Twenty Years Later:
Developments in Asset Protection Since 1997
Focus on Domestic Asset Protection Trusts

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I. INTRODUCTION

On April 1, 1997, Alaska Governor Tony Knowles signed House Bill 101 (the "Alaska Trust Act") into law, creating the first domestic self-settled asset protection trust statute. Three months later, on July 9, 1997, Delaware Governor Thomas R. Carper signed Delaware's Qualified Dispositions in Trust Act into law. Fast forward twenty years and seventeen states, consisting of just over 20% of the U.S. population, have enacted a version of a self-settled domestic asset protection trust statute (permitting the creation of what are referred to in this paper sometimes as "DAPTs" or as a "DAPT"). Exhibit A to this paper is a set of slides showing the evolution of these statutes over the ensuing twenty years.

Over the same twenty-year period, a variety of other statutes have been passed in many jurisdictions, the primary focus of which has been to increase ways to protect certain categories of property from attachment by the creditors of those who have an ownership interest in the property.

What has been the impetus (and what continues to drive) these legislative enactments? Were the large U.S. trust companies and banks unhappy to watch some of their best and wealthiest clients go "off shore"? Or to sister states? Is it that the states are racing to the top (or to the bottom) to provide the latest bells and whistles to attract business to certain jurisdictions? Is there a growing need for additional liability protection? And will there be a "tipping point," where self-settled asset protection trusts and other debtor-friendly legislation are widely available to all Americans within their own states? Perhaps the biggest question that remains unanswered in part is do domestic asset protection trusts work – both for creditor protection purposes and from a transfer tax perspective?

Running parallel to the asset protection planning revolution, of which DAPTs are a significant part but only one part, are the fraudulent transfer laws. Asset protection planning, most particularly DAPT planning, to be done properly and legally, must be done within the context of the fraudulent transfer laws. Both federal bankruptcy law and state law provide statutory procedures for creditors (or bankruptcy trustees) to satisfy claims against assets that a debtor has fraudulently transferred. The statutory law regarding fraudulent transfers dates back to the Statute of Elizabeth enacted in 1570, which declared as "utterly void" conveyances that were designed to "delay, hinder or defraud" creditors. While it is clear that the law must evolve, do these "new" self-settled asset protection trusts depart from centuries' old law, or can the two be reconciled?

The American College of Trust and Estate Counsel (ACTEC) formed the Asset Protection Committee in the fall of 2006, driven to a significant extent by the development of foreign and domestic asset protection trusts and the related focus by practitioners on the broader issue of estate planning and protecting clients' assets from future creditors. At about the same time, the American Bar Association (ABA) formed a similar committee, noting in its mission statement that the Asset Protection Planning Committee "sprung from the widespread acknowledgement throughout the estate planning bar that planning to protect a client's capital accumulation during the client's

lifetime and after death should be one of the essential considerations in an estate plan." While there has always been a vigorous debate between advocates of creditors' rights and advocates of asset protection, at some point the conversation shifted and lawyers and advisors have accepted the reality that clients have a right to conduct asset protection planning. Estate planning involves the preservation of wealth, including considering the client's interest in mechanisms that will avoid exposing their assets unnecessarily to the claims of present and future creditors.

This paper will attempt to track the developments in asset protection planning over this twenty-year period since the enactment of the Alaska and Delaware DAPT laws. It will start with a consideration of the legal underpinning of the DAPT laws and will then explore the trust laws, tax laws and debtor/creditor laws that needed to be considered in designing these laws. It will continue with a consideration of the attacks on DAPTs and will attempt to predict what the future might hold for these laws.

II. EVOLUTION OF ASSET PROTECTION STATUTES

While perhaps arcane in the current law school curriculum, many lawyers took a course in Creditors' Rights, or Debtor Creditor Law or something similar. While the focus may have been on issues such as mechanics and other liens, security interests, confessions of judgment and other contractual issues, American law has included for centuries, as did English law for a longer period, statutory, common law and sometimes Constitutional rules protecting certain categories of property from the claims of the owner's creditors. For a detailed summary of these various protections, see the authors' article entitled "Asset Protection from an Estate Planner's Perspective" available at http://www.htts.com/documents/Asset-Protection-Outline.pdf.

