporary asset freeze to preserve the SEC's ability to enforce a final judgment.[1831] Shortly thereafter, Samuel Wyly and the Charles Wyly estate filed a voluntary Chapter 11 petition in bankruptcy court.[1832] The Wylys argued that their Chapter 11 filings automatically stayed the SEC's proposed freeze with respect to properties of the bankruptcy estates. The court held that although the question was close, the automatic stay didn't apply because the SEC was acting in its police and regulatory capacity. However, according to the court, the automatic stay would apply if the SEC were acting to enforce a judgment. The court stated "[t]he SEC is merely seeking an asset freeze in anticipation of a judgment. It is not seeking to repatriate any assets located abroad."[1833] Further, according to the court, "third parties could potentially transfer or deplete [offshore trust] assets without an order in place that compels the Wylys to direct the protectors and trustees of all IOM trusts to refrain from taking any action to dissipate foreign assets."[1834]

[1831] 73 F. Supp. 3d 315 (S.D.N.Y. 2014).

[1832] Subsequently, Samuel Wyly and the estate of Charles Wyly argued in the bankruptcy court that they shouldn't be precluded from arguing that the foreign trusts Samuel and Charles formed were not grantor trusts for the purposes of determining their tax liability. The bankruptcy court disagreed and held that the issue was contested before and adjudicated by the district court in the SEC action (*In re Wyly*, 2015 WL 5042756 (Bankr. N.D. Tex. Aug. 24, 2015)). *See also In re Wyly*, 552 B.R. 338 (Bankr.

N.D. Tex. 2016) (discussing penalties for numerous badges of fraud and noncompliance with foreign trust reporting rules).

[1833] 73 F. Supp. 3d at 319.

[1834] 73 F. Supp. 3d at 321.

(8) **The Olson Case** —

In *In re Olson* (2018),[1835] a federal district court in California passed upon the propriety of a settlement agreed to by the bankruptcy trustee.[1836] The court summarized the facts as follows:[1837]

[1835] *2018 WL 2059648* (C.D. Cal. Apr. 30, 2018).

[1836] *2018 WL 2059648* at *1.

[1837] *2018 WL 2059648* at *1 (footnote omitted).

> Appellant has a 2014 money judgment against Debtor Jana W. Olson stemming from litigation filed in 2010 in California Superior Court. Within a month of being served with Appellant's lawsuit, Debtor transferred the beneficial interest in a self-settled Cook Islands trust from herself to her two pre-teen children for no consideration. Eventually, Debtor filed her bankruptcy petition. Appellants are the primary creditor of Debtor's estate.

The court continued:[1838]

[1838] *2018 WL 2059648* at *1 (footnote omitted).

> At some point, Debtor agreed to repatriate the Cook Islands trust money, and a stipulated order was entered by the Bankruptcy Court ordering Debtor to do so. The order requires repatriation, but explicitly does not decide whether the money is the property of the estate. Debtor proceeded to disobey the Bankruptcy Court's order by sabotaging the repatriation effort with a letter designed to convince the Cook Island trustee that her request to repatriate the money was made under duress. The Bankruptcy Court then ordered Debtor jailed for civil contempt. Debtor remained in custody for more than a year.

The bankruptcy court approved a compromise under which the funds in the Cook Islands trust would be repatriated, with 80% going to the bankruptcy estate and 20% going to a trust for the debtor's two minor children.[1839]

[1839] *2018 WL 2059648* at *1–2.

On appeal, the district court held that the bankruptcy court had abused its discretion in approving the settlement agreement.[1840] In particular, the district court noted:[1841]

[1840] *2018 WL 2059648* at *2.

[1841] *2018 WL 2059648* at *3 (footnote omitted).

> All concerned are well-aware of the Debtor recalcitrance in this matter. Debtor has no legitimate right to hide assets in the Cook Islands and refuse to return them to the jurisdiction of the Bankruptcy Court when ordered to do so. It would be clearly inequitable to allow her to profit from her actions, so there is no reason for a court of equity to be worried about barring her from doing so.

In the course of the opinion, the district court observed:[1842]

[1842] *2018 WL 2059648* at *3.

> The Court strongly suspects that only a very small percentage of debtors would be willing to sit in jail for a year, as the Debtor did, to keep money from their creditors. And she certainly could have sat longer—and probably would have had it been this Court's prerogative.

(9) **The Rensin Case** —

In *In re Rensin* (2019),[1843] a bankruptcy trustee attempted to reach the assets of a Belizean APT that was established long before the debtor defrauded over 50,000 retail customers of $13.5 million. Rather than analyzing §541(c)(2) of the Bankruptcy Code as described in IX.I.3.c., above, a federal bankruptcy court in Florida, improperly in the author's view, used the following test:[1844]

[1843] *In re Rensin*, *2019 WL 2004000* (Bankr. S.D. Fla. May 6, 2019).

[1844] *2019 WL 2004000* at *7 (citations omitted).

> Bankruptcy courts are split on whether state or federal law supplies the choice-of-law rules in bankruptcy cases. A bankruptcy court's jurisdiction arises from federal bankruptcy law, yet state law governs the validity of most property rights. In this case, the Court follows the so-called diversity jurisdiction approach and looks to Florida law.

The court held that, under Florida law, the assets of the APT were part of the bankruptcy estate.[1845] The debtor also conceded that Florida law governed the effect of the spendthrift clause.[1846] The court distinguished the case from *Lawrence*, finding that the debtor did not control the APT.[1847] Contempt proceedings against the debtor were in abeyance.[1848]

[1845] *2019 WL 2004000* at *8.

[1846] *2019 WL 2004000* at *7.

[1847] *2019 WL 2004000* at *12.

[1848] *2019 WL 2004000* at *4.

Concluding that the trustee of the APT was an indispensable party,[1849] the court gave the bankruptcy trustee the opportunity to obtain personal jurisdiction over the Belizean trustee or to pursue the claim in Belize.[1850]

[1849] *2019 WL 2004000* at *8.

[1850] *2019 WL 2004000* at *13–15.

d. **Implications** —

Although some debtors are willing to incur the extra risk of large fines or endure incarceration to protect their assets, others will find these risks to be unacceptable.[1851]

[1851] *In re Niroomand*, *2012 WL 4933299* at *1 (11th Cir. Oct. 17, 2012) ("The Debtor repatriated the trust funds for fear of being held in contempt"). For a more recent application of civil contempt, see *In re Icenhower*, 755 F.3d 1130, 1139 (9th Cir. 2014).

Attorneys who recommend foreign APTs contend that the imposition of these sanctions resulted from poor trust design in the cases in question, but a U.S. court might be tempted to employ sanctions when a settlor has secreted assets beyond the court's reach. In particular, it will be hard for the settlor of a foreign APT to satisfy a U.S. court that he or she does not retain control over trust assets.[1852] For example, the following provision of the law of the Cook Islands, an often-recommended offshore jurisdiction, clearly contemplates that the settlor may have or acquire rights over trust assets:[1853]

[1852] *See, e.g., United States v. Grant*, 2013 WL 1729380 at *1 n.2 (S.D. Fla. Apr. 22, 2013) (offshore trusts transferred $506,630 into bank accounts for debtor's children).

[1853] Cook Islands International Trusts Act 1984, as amended, §13C, protectyou.com/wp-content/uploads/2013/10/international_trust_act_1984_cook_islands.pdf.

> 13C Retention of control and benefits by settlor. An international trust and a registered instrument shall not be declared invalid or a disposition declared void or be affected in any way by reason of the fact that the settlor, and if more than one, any of them, either:
>
> (a) retains, possesses or acquires a power to revoke the trust or instrument;
>
> (b) retains, possesses or acquires a power of disposition over property of the trust or the subject of the instrument;
>
> (c) retains, possesses or acquires a power to amend the trust or instrument;
>
> (d) retains, possesses or acquires any benefit interest or property from the trust or any disposition or pursuant to the instrument;
>
> (e) retains, possesses or acquires the power to remove or appoint a trustee or protector;
>
> (f) retains, possesses or acquires the power to direct a trustee or protector on any matter;
>
> (g) is a beneficiary, trustee or protector of the trust or instrument either solely or together with others.

The settlor's task will be rendered all the more difficult if, as is often the case, other beneficiaries of the trust will find it difficult, if not impossible, to engage local counsel to enforce their interests.

The risk of fine or incarceration should be lower in the case of a domestic APT because the controversy will be played out within this country's legal system. The disciplinary perils for a U.S. attorney are greater for a foreign APT than for a domestic APT. An attorney in a state that does not recognize domestic APTs may escape ethical concerns by referring a client to counsel in a domestic APT state, who may discuss APTs without such concerns.[1854] A U.S. attorney, however, may not defer to any other U.S. attorney who will be without disciplinary concerns for a foreign APT.

[1854] Lischer, *Professional Responsibility Issues Associated with Asset Protection Trusts*, 39 Real Prop., Prob. & Tr. J. 561, 625 (Fall 2004).

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A. Introduction

Establishing a domestic asset-protection trust ("APT")[1855] is a multistep process, but it is not very different from creating other kinds of domestic trusts.[1856] The attorney and the trustee must perform due diligence, the client must choose assets to fund the trust, the client and his or her attorney must decide whether or not to engage local counsel, and the trust must be drafted and funded.

[1855] A domestic APT is sometimes referred to as a DAPT.

[1856] *See* Ruben & Gopman, *Delaware Statutory Tenancy by the Entireties Trusts: Potentially Powerful Asset Protection for Couples Across the Country*, 39 Tax Mgmt. Est., Gifts & Tr. J. 123, 126–28 (May 8, 2014); Weissbart, *Estate Planning Strategies for the Young and Wealthy*, 41 Est. Plan. 28, 32–35 (Feb. 2014).

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B. Due Diligence

As discussed in VIII., above, the attorney and the trustee must satisfy themselves that the initial and subsequent contributions to the trust will not be fraudulent transfers. Consequently, there should be no rush to create a domestic APT.

Practice Tip: If the client insists on haste, the attorney and the trustee should consider this a "red flag" that merits further inquiry before settling a trust. Not all rush situations are fatally flawed. Some clients generally want things done quickly. Other clients are specifically concerned about quickly funding an APT because they know that delay prolongs their exposure to unanticipated but nonetheless potentially catastrophic losses. Still other clients may be motivated by a pending lawsuit that is quite manageable in its own right (i.e., by building an adequate reserve into a plan to cover the reasonably anticipated losses) but which has nonetheless put them into hurry-up mode so that they never again find themselves unduly exposed. On the other hand, some clients may be in a rush because they are intent upon defrauding known creditors and evading known debts. Consequently, clients who are in a rush merit closer scrutiny.

The attorney and the trustee should insist that the client provide a solvency analysis in connection with the initial funding of and additions to a domestic APT. Some of the leading domestic APT statutes require the client to sign a solvency affidavit.[1857] Although other statutes do not impose such a requirement, the attorney and the trustee should insist that the client furnish written proof of solvency and, if he or she refuses, they should not proceed. A sample solvency letter is included in the Worksheets, below.

[1857] *See, e.g.*, Alaska Stat. §34.40.110(j).

The attorney and the trustee should follow their usual procedures for screening clients. This includes the use of normal intake procedures for estate planning clients, such as analyzing the client's assets, liabilities, and net worth; identifying beneficiaries; and other routine steps that are familiar to most estate planners.

If claims or obligations come to light in the due-diligence process, the attorney and the trustee should make sure that the client will retain sufficient funds to meet the reasonably anticipated value of these claims. This does not mean 100 cents on the dollar must be reserved, as discounts are allowed to reflect the likely value of the claim.[1858] However, reserve calculations should be realistic and, if anything, it is better to over-reserve against the anticipated likely value of the claim.

[1858] *See* XII.F.–XII.G., below.

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C. Involvement of Domestic APT Counsel

If a client is not represented by experienced domestic APT counsel, then the client should engage such counsel. Such counsel can often be found in the jurisdiction where the domestic APT is to be created and, in some instances, can be found outside that jurisdiction. Domestic APT counsel should either: (1) draft the trust instrument for approval by the client and his or her existing attorney; or (2) approve the trust prepared by the existing attorney, particularly if the client's existing counsel is unfamiliar with the relevant domestic APT statute. Because the domestic APT counsel's role is limited, the existing attorney-client relationship will not be disrupted.

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D. Drafting the Domestic APT

With the help of experienced domestic APT counsel, the client's attorney should make sure that the trust includes all provisions required by the pertinent domestic APT statute.

In addition to the settlor, the trust should include other beneficiaries who may benefit from the trust during the settlor's lifetime. This increases the odds that the domestic APT will work if creditor problems develop—it shows that the structure was at least partly motivated by routine estate planning concerns. In other words, it is evidence of a “good” donative intent and helps confound the argument that a transaction's sole motive was an impermissible intent to defraud.

Similarly, the terms that apply after a settlor's death should be integrated with the settlor's other estate planning documents. If the settlor is concerned that the domestic APT will permanently “lock” or “freeze” his or her estate plan in place, at least insofar as the domestic APT assets are concerned, and thereby adversely affect his or her ability to deal with changes in family circumstances, then the domestic APT should give the settlor a very broad nongeneral testamentary power of appointment. This will effectively enable the settlor to rewrite his or her estate plan without having to rewrite the domestic APT.

The trust should be drafted conservatively. Thus, the trust should not contain provisions that are not explicitly permitted by the pertinent statute. In the words of one commentator, “[i]n the absence of legislation authorizing the settlor to retain such powers, a trust that grants such powers to the settlor would result in the settlor being treated as the owner of trust assets for debtor/creditor purposes."[1859] Moreover, even if the relevant statute allows settlors to retain many rights, powers, and interests, the settlor is probably best served if he or she retains only a few of those items. Excess retained powers may cause a court to consider the trust a sham, even if those powers are expressly allowable under the relevant domestic APT statute.

[1859] *See* Spero, *Recent Cases Show Need for Strict Compliance with DAPT Statutes*, 44 Est. Plan. 8, 10 (May 2017) (footnote omitted).

Even if the pertinent statute allows a settlor to retain numerous powers and interests, the trust should not include powers (e.g., an unrestricted right to remove and replace trustees) that might jeopardize the trust's asset-protection effectiveness.[1860] Put differently, the settlor's retained powers should not include anything that he or she could potentially use against himself or herself and/or for the sake of his or her creditors. If the settlor retains such powers, then a court might force him or her to use them in ways the settlor does not like.

[1860] *See In re Johnson*, 513 B.R. 333, 343 (Bankr. S.D. Ill. 2014) ("Powers that a debtor may exercise for his own benefit are included in the bankruptcy estate").

Similarly, any clauses granting powers to a trust adviser or protector should be carefully circumscribed. The drafter should assume that the adviser or protector will be subject to a non-DAPT court's jurisdiction and that the court will happily order the protector or adviser to exercise his or her authority in ways detrimental to the client. Accordingly, protectors and advisers should primarily be given "negative" powers (e.g., the right to veto distributions or investments). Any "affirmative" powers (i.e., the right to order the trustee to do something) should be cabined by terms and conditions that limit their potential to be used for the sake of creditors.

Distribution standards should be clear, as further discussed in XIII., below.

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E. Trustee Selection

As discussed in IX.B., above, the asset-protection effectiveness of a domestic APT might be reduced if a non-DAPT court has personal jurisdiction over a trustee[1861] or over an adviser or protector.[1862] Granted, it may be hard to find any reputable domestic APT trustee who is not subject to a non-DAPT court's jurisdiction, particularly if that trustee has multiple clients in the same non-DAPT state. However, it is still worthwhile to preserve personal-jurisdiction arguments to the maximum extent possible, which may in some cases counsel against naming a co-trustee from the settlor's home state and which often will counsel in favor of naming a domestic APT state trustee that at least has a fighting chance of defeating personal jurisdiction because it has minimal contacts with the client's home jurisdiction.

[1861] *Accord* Gideon Rothschild & Daniel Rubin, *Minimize Creditor Challenges to Self-Settled Spendthrift Trusts*, 157 Tr. & Est. 14, 18–19 (Nov. 2018).

[1862] *Accord* Gideon Rothschild & Daniel Rubin, *Minimize Creditor Challenges to Self-Settled Spendthrift Trusts*, 157 Tr. & Est. 14, 19 n.25.

Consistent with the last point, an institutional trustee that does business as a single entity in multiple jurisdictions might not be a good candidate for the domestic APT trustee slot. That is especially true if the institutional trustee's home office is a non-DAPT jurisdiction. Given the way big banks and trust companies often work, it would not be surprising if discovery revealed that virtually no administrative or fiduciary work was done in the trustee's field office in the domestic APT state and that all the “real work” was instead done in the home office located in a non-DAPT state. Though not necessarily fatal, such facts could seriously call into question whether the domestic APT has meaningfully satisfied the invariable requirement that the domestic APT trustee come from the domestic APT state.

If an institutional multi-state trustee is used, it may be best to use one that has a separate subsidiary that is: (1) located in the relevant domestic APT state; and (2) clearly has primary responsibility for administering the domestic APTs established in that state.[1863]

[1863] For an example of an appropriate structure, see IX.B.4., above.

The best possible candidate for the domestic APT trustee's job will often be a trustee that: (1) is based in the domestic APT state in question; and (2) runs all of its domestic APT business from its home office.

Although a client might name a co-trustee outside the APT jurisdiction with the expectation that he or she will resign if creditor problems develop, there is no guarantee that such a trustee will resign in time. This could cause problems if the co-trustee is ordered to exercise his or her authority in ways inimical to the domestic APT's beneficiaries.

Any trustee should be reputable. This is sometimes hard to assess. Even reputable businesses are sometimes afflicted by the misconduct of rogue employees or the misfortunes of bad turns in business. However, due diligence regarding the trustee is advisable.

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F. Funding the Domestic APT: An Overview

Every domestic APT should be funded correctly and promptly upon settlement. Because a settlor's financial circumstances may change, any significant post-settlement transfers into trust that are not part of the original settlement transaction should be separately evaluated for solvency and fraudulent transfer concerns. It may be advisable in such post-settlement transactions for the settlor to provide updated proof of solvency.

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G. Asset Selection: Amount to Entrust (a Quantitative Issue)

To bolster the asset-protection effectiveness of a trust, clients should fund a domestic APT with assets that they never expect to need. A rule of thumb is that a client should not fund a domestic APT with more than one-third to one-half of his or her assets, which are not already exempt from creditor claims, that are not needed to cover existing and foreseeable obligations.[1864] Similarly, any domestic APT hoping for completed gift status or exclusion from the settlor's gross estate should also be funded with assets with which the client can afford to part.

[1864] *See Campbell v. Commissioner*, T.C. Memo 2019-4 at *16 (“We find that it was an abuse of discretion for the Appeals Officer to include the Trust assets as dissipated assets”). *See also* Stein, *Asset Protection May Risk Fraudulent Transfer Violations*, 37 Est. Plan. 12, 19–20 (Aug. 2010).

Some practitioners use an analysis known as the long-range solvency calculation (“LRSC”) to determine how much can be properly placed into any asset protection vehicle, including a domestic APT.[1865] The LRSC is mathematically expressed as follows:

[1865] *See* Sullivan, *Future Creditors and Fraudulent Transfers*, 22 Del. J. Corp. L. 955, 988 (1997).

Present Assets
+ Reasonably Foreseeable Future Assets
– Present Debts
– Reasonably Foreseeable Future Debts
Net Surplus or Deficit

The theory behind the LRSC is simple: A client may lawfully shelter any surplus remaining after he or she has fully accounted for and reserved enough assets to cover his or her known and reasonably foreseeable debts. This sort of planning does not disregard the rights of creditors but is instead designed to provide an adequate reserve for known and likely future debts. Far from acting to defraud creditors, this sort of “nest egg” or “surplus reserve” planning is designed to intentionally keep the client solvent after a transfer, which in turn will help negate any inference of bad intent if and when a disposition into trust is scrutinized for possible fraudulent transfers.[1866]

[1866] *See, e.g., Campbell v. Commissioner*, T.C. Memo 2019-4 at *6 (Feb. 4, 2019 (“it was an abuse of discretion for the Appeals officer to include the Trust assets as dissipated assets”). For a summary of the nest egg approach, see Gideon Rothschild & Daniel S. Rubin, *Minimize Creditor Challenges to Self-Settled Spendthrift Trusts*, 157 Tr. & Est. 14, 14–16 (Nov. 2018).

This approach requires a certain amount of due diligence and judgment on the part of the planner. Among other things, it requires a good faith determination of the existence, nature, value, and extent of any asset or liability. These questions sometimes delve into factual and legal gray areas. However, clients have ample good faith “wiggle room,” especially in connection with future assets and liabilities.

A key part of this calculation is determining and providing for reasonably foreseeable future assets and future liabilities. In so doing, planners should discount the face value of contingent liabilities (such as guaranties) to reflect the likelihood that they will not be called. Planners should also include the discounted value of contingent assets (such as insurance or future income).

This sort of probability-based planning has been endorsed by the courts.[1867] As one court noted, “[d]iscounting a contingent liability by the probability of its occurrence is good economics and therefore good law, for solvency… is an economic term.”[1868] The same logic applies to valuing future assets.[1869]

[1867] On the need to plan only for reasonably foreseeable liabilities, see, e.g., *In re Bergman*, 293 B.R.

580 (Bankr. W.D.N.Y. 2003) (debtor-wife's transfer of assets to husband wasn't fraudulent because transfer disclosed and business reverses were unexpected); 293 B.R. at 585 ("While a company must be adequately capitalized, it does not need resources sufficient to withstand any and all setbacks," and "the question the court must decide is not whether the projection was correct, for clearly it was not, but whether it was reasonable and prudent when made") (citations and internal quotation marks omitted). On the need to discount contingent assets and liabilities, see, e.g., *FDIC v. Bell*, 106 F.3d 258, 264 (8th Cir. 1997); *In re Heritage Org., LLC*, 375 B.R. 230, 283–84 (Bankr. N.D. Tex. 2007).

[1868] *Covey v. Commercial Bank of Peoria*, 960 F.2d 657, 659–660 (7th Cir. 1992).

[1869] For example, the court in *Heritage Org.*, 375 B.R. at 283–84 stated "The case law is clear that in determining the value of contingent assets or liabilities for purposes of a solvency analysis, a bankruptcy court should not use their face value. Rather, the court should multiply the face amount of the asset or liability times the probability that the contingency will occur." (citations and internal quotation marks omitted).

Moreover, while any discounting should be done with care,[1870] it is settled that all discounting should be done from the transferor-debtor's perspective, not from a creditor's perspective.[1871] Although the reason for this rule is not clearly articulated, the unspoken rationale seems to be that the transferor is best positioned to appraise his or her own contingencies. His or her good faith assessments will not be disturbed so long as they are within a reasonable range.

[1870] *In re Labrum & Doak, LLP*, 227 B.R. 383, 389 (Bankr. E.D. Pa. 1998).

[1871] *Covey*, 960 F.2d at 660; *Heritage Org.*, 375 B.R. at 284.

In determining what is reasonable, the general rule is that all assessments should be "based on information known or knowable as of the date of the challenged transfer, without the benefit of hindsight."[1872] However, a court may use hindsight in determining the "probable ultimate liability" of an unliquidated claim that was asserted pre-transfer but reduced to judgment post-transfer.[1873]

[1872] *Heritage Org.*, 375 B.R. at 284.

[1873] 375 B.R. at 284. *See also In re Pilavis*, 233 B.R. 1, 7–8 (Bankr. D. Mass. 1999).

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H. Asset Selection: What to Entrust (a Qualitative Issue)

Liquid assets (e.g., cash, stocks, bonds, etc.), movable tangible personalty (e.g., jewelry that can be easily transported to a domestic APT state), and movable intangible personalty (e.g., limited-liability company ("LLC") membership interests or family limited partnership ("FLP") interests) are the best assets for placing into a domestic APT. These assets are very portable and can be easily retitled or redomiciled.

Real estate poses potential problems for APTs. If the client funds the trust with real estate located in a state that does not recognize domestic APTs, then the local non-DAPT court will have in rem jurisdiction over the real estate and, more importantly, grounds for applying the local law rather than domestic APT law to the real estate and any efforts to attach it.[1874]

[1874] *Accord* Gideon Rothschild & Daniel S. Rubin, *Minimize Creditor Challenges to Self-Settled Spendthrift Trusts*, 157 Tr. & Est. 14, 19 (Nov. 2018) ("[A] self-settled spendthrift trust should be funded with intangible property, rather than real or personal property, unless the real or personal property has a situs within one of the jurisdictions that permit the creation of self-settled spendthrift trusts under local law"). *See* IX.G., above (discussing choice-of-law principles).

