

CREDITOR CLAIMS

Danger, Will Robinson, Creditors Approaching! CRTs, QPRTs, and Creditor Claims*

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This Estate Planning article examines the vulnerability of self-settled trusts, including CRTs and QPRTs, to creditor claims and suggests planning strategies to maximize creditor protection and tax benefits.

By now, most practitioners know that, without proper planning, the assets of the prototypical self-settled trust, i.e., an irrevocable trust that gives the trustee discretion to distribute funds back to the trustor, are vulnerable to claims by the trustor-beneficiary's creditors. But did you realize that:

- The charitable-remainder trust (CRT), in which the trustor keeps the right to receive annuity, unitrust, or income payments, the qualified personal-residence trust (QPRT), the grantor-retained annuity trust (GRAT), and the grantor-retained income trust (GRIT) are self-settled trusts?
- Courts have permitted creditors of the trustor-beneficiary of four CRTs to reach trust assets?
- Courts have permitted creditors of the trustor-beneficiary of four QPRTs to reach trust assets?
- The trustor's surviving spouse may disqualify a CRT by electing against the will in many states?
- Two states do not afford favorable tax treatment to CRTs?

What's the planner to do? This article will explore the foregoing issues and offer solutions.

BACKGROUND

Third-party trust rules.

Under the Second Restatement of Trusts, the Third Restatement of Trusts, and the Uniform Trust Code (UTC), clients may protect beneficiaries' interests in third-party trusts from claims by the beneficiaries' creditors by subjecting such interests to a spendthrift clause¹ or by making such interests discretionary.²

Self-settled trust rules.

Importantly, the Second Restatement of Trusts, the Third Restatement of Trusts,

and the UTC do not extend creditor protection to trustors' retained interests in self-settled trusts, even if the trusts contain a spendthrift clause or make the retained interests discretionary.³ The ability of creditors to reach the assets of self-settled spendthrift trusts is derived from a statute that was enacted in England in 1487.⁴ Professor Griswold explained:

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.⁵

The Restatements of Trusts incorporate this historic rule against self-settled spendthrift trusts. Thus, § 156 of the Second Restatement of Trusts says that:

(1) 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. (2) Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit. Similarly, § 58(2) of the Third Restatement of Trusts stipulates that:

A restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid. In addition, comment f under § 60 of the Third Restatement of Trusts says that:

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 comparable rule in the model UTC—§ 505(a)(2)—is 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.

Accordingly, the historic self-settled trust rule continues to be applicable, generally, under modern trust law.

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Notably, though, 21 states—Alabama, Alaska, Arkansas, Connecticut, Delaware, Hawaii, Indiana, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming—allow some form of domestic Asset Protection Trust (APT) as of 2025.⁶ The District of Columbia and every other state follow the historic self-settled trust rule and have a trust statute that permits creditors to reach the trustor's retained interest or the assets of a self-settled spendthrift trust.

Fraudulent-transfer rules.

By contrast, the rules that allow creditors to set aside fraudulent transfers began with a statute called the Statute of Elizabeth that was enacted in England in 1571.⁷ The modern incarnation of that rule is in § 4(a) of the Uniform Fraudulent Transfer Act (UFTA), or its successor, the Uniform Voidable Transactions Act (UVTA). Section 4(a) of the UFTA states:

(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; or (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, 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 he [or she] would incur, debts beyond his [or her] ability to pay as they became due.⁸

A claim under UFTA § 4(a)(1) is referred to as a claim for "actual fraud;" a claim under UFTA § 4(a)(2) is referred to as a claim for "constructive fraud." Section 4(b) of the UFTA lists 11 "badges of fraud" to assess in determining whether a transfer constitutes actual fraud. The counterpart to UFTA § 4(a) in the federal bankruptcy code is § 548(a).⁹

Note: If a transfer is set aside as a fraudulent transfer or voidable transaction, creditors may reach all of the transferred assets. By contrast, if a spendthrift clause is unenforceable pursuant to the historic rule against self-settled

spendthrift trusts, creditors may only access the trustor-beneficiary's retained interest—not all of the assets of the trust.

THE CRT CASES

As mentioned above, creditors have been able to reach the assets of four CRTs. Each case is summarized below.

In re Mack

The first case was *In re Mack*,¹⁰ which the Bankruptcy Court for the District of Minnesota decided in 2001. Here are the facts:

- Debtor created the Jeffrey C. Mack Charitable Remainder Unitrust on January 17, 1997 (CRUT), naming himself trustee.
- Debtor funded the CRUT with 100,000 shares of common stock of Olympic Financial, Ltd. (Olympic).
- Debtor, as trustee, sold the Olympic stock in January and February of 1997 for \$1,655,188.60.
- Debtor, as trustee, invested over \$700,000 in his new company, Emerald First Financial, a Delaware limited liability company engaged in a high-tech internet-based business.
- Debtor, as trustee, also invested in a mortgage on real estate owned by friends and in certain publicly traded equities.
- Emerald First Financial failed.
- The CRUT's value declined from around \$1.7 million in 1997 to about \$1.1 million in 2001.
- Debtor filed for bankruptcy on February 16, 2001.