Some of these exemptions are designed to protect individuals and their families in their "homestead." The theoretical and public policy impetus behind such laws are perhaps too obvious to need citation or explanation. "A man's home, is [perhaps] his castle." Florida and Texas have the most widely known and economically expansive of these protections but many states have smaller but nonetheless important protections.

Tenancy by the entireties, abolished in many states and never applicable in community property jurisdictions, has a long history and provides significant protection of assets titled this way between spouses. In some entireties states, the protection of entireties-owned assets, real, personal, tangible, intangible, is almost ironclad vis-à-vis the creditors of only one spouse.

Going back to the 18th Century and sometimes before, states have enacted statutory protections from creditors' claims with respect to certain types of property, property that the legislatures believe must be sacrosanct to permit their states' citizens to continue to live, notwithstanding their debtor status. Farm animals and implements, uniforms, vehicles, sewing machines, guns and ammunition, food in storage; a study of these statutes is a study of 18th and 19th Century views of how people survive.

More recently, federal and state laws have added newer classes of assets to the category of assets exempt from the claims of creditors. Life insurance and annuities, including their cash or surrender values, are often exempt from creditor claims. Retirement assets governed by the Employee Retirement and Income Security Act (ERISA) are exempt from creditor claims by federal law. IRAs, not governed by ERISA, are exempt from creditor claims under the laws of most states. A compendium of these exemptions is available. *See, e.g.*, Gideon Rothschild and Dan Rubin, "Asset Protection: Riches Out of Reach," available at http://www.mosessinger.com. Again, the public policy behind these exemptions, exemptions that can protect very valuable assets, seems self-evident. We want our citizens to save money for retirement and protect their families in the event of death. Shouldn't the categories of property used for these purposes be safe from creditor claims?

Related to and no less important than these traditional legal concepts is bankruptcy law, a course perhaps more frequently taken by lawyers in the modern law

school curriculum. To understand the basics of bankruptcy law, the practitioner must learn and become familiar with bankruptcy exemptions, both federal and state, and basic concepts of fraudulent transfers.

Taken together, traditional concepts of debtor-creditor law and bankruptcy law have always been on the estate lawyer's "plate" in the estate planning process. It has been true for as long as lawyers have advised their clients regarding the transmission of property during life and at death that the implementation of that advice may have debtor-creditor implications. The competent estate lawyer has always needed to understand that lifetime gifts may be unwound if in fraud of creditors; that making otherwise exempt assets such as life insurance payable to an estate may result in losing exempt status; that taking assets out of entireties ownership may inadvertently expose those assets to creditor claims.

Which brings us to 1997. In that year, American law started on what the authors would characterize as a march toward a more and more aggressive environment regarding how estate lawyers and their clients view debtor-creditor issues. What follows is an attempt to put the ensuing twenty years, a period of large and increasing "asset protection planning" into a broader context.

In an outline written by the author of this paper in 2002 titled "Domestic Asset Protection Trusts," five years after the 1997 DAPT statutes were enacted, the author suggested the following to set the stage for the discussion of the core question: Are DAPTs proper in light of centuries of legal precedent?

> "It has long been true that trusts created for the benefit of persons other than the trustor of the trust can be drafted and administered in a way that may insulate the assets in the trust, both income and principal, from the claims of the creditors of a trust beneficiary. The concept of a "spendthrift trust" has been well settled in American jurisprudence and gives rise to a variety of planning techniques, all designed in part to protect trust beneficiaries from their own improvidence. This continues to be true notwithstanding the impact of cases such as *Sligh v. First National Bank of Holmes County*, 704 So. 2d 1020 (Miss. 1997).
>
> Why, one may speculate, if this can be true of non-trustor beneficiaries, should it not also be true of trustor beneficiaries? The facile explanation is reliance on an easy citation to rules which, in most American jurisdictions, may be simplified to the following concept: "you cannot insulate yourself from your own creditors by a self-settled spendthrift trust." Notwithstanding a serious re-examination of this rule in a recent article by Professor Robert Danforth, it continues to be the case in most states that a creditor of an individual is readily able to attach all assets in a trust created by that individual, whether the trust was created before or after the claim arose, whether the trust is revocable or irrevocable, and notwithstanding the right to retain the trust assets by the trustor, even where the rights are exercisable only with the concurrence of an actively hostile trustee. Creditors' rights are deemed superior to those of other beneficiaries whether or not the creation of the trust violated applicable fraudulent spendthrift laws.