If a client insists upon entrusting real estate or its underlying value, then the client should consider: (1) borrowing against the real estate's equity and placing the loan proceeds into trust; or (2) retitling the real estate in an LLC or FLP and then placing the membership or partnership interest in trust.

The first tactic—sometimes referred to as "equity stripping"—clearly reduces the value to creditors of any efforts to foreclose on a parcel. However, foreclosure cannot be ruled out, particularly if the creditor wants to evict a debtor from his or her residence to make life miserable and thereby show that the creditor will relentlessly pursue the debtor until settlement is reached. Still, even if foreclosure is pursued, the equity strip-out preserves the equity in the trust fund, so the equity can be used to pay rent or otherwise provide alternative housing. The limited return on a foreclosure may be one more thing that wears a creditor down and drives him or her to settle more quickly and more cheaply. However, equity stripping generates interest charges and other borrowing costs, although a client may feel that the asset-protection benefits of an equity strip outweigh the carrying costs of a loan. Further, any equity stripping will be subject to standard fraudulent transfer rules, which apply to encumbrances as well as to outright dispositions.[1875]

[1875] UFTA §1(12) (1984) (defining "transfer" to include liens and encumbrances).

The second tactic—using LLCs and FLPs—may mitigate some problems because use of an entity rather than a self-settled trust obviates a creditor's ability to reach the real estate based on the rule against self-settled spendthrift trusts, which prevails in the United States' non-DAPT jurisdictions,[1876] but which is generally inapplicable to transfers to LLCs or FLPs because they simply are not trusts. Creditors may still try to invoke this rule vis-à-vis the LLC or FLP interest that has been entrusted to the domestic APT, but that leaves a creditor facing the many difficulties associated with challenging domestic APTs, which are discussed at length above. Moreover, a client employing the first technique with an LLC will need to adequately observe any applicable company formalities lest the company veil be pierced.[1877] Unfortunately, placing real property in entities did not prevent a federal bankruptcy judge in Washington State from setting aside an Alaska APT in the 2013 *Waldron v. Huber* case.[1878] The settlor also should not fund a domestic APT with interests in an LLC of which he or she is the manager because, as held in 2013 by a federal bankruptcy court in Washington State considering Alaska entities:[1879]

[1876] *See* I.B., above.

[1877] *See, e.g., Greenhunter Energy, Inc. v. W. Ecosystems Tech, Inc.*, 337 P.3d 454, 470 (Wyo. 2014) ("We affirm the district court's judgment piercing the [Wyoming] LLC's veil and imposing liability on Appellant for its debt to Western").

[1878] 493 B.R. 798 (Bankr. W.D. Wash 2013).

[1879] *Waldron v. Huber (In re Huber)*, 2013 WL 6184972 at *6 (Bankr. W.D. Wash. Nov. 25, 2013), *aff'd*, *2014 WL 3404964* (W.D. Wash. July 10, 2014). *Accord Schwartzer v. Cleveland (In re Cleveland)*, 519 B.R. 304, 306–07 (D. Nev. 2014) ("Appellant is not limited to a charging order under Nevada law, and succeeds to all of Appellees' rights in the LLCs, including the right to control those entities"); *In re Albright*, 291 B.R. 538, 541 (Bankr. D. Colo. 2003) ("Because the Trustee became the sole member of Western Blue Sky LLC upon the Debtor's bankruptcy filing, the Trustee now controls, directly or indirectly, all governance of that entity, including decisions regarding liquidation of the entity's assets").

> [T]he [Bankruptcy] Trustee succeeded to all of the Debtor's interests in Kimball and Pioneer, including management and voting rights, through DGH's 85% membership interest in these L.L.C.s.

Retitling real estate into an entity will trigger real estate recording fees (which are usually minor) and may trigger: (1) transfer taxes owed to local governments; and (2) due-on-sale clauses in connection with any encumbered real estate (either of which could involve major sums). Whether transfer taxes can be saved depends upon local tax rules, which can vary considerably from state to state. Due-on-sale clauses should be directly discussed with mortgagees before undertaking a transfer to an LLC. Whereas the federal Garn-St. Germaine Act bars enforcement of due-on-sale clauses in connection with "a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property,"[1880] it is unclear whether this federal law will have the same preventive effect in connection with transfers to entities owned by a trust (even wholly owned entities).

[1880] *12 U.S.C. §1701-j(d)(8).*

LLCs and FLPs can be used to hold other assets besides real estate, including the liquid and movable assets noted above. Whenever FLPs or LLCs are used, the documentation for the entity should be drafted with care, particularly if the objective is to draft a "poison pill" that might deter creditors, receivers, or bankruptcy trustees laying claim to the FLP or LLC interests[1881] or to generate the estate- or gift-tax discounts that are frequently sought by estate planners.

[1881] *See In re Baldwin*, 593 F.3d 1155, 1162 (10th Cir. 2010) ("¶16 entitles the limited partner to withdraw by making a buy/sell offer in accordance with the provisions off ¶16.").

The entity probably should be created in a jurisdiction in which a creditor's sole remedy is to obtain a charging order over the interest.[1882] In selecting such a jurisdiction, it is important to remember that details matter, that charging order regimes can vary considerably from state to state, and that some charging order systems are actually very creditor friendly. For instance, the LLC charging order systems for Texas and Delaware are very similar and generally thought to be very protective, in part because the systems clearly limit a creditor's remedies,[1883] whereas the LLC charging order systems of Florida and some other states are generally regarded as very unprotective because of the broad remedies the systems give creditors.

[1882] *See Olmstead v. FTC*, 44 So.3d 76, 83 (Fla. 2010) (creditors could reach assets of single-member Florida LLC). *See also* Alan S. Gassman & Denicolo, *Pass-Through Entities Have Protections in Charging Order Law*, 38 Est. Plan. 31 (Nov. 2011); Daniel S. Rubin, *Florida Supreme Court Denies Charging Order Protection to Owners of Single-Member Limited Liability Companies*, 35 Tax Mgmt. Est., Gifts & Tr. J. 272 (Nov./Dec. 2010).

[1883] *See* Del. Code Ann. tit. 6, §18-703; Tex. Bus. Orgs. Code Ann. §101.112. *See also New Times Media, LLC v. Bay Guardian Co., Inc.,* 2010 WL 2573957 at *2 (D. Del. June 28, 2010) ("Delaware law does not permit foreclosure on charging orders"). *Accord Gen. Elec. Capital Corp. v. JLT Aircraft Holding-Co.*, LLC, 2010 WL 3023316 at *3 (D. Minn. July 28, 2010) ("A charging order is the exclusive remedy under Delaware Law by which a Judgment creditor may satisfy a Judgment out of a member's interest in a limited liability company").

While not necessary, it may be helpful to form LLCs, FLPs, and domestic APTs that are all organized in the same jurisdiction because this will enhance the nexus between the domestic APT and its choice of governing law. However, this nexus-enhancing tactic may not be advisable because of the differences between charging order systems. In particular, the domestic APT state involved may not have desirable limited partnership or LLC legislation. In such cases, the soundness of the governing limited partnership or LLC statute may ultimately outweigh any nexus considerations.

Florida practitioners gave two bits of practical advice late in 2018.[1884] First, regarding where to form an LLC, they counseled: [1885]

[1884] Forster & Boughman, *LLC Entity Form Offers Asset Protection Advantage*, 45 Est. Plan. 36 (Oct. 2018).

[1885] Forster & Boughman, 45 Est. Plan. 36 at 38.

> If stability is a concern, Delaware is a traditional choice and Nevada offers a sound alternative due to its reliance on Delaware's long-standing body of favorable corporate law. If privacy is a concern, Delaware (which requires almost no public disclosure) is the best domestic option.

Second, they nevertheless advised:[1886]

[1886] Forster & Boughman, 45 Est. Plan. 36 at 38 (footnote omitted).

> It makes little sense, for instance, to rely on the protections of a Delaware LLC to house Florida real estate or investment accounts. The practical reality is that any litigation involving the property is likely to occur in Florida, where a Florida court could be expected to apply Florida's LLC law.

The planner should design the entity to ensure that the desired law will govern the ability of creditors to access its assets. In this connection, a federal district court in Florida held that the applicable law with respect to a single-member Nevis LLC created by a Florida resident was determined as follows:[1887]

[1887] *Wells Fargo Bank, N.A. v. Barber*, 85 F. Supp. 3d 1308, 1316 (M.D. Fla. 2015) (citations omitted).

> In Florida, the law of the situs of the property controls. As described more fully above, since Barber resides in Florida, so does her membership interest in Blaker. Therefore, the situs of the property at issue in this case is Florida and Florida law applies.

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I. Cost of Establishing and Administering the Domestic APT

The client must pay his or her existing and APT attorneys for their services in connection with establishing a domestic APT.

Professional domestic APT trustees will also charge a fee for administering the trust. A professional trustee's fees for administering a domestic APT customarily are the same as for administering other trusts, although each domestic APT trustee may have different fees for different types of APT arrangements. For example, many trustees charge less for “directed trusts” that make others responsible for investment decisions and more for trusts that make the trustee responsible for those decisions. The different fees reflect the different workloads and liability exposure associated with the different trustee responsibilities. Clients can avoid these professional trustee fees by naming friends or family members if the relevant domestic APT statute makes them eligible to serve, but this is usually a case of “penny wise, pound foolish,” as amateur trustees are prone to costly mistakes and/or spend heavily on outside professional advisers in any event. It is, therefore, usually cheaper in the long run to hire professional trustees.

A domestic APT will trigger the need to file various tax forms and tax returns. For domestic APTs, the most common federal tax filings are: (1) a Form SS-4 request for a taxpayer identification number; (2) a Form W-9 tax withholding statement; and (3) a Form 1041 income tax return, although the complexity and expense of the income tax return will vary with whether the domestic APT is taxed as a grantor or nongrantor trust.[1888] Other federal filings may be required. State and local tax filings will vary from state to state. These various domestic APT-related filings tend to be significantly less expensive than the returns imposed on a true foreign trust.

[1888] *See* 852 T.M., *Income Taxation of Trusts and Estates*; 819 T.M., *Grantor Trusts (Sections 671–679)*.

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J. Basic Administration Concepts: Procedures and Distributions

When administering a domestic APT, trustees should follow customary procedures for processing requests for discretionary distributions and avoid any appearance that the settlor is using the trust as his or her own personal checking account. Requests for distributions should be in writing whenever feasible and in all events submitted to the trustee for proper consideration.

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XIII. Distributions From Domestic APTs: Who Is in Charge and Other Issues

A. Introduction

Some practitioners question whether domestic asset-protection trusts (“APTs”)[1889] will ever provide protection against creditor claims. Others question whether domestic APTs will be excludible from the settlor's gross estate under §2036(a)(1).[1890] Either way, though, many of these skeptics recognize the theoretical reasons that support the effectiveness of domestic APTs and will even assume that domestic APTs will work as advertised if the domestic APT is properly administered, but they nonetheless raise practical concerns, most notably focused on the related concerns that: (1) the domestic APT's settlor and trustee will always have an “understanding” that the trustee will distribute funds whenever the settlor asks for them; (2) the trustee who denies such a request will be fired; and (3) the ousted trustee will never receive any more business or referrals from the settlor or his or her family, friends, or business associates. This harkens back to the “sham trust” issues previously discussed and, as noted, shams are hard to prove.[1891] Moreover, there are other legal and practical responses to these concerns.

[1889] A domestic APT is sometimes referred to as a DAPT.

[1890] Although this is a lesser concern because many asset protection planners do not use APTs to remove assets from a client's tax base. *See* 877 T.M., *Retained Beneficial Interests (Sections 2036(a)(1) and 2037)*.

[1891] *See* IX.F., above.

B. Recommendations

As described in the following sections, there are several ways to ameliorate the concerns mentioned in XIII.A., above.

1. **Avoid Misunderstanding at Beginning** —

If the settlor really wants the trust to work, the attorney and trustee should make clear at the outset (preferably in writing) that the settlor may receive funds only in accordance with the terms of the trust instrument and by following the trustee's procedure for processing discretionary-distribution requests.

2. **Fund With Nest Egg** —

When feasible, the settlors should fund trusts with a portion of their assets that they never expect to need. If possible, trust funds should never be distributed to them. This will reduce the opportunities for successful and proper distribution requests to be misconstrued as proof of a sham-trust arrangement.

3. **Choose Proper Law** —

Settlors should consider creating trusts under domestic APT statutes that specifically provide that settlors have only the rights set forth in trust instruments and that outside understandings are invalid.[1892]

[1892] *See* Alaska Stat. §34.40.110(i); Del. Code Ann. tit. 12, §3571; Nev. Rev. Stat. §166.045; S.D. Codified Laws Ann. Ann. §55-16-8.

4. **Choose Proper Trustee and Follow Proper Request Procedures** —

Settlors should appoint as trustees institutions or individuals that: (1) have established regular procedures for processing discretionary-payment requests from trusts (self-settled or otherwise); and (2) follow those procedures. Settlors should avoid giving control of discretionary distributions to individual trustees, advisers, and/or protectors who lack such safeguards. Additionally, settlors should follow similar procedures with any individuals serving as co-trustees, trust advisers, or protectors (assuming those persons have any authority over distributions, which is not always the case).[1893]

[1893] *See Miller v. Kresser*, 34 So.3d 172 (Fla. Dist. Ct. App. 2010) (court held that beneficiary's control over individual trustee did not invalidate spendthrift clause).

5. **Name Other Beneficiaries** —

Settlors should include other beneficiaries who might object if trustees make improper distributions. These other beneficiaries have interests in the trust funds, although the nature and extent of these interests may vary with the terms of the trust agreements. In any event, the presence of other beneficiaries may very easily give trustees good grounds to deny settlors’ requests because trustees are typically required to balance the competing interests of all trust beneficiaries when making distribution decisions (subject, again, to trust terms that vary this duty). The duty to consider competing interests is illustrated by caselaw.[1894]

[1894] *See, e.g.*, *Graninger v. Nat'l City Bank (In re Stonecipher),* 849 N.E.2d 1191 (Ind. Ct. App. 2006); *Finch v. Wachovia Bank & Tr. Co.,* 577 S.E.2d 306 (N.C. Ct. App. 2003).

6. **Domestic APTs Make It Easier for Other Beneficiaries to Sue** —

In a related vein, nonsettlor beneficiaries will find it easier to sue to enforce their rights in connection with a domestic APT than with a foreign APT, which in turn dilutes the settlor-beneficiary's interest in and/or control over the trust. Whereas settlors may not initially like this prospect, they may have a change of mind if they conclude that strengthening the practical remedies of nonsettlor beneficiaries might do much to legitimize domestic APTs in the eyes of a reviewing court.

Most reputable foreign APT jurisdictions are no different as a matter of substantive trust law, for they also give due regard to the rights of U.S.-based beneficiaries. However, the cost of litigating overseas could be significantly higher for such beneficiaries, particularly because most foreign jurisdictions follow the “English rule” (i.e., the “loser pays” system) and typically bar contingent-fee arrangements on ethical grounds. These local rules of practice, though of general application to all litigants, certainly create a potential “barrier to entry” for many prospective U.S. beneficiary-plaintiffs.

Some settlors may consider such barriers to be a good thing and think that giving beneficiaries an easy right to sue is a bad thing, in part because they do not want unduly demanding offspring to use the threat of litigation to bludgeon a trustee into making inappropriate distributions. Such settlors may conclude that offshore is better unless domestic APT states offer alternative ways to assuage their concerns. Fortunately, domestic APT states do.

One solution is to draft a domestic APT so that it gives a trustee very broad discretion and plainly deprives beneficiaries of any demand rights and/or any basis to compel a distribution. This language, if clearly drafted (see XIII.C., below), will do much to deter unruly beneficiaries because they will have no enforceable rights whatsoever.

In general, this discretionary trust approach should be viable in any domestic APT state. However, planners should be cautious about this approach in domestic APT states that have also adopted the Uniform Trust Code (“UTC”) (especially the UTC's Article V), such as Wyoming and Tennessee, which allow beneficiaries to sue for abuse of discretion.[1895] Many analysts contend that UTC Article V and (especially) its companion rules in the *Restatement (Third) of Trusts* undermine a trustee's traditional discretionary authority and therefore might enable beneficiaries to compel distributions when previously they could not.[1896] In light of this concern, planners may prefer to use this discretionary trust approach in domestic APT states that have not adopted the UTC, such as Alaska, Delaware, Nevada, or South Dakota.[1897] Alternatively, a domestic APT/UTC state might be acceptable if that state has significantly modified its local version of UTC Article V.

[1895] *See* Wyo. Stat. §4-10-504(d) (allowing beneficiary to sue trustee for abuse of discretion); Tenn. Code Ann. §35-15-504(b) (similar).

[1896] *See* Merric, Stein & Berger, *The UTC: A Continuum of Discretionary Trusts or a Continuum of Continuing Litigation?* J. Prac. Est. Plan. 40 (Dec. 2004/Jan. 2005).

[1897] For a list of states that have adopted the UTC, see www.uniformlaws.org.

A second approach to tamping down litigious heirs is to use in terrorem or “disinheritance” clauses as part of a trust. These clauses are sometimes unenforceable in whole or in part, but the mere prospect of disinheritance may deter unjustified suits.

A third way to deter unmeritorious litigation is to set up a domestic APT in a state that has adopted a version of the English rule, such as South Dakota or Alaska.[1898]

[1898] *See* S.D. Codified Laws Ann. §55-16-13; Alaska R. Civ. P. 82.

Any of these three methods (i.e., using discretionary trusts, in terrorem clauses, and domestic APT states with the English rule) will enable a settlor to strike a potentially very attractive balance by giving nonsettlor beneficiaries easy access to the courthouse if so desired, thereby making their rights more “real” and the settlor's alleged control less problematic in the eyes of various U.S. judges and juries, yet at the same time creating potentially severe adverse consequences for those nonsettlor beneficiaries who pursue unmeritorious trust litigation.

A purported advantage of foreign APTs is that they are created in jurisdictions where creditors are unable to engage local counsel to pursue claims. Beneficiaries who seek to prevent trustees of such trusts from acting improperly will be similarly disadvantaged.

7. **Settlors May Expressly Reserve Certain Rights to Income** —

Some domestic APT statutes allow settlors to expressly reserve rights to trust income.[1899] Therefore, settlors can assure themselves of access to a domestic APT's income without compromising the APT's asset-protection features, subject to the following three key exceptions: (1) any amounts that are distributed will likely be subject to attachment or garnishment (subject to local exemptions and collection procedures), which means that creditors can simply sit back and wait for distributions to occur; (2) consistent with the concepts discussed in XIII.C., below, any rights settlors have to demand income will become part of any bankruptcy or receivership estate that might subsequently be created out of the settlors’ assets; and (3) the retained income right, while statutorily authorized, may be too much for a non-DAPT court to countenance, especially if the settlor has “loaded up” the domestic APT with many other retained powers or interests. These three exceptions, however, can be managed.

[1899] *See, e.g.*, Del. Code Ann. tit. 12, §3570(11)(b)(3); S.D. Codified Laws Ann. §55-16-2(2)(c).

The first exception (the “sit back and wait” exception) is easily dealt with by making the demand right subject to forfeiture upon the entry of any judgment or the issuance of any writ of collection. This forfeiture clause approach, which is commonplace in some states in connection with trusts settled for the sake of third-party beneficiaries,[1900] will frustrate most judgment creditors because the debtor's income interest will cease the moment the creditor becomes a real threat.

[1900] *See, e.g., Scott v. Bank One Trust Co.,* 577 N.E.2d 1077 (Ohio 1991).

The second exception (the bankruptcy exception) is more complicated. If a forfeiture clause is triggered by a debtor's insolvency, financial condition, or bankruptcy filing, or by the appointment of a receiver or other custodian over the debtor, then the Bankruptcy Code's provisions against certain evaporating rights (sometimes referred to as a rule against “ipso facto” clauses) may render the forfeiture clause ineffective.[1901] This ipso facto rule is the basis for the second exception. Fortunately, it is possible to draft around the rule against ipso facto or “evaporating rights” clauses. Specifically, a forfeiture clause should be valid, even in bankruptcy, if the clause is triggered by the entry of a nonbankruptcy judgment or the start of nonbankruptcy collection activities regardless of a debtor's financial condition.[1902] Further, a bankruptcy court arguably should refuse to apply the ipso facto rule to a debtor's forfeiture of trust income interests because such a refusal would be consistent with the policy behind the rule. The ipso facto rule was designed to protect a debtor and promote his or her fresh start by disallowing forfeiture clauses that gave creditors rights to the debtor's property simply because the debtor exercised his or her right to file bankruptcy.[1903] However, in the context considered here, disallowing forfeiture would actually hurt a debtor and his or her fresh start by making his or her trust income subject to the claims of the bankruptcy trustee, whereas allowing the forfeiture would preserve trust property for future distribution to the debtor. Moreover, all is not lost, even if the ipso facto rule invalidates a domestic APT's income forfeiture clause: The domestic APT trustee can simply switch domestic APT holdings into no-income assets such as a stock that pays little or no dividends and instead focusing on share price appreciation, or undeveloped land that is likely to gain in value but yields no rental or other income. This would stop payouts to the debtor and/or his or her bankruptcy trustee and preserve trust corpus for the debtor.

[1901] *See* 11 U.S.C. §541(c)(1)(B) (rendering ineffective any restriction on transfer or other comparable provision "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"). *See also* 11 U.S.C. §365(e)(1) (similar to 11 U.S.C. §541(c)(1)(B)); *Matter of Railway Reorganization*, 133 B.R. 578 (Bankr. D. Del. 1991) (discussing ipso facto clauses); *In re Western Asbestos Co.*, 313 B.R. 832, 844 (Bankr. N.D. Cal. 2003) ("A provision that effects a termination of rights conditioned on a party's insolvency is sometimes referred to as an ipso facto clause").

[1902] *Cf. In re C.A.F. Bindery, Inc.*, 199 B.R. 828, 833 (Bankr. S.D.N.Y. 1996) ("If the debtor's default arises for some reason other than those set forth in [11 USC] section 365(e)(1), the prohibition against ipso facto clauses does not apply"); *In re Nemko, Inc.*, 163 B.R. 927, 938 (Bankr. E.D.N.Y. 1994) ("Where an executory contract has been terminated in accordance with its terms prior to bankruptcy, [11 U.S.C.] section 365(e)(1) does not authorize the bankruptcy court to reach beyond the veil of the petition to reinstate the contract") (citations and internal quotation marks and brackets omitted).

[1903] *See, e.g.*, *Railway Reorganization*, 133 B.R. 578, at 582-83 (discussing ipso facto clauses); *In re Peacock*, 87 B.R. 657, 659 (Bankr. D. Colo. 1988).

As to the third exception (the "I kept too much to make it believable" exception), "retainage" should not be a problem if the retained powers and interests are statutorily authorized.[1904] However, settlors who wish to be conservative can simply limit the number of other rights, powers, or interests the settlors retain, thus keeping the aggregate retainage at levels a court can stomach.

[1904] *See* IX.F., above (discussing retainage in connection with sham trust issues).

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C. Another Problem: Confused Distribution Standards

1. **The Nature of the Problem: Contradictory Terms** —

One easily avoidable morass is the creation of distribution standards that mix mandatory and discretionary language. Although the nature and scope of this problem can vary with each state's standards as to what creates a genuine discretionary trust, the most common problems arise when the trust states something along the following lines: Trustee "shall" distribute as much income and principal as it determines "in its sole and absolute discretion" to be "necessary" for one or more beneficiaries. The question becomes whether the word "shall" requires the trustee to consider what is necessary, and then imposes on it a duty to distribute that amount, or whether the "sole and absolute discretion" clause somehow overrides the “shall” clause. The matter can become even more complicated if the trust further states that the distributions are somehow subject to an ascertainable standard such as “health, education, maintenance, or support.” Once these words are used in conjunction with a “shall” clause, a court might conclude that this language vests a beneficiary with an enforceable right to demand distributions[1905] or, at the very least, that the trust has a confusing amalgamation of contradictory distribution standards.[1906]

[1905] *See, e.g.*, *Chenot v. Bordeleau,* 561 A.2d 891, 894 (R.I. 1989).

[1906] 561 A.2d 891, 894.

2. **The Consequences: Unwanted Demands and/or Bankruptcy Problems** —

This type of conflated, “mixed standards” drafting is dangerous for at least two reasons.

First, it is an open invitation for warfare between the trustee and beneficiaries over requested distributions, as beneficiaries may claim that they are entitled to distributions that the trustee refused to make. Moreover, if the language is confusing enough, a court may agree with the beneficiaries and order distributions that settlors never intended.