The debtor contended that his retained interests in the CRUT were excludable from his bankruptcy estate pursuant to § 541(c)(2) of the bankruptcy code, which provides:

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.¹¹

The court disagreed because neither Minnesota common law or statutory law nor IRC Section 664 or the regulations under it provided an effective anti-alienation provision.¹² It is significant that the bankruptcy

trustee did not attempt to invalidate the CRUT.¹³

In light of the above, the court held:

It is hereby determined that the income interest of the Debtor Jeffrey C. Mack in the Jeffrey C. Mack Charitable Remainder Unitrust dated January 17, 1997 is property of the bankruptcy estate, together with the power to appoint or discharge trustees of the trust and the power to amend the trust to preserve its tax qualified status. As a result, the court ordered:

Jeffrey C. Mack and Dave F. Senger, as trustees of the CRUT, together with any other or successor trustee, are hereby directed to recognize the bankruptcy estate as the holder of such lifetime income interest and powers and to pay future distributions of the Unitrust Amount, otherwise payable to Jeffrey C. Mack, to the bankruptcy Trustee.

In re Brown

The Eleventh Circuit decided *In re Brown*¹⁴ the following year. The facts are:

- Debtor's mother died in 1993 and left debtor a \$250,000 inheritance.
- Debtor, a chronic alcoholic, placed the inheritance in a 7% CRUT on August 11, 1993, to protect the assets from her own improvidence.
- Debtor filed for bankruptcy on February 4, 1999.

The court rejected the debtor's assertion that her retained interest in the CRUT was excludable from her bankruptcy estate pursuant to § 541(c)(2):

Appellee is both the settlor and a beneficiary of the trust. Consequently, the spendthrift clause contained in the trust is ineffective as against Appellee's creditors. The court concluded:

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.

Wells Fargo Bank, N.A. v. Hoag

In 2016, an Arizona intermediate appellate court decided *Wells Fargo Bank, N.A. v. Hoag*,¹⁵ which was not a bankruptcy case. Here is what happened:

- Debtor created three CRUTs between 1994 and 2000.
- Debtor funded the CRUTs with stock that he owned and acted as trustee until 2014.

- Wells Fargo obtained a \$2.5 million default judgment against the debtor in 2012.
- Wells Fargo initiated a garnishment proceeding in December 2013 to satisfy its judgment.
- Wells Fargo filed a lawsuit in June 2014, inter alia, to declare the spendthrift clauses in the CRUTs invalid.

entitled to 5% of the net fair market value of the Trust assets determined as of the first day of each taxable year, exclusive of sums to pay his taxes, during his lifetime.

Planning.

The unenforceability of spendthrift clauses in self-settled CRTs is a double-edged sword. On the one hand, there might be

instances in which trustors who are receiving annuity or unitrust distributions might want to assign those interests, and unenforceability of the spendthrift clause might make that possible. On the other hand, creditors will be able to access retained interests in self-settled CRTs in many jurisdictions. Clients who want to enjoy the customary benefits of CRTs—deferred taxation of capital gains and a charitable deduction—as well as creditor protection should consider establishing the CRT in a state that has domestic APT legislation and that extends protection to CRTs. For example, Delaware Code Annotated title 12 § 3570(11)(b)(4) extends the protections of Delaware's Qualified Dispositions in Trust Act to:

The transferor's potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust as such terms are defined in § 664 of the Internal Revenue Code of 1986 [26 U.S.C. § 664] and any successor provision thereto . . .

Practitioners should not take too much comfort from the fact that an Arizona intermediate appellate court applied Washington State law in the *Hoag* case and that a federal bankruptcy court in Wisconsin applied Michigan law in the *Goff* case. This is because the result probably would have been the same under the laws of all four of the states in question. A court in a state without domestic APT legislation might be less inclined to apply the domestic APT legislation of a sister state.¹⁸ So, clients wishing to protect retained interests should fund CRTs with real property in the domestic APT state and with personal property and should only appoint trustees, advisers, and protectors in the domestic APT state. Taking these steps should make it more likely that the courts of the domestic APT state will adjudicate controversies affecting the CRTs and that domestic APT law will be applied.¹⁹

THE QPRT CASES

As mentioned above, creditors also have been able to reach the assets of four QPRTs. The decisions are summarized below.