Second, such language may easily undermine the asset-protection features of a trust if a beneficiary is subjected to a bankruptcy because the beneficiary's right to demand domestic APT distributions will pass to his or her bankruptcy estate. This second result may also arise in nonbankruptcy receiverships. In both instances, the creditor's representative is more than just a stakeholder for creditors—the representative also steps into the debtor's shoes and takes over his or her causes of action.[1907]

[1907] *In re Rare Coin Galleries of Am., Inc.*, 862 F.2d 896, 900 (1st Cir. 1988) (“Causes of action belonging to the debtor are included as property of the estate under 11 U.S.C. §541(a)(1)”); *Gravel Resource v. Hills*, 170 P.3d 282, 287 (Ariz. Ct. App. 2007) (“When appointed, the receiver stands in the shoes of the entity it represents” and “takes the rights, causes and remedies which were available to those whose interests the receiver was appointed to represent”) (citations, internal quotation marks, and ellipses omitted; collecting cases); *In re Footstar, Inc.*, 323 B.R. 566 , 571 (Bankr. S.D.N.Y. 2005) (“Upon appointment the trustee steps into the shoes of the debtor and the creditor body as a whole in order to exercise their rights to sue on behalf of the estate”) (citations and internal quotation marks omitted).

3. **Why Spendthrift Clauses Alone Are Not Enough in Bankruptcy** —

This second point regarding bankruptcy and receiverships bears further analysis because this point is the subject of much confusion. Many estate planners are vaguely familiar with 11 U.S.C. §541(c)(2) of the Bankruptcy Code and its rule (loosely stated) that any spendthrift clause enforceable out of bankruptcy is also enforceable in bankruptcy. These planners conclude that a spendthrift clause will, by itself, defeat any and all attempts to invade a spendthrift trust for the sake of creditors. Many bankruptcy trustees reach a similar conclusion because they are only vaguely familiar with trust law and do not understand the difference between beneficial interests in a trust and powers over a trust and/or are so harried that, upon seeing a spendthrift clause, the trustees conclude that a matter simply is not worth investigating further. However, such conclusions are wrong.

Bankruptcy Code §541(c)(2) is more nuanced than a simple statement that “spendthrift clauses are enforceable in bankruptcy and therefore trusts with such clauses are off limits.” Its actual text states that “restriction[s] on transfer” are enforceable in bankruptcy to the same extent as they would be “under applicable nonbankruptcy law.” Accordingly, the routine “anti-alienation” spendthrift clause, which prevents a debtor-beneficiary from assigning, selling, pledging, hypothecating, or otherwise transferring his or her interest,[1908] prevents that beneficiary from giving his or her interest to another person and will, therefore, be honored in bankruptcy. A restriction on transfers, though, differs from a restriction that deprives a beneficiary of any rights to demand money from a trust. Moreover, the Bankruptcy Code gives a debtor's bankruptcy trustee all the legal and equitable rights held by the debtor at the time a bankruptcy petition is filed.[1909] This includes any rights or powers that the debtor-beneficiary has in or over the trust that may be claimed or exercised for his or her own benefit.[1910] This, in turn, means that the debtor's rights, if any, to demand or compel distributions from a domestic APT will also become part of his or her bankruptcy estate.

[1908] *See Miller v. United States*, 267 F. Supp. 326 n.4 (M.D. Fla. 1967) (distinguishing between anti-alienation and “terminating interest” or “forfeiture” spendthrift clauses).

[1909] 11 U.S.C. §541(a)(1).

[1910] *See, e.g.*, *In re Gilroy*, 235 B.R. 512, 517 (Bankr. D. Mass 1999) (debtor held general power of appointment and “[u]pon the filing of her bankruptcy petition, the power of appointment became an asset of the bankruptcy estate”); 235 B.R. at 518 (“The power of appointment is itself an asset of the estate” and “is not a beneficial interest in a trust, so it cannot be subject to a restriction that, pursuant to [11 U.S.C.] §541(c)(2), might keep it from the estate”); *In re Marrama*, 316 B.R. 418, 423 (B.A.P. 1st Cir. 2004) (noting in connection with debtor's power to revoke self-settled trust that “the bankruptcy estate includes a power that the debtor may exercise for his own benefit”); *Askanase v. Livingwell, Inc.*, 45 F.3d 103, 106 (5th Cir. 1995), stating the general rules as follows: “The bankruptcy estate succeeds to all legal or equitable interests of the debtor in property as of the commencement of the case, including those powers that the debtor may exercise for its own benefit. Any interest which a debtor retains in a trust is property of the estate, including the power to amend the trust and the power to revoke a revocable trust and recover the remaining funds in the trust for the benefit of the creditors. Thus, what comes to the bankruptcy estate is not only the property in which debtor has an interest, but also, the powers the debtor can exercise for its own benefit over property regardless of the title debtor may be acting under” (citations and internal quotation marks omitted).

The upshot of all this is simple: Any distribution clause that gives a debtor actual or arguable rights to compel a distribution will also give a bankruptcy trustee the same rights, notwithstanding a spendthrift clause. Similar results are likely to attach to receiverships, although this may vary with the contours of the applicable local receivership law. Drafters should, therefore, take care in drafting distribution standards.

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A. Ethical Principles

In each case, attorneys should assess whether or not they will be acting ethically and whether or not they will be sued and/or held liable by assisting—or declining to assist—clients to create domestic asset-protection trusts (“APTs”).[1911] As with every engagement, the attorney must be mindful of the need to protect confidential information and to avoid conflicts of interest. Attorneys should also make sure that they are competent to carry out such engagements.[1912]

[1911] *See* Rubin, *Asset Protection Planning: Ethical? Legal? Obligatory?* 48 U. Miami Inst. on Est. Plan. ¶1803–¶1804 at 18-7–18-13 (2014); 810 T.M., *Asset Protection Planning.* A domestic APT is sometimes referred to as a DAPT.

[1912] For additional discussion of the ethical rules to which estate planning attorneys are subject, see 801 T.M., *Ethical Rules for Estate Planning Lawyers – Conflicts, Confidentiality and Other Issues*.

Forty-nine states, the District of Columbia, and the U.S. Virgin Islands[1913] (California is the holdout) have adopted versions of the *Model Rules of Professional Conduct* ("*Model Rules*") that were adopted by the American Bar Association in 1983.[1914] No provision of the *Model Rules* specifically addresses the propriety of asset-protection planning, but the provision that is of most concern is *Model Rules* R. 1.2(d), which provides:

[1913] The states that have adopted the *Model Rules* are listed at www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/alpha_list_state_adopting_model_rules/.

[1914] Model Rules of Prof'l Conduct (2002). *See* Henry J. Lischer, *Professional Responsibility Issues Associated With Asset Protection Trusts*, 39 Real Prop., Prob. & Tr. J. 561, 602–07, 615–17 (Fall 2004).

> 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.

For purposes of the *Model Rules*, "fraud" or "fraudulent" has the following meaning: "'Fraud' or 'fraudulent' denotes conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction and has a purpose to deceive."[1915]

[1915] *Model Rules* R. 1.0(d).

Practice Tip: Note, however, that the *Model Rules* are subject to state-by-state variations, and practitioners should, therefore, consult the applicable state version of the *Model Rules* as well as the American Bar Association's prototype *Model Rules*.

Cases and ethics opinions involving the propriety of asset-protection planning have been issued in Connecticut, California, South Carolina, New Jersey, Oregon, Pennsylvania, Florida, and New York.[1916] A commentator has contended that these authorities have shown that an attorney might be engaging in an ethical violation if he or she helps a client to defraud known or foreseeable creditors but that there should be no ethical violation if the planning involves unknown and unforeseeable creditors.[1917] In addition, an outspoken critic of domestic and foreign APTs has conceded that an attorney in a non-DAPT state may avoid ethical concerns by referring a client to counsel in a domestic APT state to discuss an APT and that the domestic APT state attorney has no ethical concerns because his or her jurisdiction recognizes APTs.[1918]

[1916] *See* Daniel S. Rubin, 48 U. Miami Inst. on Est. Plan ¶1803–¶1804 at 18-8–18-13. *See also* Henry J. Lischer, *Professional Responsibility Issues Associated With Asset Protection Trusts,* 39 Real Prop., Prob. & Tr. J. 561, 599–607.

[1917] Daniel S. Rubin, 48 U. Miami Inst. on Est. Plan. ¶1804 at 18-12–18-13.

[1918] Henry J. Lischer, *Professional Responsibility Issues Associated With Asset Protection Trusts,* 39 Real Prop., Prob. & Tr. J. 561 at 625.

Attorneys may not assume that they will escape ethical problems simply by choosing not to participate in asset-protection planning because the *Model Rules* [1919] require the attorney to represent their clients zealously. Commentators have cautioned attorneys as follows:[1920]

[1919] *Model Rules* R. 1.3 cmt. 1.

[1920] Gideon Rothschild & Daniel S. Rubin, *Asset-Protection Planning: Ethical? Legal? Obligatory?* 142 Tr. & Est. 42, 45 (Sept. 2003) (footnotes omitted).

> So far there are no reported ethics decisions or malpractice cases addressing whether a lawyer is obligated to promote a client's lawful asset protection plan. But it is only a matter of time before such claims begin to be heard. Therefore, professionals should not shrink from asset protection. Handled responsibly, it should be as ethically and legally innocuous as any other type of planning. Certainly, to protect themselves, professional advisors must do their due diligence. At a minimum, they should follow established "know your client" procedures, conduct or obtain a solvency analysis of the client, review the client's circumstances—and always document that due diligence.

In 2003, the Supreme Court of Colorado suspended an attorney from practice for 15 months[1921] and later disbarred him,[1922] inter alia, for providing ineffective asset-protection advice.[1923] In 2011, an attorney was indicted, allegedly for committing multiple counts of perjury and obstruction of justice in connection with creditors' attempts to obtain information regarding a Bahamian trust.[1924] In 2013, a California attorney was suspended from practice for one year and placed on one year of probation thereafter for assisting a client to make a fraudulent transfer.[1925] Finally, in 2014, the Supreme Court of Iowa dismissed a disciplinary complaint against an attorney for his alleged involvement in a fraudulent transfer.[1926] Throughout the opinion, the court summarized cases in which attorneys had and had not been disciplined for participating in clients' efforts to avoid creditor claims.[1927]

[1921] *People v. Woodford*, 81 P.3d 370 (Colo. 2003).

[1922] *People v. Woodford*, 97 P.3d 968 (Colo. 2004).

[1923] *Woodford*, 81 P.3d at 374.

[1924] *United States v. Peter G. Rogan & Frederick M. Cuppy*, Grand Jury Charge, 11-mj-6511 (N.D. Ill. Sept. 28, 2011). *See* Nelson, *Asset Protection and Estate Planning—Why Not Have Both?* 46 U. Miami Inst. on Est. Plan ¶1500 at 15-67–15-69 (2012).

[1925] *Matter of Morris*, *2013 WL 6598701* (Rev. Dep't State Bar Ct. Cal. Dec. 4, 2013).

[1926] *Iowa Sup. Ct. Attorney Disciplinary Bd. v. Ouderkirk*, 845 N.W.2d 31, 51 (Iowa 2014).

[1927] 845 N.W.2d 31, 51.

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B. Potential Liability to the Client

Clients (particularly wealthy clients) are very interested in protecting their assets,[1928] which means that attorneys might face malpractice exposure if they do not advise their clients regarding asset-protection techniques (including, under appropriate circumstances, creating a domestic APT) and their clients' assets are later reached by creditors.

[1928] *See* Prince & Harris, *Shelter from the Storm*, 142 Tr. & Est. 38 (Sept. 2003). *See generally* Martin M. Shenkman, Sandra Glazier & Howard Zaritsky, *Raia v. Lowenstein Sandler LLP—Thoughts on a Recent Malpractice Case*, LISI Est. Plan. Newsl. #2724 (May 16, 2019), www.leimbergservices.com.

As long ago as 1978, a New York trial court denied a defendant-attorney's motion to dismiss breach-of-contract and malpractice claims where his failure to incorporate the client's business within a reasonable period allegedly forced the client into bankruptcy.[1929]

[1929] *Gunn v. Mahoney*, 408 N.Y.S.2d 896 (Sup. Ct. 1978).

Next, a client sued an attorney for malpractice for negligent advice regarding transfers to offshore accounts (in the Bahamas) for asset protection that resulted in the client's conviction for several money-related crimes.[1930] Fortunately for the attorney, the claim was barred by collateral estoppel.[1931]

[1930] *Butler v. Mooers*, 771 A.2d 1034 (Me. 2001).

[1931] 771 A.2d at 1037.

In addition, a client sued her lawyers for alleged malpractice for failing to unfreeze her assets in a proceeding involving her husband.[1932] Although the suit was unsuccessful, the risk of having to defend such a suit is real.[1933]

[1932] *Steffen v. Akerman Senterfitt*, 2007 WL 1601750 at *1 (M.D. Fla. June 1, 2007), *aff'd*, 532 F.3d 1146 (11th Cir. 2008).

[1933] 2007 WL 1601750

Finally, a former client's bankruptcy trustee sued an attorney to recover the latter's $45,000 fee for establishing an unsuccessful Cook Islands APT.[1934] The suit failed but, again, the attorney had to defend the claim.[1935]

[1934] *Niroomand*, 493 Fed. App'x 11 (11th Cir. 2012).

[1935] 493 Fed. App'x at 13.

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C. Potential Liability to Third Parties

1. **Introduction** —

California practitioners must keep in mind that participation in a fraudulent transfer might be a crime in certain circumstances,[1936] and practitioners everywhere must be aware of whether their jurisdictions might allow creditors to hold them liable for money damages in the fraudulent transfer context under the Uniform Fraudulent Conveyance Act (“UFCA”), the Uniform Fraudulent Transfer Act (“UFTA”), or the Uniform Voidable Transactions Act (“UVTA”), §548 of the Bankruptcy Code, or via state law pursuant to §544(b)(1) of that code. In particular, attorneys should know if the jurisdiction in question recognizes a cause of action for aiding and abetting a fraudulent transfer or for conspiracy to make such a transfer. The prevailing view is that non-transferees are not subject to such liability under bankruptcy or nonbankruptcy law, but there are exceptions.

[1936] Cal. Pen. Code §531.

2. **UFCA** —

As noted in VIII.A., above, New York and Maryland were the two remaining UFCA states until New York replaced its UFCA with the UVTA in 2019.

New York's *Porco* rule[1937] grants its practitioners a fair amount of leeway. Under this rule, there is no civil cause of action against those who assist fraudulent transferors.[1938] This rule has been specifically cited to protect attorneys accused of aiding and abetting a fraudulent transfer.[1939]

[1937] *See FDIC v. Porco*, 552 N.E.2d 158 (N.Y. 1990).

[1938] 552 N.E.2d at 159 (stating general rule). *Contra Joel v. Weber*, 197 A.D.2d 396 (N.Y. Sup. Ct. 1993).

[1939] *In re Parker*, 399 B.R. 577 (Bankr. E.D.N.Y. 2009) (collecting cases and applying *Porco* rule to attorneys).

In 2017, a federal bankruptcy court in Maryland concluded that “Maryland law would not recognize a conspiracy claim against any defendant for whom a claim of fraudulent transfer could not be made.”[1940]

[1940] *In re Madeoy*, 576 B.R. 484, 497 (Bankr. D. Md. 2017).

3. **UFTA/UVTA** —

As covered previously, the usual remedy for a fraudulent transfer under the UFTA is to recover the property or its value from a transferee.[1941] Given that UFTA entitles a creditor to “any other relief the circumstances may require,”[1942] however, creditors sometimes try to obtain additional money damages from attorneys and others.

[1941] UFTA §7–§8 (1984).

[1942] UFTA §7(a)(3)(iii) (1984).

Although courts may award money damages against attorneys and others for aiding and abetting a fraudulent transfer in Georgia,[1943] courts in Connecticut, Delaware, Florida, Illinois, Indiana, Maine, Minnesota, Nevada, Ohio, and Virginia may not.[1944] Courts in Arizona, Colorado, Connecticut, Georgia, and New Jersey may award money damages against attorneys and others for participating in conspiracies to commit fraudulent transfers,[1945] but courts in California, Delaware, Florida, Indiana, Maine, Minnesota, Nevada, Virginia, and West Virginia may not.[1946]

[1943] *Beaulieu Group, LLC v. Reichley, Inc.*, *2012 WL 6108022* (Ga. Super. Ct. Nov. 20, 2012) (For aiding and abetting a fraudulent transfer, “the Court finds Reichley and Creswell jointly liable with RC Flooring”). *But see Chepstow Ltd. v. Hunt*, 381 F.3d 1077, 1089 (11th Cir. 2004) (“the district court did not err in dismissing Chepstow's claim against Horizon based upon aiding and abetting liability as a non-transferee”).

[1944] *Nastro v. D'Onofrio*, 263 F. Supp. 2d 458, 466, (D. Conn. 2003) (“[T]here is no Connecticut authority confirming the validity of a cause of action against an attorney for aiding a fraudulent transfer”); *Crystallex Int'l Corp. v. Petroleos De Venezuela, S.A.,* 879 F.3d 79, 87 (3d Cir. 2018) (“The Chancery Court has foreclosed the possibility of aiding and abetting liability under DUFTA”); *Freeman v. First Union Nat'l Bank*, 865 So.2d 1272, 1276 (Fla. 2004) (“There simply is no language in FUFTA that suggests the creation of a distinct cause of action for aiding-abetting claims against non-transferees”), *accord Martinez v. Hutton (In re Harwell)*, *2011 WL 4566443* at *11 (Bankr. M.D. Fla. Sept. 30, 2011) (“[T]here's no cause of action for aiding and abetting a fraudulent transferee”); *In re Glick*, 568 B.R. 634, 678 (Bankr. N.D. Ill. 2017) (“there is no such thing as a claim for aiding and abetting a fraudulent transfer”); *Baker O'Neal Holdings, Inc. v. Ernst & Young LLP*, *2004 WL 771230* at *14 (S.D. Ind. Mar. 24, 2004) (“Accessory liability for fraudulent transfers cannot be supported by … the IUFTA.”); *FDIC v. S. Prawer & Co.*, 829 F. Supp. 453, 457 (D. Maine 1993) (“[T]he legislature has not reenacted any provision for aiding and abetting liability for those assisting in fraudulent conveyances”); *Arena Dev. Group, LLC v. Naegele Communs., Inc.*, 2007 WL 2506431 at *5 (D. Minn. Aug. 30, 2007) (“Naegele Jr. can not be held personally liable for aiding and abetting … a violation of the UFTA"); *Cadle Co. v. Woods & Erickson, LLP*, 345 P.3d 1049, 1051 (Nev. 2015) ("Nevada … does not recognize accessory liability for fraudulent transfers"); *Blake v. Wells Fargo Bank, N.A.*, 916 F. Supp. 2d 839, 842 (S.D. Ohio 2013), *citing DeVries Dairy, LLC v. White Eagle Coop Assn., Inc.*, 974 N.E.2d 1194 (Ohio 2012) ("Ohio law does not, as a matter of law, recognize a claim for aiding and abetting tortious conduct …"); *In re Rescue Rangers, LLC*, 576 B.R. 521, 529 (Bankr. E.D. Va. 2017) ("there can be no claim against the Defendants for aiding and abetting the transfers").

[1945] *Barstow v. Giordano (In re Giordano)*, *2004 WL 6002207* at *6 n.20 (Bankr. D. Alaska Jan. 7, 2004) ("To prove liability for a fraudulent conveyance scheme the plaintiff must prove: (1) An unlawful agreement; (2) The specific intent of each participant in the scheme to hinder, delay and defraud a creditor of one who participated in the scheme; (3) Acts committed pursuant to the unlawful agreement; (4) Damages caused by the acts committed pursuant to the unlawful agreement") (citation omitted); *Arab Monetary Fund v. Hashim (In re Hashim)*, 379 B.R. 912, 916 n.2 (B.A.P. 9th Cir. 2007) ("The Arizona action for conspiracy to commit fraudulent conveyances has four elements …"); *Fifth Third Bank v. Morales*, 2017 WL 6492108 at *6 (D. Colo. Dec. 19, 2017) ("A fraudulent transfer is an unlawful act that supports a creditor's claim for conspiracy"); *Ferri v. Powell-Ferri*, *2012 WL 3854425* at *4 (Conn. Super. Ct. July 30, 2012) ("Powell-Ferri's civil conspiracy claim must fail because her claim under the UFTA fails, as discussed more fully above"); *Chepstow Ltd. v. Hunt*, 381 F.3d 1077, 1090 (11th Cir. 2004) ("Georgia law permits claims against non-transferee defendants, such as Horizon, where the allegations are, as here, that they conspired with the debtor to defraud the creditor by hindering its collections of an outstanding debt in violation of §18-2-22"); *Banco Popular N. Am. v. Gandi*, 876 A.2d 253, 263 (N.J. 2005) ("[A] creditor in New Jersey may bring a claim against one who assists another in executing a fraudulent transfer").

[1946] *Forum Ins. Co. v. Devere Ltd.*, 151 F. Supp. 2d 1145, 1148–50 (C.D. Cal. 2001) ("Plaintiff has no remedy against Defendant, because UFTA provides only equitable remedies solely against transferees, and Defendant is a not a transferee"); *Crystallex Int'l Corp. v. Petroleos De Venezuela, S.A.*, 879 F.3d 79, 89 (3d Cir. 2018) ("Nor can Crystallex succeed on a theory of conspiracy, as the Chancery Court has specifically ruled to the contrary"); *Martinez v. Hutton (In re Harwell)*, *2011 WL 4566443* at *11 (Bankr. M.D. Fla. Sept. 30, 2011) ("The Court will also deny relief to the Trustee under … the … civil conspiracy counts"); *Baker O'Neal Holdings, Inc. v. Ernst & Young LLP*, *2004 WL 771230* at *14 (S.D. Ind. Mar. 24, 2004) ("Accessory liability for fraudulent transfers cannot be supported by … the IUFTA"); *FDIC v. S. Prawer & Co.*, 829 F. Supp. 453, 456 (D. Maine 1993) ("a Bulk Sales Act Claim would not be a tort to which an independent claim for conspiracy could be appended"); *Arena Dev. Group, LLC v. Naegele Commcn's., Inc.*, 2007 WL 2506431 at *5 (D. Minn. Aug. 30, 2007) ("Naegele Jr. can not be held personally liable for … conspiring to commit a violation of the UFTA."); *Cadle Co. v. Woods & Erickson, LLP*, 345 P.3d 1049, 1051 (Nev. 2015) ("Nevada … does not recognize accessory liability for fraudulent transfers"). *In re Rescue Rangers, LLC*, 576 B.R. 521, 530 n. 15 (Bankr. E.D. Va. 2017) ("The Court is also unaware of any authority under Virginia law for a cause of action for conspiring to commit a fraudulent transfer"); 576 B.R. at 531 n.17 ("The Court is reticent to expand the bounds of West Virginia policy by recognizing a civil conspiracy claim for violation of the WVUFTA").

4. **Other Statutes** —

Alaska has none of the UFCA, the UFTA, or the UVTA. But, Alaska courts appear to recognize a claim for conspiracy to commit a fraudulent conveyance.[1947] Similarly, until Kentucky enacted the UVTA in 2016,[1948] that commonwealth had neither the UFCA nor the UFTA. But, Kentucky did not allow creditors to pursue a claim for aiding and abetting a fraudulent conveyance[1949] or for conspiracy to commit such a conveyance.[1950]

[1947] *Summers v. Hagen*, 852 P.2d 1165, 1169 (Alaska 1993) ("Although Summers' position is the majority rule, we find the minority rule better reasoned. It allows one who has been legally harmed to recover damages from the party causing the harm where the existing equitable remedy of voiding the transfer is inadequate") (footnote and citation omitted)**.**

[1948] Ky. Rev. Stat. §378A.005–§378A.140.

[1949] *GATX Corp. v. Addington*, 879 F. Supp. 2d 633, 644 (E.D. Ky. 2012) ("GATX has provided no reason for the Court to deviate from the consistent conclusion of other states that non-transferees may not be liable for aiding and abetting a fraudulent conveyance").

[1950] 879 F. Supp. 2d at 650 (E.D. Ky 2012) ("[A] plaintiff may not circumvent the limitations of the fraudulent conveyance action by bringing a civil conspiracy claim …");

5. **Bankruptcy** —

The rule in the bankruptcy context is as follows:[1951]

[1951] 879 F. Supp. 2d at 644 (E.D. Ky. 2012) (citations omitted). *Accord In re Rescue Rangers, LLC*, 576 B.R. 521, 529 (Bankr. E.D. Va. 2017) ("there being no allegation that any of the Defendants were transferees or somehow benefitted from the transfers, there can be no claim against the Defendants for aiding and abetting the transfers").

> [F]ederal courts have consistently held that there is no such thing as liability for aiding and abetting a fraudulent conveyance as a matter of federal law under Section 548 of the Bankruptcy Code. The plain language of Section 548 indicates that it only reaches recipients of the property in question. To impose secondary liability on those that have not received transferred property would be writing a remedy into a statute by judicial construction, which federal courts have refused to do.

Similarly, a federal bankruptcy court in Maryland held in 2017:[1952]

[1952] *In re Madeoy*, 576 B.R. 484, 497 (Bankr. D. Md. 2017). *Accord Baker O'Neal Holdings, Inc. v. Ernst & Young LLP*, *2004 WL 771230* at *14 (S.D. Ind. Mar. 24, 2004) ("Accessory liability for fraudulent transfers cannot be supported by … the Bankruptcy Code … .").

> Accordingly, the Trustee can recover under §550 from those defendants against whom he has stated a fraudulent transfer claim and no other defendant is legally capable of committing a fraudulent transfer. The court will dismiss Count 1 to the extent it seeks to bring a claim for conspiracy to commit a fraudulent transfer.

Matters are different, though, if a nontransferee actually takes possession of transferred property. For example, a federal bankruptcy court in Florida held an attorney's professional association liable in 2011 as a transferee[1953] under §550 of the Bankruptcy Code.[1954]

[1953] *Martinez v. Hutton (In re Harwell)*, *2011 WL 4566443* at *1 (Bankr. M.D. Fla. Sept. 30, 2011).

[1954] 11 U.S.C. §550.

6. **Other Remedies** —

Creditors will not be content to raise the aiding/abetting and conspiracy theories. Rather, they will make every possible contention to reach debtors' assets.

For example, in a 2007 case,[1955] the Supreme Court of Illinois held that an advance payment retainer paid to an attorney was not reachable by creditors in a collection proceeding against a client.[1956] Furthermore, in 2010, a debtor corporation sued asset-protection attorneys for aiding and abetting and conspiracy to assist the former CEO in stealing $25.5 million from the corporation.[1957] The attorneys were fortunate that the statute of limitations had run.[1958]

[1955] *Dowling v. Chi. Options Assocs.*, 875 N.E.2d 1012 (Ill. 2007).

[1956] 875 N.E.2d at 1026.

[1957] *MarketXT Holdings Corp. v. Engel & Reiman, P.C.*, 693 F. Supp. 2d 387 (S.D.N.Y. 2010).

[1958] 693 F. Supp. 2d 387 at 399.

In *Morganroth & Morganroth v. Norris, McLaughlin & Marcus, P.C.* (2003),[1959] the Third Circuit held that a Michigan law firm could pursue a claim for damages against a New Jersey law firm in connection with the Michigan firm's attempt to enforce a $6 million judgment for counsel fees against John DeLorean. The New Jersey firm allegedly prepared false documents and helped the debtor to conceal assets. The Third Circuit reached this result because it believed that New Jersey law recognized the tort of "creditor fraud" as actionable against third parties, such as DeLorean's lawyers. Although the New Jersey Supreme Court subsequently ruled that no such cause of action exists,[1960] as further discussed below, this case nonetheless illustrates the profound litigation woes that can befall a debtor's counsel who becomes a creditor's target.

[1959] 331 F.3d 406 (3d Cir. 2003). *See* Lischer, *Professional Responsibility Issues Associated With Asset Protection Trusts*, 39 Real Prop., Prob. & Tr. J. 561, 621–22 (Fall 2004).

[1960] *Banco Popular N. Am. v. Gandi,* 876 A.2d 253, 184 (N.J. 2005).

In the *Banco Popular North America v. Gandi* case (2005),[1961] the New Jersey Supreme Court considered a creditor's claims for damages against the debtor's attorney for allegedly participating in a fraudulent transfer and for misrepresenting the debtor's financial condition. The court held that, like every other state but contrary to *Morganroth* above, New Jersey did not recognize the tort of creditor fraud.[1962] Nonetheless, the court refused to dismiss the creditor's claims against the attorney for conspiracy to violate New Jersey's Uniform Fraudulent Transfer Act and for negligently representing the debtor's finances.[1963]

[1961] 876 A.2d 253 (N.J. 2005).

[1962] 876 A.2d at 268.

[1963] 876 A.2d

Practice Tip: A longtime observer noted in 2010 that "[i]n practice, the author of this article has never come across a case involving a debtor's attorney being targeted by the creditor, except for cases when the attorney takes a very pro-active role in concealing or hiding [a] debtor's assets."[1964] Attorneys' potential exposure should be minimal if they always follow a screening procedure (including the preparation of a solvency analysis) to ensure that they are not participating in a fraudulent transfer.

[1964] Stein, *Asset Protection May Risk Fraudulent Transfer Violations*, 37 Est. Plan. 12, 19 (Aug. 2010).

7. **Statutory Protections for Attorneys** —

All of the leading domestic APT statutes[1965] include protections for trustees, advisers, and attorneys who participate in the creation of domestic APTs.

[1965] *See* Alaska Stat. §34.40.110(e); Del. Code Ann. tit. 12, §3572(d)–(e); Nev. Rev. Stat. §166.170(5)–(6); S.D. Codified Laws Ann. §55-16-12–§55-16-13.

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Worksheet 1 State Self-Settled Trust Statutes*

(As of July 2019)

PROHIBITS SETTLOR'S CREDITORS FROM REACHING SETTLOR'S INTEREST IN OR ASSETS OF SELF-SETTLED SPENDTHRIFT TRUST IN CERTAIN CIRCUMSTANCES[1] (19)

State	Citation	Effective Date
Alaska	Alaska Stat. §34.40.110	1997
Delaware	Del. Code Ann. tit. 12, §3570–§3576	1997
Hawaii	Haw. Rev. Stat. §554G-1–§554G-11	2010
Indiana	Ind. Code §30-4-8-1–§30-4-8-1-16	2019
Michigan	Mich. Comp. Laws §700.1041–§700.1050	2017
Mississippi	Miss. Code Ann. §91-9-701–§91-9-723	2014
Missouri	Mo. Ann. Stat. §456.5-505(3)	2005
Nevada	Nev. Rev. Stat. §166.010–§166.180	1999
New Hampshire	N.H. Rev. Stat. Ann. §564-B:5-505A, §564-B:5-505B	2009
Ohio	Ohio Rev. Code Ann. §5816.01–§5816.14	2013
Oklahoma	Okla. Stat. Ann. tit. 31, §10–§18	2005

Rhode Island	R.I. Gen. Laws §18-9.2-1–§18-9.2-7	1999
South Dakota	S.D. Codified Laws Ann. §55-16-1–§55-16-16	2005
Tennessee	Tenn. Code Ann. §35-16-101–§35-16-112	2007
Utah	Utah Code Ann. §25-6-502	2003
Virginia	Va. Code Ann. §64.2-745.1–§64.2-745.2	2012
West Virginia	W. Va. Code §44D-5-503a–§44D-503c	2016
Wyoming	Wyo. Stat. §4-10-510–§4-10-523	2007

PERMITS SETTLOR'S CREDITORS TO REACH SETTLOR'S INTEREST IN SELF-SETTLED SPENDTHRIFT TRUST	
State	**Citation**
Alabama	Ala. Code §19-3B-505(a)(2)
Alaska[2]	Alaska Stat. §34.40.110
Arizona	Ariz. Rev. Stat. Ann. §14-10505(A)(2)
Arkansas	Ark. Code Ann. §28-73-505(a)(2)
California	Cal. Prob. Code §15304
Colorado	Colo. Rev. Stat. §38-10-111
Delaware[2]	Del. Code Ann. tit. 12, §3536(c)
District of Columbia	D.C. Code Ann. §19-1305.05(a)(2)
Florida	Fla. Stat. §736.0505(1)(b)
Georgia	Ga. Code. Ann. §53-12-82(2)
Hawaii[2]	Haw. Rev. Stat. §554G-2
Idaho	Idaho Code §55-905, §15-7-502(4)
Illinois	735 ILCS 5/2-1403
Indiana[2]	Ind. Code Ann. §30-4-3-2(b)
Iowa	Iowa Code Ann. §633A.2303–§633A.2304
Kansas	Kan. Stat. Ann. §58a-505(a)(2)
Kentucky	Ky. Rev. Stat. Ann. §386B.5-040(1)(b)
Louisiana	La. Rev. Stat. Ann §9:2004
Maine	Me. Rev. Stat. Ann. tit. 18-B, §505(1)(B)
Maryland	*Md. Code Ann., Est. & Trusts §14.5-508(a)(2)*
Massachusetts	Mass. Gen. L. ch.203E, §505(a)(2)
Michigan[2]	Mich. Comp. Laws §700.7506(1)(c)
Minnesota	Minn. Stat. §501C.0505(2)
Mississippi[2]	Miss. Code Ann. §91-9-509
Missouri[2]	Mo. Ann. Stat. §456.5-505(3)
Montana	Mont. Code Ann. §72-38-505(1)(b)
Nebraska	Neb. Rev. Stat. §30-3850(a)(2)

[1] For summaries of most of the statutes in this category, see Shaftel, *Eleventh Annual ACTEC Comparison of the Domestic Asset Protection Trust Statutes* (Aug. 2017), www.actec.org/assets/1/6/Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust-Statutes.pdf.

[2] Unless requirements of domestic APT legislation are met.

Nevada[2]	Nev. Rev. Stat. §166.015
New Hampshire[2]	N.H. Rev. Stat. Ann. §564-B:5-505A(a)
New Jersey	N.J. Rev. Stat. §3B:31-39(a)(2), §3B:11-1(a)
New Mexico	N.M. Stat. Ann. §46A-5-505(A)(2)
New York	N.Y. Est. Powers & Trusts Law §7-3.1(a); N.Y. C.P.L.R. §5205(c)(1)
North Carolina	N.C. Gen. Stat. §36C-5-505(a)(2)
North Dakota	N.D. Cent. Code §59-13-05(1)
Ohio[2]	Ohio Rev. Code Ann. §5805.06(A)(2)
Oklahoma[2]	Okla. Stat. Ann. tit. 60, §175.25(H)
Oregon	Or. Rev. Stat. §130.315(1)(b)
Pennsylvania	20 Pa. Cons. Stat. §7745(2)
Rhode Island[2]	R.I. Gen. Laws §18-9.1-1
South Carolina	S.C. Code Ann. §62-7-505(a)(2)
South Dakota[2]	S.D. Codified Laws Ann. §55-1-36
Tennessee[2]	Tenn. Code Ann. §35-15-505(a)(2)
Texas	Tex. Prop. Code Ann. §112.035(d)
Utah [2]	Utah Code Ann. §75-7-505(2)
Vermont	Vt. Stat. Ann. tit. 14A, §505(a)(2)
Virginia[2]	Va. Code Ann. §64.2-747(A)(2)
Washington	Wash. Rev. Code §19.36.020
West Virginia[2]	W. Va. Code §44D-5-505(a)(2)
Wisconsin	Wis. Stat. §701.0505(1)(b)(2)
Wyoming[2]	Wyo. Stat. §4-10-506(b)

PROVIDES THAT SELF-SETTLED SPENDTHRIFT TRUST IS VALID EVEN THOUGH SETTLOR'S CREDITORS MAY REACH SETTLOR'S INTEREST

State	Citation
California	Cal. Prob. Code §15304(a)
Mississippi	Miss. Code Ann. §91-9-509

PROVIDES THAT SELF-SETTLED TRUST IS VOID AS TO CREDITOR CLAIMS

State	Citation
Idaho	Idaho Code §55-905
New York	N.Y. Est. Powers & Trusts Law §7-3.1(a); N.Y. C.P.L.R. §5205(c)(1)
Washington	Wash. Rev. Code §19.36.020

HAS NO RELEVANT STATUTE

Connecticut	

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Worksheet 2 Protects Settlor's Retained Contingent Interest in Lifetime Marital Deduction and Other Trusts*

(As of July 1, 2019)

State	Citation	Year
Arizona	Ariz. Rev. Stat. §14-10505(E)	2009
Arkansas	Ark. Code Ann. §28-73-505(c)(1)	2015
Delaware	Del. Code Ann. tit. 12, §3536(c)(4), §3536(e)	2009
Florida	Fla. Stat. §736.0505(3)	2010
Georgia	Ga. Code Ann. §53-12-82(b)	2018
Kentucky	Ky. Rev. Stat. Ann. §386B.5-020(8)	2014
Maryland	*Md. Code Ann., Est. & Trusts §14.5-1003(a)(2)*	2015
Michigan	Mich. Comp. Laws §700.7506(b)	2010
New Hampshire	N.H. Rev. Stat. Ann. §564-B:5-505A(e)(3)–§564-B:5-505A(e)(4)	2014
North Carolina	N.C. Gen. Stat. §36C-5-505(c)(1)	2011
Oregon	Or. Rev. Stat. §130.315(4)	2013
South Carolina	S.C. Code Ann. §62-7-505(b)(2)	2014
Tennessee	Tenn. Code Ann. §35-15-505(d)	2010
Texas	Tex. Prop. Code Ann. §112.035(g)–§112.035(h)	2013
Virginia	Va. Code Ann. §64.2-747(B)(3)	2012
Wyoming	Wyo. Stat. Ann. §4-10-506(f)	2011

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Worksheet 3 State Fraudulent-Transfer Statutes*

(As of July 1, 2019)

Follows Uniform Fraudulent Conveyance Act	
State	**Citation**
Maryland	Md. Code Ann., Com. Law §15-201–§15-214

Follows Uniform Fraudulent Transfer Act	
State	**Citation**
Alabama[1]	Ala. Code §8-9B-1–§8-9B-15
Arizona	Ariz. Rev. Stat. §44-1001–§44-1010
Arkansas[2]	Ark. Code Ann. §4-59-201–§4-59-215
California[1]	Cal. Civ. Code §3439–§3439.14
Colorado	Colo. Rev. Stat. §38-8-101–§38-8-112
Connecticut	Conn. Gen. Stat. §52-552a–§52-552l
Delaware	Del. Code Ann. tit. 6, §1301–§1311
District of Columbia	D.C. Code Ann. §28-3101–§28-3111
Florida	Fla. Stat. §726.101–§726.112, §726.201
Georgia[1]	Ga. Code Ann. §18-2-70–§18-2-85
Hawaii	Haw. Rev. Stat. §651C-1–§651C-10
Idaho[1]	Idaho Code §55-910–§55-922
Illinois	740 ILCS 160/1–160/12
Indiana[2]	Ind. Code Ann. §32-18-2-1–§32-18-2-23
Iowa[1]	Iowa Code Ann. §684.1–§684.12
Kansas	Kan. Stat. Ann. §33-201–§33-212
Kentucky[1]	Ky. Rev. Stat. Ann. §378A.005–§378A.140
Maine	Me. Rev. Stat. Ann. tit. 14, §3571–§3582
Massachusetts	Mass. Gen. L. ch. 109A, §1–§12
Michigan[1]	Mich. Comp. Laws §566.31–§566.45
Minnesota[1]	Minn. Stat. §513.41–§513.51
Mississippi	Miss. Code Ann. §15-3-101–§15-3-121
Missouri	Mo. Ann. Stat. §428.005–§428.059
Montana	Mont. Code Ann. §31-2-326–§31-2-342
Nebraska[1]	2019 Neb. Laws L.B. 70, §1–§15
Nevada	Nev. Rev. Stat. §112.140–§112.250
New Hampshire	N.H. Rev. Stat. Ann. §545-A:1–§545-A:12
New Jersey	N.J. Rev. Stat. §25:2-20–§25:2-33
New Mexico[1]	N.M. Stat. Ann. §56-10-14–§56-10-29
New York[2]	N.Y. Debt. & Cred. Law §270–§281
North Carolina[1]	N.C. Gen. Stat. §39-23.1–§39-23.12
North Dakota[1]	N.D. Cent. Code §13-02.1-01–§13-02.1-13
Ohio	Ohio Rev. Code Ann. §1336.01–§1336.11
Oklahoma	Okla. Stat. Ann. tit. 24, §112–§123
Oregon	Or. Rev. Stat. §95.200–§95.310
Pennsylvania[1]	12 Pa. Cons. Stat. §5101–§5114
Rhode Island[1]	R.I. Gen. Laws §6-16-1–§6-16-17

South Dakota	S.D. Codified Laws §54-8A-1–§54-8A-12
Tennessee	Tenn. Code Ann. §66-3-101, §66-3-301–§66-3-313

[1] Has enacted Uniform Voidable Transactions Act amendments.

[2] Has enacted Uniform Voidable Transactions Act amendments and has addressed or acknowledged issue in UVTA comments regarding domestic APTs.

Texas	Tex. Bus. & Com. Code Ann. §24.001–§24.013
Utah[1]	Utah Code Ann. §25-6-101–§25-6-502
Vermont[1]	Vt. Stat. Ann. tit. 9, §2285–§2299
Washington[1]	Wash. Rev. Code §19.40.011–§19.40.905
West Virginia[1]	W. Va. Code §40-1A-1–§40-1A-15
Wisconsin	Wis. Stat. §242.01–§242.11
Wyoming	Wyo. Stat. §34-14-201–§34-14-212

Other	
State	**Citation**
Alaska	Alaska Stat. §34.40.010, §34.40.090
Louisiana	La. Civ. Code Ann. §2036–§2044
South Carolina	S.C. Code Ann. §27-23-10–§27-23-90
Virginia	Va. Code Ann. §55.1-400–§55.1-414

[1] Has enacted Uniform Voidable Transactions Act amendments.

[2] Has enacted Uniform Voidable Transactions Act amendments and has addressed or acknowledged issue in UVTA comments regarding domestic APTs.

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Working Papers

Worksheet 4 A Practitioner-Friendly Guide to the Delaware Asset-Protection Trust*

(As of July 1, 2019)

Since July 9, 1997, when Governor Thomas R. Carper signed Delaware's Qualified Dispositions in Trust Act (“Delaware Act”), Delaware and non-Delaware residents have been using the Delaware Act to save taxes, to protect assets, and to accomplish other purposes summarized below. This paper highlights key features of this kind of trust.

BACKGROUND

Under the common-law rule against self-settled trusts, an individual traditionally could not create a self-settled trust (i.e., an irrevocable trust from which he or she could benefit) and protect trust assets from claims by his or her creditors. So, if a client created an irrevocable trust and gave the trustee discretion to use the income and principal for the client and his or her spouse and children, the client's creditors could reach all trust assets, even if the trust had a spendthrift clause.

As American society became increasingly litigious, interest developed in a trust in which the person creating the trust could retain some potential benefits that could not be reached by his or her creditors. Until 1997, this interest was satisfied only by a trust, often called an “asset-protection trust” (“APT”), created in a foreign jurisdiction.

The Delaware Act (Del. Code Ann. tit. 12, §3570–§3576) gave birth to the Delaware APT. Besides Delaware, the states that now have some form of APT law are Alaska, Connecticut, Hawaii, Indiana, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming. New Delaware APTs are signed regularly.

The Delaware APT is not for every client. Instead, it is an option to consider along with other techniques for shielding assets (e.g., liability insurance, incorporation, tenancy-by-the-entireties property, homestead exemption, retirement plans, and IRAs).

BENEFITS OF DELAWARE APTS

A trust that is structured as a Delaware APT may provide several benefits, including:

Save Taxes

Employ Tax Benefits: A client might be reluctant to give away assets to use part or all of his or her $11.4 million gift-tax exemption (as well as a deceased spouse's unused exemption) for fear that he or she will need the funds in later life. Although the tax treatment is less certain than for an outright gift or a gift to a third-party trust, the client should consider using a Delaware APT for these tax benefits because he or she may be a discretionary beneficiary of the trust and could get assets back in an emergency.

Reduce Federal Transfer Tax: A client will save federal transfer tax if he or she makes a gift that incurs gift tax, if he or she lives at least three years after making the gift, and if his or her estate must pay estate tax. If a client makes the gift through a Delaware APT, he or she might be able to get funds back from the trust if needed.

Avoid State Death Tax: If your client's state of residence imposes an estate or inheritance tax, he or she might be able to reduce that tax by making a gift before death. If the client makes the gift to a Delaware APT, he or she potentially could get funds back in the event of need.

Assure Favorable Tax Treatment for Grantor Trusts: A client's payment of income taxes attributable to a grantor trust is not a taxable gift, and inclusion in a grantor trust of a provision that gives the trustee discretion to reimburse the client for such taxes will not cause the trust to be included in the client's gross estate, provided that, as is true under the Delaware Act, the client's creditors may not reach trust assets by reason of the inclusion of that discretion (Rev. Rul. 2004-64).

Save State Income Tax: A client might try to use a type of Delaware APT commonly known as a “Delaware Incomplete Nongrantor Trust” (“DING Trust”) to eliminate income tax on undistributed ordinary income and capital gains of a trust imposed by a state that has not adopted the federal grantor-trust rules (i.e., Pennsylvania). Also, the IRS has ruled several times that APTs may be nongrantor trusts if they are structured so that distributions to the grantor are controlled by adverse parties (see, e.g., PLR 201510001). Consequently, your client might be able to escape state tax on undistributed ordinary income and capital gains of a trust imposed by one of the 43 states that follow the federal grantor-trust rules. As a nongrantor trust for state tax purposes, the client's home state may not tax the trust due to a lack of contacts with the trust and Delaware would not impose a tax on income accumulated for non-Delaware beneficiaries. In later years, your client possibly could receive tax-free distributions of the untaxed income.

This option is not available in New York.

Obtain Asset Protection

General: Through success in business, savvy investing, or the receipt of a gift, inheritance, or personal-injury award, your client might own substantial assets outright. He or she could fund a Delaware APT with some of those assets to get protection from future creditor claims and business reverses.

Protect Young Adults' Assets: A client should encourage his or her children to put assets that they receive (or may withdraw from a trust) at majority in a Delaware APT. Although the children may receive distributions from the trust, they will not have the unlimited ability to squander them.

Provide Pre-Marital Planning: Because Delaware APTs are immune from claims by future spouses, a client's children may use them to shield assets from those claims without providing the financial disclosure that is required to implement effective pre-nuptial agreements.

Protect Vulnerable Persons: If your client is mentally, physically, or financially vulnerable, he or she should consider using a Delaware APT to protect assets.

Protect Estate Planning Vehicles

Several common estate-planning vehicles (e.g., CRTs, GRATs, and QPRTs) are self-settled trusts and therefore are vulnerable to creditor claims. In fact, two courts have included the debtor's interest in a CRT in the bankruptcy estate[1] and two other courts have included the debtor's interest in a QPRT in the bankruptcy estate.[2] The Delaware Act extends protection to these arrangements.

[1] *In re Brown*, 303 F.3d 1261 (11th Cir. 2002); *In re Mack*, 269 Bankr. 392 (Bankr. D. Minn. 2001).

[2] *In re Ferrante*, No. CC-14-1222, CC-14-1223, 2015 BL 276690, *2015 WL 5064087* (B.A.P. 9th Cir. Aug. 26, 2015); *In re Earle*, 307 Bankr. 276 (Bankr. S.D. Ala. 2002).

Provide Options for NRAs

If your client is a “nonresident alien” (“NRA”), he or she should consider a Delaware APT for two purposes. First, a Delaware APT is a viable estate-planning and asset-protection option for an NRA, whether or not he or she has family members in this country. Second, if your client is considering immigrating to the United States, he or she might want to create a Delaware APT to take advantage of the favorable tax treatment afforded lifetime gifts by NRAs prior to immigration and to keep the ability to get funds back if needed.

Provide Protection for Existing Trusts

If your client has created a self-settled trust in a state where it does not have protection from creditors, he or she should explore moving it to Delaware. Similarly, for a number of reasons, a client might want to relocate a foreign APT to Delaware.

HOW TO CREATE A DELAWARE APT

To create a Delaware APT,[3] a client must establish an irrevocable trust that contains a spendthrift clause, designates Delaware law to govern the trust, and appoints at least one “qualified trustee.” A “qualified trustee” is an individual who lives in Delaware (except the client) or a Delaware trust company that performs certain duties. The trust may have non-Delaware cotrustees and Delaware or non-Delaware advisers.

[3] *See* Del. Code Ann. tit. 12, §3570(8), §3570(11), §3571.

The Delaware Act specifically permits a client to have the power to:

1. consent to or direct investment changes;
2. veto distributions;
3. replace trustees or advisers; and/or
4. reacquire trust assets in a nonfiduciary capacity.