In re Earle

A federal bankruptcy court in Alabama addressed whether and to what extent

The charitable-remainder trust (CRT), in which the trustor keeps the right to receive annuity, unitrust, or income payments, the qualified personal-residence trust (QPRT), the grantor-retained annuity trust (GRAT), and the grantor-retained income trust (GRIT) are self-settled trusts.

The court first dealt with a conflict-of-laws issue:

The CRUTs expressly provide that "[t]he 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.

The court then summarized Washington law regarding spendthrift trusts:

Under Washington state law, a valid spendthrift provision may protect trust property from a creditor. However, pursuant to Revised Code of Washington ("R.C.W."), section 6.32.250, this protection only includes trust property "held in trust for a judgment debtor where the trust has been created by, or the fund so held in trust has proceeded from, a person *other than the judgment debtor*." (citations omitted, emphasis in original).

On this ground, the court therefore held:

Here, 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. § 6.32.250.3.

Relying on *In re Mack*, the court also concluded that "26 U.S.C.A. § 664(d)(2) does not prohibit Wells Fargo from reaching Hoag's noncharitable beneficiary interest paid to him in the CRUTs."

In re Goff

The fourth case is another bankruptcy decision, *In re Goff*,¹⁶ which the United States Bankruptcy Court for the Eastern District of Wisconsin decided in 2024.

Here are the facts:

- Debtor received an inheritance from his mother, who died in 1997.
- Debtor funded a 5% CRUT with stock valued at approximately \$220,000 on August 4, 1998.
- Debtor filed for bankruptcy in April 2023.

Applying Michigan law designated by the CRUT, the Wisconsin court observed that:

Mr. Goff's interest in the Randall K. Goff Charitable Remainder Unitrust is property of the estate if: (1) Mr. Goff has a beneficial interest in the Trust; (2) the Trust restricts the transfer of Mr. Goff's beneficial interest in the Trust; and (3) the transfer restriction in the Trust is not enforceable under Michigan law.

The court held that the § 541(c)(2) exclusion was not available:

[U]nder the Michigan Trust Code, Mr. Goff, the settlor and a beneficiary of the Trust, may not use the Trust as a shield against his creditors. As an irrevocable trust, and regardless of the spendthrift provision in the Trust, Mr. Goff's creditors can reach the lesser of "the claim of the creditor or assignee" or "the maximum amount that can be distributed to or for the settlor's benefit exclusive of sums to pay the settlor's taxes during the settlor's lifetime" as provided in the Michigan Trust Code. The transfer restriction in the Trust that attempts to shield Mr. Goff's interest from any claims made by Mr. Goff's creditors is unenforceable under Michigan law.¹⁷

Consequently, the court concluded:

Under Mich. Comp. Laws § 700.7506(1)(c), Mr. Goff's creditors are

creditors could reach the assets of a QPRT in *In re Earle*.²⁰ Here are the facts:

- Debtor-wife established a QPRT on June 26, 1998, and transferred her husband's and her residence to it.
- Debtors—husband and wife—filed for bankruptcy on November 26, 2001.
- Premier Capital Funding, Inc. (PCF) subsequently filed an adversary proceeding against the debtor-wife and the trustees of the QPRT.

The bankruptcy trustee sought to recover the transferred property pursuant to § 544(b)(1) of the bankruptcy code,²¹ which the court described:

11 U.S.C. § 544(b)(1) states in pertinent part that "... 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 ..." "Pursuant to 11 U.S.C. § 544(b), a trustee in bankruptcy or the debtor acting as trustee may avoid any

- Debtor filed for bankruptcy on January 11, 2010.
- The bankruptcy trustee sought a declaration that the QPRT was revocable and that the trust property should become part of the debtor's bankruptcy estate.²³

The appellate panel reported that:

On December 23, 1997, the Department of Treasury promulgated regulations prohibiting QPRT documents from allowing the sale of the residence to the grantor during the QPRT Term or at any time after the QPRT Term that the trust is a grantor trust. This regulation also added 26 C.F.R. § 25.2702-5(a)(2), which provides in relevant part: "Modification of trust. A trust that does not comply with one or more of the regulatory requirements under paragraph (b) or (c) of this section will, nonetheless, be treated as satisfying these requirements if the trust is modified, by judicial reformation (or non-judicial reformation if effective under state law), to comply with the requirements.... In the case of a trust created before January 1, 1997, the reformation

must be commenced within 90 days after December 23, 1997 and must be completed within a reasonable time after commencement." (citation omitted). The appellate panel then pointed out that:

[I]n order to comply with QPRT regulations, modification of the 518 Trust needed to "commence" within 90 days after December 23, 1997, and had to be completed "within a reasonable time from commencement." The Trustee never modified the 518 Trust to comply with the third sentence of Treas. Reg. 25.2702-5(b)(1), which disqualified the 518 Trust as a QPRT if the Residence could be sold or transferred during the original term of the 518 Trust. The appellate panel therefore held:

Because of this failure to modify the 518 Trust to eliminate the disqualifying language in paragraph III B.4. that is contrary to the third sentence of Treas. Reg. 25.2702-5(b)(1), the 518 Trust does not comply with QPRT regulations and ceased to be a QPRT.

Consequently, the panel concluded:

Paragraph III B.3. in the 518 Trust provides that the "trust shall terminate when it ceases to be a [QPRT], and on such termination the Trustee shall distribute all of the trust assets to the Grantor." Although Paragraph III C. of the 518 Trust provides that within thirty days of the trust's termination the trustee may elect to convert it to a GRAT, this was not done. Thus, the 518 Trust terminated in 1998 and its terms required distribution of the trust assets, including the 518 Property, to Debtor at that time. As a result, these assets are property of Debtor's bankruptcy estate. (citation omitted).

The bankruptcy trustee raised a frightening argument for all QPRTs that the trial court accepted. Specifically, he contended:

[T]he 518 Trust was revocable, despite the irrevocability language contained in Paragraph II. Under Paragraph III B.3., the 518 Trust would lose its QPRT status once the 518 Property ceased to be Debtor's personal residence or ceased to be held by the trustee for Debtor's use as a personal residence. And, once the 518 Trust lost its QPRT status, the trust terminated and all trust assets reverted to Debtor.

Trustee argued that Ferrante could revoke the 518 Trust simply by not using the 518 Property as his personal residence, which was solely within his control. This "back door" provision gave Debtor the power to revoke the 518 Trust at will, thereby rendering it a revocable trust under California law and property of the estate.

Clients who want to enjoy the customary benefits of CRTs—deferred taxation of capital gains and a charitable deduction—as well as creditor protection should consider establishing the CRT in a state that has domestic APT legislation and that extends protection to CRTs.

transfer of property of the debtor that is voidable under the applicable state law..." "Applicable state law" includes state law fraudulent transfer statutes. (citations omitted).

The bankruptcy trustee submitted that debtor-wife had fraudulently transferred real property to the QPRT with actual intent to hinder, delay, or defraud creditors in violation of Alabama Code § 8-9A-4(a), which is Alabama's version of UFTA § 4(a)(1). After analyzing badges of fraud (some of which went to debtor-wife; some of which went to the bankruptcy trustee), noting that debtor-wife created the QPRT for estate planning purposes, and reviewing relevant case law, the court held:

PCF's fraudulent transfer claim brought pursuant to 11 U.S.C. § 544(b)(1) and Alabama Code § 8-9A-4(a) is DISMISSED WITH PREJUDICE with each party to bear their own costs.

It appears that it was taken for granted

that debtor-wife's retained interest in the QPRT was includible in her bankruptcy estate. Thus, the court Ordered:

PCF shall . . . present appropriate admissible evidence to the Court of Mrs. Earle's life expectancy, and evidence of the value of her life estate in the Stockton property (with an actuarial analysis based on her life expectancy) so that the Court may also determine the specific value of Mrs. Earle's interest in the Earle Residence Trust.

In re Ferrante

The second QPRT case is the Bankruptcy Appellate Panel for the Ninth Circuit's 2015 decision in *In re Ferrante*.²² The facts are:

- Debtor created the 518 Trust as a QPRT with a residence in Newport Beach, California, in 1994.
- The QPRT authorized the debtor to repurchase the residence.

Fortunately, the appellate panel did not reach that issue:

[W]e conclude 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. Because we are able to affirm the MSJ Order on that basis, we need not address Appellants' other argument that the

bankruptcy court erred in ruling that the 518 Trust is, and QPRTs in general are, revocable trusts as a matter of law.

Sohn v. United States

The United States District Court for the Northern District of California decided *Sohn v. United States*²⁴ in 2024. The facts are:

The Second Restatement of Trusts, the Third Restatement of Trusts, and the Uniform Trust Code (UTC) do not extend creditor protection to trustors' retained interests in self-settled trusts, even if the trusts contain a spendthrift clause or make the retained interests discretionary.

- Taxpayers—husband and wife—transferred their residence to a 25-year QPRT on March 21, 1996, that named themselves trustees, contained a buy-back clause, and provided that the QPRT would convert to a GRAT if it ceased to qualify as a QPRT.
- Trustees transferred title back into the taxpayers' names in February of 1998.
- Taxpayers transferred the residence back to the QPRT in April of 1998.
- Trustees transferred title back to the taxpayers in April of 2004, where title remained until January of 2023.
- The IRS placed tax liens on the residence in an effort to collect \$4.5 million of penalties and interest for the taxpayer-husband's failure to meet reporting requirements for foreign corporations, partnerships, and trusts under IRC Sections 6038 and 6048 for tax years 1997-2004 in May and June of 2014.
- Taxpayers filed a quiet-title action on January 20, 2022; the IRS counterclaimed to invalidate the QPRT and to enforce its tax lien on the residence.