The Delaware Act also expressly authorizes the client to have one or more of the following:

1. the ability to receive income or principal pursuant to broad discretion or a standard;
2. the right to receive current income distributions;
3. an interest in a CRT, a GRAT, or a QPRT;
4. up to a 5% interest in a total-return unitrust;
5. a lifetime or testamentary power to appoint the principal in the trust to or for anyone except the client, the client's estate, the client's creditors, or the creditors of the client's estate;
6. the ability to be reimbursed for income taxes attributable to the trust on a mandatory or discretionary basis;
7. the power to provide for the payment of taxes, debts, and expenses payable at the client's death; or
8. the option to serve as designated representative for other beneficiaries.

Under the Delaware Act, any “understanding” that your client will receive money whenever he or she asks is void.

A Delaware APT may be funded with tenancy-by-the-entireties property without destroying protection from each spouse's separate creditors.

DRAFTING ISSUES

Unauthorized Provisions

Because not specifically permitted by the Delaware Act, a Delaware APT should not:

1. appoint the client as trustee or cotrustee;
2. provide that the client will get trust assets back at a certain age or after a certain amount of time;
3. authorize the trustee, adviser, protector, or committee to terminate the trust; or
4. authorize the trustee to reimburse the client for gift taxes.

Unwise Provisions

Although permitted by the Delaware Act, a Delaware APT should not, in certain circumstances:

1. appoint a cotrustee in the state where the client lives or works; or
2. give the client the power to replace the trustee.

FUNDING ISSUES

General

The client should fund a Delaware APT with assets that he or she never expects to need. A rule-of-thumb for avoiding a fraudulent transfer (see below) is to fund a Delaware APT with no more than one-third to one-half of your client's surplus assets that are not already exempt from creditor claims after he or she performs an analysis of existing and foreseeable assets and liabilities.

Intangible Property

The best assets to put in a Delaware APT are cash, stocks, and bonds.

FLP-LLC Interests

Interests in a family limited partnership (FLP) or limited liability company (LLC) are good assets to put in a Delaware APT, provided that your client is not the general partner or the manager and that the entity does not own real estate outside Delaware.

Non-Delaware Real Estate

The client should not put real estate outside Delaware in a Delaware APT because it will give non-Delaware courts jurisdiction over the trust and a basis for applying non-Delaware law. Putting non-Delaware real estate in an FLP or LLC and funding the trust with interests in that entity might help, but this strategy failed in a case involving an Alaska APT.[4]

[4] *In re Huber*, 493 B.R. 798 (Bankr. W.D. Wash. 2013).

Custody

To prevent a non-Delaware court from having jurisdiction, the qualified trustee should have custody of all assets of a Delaware APT.

FEDERAL TAX CONSEQUENCES

Income Tax

A Delaware APT usually will be a grantor trust for federal income-tax purposes, which means that the client—not the trust—must pay all income taxes on interest and dividends that the trustee receives and on capital gains that the trust incurs (§677). The IRS has ruled several times, though, that such a trust is a nongrantor trust, which means that the trustee—not the client—must pay all such income taxes, if distributions to the client are controlled by adverse parties (e.g., children who will receive assets that are not distributed to the client) (see, e.g., PLR 201925005–PLR 201925010).

Gift and Estate Taxes

If the trust gives the trustee or someone else discretion to distribute trust funds to your client and if your client retains lifetime and testamentary nongeneral powers of appointment and a power to veto distributions, he or she will not make a taxable gift when he or she creates a Delaware APT (see, e.g., PLR 201925005–PLR 201925010). However, if a client does not keep those powers, he or she probably will make a taxable gift when he or she creates a Delaware APT (see CCA 201208026) and the trust probably will not be included in the gross estate.

Generation-Skipping Transfer Tax

If the creation of a Delaware APT is a completed gift and if the trust is not includable in the gross estate, a client may allocate GST exemption at the creation of the trust.

DISTRIBUTION ISSUES

General

As mentioned above, your client should fund a Delaware APT with assets that he or she doesn't expect to need. If the Delaware APT gives the trustee discretion to use income or principal for the client, a Delaware corporate trustee will process requests for distributions in accordance with its usual procedures. For the trust to work, the client must give up control. So, he or she should request discretionary distributions rarely, if ever, and should not expect to use the trust as a checking account or to get money whenever he or she asks. If the client prefers, he or she may retain the right to receive regular income or unitrust distributions along with the ability to receive principal distributions on a discretionary basis.

Income Taxes

A Delaware APT typically will be a grantor trust for federal income-tax purposes so that your client will have to pay income taxes on trust income and capital gains that he or she does not actually receive. The client should keep enough money to pay those taxes and should not ask the trustee every April to exercise its discretion to give the client money to cover them. Nevertheless, unless a client's trust says otherwise, the trustee has discretion to reimburse your client for such taxes. Alternatively, the trust may direct the trustee to pay (or reimburse the client for) those taxes.

MOVING TRUSTS TO DELAWARE

The Delaware Act[5] provides for the move to Delaware of self-settled trusts created in other states or abroad, and the time that the trust existed before it is moved counts toward the four-year period (see below) during which a creditor may pursue a claim against the trust. Thus, your client might be able to move an existing self-settled trust to Delaware that cannot be defeated under the Delaware Act.

[5] *See* Del. Code Ann. tit. 12, §3570(10), §3570(11), §3572(c), §3575.

AVOID FRAUDULENT TRANSFER

If a client makes a transfer, whether he or she gives money to children, establishes an FLP, or creates a Delaware APT, and does not keep enough assets to pay existing and foreseeable creditors, your client has made a fraudulent transfer and the transfer may be undone. So, your client is a good candidate for a Delaware APT if he or she has surplus assets after performing a realistic assessment of existing and foreseeable assets and liabilities. Conversely, your client is a bad candidate for such a trust if he or she has—or is about to incur—a large obligation and wants to hide assets to avoid paying it. Nevertheless, if your client must meet a specific debt or claim, he or she may consider a Delaware APT for assets that aren't needed to satisfy that obligation. The Delaware Court of Chancery has held that creditors' efforts to set aside transfers to Delaware APTs as fraudulent transfers were time-barred.[6]

[6] *See TrustCo Bank v. Mathews*, No. 8374-VCP, *2015 BL 15306*, 2015 WL 295373 (Del. Ch. Jan. 22, 2015).

To ensure that your client doesn't make a fraudulent transfer when establishing a Delaware APT, the qualified trustee probably will require him or her to provide background information and to complete a solvency letter.

WHO MAY DEFEAT A DELAWARE APT

The Delaware Act[7] bars original actions and actions to enforce judgments, including judgments entered outside Delaware, and it requires a creditor to bring an action against a Delaware APT in the Delaware Court of Chancery.

[7] *See* Del. Code Ann. tit. 12, §3572–§3573.

Under the Supremacy Clause of the U.S. Constitution, certain supercreditors, such as the IRS, the SEC, the FTC, and minor children seeking support, may reach the assets of vehicles (e.g., tenancy-by-the-entireties property and domestic APTs) otherwise shielded from creditors by state law. Under the Delaware Act, the following four categories of creditors may reach the assets of a Delaware APT:

Pre-Transfer Claims

If a creditor's claim arises before your client transfers assets to a Delaware APT, that creditor must bring suit within four years of the transfer or, if later, within one year after the creditor discovers (or should have discovered) the transfer. The creditor also must prove by clear and convincing evidence that the transfer was a fraudulent transfer.

Post-Transfer Claims

If a creditor's claim arises after your client transfers assets to a Delaware APT, that creditor must bring suit within four years of the transfer and must prove by clear and convincing evidence that the transfer was a fraudulent transfer as to that creditor.

Family Claims

A spouse, former spouse, or minor child who has a claim resulting from an agreement or court order for alimony, child support, or property division incident to a judicial proceeding with respect to a separation or divorce may reach the assets of your client's Delaware APT at any time, but a spouse whom the client marries after creating the trust may not take advantage of this exception. A surviving spouse probably will not be able to reach the assets of a Delaware APT by electing against the Will.

Tort Claims

A person who suffers death, personal injury, or property damage before the client establishes a Delaware APT for which your client is liable may reach trust assets.

CONSEQUENCES IF A DELAWARE APT IS DEFEATED

If a creditor proves that one of the above exceptions applies, your client's Delaware APT will be defeated only to the extent necessary to pay that creditor's claim and related costs, including attorneys' fees.[8] Thus, each creditor must bring a separate action against the trustee. Unless a creditor proves that the trustee acted in bad faith, that trustee may use trust assets to pay its costs of litigating the claim before satisfying the claim. A beneficiary (including your client) who received a distribution before a creditor brings a successful suit to defeat a Delaware APT may keep the distribution unless the creditor proves that the beneficiary acted in bad faith. The Delaware Act protects trustees, attorneys, and other advisers who work on a Delaware APT.

[8] *See* Del. Code Ann. tit. 12, §3574.

INFRASTRUCTURE

An important factor in evaluating the effectiveness of Delaware APTs is that Delaware has a long-standing tradition of leadership in the trust industry. The original Delaware Act was written and enacted over a three-month period in 1997, and amendments have been drafted and enacted in short order. As noted above, the Delaware Court of Chancery has held that creditors' claims that transfers to Delaware APTs were fraudulent transfers were barred by laches.[9] In other situations, that court has upheld Delaware statutes in difficult cases, such as those that might arise if creditors were to challenge a Delaware APT.

[9] *See TrustCo Bank v. Mathews*, No. 8374-VCP, *2015 BL 15306*, 2015 WL 295373 (Del. Ch. Jan. 22, 2015).

DEFENDING DELAWARE APTS

If your client lives in one of the 19 states that allow APTs or if he or she is an NRA, creditors should not be able to reach the assets of his or her Delaware APT except in the situations mentioned above. If your client lives in a state that does not recognize APTs, a Delaware APT should afford the same protection, but this cannot be guaranteed because issues under the U.S. Constitution might come into play. The danger is that a court in a state that doesn't recognize APTs might decide that its law—not Delaware law—applies and order the trustee to pay a creditor, even if the claim is not one that is recognized under the Delaware Act.

There are several reasons why your client's trust should stand even if he or she is not a Delaware resident or an NRA. They include:

1. a judgment against a client is not binding on the trustee of the client's valid trust;

2. a non-Delaware court may not enter a judgment that binds the trustee of a Delaware APT if the court does not have jurisdiction over trust assets or a trustee;

3. a non-Delaware court should defer to Delaware courts on issues that involve a Delaware trust;

4. a non-Delaware court should apply Delaware law — not the court's own law — on questions involving a Delaware APT;

5. Delaware may set deadlines for the enforcement of judgments from other states;

6. Delaware courts might not have to recognize (i.e., give full faith and credit to) judgments that non-Delaware courts enter against a trust; and

7. creditors should not be able to reach a Delaware APT if your client ends up in bankruptcy.

CONCLUSION

No court has yet considered how effectively a Delaware APT protects assets, so the Delaware APT is not yet fail-safe. But, a properly designed and implemented Delaware APT will raise formidable obstacles for creditors. The Delaware APT also offers planning options, outside of creditor protection, that might be of great benefit to your clients.

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Worksheet 5 Client Letter Summarizing Delaware Asset-Protection Trusts*

(As of July 1, 2019)

Note: This document is not designed or intended to provide financial, tax, legal, accounting, or other professional advice because such advice always requires consideration of individual circumstances. If professional advice is needed, the services of a professional advisor should be sought. This document is for informational purposes only; it is not intended as a recommendation, offer, or solicitation with respect to the purchase or sale of any security.

__________, 2019

Re: **The Delaware Asset-Protection Trust**

Dear __________:

On July 9, 1997, Governor Thomas R. Carper signed Delaware's Qualified Dispositions in Trust Act ("Delaware Act"). Wilmington Trust Company ("WTC") clients, including non-Delaware residents, use the Delaware Act to save taxes, to protect assets, and to achieve other purposes summarized below. This letter highlights key features of this kind of Delaware trust.

Background

Traditionally, an individual could not create a self-settled trust (i.e., an irrevocable trust from which he or she could benefit) and protect trust assets from claims by his or her creditors. So, if you created an irrevocable trust and gave the trustee discretion to use the income and principal for you, your spouse, and your children, your creditors could reach all trust assets. As American society became increasingly litigious, interest developed in a trust, often called an "asset-protection trust" ("APT"), in which the person creating the trust could retain some potential benefits that could not be reached by his or her creditors.

The Delaware Act gave birth to the Delaware APT. New trusts are signed regularly, but the Delaware APT is not for everyone. It should be viewed as an option to consider along with other techniques for protecting assets.

Benefits of Delaware APTs

There are several viable uses for Delaware APTs, including:

Save Taxes

Employ Tax Benefits: You might be reluctant to give away assets to use part or all of your $11.4 million exemptions from the federal gift tax and the federal generation-skipping transfer tax (“GST exemption”) for fear that you will need the funds later in life. Although the tax treatment is less certain, you should consider using a Delaware APT for these tax benefits because you might be able to get assets back in an emergency.

Reduce State Death Tax: If your state has an estate or inheritance tax, you might be able to lower that tax by making a gift before death. If you make the gift to a Delaware APT, you potentially could get funds back in the event of need.

Save State Income Tax: If you are willing to subject distributions to yourself to the control of adverse parties, you might be able to eliminate tax on undistributed ordinary income and capital gains of a trust imposed by one of the 43 states that follow the federal grantor-trust rules because the IRS has ruled several times that APTs structured in this way may be nongrantor trusts. You possibly could receive tax-free distributions of the untaxed income in later years. This option is not available if you live in New York.

Obtain Asset Protection

General: If you own substantial assets outright, you could fund a Delaware APT with some of them to get protection from future creditor claims and business reverses.

Protect Officers and Directors: If you are a corporate officer or director, your activities are receiving increased scrutiny. With this in mind, you should consider shielding some of your assets through a Delaware APT.

Protect Estate-Planning Vehicles: Several common estate-planning vehicles are self-settled trusts and therefore are vulnerable to creditor claims. These include charitable-remainder trusts (“CRTs”), grantor-retained annuity trusts (“GRATs”), and qualified personal-residence trusts (“QPRTs”). The Delaware Act extends protection to these arrangements.

Protect Estate Planning Vehicles: Several common estate planning vehicles are self-settled trusts and therefore are vulnerable to creditor claims. These include charitable remainder trusts (CRTs), grantor retained annuity trusts (GRATs), and qualified personal residence trusts (QPRTs). The Delaware Act extends protection to these arrangements.

Provide Options for NRAs

If you are a nonresident alien of the United States (“NRA”), you should consider a Delaware APT for two reasons. First, a Delaware APT is a viable estate-planning and asset-protection option for an NRA, whether or not you have family members in this country. Second, if you are considering immigrating to the United States, you might want to create a Delaware APT beforehand to take advantage of the favorable tax treatment afforded lifetime gifts and to keep the ability to get funds back if you have need of them.

Provide Protection for Existing Trusts

If you have created a foreign APT or a self-settled trust in a state where it does not have protection from creditors, you should explore moving it to Delaware.

How to Create a Delaware APT

To create a Delaware APT, you must establish an irrevocable trust that contains a spendthrift clause, provides that Delaware law governs the trust, and appoints at least one “Delaware trustee.” A “Delaware trustee” is an individual who lives in Delaware (except you) or a Delaware trust company that performs certain duties. The trust may have non-Delaware cotrustees and Delaware or non-Delaware advisers.

The Delaware Act specifically permits you to have the power to:

1. consent to or direct investment changes;

2. veto distributions;

3. replace trustees or advisers; and/or

4. reaquire trust assets in a nonfiduciary capacity.

The Delaware Act also expressly authorizes you to have one or more of the following:

1. the ability to receive income or principal pursuant to broad discretion or a standard;

2. the right to receive current income distributions;

3. an interest in a CRT or a QPRT;

4. up to a 5% interest in a total-return unitrust or a GRAT;

5. a power, which you may exercise during your lifetime or at your death, to appoint trust property to or for anyone except yourself, your estate, your creditors, or the creditors of your estate;

6. the ability to be reimbursed for income taxes attributable to the trust on a mandatory or discretionary basis;

7. the ability to provide for the payment of death taxes, debts, and expenses after your death; or

8. the option to serve as designated representative for other beneficiaries.

Under the Delaware Act, any “understanding” that you will receive money whenever you ask is void.

Drafting Issues

Unauthorized Provisions

Because not specifically permitted by the Delaware Act, your Delaware APT should not:

1. appoint you trustee or cotrustee;

2. provide that you will get trust assets back at a certain age or after a certain amount of time;

3. authorize the trustee, adviser, protector, or committee to terminate the trust; or

4. authorize the trustee to reimburse you for gift taxes.

Unwise Provisions

Although permitted by the Delaware Act, your Delaware APT should not, in certain circumstances:

1. appoint a cotrustee in the state where you live or work; or

2. give you the power to replace the trustee.

Funding Issues

General

You should fund your Delaware APT with assets that you never expect to need. Generally, you should fund your Delaware APT with no more than one-third to one-half of your surplus assets that are not already exempt from creditor claims after you perform an analysis of your existing and foreseeable assets and liabilities. (See “Avoid Fraudulent Transfer” below.)

Intangible Property

The best assets to put in your Delaware APT are cash, stocks, and bonds.

FLP-LLC Interests

Interests in a family limited partnership (“FLP”) or a limited-liability company (“LLC”) are good assets to put in your Delaware APT, provided that you are not the general partner or the manager and that the entity does not own real estate outside Delaware.

Non-Delaware Real Estate

For legal reasons, you should not put real estate outside Delaware in your Delaware APT. Putting the non-Delaware real estate in an FLP or LLC might help, but this strategy has not been validated.

Custody

To prevent a non-Delaware court from having jurisdiction, WTC should have custody of all assets of your Delaware APT.

Distribution Issues

General

For the trust to work, you must give up control. So, you should request discretionary distributions of income or principal rarely, if ever, and you should not expect to use the trust as a checking account or to get money whenever you ask. If you like, you may keep the right to get regular income or unitrust distributions along with the ability to get principal on a discretionary basis.

Income Taxes

If your Delaware APT is a grantor trust, you will have to pay income taxes on the trust's income and capital gains even though you don't get them. You should keep enough money to pay those taxes and should not ask the trustee for money every April to pay them. Alternatively, your trust may direct the trustee to pay (or reimburse you for) those taxes.

Federal Tax Consequences

Income Tax

Your Delaware APT usually will be a grantor trust for federal income-tax purposes, which means that you—not the trust—must pay all income taxes on interest and dividends that the trustee receives and on capital gains that the trust incurs. As just noted, your trust may direct the trustee to pay (or reimburse you for) those taxes.

Transfer Taxes

If your trust gives your trustee or someone else discretion to distribute trust funds to you and if you retain lifetime and testamentary powers of appointment and a power to veto distributions, you will not make a taxable gift when you create your Delaware APT. However, if you do not keep those powers, you probably will make a taxable gift when you create your Delaware APT and the trust probably will not be included in your gross estate. If the creation of your Delaware APT is a completed gift and if the trust is not includable in your gross estate, you may allocate GST exemption at the creation of your trust.

Moving Trusts to Delaware

The Delaware Act provides for the move to Delaware of self-settled trusts created in other states or abroad, and the time that the trust existed before it is moved counts toward the four-year period during which a creditor may pursue a claim against the trust.

Avoid Fraudulent Transfer

If you make a transfer, whether you give money to your children, establish a family partnership, or create a Delaware APT, and do not keep enough assets to pay your existing and foreseeable creditors, you have made a fraudulent transfer and the transfer may be undone. To ensure that you don't make a fraudulent transfer when you establish a Delaware APT, WTC will require you to provide background information and to complete a solvency letter.

Who May Defeat a Delaware APT

Under the U.S. Constitution, certain supercreditors, such as the IRS, the SEC, the FTC, and minor children seeking support, may reach the assets of any APT. Under the Delaware Act, the following four categories of creditors may reach the assets of your Delaware APT.

Pre-Transfer Claims

If a creditor's claim arises before you transfer assets to a Delaware APT, that creditor must bring suit within four years of the transfer or, if later, within one year after the creditor discovers (or should have discovered) the transfer. The creditor also must prove that the transfer was a fraudulent transfer.

Post-Transfer Claims

If a creditor's claim arises after you transfer assets to a Delaware APT, that creditor must bring suit within four years after the transfer and must prove that the transfer was a fraudulent transfer as to that creditor.

Family Claims

A spouse, former spouse, or minor child who has a claim resulting from an agreement or court order for alimony, child support, or property division may reach the assets of your Delaware APT, but a spouse whom you marry after you create your trust may not take advantage of this exception.

Tort Claims

A person who suffers death, personal injury, or property damage for which you are liable before you establish a Delaware APT may reach trust assets.

Defending Delaware APTs

If you live in one of the 19 states that allow APTs or if you are an NRA, your creditors should not be able to reach the assets of your Delaware APT except in the situations mentioned above. If you live in a state that does not recognize APTs, your Delaware APT should afford the same protection, but this cannot be guaranteed because issues under the U.S. Constitution might come into play. The danger is that a court outside Delaware might apply its law—not Delaware law—and order your trustee to pay a creditor, even if the claim is not one that is recognized under the Delaware Act. There are several reasons why your trust should stand in these circumstances.

Conclusion

No court has yet considered how effectively a Delaware APT protects assets, so the Delaware APT is not yet fail-safe. But, a properly designed and implemented Delaware APT will raise formidable obstacles for creditors. The Delaware APT also offers planning options that might be of great benefit to you and your family.

I will be happy to discuss the Delaware APT option with you.

Sincerely,

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Worksheet 6 Solvency Letter*

(As of July 1, 2019)

Note: Some domestic asset protection trust (APT) jurisdictions require a sworn affidavit of solvency and/or that the affidavit contain certain very precise representations. Check the relevant domestic APT statute for further details. This document is not designed or intended to provide financial, tax, legal, accounting, or other professional advice because such advice always requires consideration of individual circumstances. If professional advice is needed, the services of a professional advisor should be sought. This document is for informational purposes only; it is not intended as a recommendation, offer, or solicitation with respect to the purchase or sale of any security.

To:	Wilmington Trust Company, Trustee
From:	[Trustor Full Name]
Re:	The [Trustor Full Name] Irrevocable Trust Agreement, dated [Date of Execution] (“Trust”)
Date:	[Date of Execution]

This letter is written to you in connection with my creation of the Trust, which Trust I have signed (as Trustor) concurrent with the execution of this letter and which Trust I (as Trustor) will fund (i.e., transfer property to) subsequent to the execution of this letter.

I am aware that I will ***not*** receive funds from the Trust upon request and that I may receive funds from the Trust only in accordance with your internal procedure for processing discretionary payment requests.

I am aware that, under certain circumstances, assets held in the Trust may not be reached by my personal creditors. But, I understand that, under existing Delaware law,[1] a personal creditor of mine could reach assets held in the Trust if the creditor could prove that my transfer of assets to the Trust was a fraudulent transfer. I also understand that no assurance can be given that Delaware law would apply to the determination as to whether a transfer of assets to the Trust is a fraudulent transfer. Accordingly, I acknowledge that I have, to the extent I deem advisable, had the opportunity to consult with counsel in Delaware and in other states, including my state of residence, regarding the laws pertaining to fraudulent transfers in those states

[1] Under Delaware law, a transfer is fraudulent if: (i) made by the debtor with actual intent to hinder, delay, or defraud a creditor; (ii) the debtor engages in a business or transaction for which his or her assets remaining thereafter are unreasonably small in relation to the business or transaction; or (iii) the debtor intended or should have known that he or she would incur debts beyond his or her ability to pay when due. *See* Del. Code. Ann. tit. 6, §1304(a). The fraudulent-transfer laws of other states may be more or less restrictive.

You have not advised me in any manner with respect to the fraudulent-transfer laws, or law of similar import, in any state.

I have no intent to hinder, delay, or defraud any creditor of mine in connection with the transfer of assets to the Trust or otherwise.

I am not now engaged in, nor do I have any intent or plan to engage in, any business or transaction for which my assets remaining after the completion of my intended transfer of assets to the Trust would be unreasonably small in relation to the business or transaction.

I do not intend to incur, nor do I have any belief or reason to believe that I will incur, debts beyond my ability to pay when due.

Except for those matters, if any, that are disclosed on attached *Exhibit A*, I am not presently involved in, nor am I aware of, any pending or threatened litigation in which any person is directly or indirectly seeking damages against me. Except for those matters, if any, that are disclosed on the attached *Exhibit A*, I am not involved in any administrative proceeding under the jurisdiction of a federal, state, or municipal government as of this date.

Upon the completion of my intended transfer of assets to the Trust, I will ***not*** have made a transfer to the Trust of substantially all of my assets.

Except for those matters, if any, that are disclosed on attached *Exhibit B*, to the best of my knowledge, I am not liable for, or indebted to, any person who suffered death, personal injury, or property damage on or before the date upon which I create and fund the Trust, whose death, personal injury, or property damage may be determined at any time to have been caused, in whole or in part, either by my act or omission or by the act or omission of another person for whom I am vicariously liable.

Except for those matters, if any, that are disclosed on attached *Exhibit C*, I am not presently in arrears on account of any agreement or court order for the payment of support or alimony in favor of a former spouse or my children, nor have I failed to comply with any agreement or court order providing for the division of property in favor of a former spouse.

I have no intent to abscond.

No part of my intent in creating the Trust is to conceal assets.

I am not currently insolvent, nor have I incurred debts I am unable to pay when due. I do not currently contemplate filing for relief under the provisions of the United States Bankruptcy Code, nor am I involved in any situation that I reasonably anticipate would cause me to file for relief thereunder in the future.

Following the completion of my intended transfer of assets to the Trust, I will remain solvent and the value of my assets will substantially exceed my debts. To the best of my knowledge, I will remain able to pay my debts as they come due.

When I state that my assets will exceed my debts, I am referring to all of my assets, ***except*** the following: (1) the value of any valid liens against my assets; (2) my assets that are generally exempt under non-bankruptcy law; and (3) any tenancy-by-the entirety asset that is subject to process by a creditor holding a claim against both tenants.

I am not about to incur substantial debt, nor have I already incurred a substantial debt in relation to the value of my assets.

I have full right, title, and authority to make the intended transfer of assets to the Trust. None of the assets that I intend to transfer to the Trust have been pledged or otherwise promised in satisfaction of any debt, and none of those assets are subject to any lien, encumbrance, or security interest of any type.

The assets intended to be transferred to the Trust were not derived from unlawful activities.

Whenever, in this letter, I refer to my “creditors” or my “debts” I mean to include both my direct creditors and direct debts and those creditors to whom, and those debts for which, I am, or may be, jointly and severally liable or indirectly liable such as, for example, those creditors to whom, and debts for which, I am, or may be, liable on account of my status as a general partner in a partnership or guarantor of the debt of another.

I intend that each person now or hereafter serving as Trustee or Adviser under the Trust may rely upon this letter in agreeing to act as a fiduciary of the Trust. You, along with any other Trustee of the Trust, may rely upon it for any purpose including assisting in any defense in any legal proceeding that may be brought against you in your corporate or fiduciary capacity.

Very truly yours,

____

[Trustor Full Name]

STATE OF _________________________)

COUNTY OF _______________________)

The foregoing instrument was acknowledged before me this __________ day of _________, 20____, by [Trustor Full Name].

____

Notary Public

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Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Working Papers

Worksheet 7 Delaware Asset Protection Trust Form*

Caution: This trust form is only meant to be a sample. It is not appropriate for all cases and therefore it should not be used unless it has been thoroughly reviewed and approved by competent asset protection trust (APT) counsel for use in connection with a specific case. This form has been drafted with Delaware in mind and may be inappropriate for use in other domestic APT jurisdictions. Many qualified APT attorneys have their own APT forms, which are designed for use in connection with other documents being prepared by that attorney. This form may not be compatible with such other documents. This document is not designed or intended to provide financial, tax, legal, accounting, or other professional advice because such advice always requires consideration of individual circumstances. If professional advice is needed, the services of a professional advisor should be sought. This document is for informational purposes only; it is not intended as a recommendation, offer, or solicitation with respect to the purchase or sale of any security.

SAMPLE IRREVOCABLE TRUST AGREEMENT

Not Intended to be Completed Gift

(As of July 1, 2019)

THIS AGREEMENT, made this _________ day of ____________________, 20____, between *SETTLOR'S NAME*, of _ ______________ County, State of __________, hereafter called “Trustor,” and WILMINGTON TRUST COMPANY, a Delaware trust company, hereafter called “Trustee,” WITNESSETH:

WHEREAS, Trustor desires to establish a trust of the property described in the attached “Schedule A” and other property which may be added from time to time, all of which is hereafter called the “trust fund;” and

WHEREAS, Trustee accepts such trust and agrees to administer it in accordance with the terms and conditions of this agreement;

NOW, THEREFORE, Trustor hereby gives Trustee the property described in “Schedule A,” in trust, for the following purposes:

SECTION 1: DISTRIBUTION.

A. *During Trustor's Lifetime*. During Trustor's lifetime, Trustee may, from time to time and subject to Subsection F of this

Section 1, distribute to [Trustor, Trustor's husband/wife], and Trustor's issue all, some, or none, of the net income and/or principal in such amounts and proportions (whether equally or unequally, and even to the exclusion of one or more beneficiaries) as Trustee, in its sole discretion, deems appropriate after taking account of all other sources of funds available to them. Trustee shall accumulate any net income not so distributed and add it to principal at least annually, to be disposed of as a part of it. No such distribution shall be deemed to be an advancement.

B. *On Trustor's Death*. On Trustor's death, Trustee shall distribute the trust fund to such person or persons, other than Trustor, Trustor's creditors, Trustor's estate, and the creditors of Trustor's estate, in such manner and amounts, and on such terms, whether in trust or otherwise, as Trustor effectively appoints by specific reference hereto in [*his/her*] Will. However, Trustor may, from time to time, release this nongeneral special power of appointment, in whole or in part, by a written instrument delivered to Trustee during Trustor's lifetime.

On Trustor's death, if [Trustor's *husband/wife*] survives [*him/her*], Trustee shall set aside, as the “Marital Trust,” so much of the trust fund, to the extent not effectively appointed, that is includable in Trustor's gross estate for federal estate tax purposes.

The remainder of the trust fund not set aside as the Marital Trust, or all of the trust fund if Trustor's [*husband/wife*] predeceases Trustor, or if none of the trust fund is includable in Trustor's gross estate for federal estate tax purposes, shall be set aside as the “Residuary Trust.”

C. *Marital Trust*.

(1) *During Trustor's [Husband's/Wife's] Lifetime*. Commencing with Trustor's date of death, Trustee shall distribute the net income of the Marital Trust to [Trustor's *husband/wife*] at least annually for life and as much principal as [*he/she*] requests in writing at any time or times.

In addition, Trustee may, from time to time, distribute so much, or all, of the principal to [Trustor's *husband/wife*], as Trustee deems appropriate to provide for [*his/her*] benefit. Trustee may, but need not, take into account other sources of funds available to [*him/her*].

(2) *On the Death of [Trustor's Husband/Wife].* On the death of [Trustor's *husband/wife*], Trustee shall distribute the principal, free from this trust, to such person or persons, including [Trustor's *husband's/wife's*] estate, in such manner and amounts, and on such terms, whether in trust or otherwise, as [Trustor's *husband/wife*] effectively appoints by specific reference hereto in the last written instrument which [*he/she*] executes and delivers to Trustee during [*his/her*] lifetime, or, failing any such instrument, in [*his/her*] Will.

On the death of Trustor's *husband/wife*, Trustee shall distribute the balance of the principal, to the extent not effectively appointed, to the Trustee of the Residuary Trust, to be added to its principal and disposed of as though it had been a part of it immediately before the death of Trustor's *husband/wife*.

D. *Residuary Trust.*

(1) *During [Trustor's Husband's/Wife's] Lifetime*. Commencing with Trustor's date of death, Trustee shall distribute the net income of the Residuary Trust to [Trustor's *husband/wife*] at least annually for life.

In addition, Trustee may, from time to time, distribute so much, or all, of the principal to [Trustor's *husband/wife*] and Trustor's issue, as Trustee deems appropriate to provide for their health, maintenance, education, and/or support, provided that no such distribution or application of principal shall be made out of the Residuary Trust for the benefit of [Trustor's *husband/wife*] at any time when such distribution could be made from the Marital Trust. Trustee shall take into account other sources of funds available to them. No such distribution shall be deemed to be an advancement.

(2) *On the Death of the Survivor of Trustor and [Trustor's Husband/Wife].* On the death of [Trustor's *husband/wife*], if [*he/she*] survives Trustor, Trustee shall distribute the principal, free from this trust, to such of Trustor's issue, in such manner and amounts, and on such terms, whether in trust or otherwise, as [Trustor's *husband/wife*] effectively appoints by specific reference hereto in the last written instrument which [*he/she*] executes and delivers to Trustee during [*his/her*] lifetime, or, failing any such instrument, in [*his/her*] Will. Before [Trustor's *husband/wife*] exercises this nongeneral power of appointment, [*he/she*] should consider Section 2041(a)(3) of the Code and 25 Delaware Code Sections 501–505, as amended, or any corresponding Delaware statutes enacted after the date of this agreement.

On the death of the survivor of Trustor and [Trustor's *husband/wife*], Trustee shall divide the principal then held in trust hereunder, to the extent not effectively appointed, into shares for Trustor's then living issue, per stirpes.

(3) *Shares Held for Children*. Trustee shall hold each living child's share in further trust and distribute the net income to the child for life.

In addition, Trustee may, from time to time, distribute so much, or all, of the principal of a child's share to the child, as Trustee deems appropriate to provide for the child's health, maintenance, education, and/or support. Trustee may, but need not, take into account other sources of funds available to the child.

On the death of the child, Trustee shall distribute so much of the child's share as is then held hereunder, free from this trust, to such person or persons, including the child's estate, in such manner and amounts, and on such terms, whether in trust or otherwise, as effectively appointed by specific reference hereto in the last written instrument which the child executes and delivers to Trustee during his or her lifetime or, failing any such instrument, in his or her Will.

On the death of the child, Trustee shall distribute the balance of the share, to the extent not effectively appointed, free from trust, to the child's then living issue, per stirpes, but if no such issue is then living, then to Trustor's then living issue, per stirpes. However, any principal distributable to an issue of Trustor for whose benefit a share of the Residuary Trust is then held in trust under the provisions of this agreement shall instead be distributed to the Trustee of such share, to be added to its principal and disposed of as a part of it.

(4) *Shares for Remote Issue.* Trustee shall distribute each share set aside (at the time previously provided for dividing the Residuary Trust into shares) for an issue of Trustor more remote than a child of Trustor to such issue, free from trust.

E. *Failure of Beneficiaries*. If, at any time, Trustee holds any portion of the principal of any trust not disposed of effectively under the previous provisions, then, at such time, Trustee shall distribute such principal, free from trust, to such then living person or persons as are then determined to be Trustor's distributees by the application of the intestacy laws of the State of Delaware governing the distribution of intestate personal property then in effect, as though Trustor had died at that particular time, intestate, a resident of the State of Delaware and owning such property then so distributable.

F. *Trustor's Veto Power*. Trustee shall exercise its discretionary power to distribute income and/or principal to any beneficiary other than Trustor pursuant to Subsection A of this Section 1 only with the written consent of Trustor.

If, at any time, Trustor fails to express in writing to Trustee consent or disapproval as to the exercise of any discretionary power within ten (10) calendar days after Trustee has sent a written request for such consent to Trustor's last known address by certified mail (or by any other means for which the sender shall have evidence of receipt by the addressee), Trustee may act in the matter as it deems appropriate.

In exercising the veto power conferred on [*him/her*] by this Subsection, Trustor shall not be required to act in a fiduciary capacity and shall have no duty to inquire into or see to the performance by Trustee of its duties under this agreement.

Trustor shall receive no compensation and shall not be reimbursed for expenses incurred for services performed under this Subsection.

SECTION 2: MINORITY OR OTHER INCAPACITY.

If any property is otherwise required to be distributed to a beneficiary who has not attained age twenty-five (25) or is, in Trustee's opinion, unable to manage funds due to illness or infirmity, Trustee may:

A. Distribute such property to such beneficiary himself or herself; or

B. Apply such property for the benefit of such beneficiary; or

C. Hold the property not so distributed or applied in a separate trust hereunder for the benefit of such beneficiary, and distribute or apply the net income and principal thereof as provided in Subsections A and B hereof.

Trustee shall distribute the property in such trust to the beneficiary upon his or her attaining age twenty-five (25) or upon the termination of his or her incapacity (as the case may be). If the beneficiary dies prior to such distribution, Trustee shall distribute the property to the beneficiary's estate.

Notwithstanding the foregoing, income (including income attributable to property held pursuant to this Section) which is required to be distributed to a beneficiary in order to qualify a trust hereunder for the marital deduction under Section 2056 of the Code, or for any other tax deduction, exemption, or credit, shall be distributed to such beneficiary or any guardian of such beneficiary's property if requested in writing by such beneficiary or guardian.

SECTION 3: MERGER WITH SIMILAR TRUSTS.

If, at any time, a trust is set aside for any person or persons under the terms of this agreement which is substantially the same as any other trust established for that person or persons by Trustor or [Trustor's *husband/wife*], Trustee may, in its sole discretion, merge the trust created hereunder with the other trust for such person or persons, and the two trusts shall thereafter be held, administered, and distributed as one.

SECTION 4: *ALTERNATIVE METHODS OF DISTRIBUTION.*

Trustee may take any reasonable steps to disburse funds to or for a beneficiary, including: (i) distribution, either by hand or mail, to the beneficiary or the guardian of the person or property (whether the guardian is formally appointed or a natural guardian), (ii) distribution to a custodian for the beneficiary under the Uniform Transfers to Minors Act (or similar statute) of any state, (iii) deposit to the account of the beneficiary in any federally insured depository, (iv) direct application for the benefit of the beneficiary, or (v) distribution to a new or existing trust for the beneficiary.

SECTION 5: SPENDTHRIFT PROVISION.

No beneficiary (including Trustor) may alienate or in any other manner, whether voluntary or involuntary, assign, transfer, pledge, or mortgage his or her interest in any trust hereunder, and no one (including a spouse or former spouse) may attach or otherwise reach any interest of any beneficiary hereunder to satisfy a claim against that beneficiary, whether the claim is legal or equitable in origin. The provisions of this Section shall not limit or otherwise affect any power of appointment conferred upon a beneficiary or the right of a beneficiary to disclaim or release any interest created hereunder. This Section constitutes a restriction on the transfer of Trustor's beneficial interest in the trust fund that is enforceable under applicable non-bankruptcy law within the meaning of Section 541(c)(2) of the Bankruptcy Code (11 USC §541(c)(2)) or any other similar or successor statute.

SECTION 6: PAYMENT OF DEATH TAXES, DEBTS, AND EXPENSES OF ADMINISTRATION.

A. *Death of a Beneficiary (Including Trustor).* On the death of the beneficiary of any trust created hereunder (including Trustor), if the principal of such trust is included in the estate of the beneficiary for transfer tax purposes, Trustee shall, unless otherwise directed by the beneficiary's Will, distribute from such trust to the Personal Representative of the beneficiary's estate an amount equal to the sum of all additional transfer taxes and costs of administration payable by such Personal Representative as a result of the inclusion of the trust in the beneficiary's estate. Certification of such Personal Representative as to the amount of such additional taxes and costs will be determinative for all purposes.

Trustee shall make such distributions directly to the appropriate payee if so directed by such Personal Representative.

B. *Generation-Skipping Transfer Tax*. Trustee shall pay any tax imposed under Chapter 13 of the Code as a result of a “taxable termination” attributable to any trust created hereunder from the principal of such trust, charging such payments ratably against the property in respect of which such termination occurred.

SECTION 7: TRUSTEE'S POWERS.

In addition to those powers granted by law, Trustee is specifically authorized and empowered, in its sole discretion, but subject to the provisions of Section 8:

A. To sell at public or private sale, exchange for like or unlike property, convey, lease for terms longer or shorter than the trust, and otherwise dispose of any or all property held hereunder, for such price and upon such terms and credits as it deems proper.

B. To invest in any kind of property, real, personal, or mixed, regardless of the laws governing investments by fiduciaries, without any duty to diversify investments.

C. Unless otherwise directed by the investment adviser named in Section 8 hereof, to execute securities transactions without necessity of providing written confirmation thereof to such adviser at the time of settlement, and to execute securities transactions through any brokerage service, whether discount or full service, including M&T Securities Brokerage Services at its normal rates of compensation, without diminution of compensation otherwise payable to Trustee, even if Wilmington Trust Company is serving as Trustee.

D. To vote directly or by proxy at any election or stockholders' meeting any shares of stock, including stock of M&T Bank Corporation, even in Wilmington Trust Company is serving as Trustee.

E. To participate in any plan or proceeding, including any voting trust plan for liquidating, protecting, or enforcing any interest in any property, or for reorganizing, consolidating, merging, or adjusting the finances of any corporation issuing any such interest; to accept in lieu thereof any new or substituted stocks, bonds, notes, or securities, whether of the same or a different kind or class, or with different priorities, rights, or privileges; to pay any assessment or any expense incident thereto; and to do any other act or thing that it deems necessary or advisable in connection therewith.

F. To deposit, or arrange for the deposit of, securities at Depository Trust Company (DTC) and/or at any other securities depository or clearing corporation.

G. To make any division or distribution in cash or in kind, or partly in cash and partly in kind; to make reasonable valuations of the property so divided or distributed, consistent with the provisions for allocating property to the Marital Trust; and to elect to recognize taxable gain or loss resulting from a distribution. Trustee may consider the income tax basis of the property then available for division or distribution, as well as the circumstances of the beneficiaries, and need not make division or distribution on a pro rata, asset-by-asset basis. Trustee shall not adjust the interest of any beneficiary as a result of any action taken or forborne under the provisions of this Subsection G.

H. To make loans, against adequate collateral, to any person including the Personal Representative of the estate of Trustor or any beneficiary and/or to purchase any property at its then fair market value from any person including such Personal Representative.

I. To borrow money, extend loans, pledge assets, and provide guarantees for any purpose connected with the protection, preservation, or improvement of the trust estate whenever in its judgment advisable, and as security to pledge any real or personal property forming a part of the trust estate upon such terms and conditions as it may deem advisable.

J. To bring or defend litigation, participate in arbitration or mediation, compromise or settle any claim in favor of or against any trust hereunder, and to execute all agreements, deeds, and releases necessary or proper in connection therewith. However, Trustee need not institute or defend any suit or proceeding unless its expenses, including counsel fees and costs, are available in the trust fund or are advanced or guaranteed in an amount and in a manner reasonably satisfactory to it. Trustee shall incur no liability to anyone for any action taken or not taken pursuant to the preceding sentence.

K. To retain attorneys-at-law, accountants, investment counsel, agents, and other advisers and to pay all compensation and other costs associated therewith from the trust without diminution of compensation otherwise payable to Trustee.

L. To pay the taxes and expenses of maintaining, repairing, improving, and insuring any real property held hereunder.

M. Except as otherwise provided, to determine whether receipts and disbursements, including its commissions, are allocable or chargeable to income or principal. This power shall only be exercised in a manner consistent with the right of [Trustor's *husband/wife*] to receive all the net income of the Marital Trust under applicable state law.

N. To receipt for the proceeds of any life insurance made payable to Trustee, to institute any suit or proceeding, and to take any action necessary to collect such proceeds. However, Trustee need not institute any suit or proceeding unless its expenses, including counsel fees and costs, are available in the trust fund or are advanced or guaranteed in an amount and in a manner reasonably satisfactory to it.

O. To renounce, in whole or in part, any property or interest in property which may become payable to any trust hereunder, except to the extent that the distribution of such property resulting from such renunciation is fundamentally inconsistent with the provisions of this agreement.

P. To divide any trust hereunder into separate trusts if the purposes for which the trust was created are better served thereby.

Q. To take such actions as are necessary to cause gains from the sale or exchange of trust assets (as determined for federal income-tax purposes) to be taxed for federal income-tax purposes as part of a distribution of principal to a beneficiary.

R. To invest in any closely held company, limited-liability company, or partnership, or in any successor entity, and to purchase additional interests in any such entity, even though, as a result, such trust is invested largely or entirely in such entity.

S. To settle its accounts judicially or nonjudicially at any time and from time to time and to pay all of its counsel, accountant, or other professional fees and costs associated therewith from the trust without diminution of compensation otherwise payable to Trustee.

T. To invest in, retain, or otherwise deal in any securities managed, issued, underwritten, or distributed by Trustee or by any of its affiliates, any participation in any investment company registered under the Investment Company Act of 1940, any investment fund exempt from registration under the Investment Company Act of 1940, for which Trustee or its affiliates is an adviser or agent, and any other “affiliated investment” within the meaning of 12 Delaware Code Section 3312, as amended, or any corresponding Delaware statute enacted after the date of this agreement, and is authorized to otherwise deal with or transact business with any of its affiliates, notwithstanding the fact that such trustee or affiliate may receive separate fees, commissions, or other costs directly from such security, fund, “affiliated investment,” dealing, or transaction.

SECTION 8: INVESTMENT ADVISER.

During any period in which an investment adviser is serving and notwithstanding any other provision hereunder, the investment adviser Trustee shall:

A. To settle its accounts judicially or nonjudicially at any time and from time to time and to pay all of its counsel, accountant, or other professional fees and costs associated therewith from the trust without diminution of compensation otherwise payable to Trustee.A. Serve in a fiduciary capacity and hold and exercise the full powers to manage the investments of the Trust. Trustee shall exercise such powers only upon the investment adviser's written directions and shall be required to exercise such powers if so directed, including, but not limited to, all investment powers granted under Subsections (2) through (5), and Subsections (7) through (14) of 12 Delaware Code Section 3325, as amended, or any corresponding Delaware statute enacted after the date of this agreement, all powers described as an “investment decision” in 12 Delaware Code Section 3313(d), as amended, or any corresponding Delaware statute enacted after the date of this agreement, and all the powers in Subsections A, B, D, E, I, Q, and S of Section 6 with respect to each trust hereunder; provided that: (i) Trustee shall sell any M&T Bank Corporation stock held by it hereunder unless specifically directed to do otherwise by such adviser; (ii) the purchase, sale, and voting of M&T Bank Corporation stock shall be solely on the direction of the investment adviser; (iii) Trustee shall manage and invest the otherwise uninvested cash in each such trust in its sole discretion; and (iv) notwithstanding the foregoing, during an emergency or based upon exigent circumstances, where the Trustee reasonably believes based upon its actual knowledge that its inaction would be “wilful misconduct” within the meaning of 12 Delaware Code Section 3313(b), as amended, or any corresponding Delaware statute enacted after the date of this agreement, then the Trustee is hereby authorized and empowered to take such action regarding the investment management of such trust as it, in its sole discretion, shall deem to be for the best interest of the beneficiaries of such trust. The power set forth in (iv) above is solely intended to give the Trustee the ability to act should such action become essential to the trust fund, but does not impose a duty upon the Trustee to monitor or warn an interested party concerning the investments of the trust fund nor does this power create a duty of the Trustee to take such action.

B. The initial investment adviser shall be [*Name of Adviser*]. The investment adviser may resign as investment adviser of any trust hereunder by written notice delivered to the Trustee and the adult beneficiaries who may then receive income or principal. Until Trustor's death, a majority of the Trustor's then living issue who have attained age twenty-five (25) may remove the investment adviser and a successor investment adviser may be a person, if any, chosen from time to time by a majority of Trustor's then living issue who have attained age twenty-five (25) as shall be able to act. After Trustor's death, the investment adviser of each trust hereunder shall be the beneficiary for whom the trust was set aside, provided that he or she has attained age twenty-five (25). If such beneficiary has not attained age twenty-five (25) or is unwilling or unable to serve, the investment adviser of such trust shall be the person, if any, chosen from time to time by a majority of Trustor's then living issue who have attained age twenty-five (25) as shall be able to act, until such beneficiary attains age twenty-five (25) or is no longer unwilling or unable to act, at which time such beneficiary shall become the investment adviser of such trust. To qualify, any person appointed investment adviser of a trust hereunder shall deliver a written instrument to Trustee indicating acceptance and agreement that all powers conferred upon such adviser will be exercised in a fiduciary capacity for the exclusive interest of the beneficiaries.