Like the debtor in *Ferrante*, the taxpayers in *Sohn* were tripped up by the treasury regulation that required trustees to modify pre-January 1, 1997, QPRTs to eliminate buy-back provisions. Thus, the *Sohn* court reported:

It is undisputed that the Yu Personal Residence Trust is dated March 21, 1996 and that the Yus did not modify

the Yu Personal Residence Trust after Treas. Reg. § 25.2702-5 was amended. It is also undisputed that the Yus transferred the Sarahills Drive Property to themselves in both 1998 and 2004. A strict reading of the regulations makes clear that the Yu Personal Residence Trust does not meet the definition of a QPRT. Section 25.2702-5(c) explicitly states that a QPRT "is a trust meeting all the requirements of this paragraph." (citations omitted). The court therefore found:

Because the Trust Agreement not only fails to prohibit buy-backs, as required by Section 25.2702-5(c)(9) clause, but also contains a buy-back provision specifically prohibited by that provision, the Yu Personal Residence Trust does not meet "all" the requirements under the paragraph. Therefore, it does not qualify as a QPRT.

The result of the above analysis was that the IRS could foreclose its tax lien on the property.

Turner v. Turner

The fourth QPRT decision was *Turner v. Turner*,²⁵ which an Arizona intermediate appellate court decided in 2025. Here are the facts:

- Brother's and sister's father established two 10-year QPRTs, which named father and his wife as trustees, and funded them with New York real property in May of 1996.
- Father repurchased both properties in May of 2006.
- Sister filed for bankruptcy in June of 2008.

Sister sought to surcharge brother for actions that he took as trustee of

the QPRTs. The court described her contention:

Melissa contends that claims related to the QPRTs were never part of the bankruptcy estate, so those claims could not be released by her bankruptcy settlement. She argues that a debtor's beneficiary interest in a trust that has a spendthrift provision is not part of the bankruptcy estate, 11 U.S.C. § 541(c)(2), and that the QPRTs contain spendthrift provisions, as found in the Eighth Article.

To resolve the status of the QPRTs, the Arizona court, referring to § 277 of the Second Restatement of Conflict of Laws, looked to New York law for the following reason:

Because both QPRTs contain New York choice-of-law provisions and hold New York real property, this Court must consult New York law to resolve this issue.

Consequently, the court concluded:

[A]s discussed above, the QPRTs ceased to exist after May 2006. Thus, the spendthrift provisions were inoperable. Any claims Melissa could have asserted relating to the extinguished QPRTs—the mortgages and notes—were part of her bankruptcy estate and those claims were released.

Planning.

The following options are available under Treas. Reg. 25.2702-5(c)(8)(i) if a trust no longer satisfies the QPRT requirements:

The governing instrument must provide that, within 30 days after the date on which the trust has ceased to be a qualified personal residence trust with respect to certain assets, either— (A) The assets be distributed outright to the term holder; (B) The assets be converted to and held for the balance of the term holder's term in a separate share of the trust meeting the requirements of a qualified annuity interest; or (C) In the trustee's sole discretion, the trustee may elect to comply with either paragraph (c)(8)(i) (A) or (B) of this section pursuant to their terms. In light of *Ferrante*, QPRTs probably should not contain the first option.

To prevent creditors from being able to access the trustor's retained interest in a QPRT, the planner might create the QPRT in a domestic APT state that affords protection to QPRTs. For example, Delaware Code Annotated title 12 § 3570(11)(b)(8) says that the protections under Delaware's Qualified Dispositions in Trust Act²⁶ cover:

The transferor's possession and enjoyment of an interest in a qualified personal residence trust within the meaning of such term as described in Treasury Regulation § 25.2702-5(c) (26 C.F.R. 25.2702-5(c)) and any successor provision thereto . . .

Unfortunately, as shown by *Turner*, given that a QPRT holds real property, the Second Restatement of Conflict of Laws indicates that the courts of the state where the property is located should adjudicate controversies affecting the property and that the law of that state should apply.²⁷ If permitted by the QPRT rules, the real property might be converted into an interest in personal property by placing it in a limited-liability company (LLC), provided that LLC interests constitute personal property under the law of the domestic APT state. This is the case in Delaware.²⁸

CRUT may be invaded for the benefit of S, causes the trust to fail to qualify under § 664(d). As a result, the following requirement was imposed:

This procedure generally requires that S irrevocably waive the right of election with regard to the assets of the CRAT or CRUT to ensure that no part of the trust will be used to satisfy the elective share.