C. With regard to trust assets over which the investment adviser holds the power to direct Trustee and in addition to the investment adviser's other duties herein, the investment adviser shall have the duty (i) to confirm to Trustee, in writing, the value of trust assets, whether publicly traded or nonpublicly traded assets, at least annually and upon request by Trustee, (ii) to direct Trustee with respect to making any representation, warranty, or covenant required to be made in order to maintain any investment, (iii) to direct and instruct Trustee on future actions, if any, to be taken with respect to such representations, warrantees, and covenants, (iv) to manage or participate in the management of any entity owned by the trust, to the extent such entity's governing instruments or applicable law require the owners to manage the same, and (v) to direct Trustee to sign agreements and any other documentation required in connection with the purchase of any investment and the maintenance of any such investment. With regard to the investment adviser's exercise of the foregoing powers, all such directions to the Trustee shall be in writing, delivered in such manner as the Trustee may specify from time to time by written notice to investment adviser. Further, the Trustee shall have no obligation to investigate or confirm the authenticity of directions it receives or the authority of the person or persons conveying them, and the Trustee shall be exonerated from any and all liability in relying on any such direction from a person purporting to be the investment adviser without further inquiry by the Trustee. Notwithstanding the foregoing, Trustee has no duty to monitor whether the investment adviser is abiding by its duty to provide valuation of publicly traded or nonpublicly traded assets and shall not be liable for failing to request a valuation or for the investment adviser's failure to give Trustee a valuation.

D. Whenever, pursuant to the terms of this Agreement, Trustee acts at the direction of any investment adviser regarding the exercise of the Trustee's powers as to any particular matter, or whenever Trustee takes no action except at the direction of any investment adviser, then notwithstanding any other provision hereunder, (i) as provided in 12 Delaware Code Section 3313(b), as amended, or any corresponding Delaware statute enacted after the date of this agreement, Trustee shall not be liable for any loss resulting from such acts or inaction except in cases of wilful misconduct proven by clear and convincing evidence, and (ii) to the extent any such action or inaction concerns a matter outside the scope of 12 Delaware Code Section 3313(b), as amended, or any corresponding Delaware statute enacted after the date of this agreement, in accordance with 12 Delaware Code Section 3303, as amended, or any corresponding Delaware statute enacted after the date of this agreement, Trustee shall have no liability hereunder except for Trustee's own wilful misconduct proven by clear and convincing evidence. Trustee shall be under no obligation to review the trust assets, make any investment recommendations with respect to trust assets, solicit any direction from the investment adviser, value the assets if they are nonpublicly traded, or insure trust assets. As provided in 12 Delaware Code Section 3313(e), as amended, or any corresponding Delaware statute enacted after the date of this agreement, Trustee shall have no duty to monitor the conduct of the investment adviser, provide advice to the investment adviser, consult with the investment adviser, or communicate with or warn or apprise any beneficiary or third party concerning instances in which Trustee would or might have exercised Trustee's own discretion in a manner different from the manner directed by the investment adviser.

E. The investment adviser may direct the Trustee to employ the professional services of accountants, investment management professionals, attorneys, tax advisers, and such other advisers (“Agent”) as the investment adviser determines necessary to fulfill the duties of managing the investments of the trust. The investment adviser shall be solely responsible for the oversight, supervision, and monitoring of such Agent and shall notify the Trustee in writing of the employment of such Agent. The Trustee shall have no obligation to investigate or confirm the authenticity of directions it receives or the authority of the Agent conveying any such directions, and the Trustee shall be exonerated from any and all liability in relying on any such direction from a person purporting to be an Agent of the investment adviser without further inquiry by the Trustee until such time as the Trustee is notified in writing of the termination of such Agent's employment. The fees associated with the retention of an Agent by the investment adviser shall not diminish the compensation otherwise payable to Trustee.

F. The investment adviser need not inquire into Trustee's performance of its duties and shall not be held liable for any loss whatsoever to any trust hereunder, unless it results from actions taken in bad faith. The investment adviser shall serve without compensation but may be reimbursed for out of pocket expenses, including investment counsel fees.

SECTION 9: ADDITIONS TO THE TRUST FUND.

With the consent of Trustee, any person may add property to any trust hereunder, and such property shall thereafter be held by Trustee as a part thereof.

SECTION 10: IRREVOCABILITY.

This trust shall be irrevocable and not subject to amendment by Trustor or any other person. However, Trustee is authorized to modify or amend the provisions of this agreement to ensure that this agreement is a trust instrument under the Act. Trustee may rely upon the advice of counsel in taking any action pursuant to the authority given to Trustee, and Trustee shall be without liability therefor.

SECTION 11: PAYMENT OF INCOME.

Except where otherwise provided, the payment of the net income of any trust hereunder shall be made at such times as are convenient to the beneficiary and agreed to by Trustee.

SECTION 12: NON-ACCRUAL OF INCOME.

Except with respect to the Marital Trust, any statute or rule of law to the contrary notwithstanding, any income accrued or on hand and not actually distributed to a beneficiary upon the termination of his or her interest shall be treated as though it had, in fact, accrued thereafter.

Any income accrued upon shares of stock or interest-bearing property when delivered to Trustee shall be treated as though such income had, in fact, accrued after such delivery.

SECTION 13: THIRD PARTIES NOT OBLIGED TO FOLLOW FUNDS.

No person or corporation dealing with Trustee shall be obliged to see to the application of money paid or property delivered to Trustee, to inquire into the propriety of Trustee's exercising its powers, or to determine the existence of any fact upon which Trustee's power to perform any act hereunder may be conditioned.

SECTION 14: TRUSTEE'S COMPENSATION.

Unless otherwise agreed upon in writing between Trustee and Trustor (or, after Trustor's death or incapacity, by the investment adviser, or, if none, by a majority of the current beneficiaries of any trust created under this trust agreement who are over the age of twenty-five (25) years), Trustee shall receive compensation for its services hereunder from time to time in accordance with the current rates then charged by it for trusts of similar size and character. If Trustee renders any extraordinary services, it may receive additional compensation therefor.

SECTION 15: RESIGNATION AND REMOVAL OF TRUSTEE.

At any time during the remainder of Trustor's life, Trustee may resign by written notice delivered to Trustor, and [*Person Not Trustor*] may remove Trustee by written notice delivered to it. In either case, [*Person Not Trustor*] may appoint another bank or trust company, that is described in Section 3570 of the Act, as successor Trustee by written notice delivered to Trustee.

During Trustor's lifetime, Trustee shall be deemed to have resigned on the date on which: (i) it ceases to be a Trustee described in Section 3570 of the Act; or (ii) a court takes any action whereby such court declines to apply Delaware law in determining the validity, construction, or administration of any trust hereunder or of the effect of the spendthrift provision hereunder in any action brought against Trustee.

Unless objections are filed as provided below, Trustee shall deliver any assets held hereunder to the successor Trustee. If [*Person Not Trustor*] does not appoint such a successor Trustee, Trustee may petition the Delaware Court of Chancery to appoint such a successor Trustee.

After Trustor's death, Trustee may resign as Trustee of a trust hereunder by written notice delivered to the beneficiary for whom the trust was set aside, and Trustee may be removed by written notice delivered to Trustee signed by such beneficiary, provided that he or she has attained age thirty (30). In either case, another bank or trust company shall be appointed successor Trustee by written notice signed by such beneficiary, provided that he or she has attained age twenty-one (21).

Unless objections are filed as provided below, Trustee shall deliver the assets held in such trust to the successor Trustee. If such beneficiary does not appoint such a successor Trustee, Trustee may petition the Delaware Court of Chancery to appoint such a successor Trustee.

Upon resignation or removal, Trustee shall, within ninety (90) days after it resigns or is removed, deliver a statement of its activities to the date of such resignation or removal for which it has not reported to the person to whom Trustee was directed to give notice of resignation or who was authorized to remove Trustee. Such person shall have sixty (60) days from receipt of such statement to file with Trustee any objections to its actions as Trustee. If no such objections are filed, Trustee shall be without any further liability or responsibility to any past, present, or future beneficiaries.

No successor Trustee shall be required to examine into the acts of its predecessor Trustee, and each successor Trustee shall have responsibility only with respect to the property actually delivered to it by its predecessor Trustee.

Notwithstanding the foregoing provisions of this Section, Trustee may, but shall not be required to, prepare and file accountings for a trust hereunder with the Delaware Court of Chancery. Further, prior to delivering all the property of a trust hereunder to a successor trustee or to making any partial or complete distribution of the trust estate, Trustee may require an approval of the trust's accounting either by a release and discharge by the beneficiary or beneficiaries of the trust or by the Delaware Court of Chancery. All of Trustee's fees and expenses (including reasonable counsel, accountant, or other professionals fees) attributable to any accounting and/or approval shall be paid by the trust.

SECTION 16: MERGER OF CORPORATE TRUSTEE.

Any corporation resulting from any merger, conversion, reorganization, or consolidation to which any corporation acting as Trustee hereunder shall be a party, or any corporation to which shall be transferred all or substantially all of any such corporation's trust business, shall be the successor of such corporation as Trustee hereunder, without the execution or filing of any instrument or the performance of any further act and shall have the same powers, authorities, and discretions as though originally named in this agreement; provided, however, that in the case of any corporation that is acting as a Trustee hereunder, the provisions of this Section shall apply only if the resulting or transferee corporation is domiciled in the same jurisdiction as the corporation that was acting as Trustee.

SECTION 17: SIMULTANEOUS DEATH.

If Trustor and [Trustor's *husband/wife*] die under circumstances where the order of deaths cannot be determined, and if any of the principal is includable in Trustor's estate for transfer tax purposes, then for the purposes of this agreement with respect to such principal, [Trustor's *husband/wife*] shall be deemed to have survived Trustor and died immediately thereafter.

SECTION 18: TRUST SITUS.

This agreement creates a Delaware trust, and all matters pertaining to the validity, construction, and application of this agreement; to the administration of the trusts created by it; and to the effectiveness of restraints on alienation of beneficiaries' interests hereunder shall be governed by Delaware law. The Delaware Court of Chancery shall have exclusive jurisdiction over any action brought with respect to any trust hereunder.

SECTION 19: ADOPTED PERSONS AND PERSONS BORN OUT OF WEDLOCK.

For all purposes of this agreement, with regard to adopted persons, only a person adopted while under age twenty-one (21) shall be deemed to be a child and an issue of the adopting person and an issue of the ascendants of the adopting person, and, furthermore, the children and issue of the person so adopted shall be deemed to be issue of the adopting person and his or her ascendants. A person born out of wedlock shall not be deemed to be a child or an issue of his or her parent or an issue of the ascendants of his or her parent unless such child is acknowledged in writing by such parent.

SECTION 20: DEEMED INCAPACITY OF TRUSTOR, TRUSTEE, OR ADVISER.

An individual Trustor, Trustee, or adviser shall be deemed to be incapacitated: (i) during any period that such individual is legally incompetent as determined by a court of competent jurisdiction; (ii) during any period that a conservator or guardian for such individual has been appointed, based upon his or her incapacity; (iii) during any period when two (2) physicians licensed to practice medicine certify in writing to Trustee (if Trustor's capacity is at issue), to Trustor or the adviser (if a Trustee's capacity is at issue), or to Trustor and Trustee (if an adviser's capacity is at issue), that in the opinion of such physicians, such individual, as a result of illness, age, or other cause, no longer has the capacity to act prudently or effectively in financial affairs; or (iv) thirty (30) days after Trustee or any trust beneficiary requests such Trustor, Trustee, or adviser, as applicable, to provide a certificate from a physician licensed to practice medicine that, in the opinion of such physician, such individual has the capacity to act prudently or effectively in financial affairs if such Trustor, Trustee, or adviser, as applicable, fails to provide such certification within such period.

SECTION 21: ILLIQUID ASSETS.

To the extent that any of the creditors of Trustor, or any other beneficiary of a trust hereunder, asserts a claim that it is entitled, through the exercise of the judicial process or otherwise, to reach the assets of the trust in satisfaction of its claim, Trustee shall have no obligation to defend the trust or its assets against any such claim or to initiate or intervene in any litigation, arbitration proceeding, or mediation proceeding for the purpose of resisting any such claim, unless Trustee is reasonably satisfied that it will be fully indemnified from the assets of the trust for all of its liabilities and expenses (including professional fees and expenses of counsel, accountants, and expert witnesses) arising from or attributable to Trustee's participation therein. If Trustee reasonably determines that the readily marketable assets of the trust are, or have become, insufficient for such purposes, Trustee may request that the Trustor or beneficiary provide Trustee with comparable indemnity, supported with such security as may be satisfactory to Trustee in its sole discretion, and in the absence of such additional indemnity or security, Trustee may refuse to participate in any such proceeding or may withdraw from an ongoing proceeding, even if such refusal or withdrawal may result in the granting or awarding of relief against the trust (including a distribution of trust assets in satisfaction of a claim). Trustee shall incur no liability to anyone whomsoever in connection with any such refusal or withdrawal pursuant to this Section 21.

SECTION 22: HIPAA AUTHORIZATION.

By commencing to act as Trustee or Adviser hereunder, an individual authorizes the release by any health care provider of medical information (including but not limited to all individually identifiable health information and medical records) needed to make a medical determination of the Trustee's or Adviser's capacity. This authorization is intended to apply to any information covered by the Health Insurance Portability and Accountability Act of 1996 (HIPAA) *42 USC Section 1329d-6* and 45 CFR Parts 160–164.

SECTION 23: DEFINITIONS.

A. “[Trustor's *husband/wife*]” refers to _________. However, if [Trustor's *husband/wife*] is divorced or separated from Trustor under a written agreement or decree of court, [*he/she*] will be treated as if *he/she* predeceased Trustor.

B. “Issue” of a person means all the lineal descendants of that person of all generations.

C. “Code” means the Internal Revenue Code of 1986, as amended, or any corresponding federal tax statute enacted after the date of this agreement. A reference to a specific section of the Code refers not only to that section but also to any corresponding provision of any federal tax statute enacted after the date of this agreement, as in effect on the date of application.

D. “Transfer taxes” means all applicable federal estate taxes (except additional estate taxes imposed under Section 2032A of the Code), state estate or inheritance taxes, and generation-skipping transfer taxes imposed on any “direct skip” (as defined in Chapter 13 of the Code) other than a direct skip from a trust or resulting from a disclaimer, and any interest and penalties thereon. The term does not include federal or state gift taxes, generation-skipping transfer taxes imposed on a “taxable termination,” a “taxable distribution,” or a “direct skip” from a trust or resulting from a disclaimer, income taxes, real estate transfer taxes, or any tax or duty imposed by a foreign country or political subdivision thereof. In addition, the term does not include any tax imposed by Section 2056A of the Code or any corresponding provision of applicable state law.

E. “Act” means the Delaware Qualified Dispositions in Trust Act (12 Delaware Code Section 3570, et seq.), as amended, or any corresponding Delaware statutes enacted after the date of this agreement. A reference to a specific section of the Act refers not only to that section but also to any corresponding provision of any Delaware statute enacted after the date of this agreement, as in effect on the date of application.

F. Use of any gender in this agreement includes the masculine, feminine, and neuter genders as appropriate. Use of the singular number includes the plural and vice versa unless the context clearly requires otherwise.

G. In applying any provision of this agreement which refers to a person's issue, “per stirpes,” the children of that person are the heads of their respective stocks of issue, whether or not any child is then living.

H. “Personal Representative” means the executor or administrator of a decedent's estate and shall include all persons serving in such capacity from time to time.

I. Use of the verb “shall” in this agreement indicates a mandatory direction, and use of the verb “may” indicates authorization to take action.

J. Captions, headings, and sub-headings, as used herein, are for convenience only and have no legal or dispositive effect.

IN WITNESS WHEREOF, [*TRUSTOR'S NAME*], Trustor, has set [*his/her*] Hand and Seal the ______ day of _________ ______, 20____, and WILMINGTON TRUST COMPANY, Trustee, has caused this agreement to be signed in its name by one of its Vice Presidents and its corporate seal to be affixed by one of its Assistant Secretaries, the _____ day of __ _____________, 20____, all done in duplicate as of the date of execution by Trustor, which date shall be the effective date of this instrument.

WITNESS:

__________________________ ___________________________ (SEAL)
[TRUSTOR'S NAME], Trustor
___________________________________, Trustee
By:________________________________
Vice President
Attest: ____________________________
Assistant Secretary

“SCHEDULE A”

Consisting of One Page

of

Irrevocable Trust Agreement

Dated ____________________

Between

TRUSTOR'S NAME

and

WILMINGTON TRUST COMPANY

* * *

CASH in the amount of One Dollar ($1.00)

* * *

STATE OF ___________________)
) SS.
COUNTY OF ___________________)

The foregoing instrument was acknowledged before me this _____ day of _______________, 20____, by *TRUSTOR'S NAME*.

____

Notary Public

STATE OF DELAWARE)
) SS.
COUNTY OF NEW CASTLE)

The foregoing instrument was acknowledged before me this _____ day of _______________, 20____, by ___________ ____________, a Vice President of Wilmington Trust Company, a Delaware corporation, on behalf of the corporation.

____

Notary Public

____

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Estates, Gifts and Trusts Portfolios
Estates, Gifts and Trusts Portfolios: Trusts
Portfolio 868-2nd: Domestic Asset Protection Trusts
Working Papers

Worksheet 8 Delaware Asset Protection Trust Form*

Caution: This trust form is only meant to be a sample. It is not appropriate for all cases and therefore it should not be used unless it has been thoroughly reviewed and approved by competent asset protection trust (APT) counsel for use in connection with a specific case. This form has been drafted with Delaware in mind and may be inappropriate for use in other domestic APT jurisdictions. Many qualified APT attorneys have their own APT forms, which are designed for use in connection with other documents being prepared by that attorney. This form may not be compatible with such other documents. This document is not designed or intended to provide financial, tax, legal, accounting, or other professional advice because such advice always requires consideration of individual circumstances. If professional advice is needed, the services of a professional advisor should be sought. This document is for informational purposes only; it is not intended as a recommendation, offer, or solicitation with respect to the purchase or sale of any security.

SAMPLE IRREVOCABLE TRUST AGREEMENT

Intended to be Completed Gift and Excluded From Gross Estate

(As of July 1, 2019)

THIS AGREEMENT, made this _________ day of ____________________, 20____, between *SETTLOR'S NAME*, of _ ______________ County, State of __________, hereafter called “Trustor,” and WILMINGTON TRUST COMPANY, a Delaware trust company, hereafter called “Trustee,” WITNESSETH:

WHEREAS, Trustor desires to establish a trust of the property described in the attached “Schedule A” and other property which may be added from time to time, all of which is hereafter called the “trust fund;” and

WHEREAS, Trustee accepts such trust and agrees to administer it in accordance with the terms and conditions of this agreement;

NOW, THEREFORE, Trustor hereby gives Trustee the property described in “Schedule A,” in trust, for the following purposes:

SECTION 1: DISTRIBUTION.

A. *During Trustor's Lifetime*. During Trustor's lifetime, Trustee may, from time to time, distribute to [Trustor, Trustor's husband/wife], and Trustor's issue all, some, or none, of the net income and/or principal in such amounts and proportions (whether equally or unequally, and even to the exclusion of one or more beneficiaries) as Trustee, in its sole discretion, deems appropriate after taking account of all other sources of funds available to them. Trustee shall accumulate any net income not so distributed and add it to principal at least annually, to be disposed of as a part of it. No such distribution shall be deemed to be an advancement.

B. *On Trustor's Death*. On Trustor's death, Trustee shall divide the assets then held hereunder into shares for Trustor's then living issue, per stirpes, and administer and distribute such shares according to the provisions of Subsection C of this Section 1.

C. *Shares Held for Issue*.

Trustee shall hold each share set aside for an issue of Trustor in further trust for such issue, referred to hereafter in this Subsection C as the “beneficiary.”

(1) *During the Beneficiary's Life*. During the beneficiary's life, Trustee may, from time to time, distribute to the beneficiary and his or her issue all, some, or none of the net income and/or principal in such amounts and proportions (whether equally or unequally, and even to the exclusion of one or more beneficiaries) as Trustee, in its sole discretion, deems appropriate, after taking account of all other sources of funds available to them. Trustee shall accumulate any net income not so distributed and add it to principal at least annually, to be disposed of as a part of it. No such distribution shall be deemed to be an advancement, and no such distribution shall be made that would discharge the beneficiary's legal obligation to support any of such issue.

(2) *On the Death of the Beneficiary.* On the death of the beneficiary, Trustee shall distribute so much of the beneficiary's share as is then held hereunder, free from this trust, to such of Trustor's issue (other than the beneficiary) and the spouses of such issue (including the beneficiary's spouse), in such manner and amounts, and on such terms, whether in trust or otherwise, as is effectively appointed by specific reference hereto in the last written instrument which the beneficiary executes and delivers to Trustee during his or her lifetime or, failing any such instrument, in his or her Will. However, the beneficiary may not appoint any more than an income interest to his or her spouse or to a spouse of any other issue of Trustor. Before the beneficiary exercises this nongeneral power of appointment, he or she should consider Section 2041(a)(3) of the Code and 25 Delaware Code Sections 501–505, as amended, or any corresponding Delaware statutes enacted after the date of this agreement.

On the death of the beneficiary, Trustee shall divide the balance of the beneficiary's share, to the extent not effectively appointed, into further shares for his or her then living issue, per stirpes, but if no such issue is then living, then for the then living issue, per stirpes, of the closest ascendant of the beneficiary who was an issue of Trustor and who has then living issue, but if no such issue is then living, then for Trustor's then living issue, per stirpes. Trustee shall hold each share set aside pursuant to the preceding sentence in further trust under the provisions of this Subsection C. Any share set aside for an issue of Trustor for whose benefit a share is then held in trust under the provisions of this Subsection C shall be distributed to the Trustee of such share, to be added to its principal and disposed of as a part of it.

D. *Perpetuities Savings Clause.* Notwithstanding the foregoing provisions, unless sooner terminated in the manner previously provided, each trust held hereunder shall end in its entirety or with respect to certain of its assets on the date, if any, required by the Delaware rule against perpetuities. Thereupon, Trustee shall distribute the principal of such trust or such assets, as the case may be, free from trust, to the beneficiary for whom the trust was set aside.

E. *Failure of Issue.* If, at any time, Trustee holds any portion of the principal of the trust fund not disposed of effectively under the previous provisions, then, at such time, Trustee shall distribute such principal, free from trust, to such then living person or persons as are then determined to be Trustor's distributees by the application of the intestacy laws of the State of Delaware governing the distribution of intestate personal property then in effect, as though Trustor had died at that particular time, unmarried, intestate, a resident of the State of Delaware, and owning such property then so distributable.

SECTION 2: MINORITY OR OTHER INCAPACITY.

If any property is otherwise required to be distributed to a beneficiary who has not attained age twenty-five (25) or is, in Trustee's opinion, unable to manage funds due to illness or infirmity, Trustee may:

A. Distribute such property to such beneficiary himself or herself; or

B. Apply such property for the benefit of such beneficiary; or

C. Hold the property not so distributed or applied in a separate trust hereunder for the benefit of such beneficiary, and distribute or apply the net income and principal thereof as provided in Subsections A and B hereof.

Trustee shall distribute the property in such trust to the beneficiary upon his or her attaining age twenty-five (25) or upon the termination of his or her incapacity (as the case may be). If the beneficiary dies prior to such distribution, Trustee shall distribute the property to the beneficiary's estate.

SECTION 3: MERGER WITH SIMILAR TRUSTS.

If, at any time, a trust is set aside for any person or persons under the terms of this agreement which is substantially the same as any other trust established for that person or persons, Trustee may, in its sole discretion, merge the trust created hereunder with the other trust for such person or persons, and the two trusts shall thereafter be held, administered, and distributed as one. However, Trustee shall not combine any trust having an inclusion ratio, as defined in Section 2642 of the Code (hereafter “inclusion ratio”), of other than zero (0) with a trust having an inclusion ratio of zero (0).

SECTION 4: ALTERNATIVE METHODS OF DISTRIBUTION.

Trustee may take any reasonable steps to disburse funds to or for a beneficiary, including: (i) distribution, either by hand or mail, to the beneficiary or the guardian of the person or property (whether the guardian is formally appointed or a natural guardian), (ii) distribution to a custodian for the beneficiary under the Uniform Transfers to Minors Act (or similar statute) of any state, (iii) deposit to the account of the beneficiary in any federally insured depository, (iv) direct application for the benefit of the beneficiary, or (v) distribution to a new or existing trust for the beneficiary.

SECTION 5: SPENDTHRIFT PROVISION.

No beneficiary (including Trustor) may alienate or in any other manner, whether voluntary or involuntary, assign, transfer, pledge, or mortgage his or her interest in any trust hereunder, and no one (including a spouse or former spouse) may attach or otherwise reach any interest of any beneficiary hereunder to satisfy a claim against that beneficiary, whether the claim is legal or equitable in origin. The provisions of this Section shall not limit or otherwise affect any power of appointment conferred upon a beneficiary or the right of a beneficiary to disclaim or release any interest created hereunder. This Section constitutes a restriction on the transfer of Trustor's beneficial interest in the trust fund that is enforceable under applicable non-bankruptcy law within the meaning of Section 541(c)(2) of the Bankruptcy Code (11 USC §541(c)(2)) or any other similar or successor statute.

SECTION 6: TRUSTEE'S POWERS.

In addition to those powers granted by law, Trustee is specifically authorized and empowered, in its sole discretion, but subject to the provisions of Section 8:

A. To sell at public or private sale, exchange for like or unlike property, convey, lease for terms longer or shorter than the trust, and otherwise dispose of any or all property held hereunder, for such price and upon such terms and credits as it deems proper.

B. To invest in any kind of property, real, personal, or mixed, regardless of the laws governing investments by fiduciaries, without any duty to diversify investments.

C. Unless otherwise directed by the investment adviser named in Section 7 hereof, to execute securities transactions without necessity of providing written confirmation thereof to such adviser at the time of settlement, and to execute securities transactions through any brokerage service, whether discount or full service, including M&T Securities Brokerage Services at its normal rates of compensation, without diminution of compensation otherwise payable to Trustee, even if Wilmington Trust Company is serving as Trustee.

D. To vote directly or by proxy at any election or stockholders' meeting any shares of stock, including stock of M&T Bank Corporation, even in Wilmington Trust Company is serving as Trustee.

E. To participate in any plan or proceeding, including any voting trust plan for liquidating, protecting, or enforcing any interest in any property, or for reorganizing, consolidating, merging, or adjusting the finances of any corporation issuing any such interest; to accept in lieu thereof any new or substituted stocks, bonds, notes, or securities, whether of the same or a different kind or class, or with different priorities, rights, or privileges; to pay any assessment or any expense incident thereto; and to do any other act or thing that it deems necessary or advisable in connection therewith.

F. To deposit, or arrange for the deposit of, securities at Depository Trust Company (DTC) and/or at any other securities depository or clearing corporation.

G. To make any division or distribution in cash or in kind, or partly in cash and partly in kind; to make reasonable valuations of the property so divided or distributed; and to elect to recognize taxable gain or loss resulting from a distribution. Trustee may consider the income tax basis of the property then available for division or distribution, as well as the circumstances of the beneficiaries, and need not make division or distribution on a pro rata, asset-by-asset basis. Trustee shall not adjust the interest of any beneficiary as a result of any action taken or forborne under the provisions of this Subsection G.

H. To make loans, against adequate collateral, to any person or any beneficiary and/or to purchase any property at its then fair market value from any person.

I. To borrow money, extend loans, pledge assets, and provide guarantees for any purpose connected with the protection, preservation, or improvement of the trust estate whenever in its judgment advisable, and as security to pledge any real or personal property forming a part of the trust estate upon such terms and conditions as it may deem advisable.

J. To bring or defend litigation, participate in arbitration or mediation, compromise or settle any claim in favor of or against any trust hereunder, and to execute all agreements, deeds, and releases necessary or proper in connection therewith. However, Trustee need not institute or defend any suit or proceeding unless its expenses, including counsel fees and costs, are available in the trust fund or are advanced or guaranteed in an amount and in a manner reasonably satisfactory to it. Trustee shall incur no liability to anyone for any action taken or not taken pursuant to the preceding sentence.

K. To retain attorneys-at-law, accountants, investment counsel, agents, and other advisers and to pay all compensation and other costs associated therewith from the trust without diminution of compensation otherwise payable to Trustee.

L. To pay the taxes and expenses of maintaining, repairing, improving, and insuring any real property held hereunder.

M. Except as otherwise provided, to determine whether receipts and disbursements, including its commissions, are allocable or chargeable to income or principal.

N. To receipt for the proceeds of any life insurance made payable to Trustee, to institute any suit or proceeding, and to take any action necessary to collect such proceeds. However, Trustee need not institute any suit or proceeding unless its expenses, including counsel fees and costs, are available in the trust fund or are advanced or guaranteed in an amount and in a manner reasonably satisfactory to it.

O. To renounce, in whole or in part, any property or interest in property which may become payable to any trust hereunder, except to the extent that the distribution of such property resulting from such renunciation is fundamentally inconsistent with the provisions of this agreement.

P. To divide any trust hereunder into separate trusts if the purposes for which the trust was created are better served thereby.

Q. To take such actions as are necessary to cause gains from the sale or exchange of trust assets (as determined for federal income-tax purposes) to be taxed for federal income-tax purposes as part of a distribution of principal to a beneficiary.

R. To invest in any closely held company, limited-liability company, or partnership, or in any successor entity, and to purchase additional interests in any such entity, even though, as a result, such trust is invested largely or entirely in such entity.

S. To settle its accounts judicially or nonjudicially at any time and from time to time and to pay all of its counsel, accountant, or other professional fees and costs associated therewith from the trust without diminution of compensation otherwise payable to Trustee.

T. To invest in, retain, or otherwise deal in any securities managed, issued, underwritten, or distributed by Trustee or by any of its affiliates, any participation in any investment company registered under the Investment Company Act of 1940, any investment fund exempt from registration under the Investment Company Act of 1940, for which Trustee or its affiliates is an adviser or agent, and any other “affiliated investment” within the meaning of 12 Delaware Code Section 3312, as amended, or any corresponding Delaware statute enacted after the date of this agreement, and is authorized to otherwise deal with or transact business with any of its affiliates, notwithstanding the fact that such trustee or affiliate may receive separate fees, commissions, or other costs directly from such security, fund, “affiliated investment,” dealing, or transaction.

SECTION 7: INVESTMENT ADVISER.

During any period in which an investment adviser is serving and notwithstanding any other provision hereunder, the investment adviser Trustee shall:

A. To settle its accounts judicially or nonjudicially at any time and from time to time and to pay all of its counsel, accountant, or other professional fees and costs associated therewith from the trust without diminution of compensation otherwise payable to Trustee.A. Serve in a fiduciary capacity and hold and exercise the full powers to manage the investments of the Trust. Trustee shall exercise such powers only upon the investment adviser's written directions and shall be required to exercise such powers if so directed, including, but not limited to, all investment powers granted under Subsections (2) through (5), and Subsections (7) through (14) of 12 Delaware Code Section 3325, as amended, or any corresponding Delaware statute enacted after the date of this agreement, all powers described as an “investment decision” in 12 Delaware Code Section 3313(d), as amended, or any corresponding Delaware statute enacted after the date of this agreement, and all the powers in Subsections A, B, D, E, I, Q, and S of Section 6 with respect to each trust hereunder; provided that: (i) Trustee shall sell any M&T Bank Corporation stock held by it hereunder unless specifically directed to do otherwise by such adviser; (ii) the purchase, sale, and voting of M&T Bank Corporation stock shall be solely on the direction of the investment adviser; (iii) Trustee shall manage and invest the otherwise uninvested cash in each such trust in its sole discretion; and (iv) notwithstanding the foregoing, during an emergency or based upon exigent circumstances, where the Trustee reasonably believes based upon its actual knowledge that its inaction would be “wilful misconduct” within the meaning of 12 Delaware Code Section 3313(b), as amended, or any corresponding Delaware statute enacted after the date of this agreement, then the Trustee is hereby authorized and empowered to take such action regarding the investment management of such trust as it, in its sole discretion, shall deem to be for the best interest of the beneficiaries of such trust. The power set forth in (iv) above is solely intended to give the Trustee the ability to act should such action become essential to the trust fund, but does not impose a duty upon the Trustee to monitor or warn an interested party concerning the investments of the trust fund nor does this power create a duty of the Trustee to take such action.

B. The initial investment adviser shall be [*Name of Adviser*]. The investment adviser may resign as investment adviser of any trust hereunder by written notice delivered to the Trustee and the adult beneficiaries who may then receive income or principal. Until Trustor's death, a majority of the Trustor's then living issue who have attained age twenty-five (25) may remove the investment adviser and a successor investment adviser may be a person, if any, chosen from time to time by a majority of Trustor's then living issue who have attained age twenty-five (25) as shall be able to act. After Trustor's death, the investment adviser of each trust hereunder shall be the beneficiary for whom the trust was set aside, provided that he or she has attained age twenty-five (25). If such beneficiary has not attained age twenty-five (25) or is unwilling or unable to serve, the investment adviser of such trust shall be the person, if any, chosen from time to time by a majority of Trustor's then living issue who have attained age twenty-five (25) as shall be able to act, until such beneficiary attains age twenty-five (25) or is no longer unwilling or unable to act, at which time such beneficiary shall become the investment adviser of such trust. To qualify, any person appointed investment adviser of a trust hereunder shall deliver a written instrument to Trustee indicating acceptance and agreement that all powers conferred upon such adviser will be exercised in a fiduciary capacity for the exclusive interest of the beneficiaries.

C. With regard to trust assets over which the investment adviser holds the power to direct Trustee and in addition to the investment adviser's other duties herein, the investment adviser shall have the duty (i) to confirm to Trustee, in writing, the value of trust assets, whether publicly traded or nonpublicly traded assets, at least annually and upon request by Trustee, (ii) to direct Trustee with respect to making any representation, warranty, or covenant required to be made in order to maintain any investment, (iii) to direct and instruct Trustee on future actions, if any, to be taken with respect to such representations, warrantees, and covenants, (iv) to manage or participate in the management of any entity owned by the trust, to the extent such entity's governing instruments or applicable law require the owners to manage the same, and (v) to direct Trustee to sign agreements and any other documentation required in connection with the purchase of any investment and the maintenance of any such investment. With regard to the investment adviser's exercise of the foregoing powers, all such directions to the Trustee shall be in writing, delivered in such manner as the Trustee may specify from time to time by written notice to investment adviser. Further, the Trustee shall have no obligation to investigate or confirm the authenticity of directions it receives or the authority of the person or persons conveying them, and the Trustee shall be exonerated from any and all liability in relying on any such direction from a person purporting to be the investment adviser without further inquiry by the Trustee. Notwithstanding the foregoing, Trustee has no duty to monitor whether the investment adviser is abiding by its duty to provide valuation of publicly traded or nonpublicly traded assets and shall not be liable for failing to request a valuation or for the investment adviser's failure to give Trustee a valuation.

D. Whenever, pursuant to the terms of this Agreement, Trustee acts at the direction of any investment adviser regarding the exercise of the Trustee's powers as to any particular matter, or whenever Trustee takes no action except at the direction of any investment adviser, then notwithstanding any other provision hereunder, (i) as provided in 12 Delaware Code Section 3313(b), as amended, or any corresponding Delaware statute enacted after the date of this agreement, Trustee shall not be liable for any loss resulting from such acts or inaction except in cases of wilful misconduct proven by clear and convincing evidence, and (ii) to the extent any such action or inaction concerns a matter outside the scope of 12 Delaware Code Section 3313(b), as amended, or any corresponding Delaware statute enacted after the date of this agreement, in accordance with 12 Delaware Code Section 3303, as amended, or any corresponding Delaware statute enacted after the date of this agreement, Trustee shall have no liability hereunder except for Trustee's own wilful misconduct proven by clear and convincing evidence. Trustee shall be under no obligation to review the trust assets, make any investment recommendations with respect to trust assets, solicit any direction from the investment adviser, value the assets if they are nonpublicly traded, or insure trust assets. As provided in 12 Delaware Code Section 3313(e), as amended, or any corresponding Delaware statute enacted after the date of this agreement, Trustee shall have no duty to monitor the conduct of the investment adviser, provide advice to the investment adviser, consult with the investment adviser, or communicate with or warn or apprise any beneficiary or third party concerning instances in which Trustee would or might have exercised Trustee's own discretion in a manner different from the manner directed by the investment adviser.

E. The investment adviser may direct the Trustee to employ the professional services of accountants, investment management professionals, attorneys, tax advisers, and such other advisers (“Agent”) as the investment adviser determines necessary to fulfill the duties of managing the investments of the trust. The investment adviser shall be solely responsible for the oversight, supervision, and monitoring of such Agent and shall notify the Trustee in writing of the employment of such Agent. The Trustee shall have no obligation to investigate or confirm the authenticity of directions it receives or the authority of the Agent conveying any such directions, and the Trustee shall be exonerated from any and all liability in relying on any such direction from a person purporting to be an Agent of the investment adviser without further inquiry by the Trustee until such time as the Trustee is notified in writing of the termination of such Agent's employment. The fees associated with the retention of an Agent by the investment adviser shall not diminish the compensation otherwise payable to Trustee.

F. The investment adviser need not inquire into Trustee's performance of its duties and shall not be held liable for any loss whatsoever to any trust hereunder, unless it results from actions taken in bad faith. The investment adviser shall serve without compensation but may be reimbursed for out of pocket expenses, including investment counsel fees.

SECTION 8: ADDITIONS TO THE TRUST FUND.

With the consent of Trustee, any person may add property to any trust hereunder, and such property shall thereafter be held by Trustee as a part thereof. However, no property shall be added to a trust if such addition would cause the inclusion ratio of such trust to become other than zero (0). Instead, such property shall be held as a separate trust with terms identical to those of the trust to which the property would have been added.

SECTION 9: IRREVOCABILITY.

This trust shall be irrevocable and not subject to amendment by Trustor or any other person. However, Trustee is authorized to modify or amend the provisions of this agreement to ensure that this agreement is a trust instrument under the Act. Trustee may rely upon the advice of counsel in taking any action pursuant to the authority given to Trustee, and Trustee shall be without liability therefor.

SECTION 10: NON-ACCRUAL OF INCOME.

Any statute or rule of law to the contrary notwithstanding, any income accrued or on hand and not actually distributed to a beneficiary upon the termination of his or her interest shall be treated as though it had, in fact, accrued thereafter.

Any income accrued upon shares of stock or interest-bearing property when delivered to Trustee shall be treated as though such income had, in fact, accrued after such delivery.

SECTION 11: THIRD PARTIES NOT OBLIGED TO FOLLOW FUNDS.

No person or corporation dealing with Trustee shall be obliged to see to the application of money paid or property delivered to Trustee, to inquire into the propriety of Trustee's exercising its powers, or to determine the existence of any fact upon which Trustee's power to perform any act hereunder may be conditioned.

SECTION 12: TRUSTEE'S COMPENSATION.

Unless otherwise agreed upon in writing between Trustee and Trustor (or, after Trustor's death or incapacity, by the investment adviser, or, if none, by a majority of the current beneficiaries of any trust created under this trust agreement who are over the age of twenty-five (25) years), Trustee shall receive compensation for its services hereunder from time to time in accordance with the current rates then charged by it for trusts of similar size and character. If Trustee renders any extraordinary services, it may receive additional compensation therefor.

SECTION 13: RESIGNATION AND REMOVAL OF TRUSTEE.

At any time during the remainder of Trustor's life, Trustee may resign by written notice delivered to Trustor, and [*Person Not Trustor*] may remove Trustee by written notice delivered to it. In either case, [*Person Not Trustor*] may appoint another bank or trust company, that is described in Section 3570 of the Act, as successor Trustee by written notice delivered to Trustee.

During Trustor's lifetime, Trustee shall be deemed to have resigned on the date on which: (i) it ceases to be a Trustee described in Section 3570 of the Act; or (ii) a court takes any action whereby such court declines to apply Delaware law in determining the validity, construction, or administration of any trust hereunder or of the effect of the spendthrift provision hereunder in any action brought against Trustee.

Unless objections are filed as provided below, Trustee shall deliver any assets held hereunder to the successor Trustee. If [*Person Not Trustor*] does not appoint such a successor Trustee, Trustee may petition the Delaware Court of Chancery to appoint such a successor Trustee.

After Trustor's death, Trustee may resign as Trustee of a trust hereunder by written notice delivered to the beneficiary for whom the trust was set aside, and Trustee may be removed by written notice delivered to Trustee signed by such beneficiary, provided that he or she has attained age thirty (30). In either case, another bank or trust company shall be appointed successor Trustee by written notice delivered to Trustee signed by such beneficiary, provided that he or she has attained age twenty-one (21).

Unless objections are filed as provided below, Trustee shall deliver the assets held in such trust to the successor Trustee. If such beneficiary does not appoint such a successor Trustee, Trustee may petition the Delaware Court of Chancery to appoint such a successor Trustee.

Upon resignation or removal, Trustee shall, within ninety (90) days after it resigns or is removed, deliver a statement of its activities to the date of such resignation or removal for which it has not reported to the person to whom Trustee was directed to give notice of resignation or who was authorized to remove Trustee. Such person shall have sixty (60) days from receipt of such statement to file with Trustee any objections to its actions as Trustee. If no such objections are filed, Trustee shall be without any further liability or responsibility to any past, present, or future beneficiaries.

No successor Trustee shall be required to examine into the acts of its predecessor Trustee, and each successor Trustee shall have responsibility only with respect to the property actually delivered to it by its predecessor Trustee.

Notwithstanding the foregoing provisions of this Section, Trustee may, but shall not be required to, prepare and file accountings for a trust hereunder with the Delaware Court of Chancery. Further, prior to delivering all the property of a trust hereunder to a successor trustee or to making any partial or complete distribution of the trust estate, Trustee may require an approval of the trust's accounting either by a release and discharge by the beneficiary or beneficiaries of the trust or by the Delaware Court of Chancery. All of Trustee's fees and expenses (including reasonable counsel, accountant, or other professionals fees) attributable to any accounting and/or approval shall be paid by the trust.

SECTION 14: MERGER OF CORPORATE TRUSTEE.

Any corporation resulting from any merger, conversion, reorganization, or consolidation to which any corporation acting as Trustee hereunder shall be a party, or any corporation to which shall be transferred all or substantially all of any such corporation's trust business, shall be the successor of such corporation as Trustee hereunder, without the execution or filing of any instrument or the performance of any further act and shall have the same powers, authorities, and discretions as though originally named in this agreement; provided, however, that in the case of any corporation that is acting as a Trustee hereunder, the provisions of this Section shall apply only if the resulting or transferee corporation is domiciled in the same jurisdiction as the corporation that was acting as Trustee.

SECTION 15: TRUST SITUS.

This agreement creates a Delaware trust, and all matters pertaining to the validity, construction, and application of this agreement; to the administration of the trusts created by it; and to the effectiveness of restraints on alienation of beneficiaries' interests hereunder shall be governed by Delaware law. The Delaware Court of Chancery shall have exclusive jurisdiction over any action brought with respect to any trust hereunder.

SECTION 16: ADOPTED PERSONS AND PERSONS BORN OUT OF WEDLOCK.

For all purposes of this agreement, with regard to adopted persons, only a person adopted while under age twenty-one (21) shall be deemed to be a child and an issue of the adopting person and an issue of the ascendants of the adopting person, and, furthermore, the children and issue of the person so adopted shall be deemed to be issue of the adopting person and his or her ascendants. A person born out of wedlock shall not be deemed to be a child or an issue of his or her parent or an issue of the ascendants of his or her parent unless such child is acknowledged in writing by such parent.

SECTION 17: DEEMED INCAPACITY OF TRUSTOR, TRUSTEE, OR ADVISER.

An individual Trustor, Trustee, or adviser shall be deemed to be incapacitated: (i) during any period that such individual is legally incompetent as determined by a court of competent jurisdiction; (ii) during any period that a conservator or guardian for such individual has been appointed, based upon his or her incapacity; (iii) during any period when two (2) physicians licensed to practice medicine certify in writing to Trustee (if Trustor's capacity is at issue), to Trustor or the adviser (if a Trustee's capacity is at issue), or to Trustor and Trustee (if an adviser's capacity is at issue), that in the opinion of such physicians, such individual, as a result of illness, age, or other cause, no longer has the capacity to act prudently or effectively in financial affairs; or (iv) thirty (30) days after Trustee or any trust beneficiary requests such Trustor, Trustee, or adviser, as applicable, to provide a certificate from a physician licensed to practice medicine that, in the opinion of such physician, such individual has the capacity to act prudently or effectively in financial affairs if such

Trustor, Trustee, or adviser, as applicable, fails to provide such certification within such period.

SECTION 18: ILLIQUID ASSETS.

To the extent that any of the creditors of Trustor, or any other beneficiary of a trust hereunder, asserts a claim that it is entitled, through the exercise of the judicial process or otherwise, to reach the assets of the trust in satisfaction of its claim, Trustee shall have no obligation to defend the trust or its assets against any such claim or to initiate or intervene in any litigation, arbitration proceeding, or mediation proceeding for the purpose of resisting any such claim, unless Trustee is reasonably satisfied that it will be fully indemnified from the assets of the trust for all of its liabilities and expenses (including professional fees and expenses of counsel, accountants, and expert witnesses) arising from or attributable to Trustee's participation therein. If Trustee reasonably determines that the readily marketable assets of the trust are, or have become, insufficient for such purposes, Trustee may request that the Trustor or beneficiary provide Trustee with comparable indemnity, supported with such security as may be satisfactory to Trustee in its sole discretion, and in the absence of such additional indemnity or security, Trustee may refuse to participate in any such proceeding or may withdraw from an ongoing proceeding, even if such refusal or withdrawal may result in the granting or awarding of relief against the trust (including a distribution of trust assets in satisfaction of a claim). Trustee shall incur no liability to anyone whomsoever in connection with any such refusal or withdrawal pursuant to this Section 18.

SECTION 19: HIPAA AUTHORIZATION.

By commencing to act as Trustee or Adviser hereunder, an individual authorizes the release by any health care provider of medical information (including but not limited to all individually identifiable health information and medical records) needed to make a medical determination of the Trustee's or Adviser's capacity. This authorization is intended to apply to any information covered by the Health Insurance Portability and Accountability Act of 1996 (HIPAA) *42 USC Section 1329d-6* and 45 CFR Parts 160–164.

SECTION 20: DEFINITIONS.

A. “[Trustor's *husband/wife*]” refers to _________. However, if [Trustor's *husband/wife*] is divorced or separated from Trustor under a written agreement or decree of court, [*he/she*] will be treated as if *he/she* predeceased Trustor.

B. “Issue” of a person means all the lineal descendants of that person of all generations.

C. “Code” means the Internal Revenue Code of 1986, as amended, or any corresponding federal tax statute enacted after the date of this agreement. A reference to a specific section of the Code refers not only to that section but also to any corresponding provision of any federal tax statute enacted after the date of this agreement, as in effect on the date of application.

D. “Act” means the Delaware Qualified Dispositions in Trust Act (12 Delaware Code Section 3570, et seq.), as amended, or any corresponding Delaware statutes enacted after the date of this agreement. A reference to a specific section of the Act refers not only to that section but also to any corresponding provision of any Delaware statute enacted after the date of this agreement, as in effect on the date of application.

E. Use of any gender in this agreement includes the masculine, feminine, and neuter genders as appropriate. Use of the singular number includes the plural and vice versa unless the context clearly requires otherwise.

F. In applying any provision of this agreement which refers to a person's issue, “per stirpes,” the children of that person are the heads of their respective stocks of issue, whether or not any child is then living.

G. “Personal Representative” means the executor or administrator of a decedent's estate and shall include all persons serving in such capacity from time to time.

H. Use of the verb “shall” in this agreement indicates a mandatory direction, and use of the verb “may” indicates authorization to take action.

I. Captions, headings, and sub-headings, as used herein, are for convenience only and have no legal or dispositive effect.

IN WITNESS WHEREOF, [*TRUSTOR'S NAME*], Trustor, has set [*his/her*] Hand and Seal the ______ day of _________ ______, 20____, and WILMINGTON TRUST COMPANY, Trustee, has caused this agreement to be signed in its name by one of its Vice Presidents and its corporate seal to be affixed by one of its Assistant Secretaries, the _____ day of __ _____________, 20____, all done in duplicate as of the date of execution by Trustor, which date shall be the effective date of this instrument.

WITNESS:

________________________ ________________________ (SEAL)
[TRUSTOR'S NAME], Trustor
________________________________, Trustee
By:____________________________
Vice President
Attest: ________________________
Assistant Secretary

“SCHEDULE A”

Consisting of One Page

of

Irrevocable Trust Agreement

Dated __________________

Between

TRUSTOR'S NAME

and

WILMINGTON TRUST COMPANY

* * *

CASH in the amount of One Dollar ($1.00)

* * *

STATE OF _________________)
) SS.
COUNTY _________________)

OF

The foregoing instrument was acknowledged before me this _____ day of _______________, 20____, by *TRUSTOR'S NAME*.

____

Notary Public

STATE OF DELAWARE)
) SS.
COUNTY OF NEW CASTLE)

The foregoing instrument was acknowledged before me this _____ day of _______________, 20____, by ___________ ____________, a Vice President of Wilmington Trust Company, a Delaware corporation, on behalf of the corporation.

____

Notary Public

____

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