Revenue Procedure 2005-24 applied to the following CRTs:

For CRATs and CRUTs within the scope of this revenue procedure created by G on or after June 28, 2005, the failure of S to waive the right of election in accordance with the requirements of this revenue procedure will result in the CRAT or CRUT failing to qualify under § 664(d) continuously since its creation, whether or not S exercises the right of election. For CRATs and CRUTs within the scope of this revenue procedure created by G before June 28, 2005, the failure of S to waive

Probate Code (UPC),³⁰ which specifies that the augmented estate to which the right of election applies includes:

Any irrevocable transfer in which the decedent retained the right to the possession or enjoyment of, or to the income from, the property if and to the extent the decedent's right terminated at or continued beyond the decedent's death.

As of this writing, it appears that statutes of concern are in effect in at least 14 states—Alaska, Colorado, Hawaii, Kansas, Maine, Maryland, Minnesota, Nebraska, New Jersey, North Dakota, South Dakota, Utah, Virginia, and West Virginia.³¹

Planning.

Some clients might want to defeat surviving spouses' elective-share rights, such as to ensure that assets pass to children from prior marriages. Such clients might want to create CRTs in states where trust assets may not be reached to satisfy rights of election. In Delaware, for example, Delaware Code Annotated title 12 § 3536(a) says that the spendthrift clause in a third-party trust bars a claim by "any person that has a claim against the beneficiary, the beneficiary's estate, or the beneficiary's property by reason of any forced heirship, legitimate, *marital elective share*, or similar rights." Similarly, § 3573(b), part of Delaware's Qualified Dispositions in Trusts Act, provides that a Delaware APT may not be reached to satisfy a claim for elective share.

If a transfer is set aside as a fraudulent transfer or voidable transaction, creditors may reach all of the transferred assets. By contrast, if a spendthrift clause is unenforceable pursuant to the historic rule against self-settled spendthrift trusts, creditors may only access the trustor-beneficiary's retained interest—not all of the assets of the trust.

CRTS AND THE SURVIVING SPOUS'S RIGHT OF ELECTION

Revenue Procedure 2005-24.

Revenue Procedure 2005-24 asserted that a CRT would not qualify in certain states that gave a surviving spouse a right of election. The procedure stated:

Sections 664(d)(1)(B) (in the case of a CRAT) and (d)(2)(B) (in the case of a CRUT) provide that no amount other than the annuity payments described in § 664(d)(1)(A) or the unitrust payments described in § 664(d)(2)(A), respectively, (other than qualified gratuitous payments described in §§ 664(d)(1)(C) and (d)(2)(C)) may be paid to or for the use of any person other than an organization described in § 170(c). The requirements of §§ 664(d)(1)(B) and (d)(2)(B) are not satisfied in situations in which S may exercise the right of election to receive an elective share and the share could include assets of the CRAT or CRUT, because the mere existence of the right of election under applicable law, whether or not exercised, and the resulting possibility that the CRAT or

the right of election, combined with S's exercise of that right of election, will result in the CRAT or CRUT failing to qualify under § 664(d) continuously since its creation.

Notice 2006-15.

After considerable outcry from the estate planning community, the IRS modified Revenue Procedure 2005-24 less than a year later in Notice 2006-15,²⁹ which provided:

Until further guidance is issued, the Service will disregard a spousal right of election for purposes of determining whether a charitable remainder annuity trust (CRAT) or charitable remainder unitrust (CRUT) meets the requirements of section 664(d)(1)(B) or (d)(2)(B) of the Code, provided that the right of election is not exercised.

The IRS has not issued any further guidance.

Affected states.

This issue is of particular concern in states that have adopted a provision such as § 2-205(2)(A) of the Uniform

THE CRT AND STATE INCOME TAXATION

Introduction.

Many practitioners will be shocked to learn that two states—New Jersey and Pennsylvania—do not afford favorable income-tax treatment to CRTs. Clients often create CRTs to diversify portfolios of low-basis securities without incurring immediate income tax on the gain. Such clients might be dismayed to learn that state tax is due on the entire gain right away.

New Jersey.

In 2009, the New Jersey Division of Taxation announced that:

Only exclusively charitable trusts qualify for income tax exemption under the New Jersey Gross Income

Tax Act. A Charitable Remainder Trust, in contrast to a charitable trust, has "noncharitable" beneficiaries and does not operate exclusively for charitable purposes. Accordingly, a Charitable Remainder Trust is not an exclusively "charitable trust" exempt from New Jersey income tax under N.J.S.A. 54A:2-1 and income that is not distributed and which is not deemed to be permanently and irrevocably set aside or credited to a charitable beneficiary is taxable income to the trust.³²

Pennsylvania.

The instructions to the Pennsylvania fiduciary income tax return provide in relevant part:

Important: CRATs, charitable remainder trusts, CRUTs and pooled income fund trusts of public charities are ordinary trusts that are not exempt from PA-41, Fiduciary Income Tax Return, filing requirements or taxation. These types of charitable trusts must file a Pennsylvania trust tax return, pay tax on any undistributed income, and report the income to the beneficiary on the same basis as any other ordinary trust.³³

Planning.

Tax can be eliminated in New Jersey by taking advantage of a safe harbor offered by the tax return instructions:

A resident . . . trust is not subject to New Jersey tax if it: Does not have any tangible assets in New Jersey; Does not have any income from New Jersey sources; and Does not have any trustees . . . in New Jersey.

However, the fiduciary must file Form NJ-1041 for such . . . trust, enclose a statement certifying that the . . . trust is not subject to tax, and check the box on line 27.³⁴

Pennsylvania offers a less generous safe harbor. Thus, according to the Pennsylvania fiduciary income tax return instructions, a trust created by a resident will not be taxed in the following circumstances:

An inter vivos trust or a testamentary trust created by a resident can become a nonresident trust if the settlor is no longer a resident or is deceased, and the trust lacks sufficient contact with Pennsylvania to establish nexus. Any one of the following conditions provides sufficient contact for a resident trust to remain a resident trust or to requalify as a resident trust: The trust has a resident trustee; Any trust administration occurs in Pennsylvania; Trust assets include: Real or tangible personal

property located within Pennsylvania, or Stock, securities or intangible personal property, evidenced by the documents, certificates or other instruments that are physically located, or have a business situs within Pennsylvania; or The situs of the trust is Pennsylvania as provided in 20 PA. C.S. § 7708.³⁵

Section 7708(a) specifies:

Without precluding other means for establishing a sufficient connection with the designated jurisdiction, the terms of a trust designating the situs of the trust 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; (2) all or part of the trust administration occurs in the designated jurisdiction; (3) one or more of the beneficiaries resides in the designated jurisdiction; or (4) a trust director's principal place of business is located in or a trust director is a resident of the designated jurisdiction.³⁶

Curiously, even though the safe harbor indicates that the presence of a resident trustee and

§ 7708(a) indicates that the presence of a resident trustee or a resident beneficiary will cause a trust to be taxed as a Resident Trust, a regulation states that in classifying a trust for income-tax purposes "[t]he residence of the fiduciary and the beneficiaries of the trust shall be immaterial."³⁷

CONCLUSION

When working with clients to establish CRTs, QPRTs, and other self-settled estate planning trusts, practitioners rarely consider potential creditor issues. Perhaps we should!

End Notes

* The title of this article is based on an alert of impending peril given by the B-9 Class M-3 General Utility Non-Theorizing Environmental Control Robot (usually referred to simply as "Robot") in the 1960s television program "Lost in Space."

¹ Restatement Second, Trusts §§ 152, 153(1), 157; Restatement Second, Trusts § 157 cmts. a-e; Restatement Third, Trusts §§ 58(1), 59; Restatement Third, Trusts § 58 cmt. a; Restatement Third, Trusts § 59 cmts. a(1), a(2), b-d; Uniform Trust Code (UTC) §§ 502-503. The text of the UTC and a compilation of the jurisdictions that have enacted it may be viewed at www.uniformlaws.org.

² Restatement Second, Trusts §§ 155(1), 187; Restatement Second, Trusts § 155 cmt.

b; Restatement Second, Trusts § 187 cmts. d-i; Restatement Third, Trusts §§ 50, 60; Restatement Third, Trusts § 50 cmts. b, d; Restatement Third, Trusts § 60 cmt. e; UTC §§ 504, 814(a).

³ Restatement Second, Trusts § 156(1); Restatement Third, Trusts § 58(2); Restatement Third, Trusts § 58 cmt. e; UTC § 505(a)(2). See Karibjanian, Nenko, & Rubin, "The Uniform Voidable Transactions Act: Why Transfers to Self-Settled Spendthrift Trusts by Settlers in Non-APT States Are Not Voidable Transfers Per Se," 42 Est., Gifts & Tr. J. 173 (July 13, 2017).

⁴ Statute 3 Hen. VII, c.4 (1487).

⁵ Griswold, *Spendthrift Trusts* § 473 (2d ed. 1947) (footnotes omitted).

⁶ See Ala. Code §§ 19-3E-1—19-3E-11; Alaska Stat. § 34.40.110; Ark. Code Ann. §§ 28-72-701—28-72-714; Conn. Gen. Stat. §§ 45a-487j—45a-487t; Del. Code Ann. tit. 12 §§ 3570-3576; Haw. Rev. Stat. §§ 554G-1—554G-10; Ind. Code §§ 30-4-8-1—30-4-8-15; Mich. Comp. Laws Ann. §§ 700.1041—700.1050; Miss. Code Ann. §§ 91-9-701—91-9-723; Mo. Rev. Stat. § 456.5-505; Nev. Rev. Stat. §§ 166.010—166.180; N.H. Rev. Stat. Ann. §§ 564-B:5-505A—564-B:5-505B; Ohio Rev. Code Ann. §§ 5816.01—5816.14; Okla. Stat. tit. 31, §§ 10—18; R.I. Gen. Laws §§ 18-9.2-1—18-9.2-7; S.D. Codified Laws §§ 55-16-1—55-16-16; Tenn. Code Ann. §§ 35-16-101—35-16-112; Utah Code Ann. § 75B-1-302; Va. Code Ann. §§ 64.2-745.1; W. Va. Code Ann. §§ 44D-5-503a—44D-5-503c; Wyo. Stat. Ann. § 4-10-510—4-10-523.

⁷ Statute 13 Eliz. I, c.5 (1571).

⁸ The text of the UFTA, the text of the UVTA, and a compilation of the jurisdictions that have enacted them may be viewed at www.uniformlaws.org.

⁹ 11 U.S.C. § 548(a).

¹⁰ 269 B.R. 392 (BC D. Minn. 2001).

¹¹ 11 U.S.C. § 541(c)(2).

¹² See Note 10, *supra*, at 399. By contrast, regarding pension plans, the Employee Retirement Income Security Act (ERISA) provides in 29 U.S.C. § 1056(d)(1) that "Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated." The corresponding section in the Internal Revenue Code—IRC Section 401(a)(13)(A)—stipulates that "[a] trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under the plan may not be assigned or alienated." In *Patterson v. Shumate*, 504 U.S. 753 (1992), the United States Supreme Court held 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" and that a debtor's interest in an ERISA-qualified plan therefore was excludable from his bankruptcy estate. IRC Section 664 and its regulations do not require CRTs to contain anti-alienation clauses.

¹³ See Note 10, *supra*, at 394.

¹⁴ 303 F.3d 1261 (11th Cir. 2002).

¹⁵ 2016 WL 6436830 (Ariz. Ct. App. 2016).

¹⁶ 2024 WL 4139369 (BC E.D. Wis. 2024).

¹⁷ Effective for qualified dispositions made on or after March 8, 2017, APTs are allowed under Michigan's Qualified Dispositions in Trust Act (Mich. Comp. Laws Ann. §§ 700.1041–700.1050).

¹⁸ See *In re Huber*, 493 B.R. 798, 809 (BC W.D. Wash. 2013) (“[T]his 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.”).

¹⁹ See Restatement Second, Conflict of Laws §§ 267, 268, 270, 272, 273.

²⁰ 307 B.R. 276 (BC. S.D. Ala. 2002).

²¹ 11 U.S.C. § 544(b).

²² 2015 WL 5064087 (BAP 9th Cir. 2015).

²³ The requirements for a QPRT are set forth in Treas. Reg. 25.2702-5(c).

²⁴ 723 F.Supp.3d 763 (N.D. Cal. 2024).

²⁵ 2025 WL 1640445 (Ariz. Ct. App. 2025).

²⁶ Del. Code Ann. tit.12 §§ 3570–3576.

²⁷ See Restatement Second, Conflict of Laws §§ 223, 276–280.

²⁸ Del. Code Ann. tit. 6 § 18-701.

²⁹ Notice 2006-15, 2006-1 C.B. 501 (Feb. 3, 2006).

³⁰ The text of the UPC may be viewed at www.uniformlaws.org.

³¹ 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-C, § 2-205(2)(A); Md. Code Ann., Est. & Trusts §§ 3-401(i), 3-404(a)(1)(v), (c); 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).

³² N.J. Div. of Tax’n Technical Bull. TB-64, *Charitable Remainder Trusts* (June 29, 2009), www.state.nj.us/treasury.

³³ Instructions to 2024 Form PA-41 at 3. See 72 Pa. Cons. Stat. § 7301(c:1).

³⁴ Instructions to 2024 Form NJ-1041 at 2. See Instructions to 2024 Form NJ-1041 at 10.

³⁵ Instructions to 2024 Form PA-41 at 4.

³⁶ 20 Pa. Cons. Stat. § 7708(a). Section 7708(b) gives rules for determining situs when the trust instrument is silent.

³⁷ 61 Pa. Code § 101.1.