It is this rule which has directly and indirectly given rise to the explosive growth of foreign asset protection trusts in jurisdictions which, either historically or by legislative change, revoked or modified the general rule.

The Foreign Asset Protection Trust in turn gave rise to the Domestic Asset Protection Trust which is enjoying its own rapid growth."

A good deal has been written about the general American rule, with ancient British precedents, that an individual cannot "spendthrift" himself or herself. Attached as Exhibit B is an excerpt from an article co-written by the author and Richard G. Bacon, Esq. and published in 2001. In it, the authors address the 16th Century genesis of the prohibition against self-spendthrifting.

While it is perhaps much too late to challenge the development of foreign and domestic asset protection trusts based on this historical underpinning, except to see how jurisdictions chose to modify these laws, it is helpful to note how the issue of self-settled trusts and creditors' rights was addressed in 2002 when the National Conference of Commissioners on Uniform State Laws ("NCCUSL") enacted the first version of the Uniform Trust Code (the "UTC"). The UTC directly enacts by statute what most states already had within their statutory or common law: To deny creditor protection to "self-settled spendthrift trusts" because it is against public policy for an individual to be able to have access to assets while protecting them from proper creditors. Traditionally, this rule has been upheld pursuant to case law, not statutory law. Many states have adopted one version or another of the Uniform Trust Code and for practitioners in those states, care must be taken to consider the impact of the applicable language. In particular, section 505 of the Uniform Trust Code provides as follows:

(a) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

(1) During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

(2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

(3) After the death of a settlor, and subject to the settlor's right to direct the source from which liabilities will be paid, the property of a trust that was revocable at the settlor's death is subject to claims of the settlor's creditors, costs of administration of the settlor's estate, the expenses of the settlor's funeral and disposal of remains, and statutory allowances to a surviving spouse and children to the extent the settlor's probate estate is inadequate to satisfy those claims, costs, expenses, and allowances.

This statute settles once and for all in jurisdictions adopting this part of the UTC the issue of whether a living trust provides creditor protection during the trustor's lifetime **but only in the absence of a DAPT statute in that jurisdiction**. Except to the extent that the trustor of an irrevocable trust is specifically limited as to the amount that the trustee may distribute to him or her (e.g., a trust providing that discretionary distributions to the trustor may not exceed one-half of the trust principal), all revocable and virtually all irrevocable trusts in which the trustor retains a right to distributions will be fully available for attachment and execution by the trustor's creditors during his or her lifetime.

In jurisdictions that have not adopted the UTC, and do not have DAPTs, the prohibition against self-spendthrifting as set forth above appears either by statute or by case law.

A. Offshore Trusts.

Notwithstanding the centuries-old common law, implemented by statute in some jurisdictions, it is not difficult to imagine lawyers, and their clients, asking themselves the following question: Why should I be able to insulate my family from the claims of their creditors by use of a trust for their benefit, but not be able to insulate myself from the claims of my own (presumably future) creditors using the same mechanism? In other words, what is so special about the Statutes of Henry, VII and Elizabeth?

In 1989, the Cook Islands amended its international trust law to include a number of provisions that were friendly to debtors and specifically allowed for self-settled spendthrift trusts. These trusts were commonly referred to as "offshore trusts," and similar statutes soon followed in the Cayman Islands, Belize, Nevis, Gibraltar and other jurisdictions.

A detailed technical and legal analysis of such trusts is beyond the scope of this paper and anyone interested in such trusts should consult an expert in this particular area. Generally speaking, if a United States creditor wishes to pursue assets of an offshore trust then the impediments will be considerable. In 2006, the Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs issued a lengthy report on what it considered to be abusive use of offshore structures by United States citizens to avoid taxes and other obligations. Included in the report are references to the improper use of offshore trusts, including those designed for creditor protection. The report can be found in BNA, Inc. Daily Tax Report for August 1, 2006. Advisors involved in offshore planning would do well to consider the serious allegations made by the Senate in this report.

General Structure. Most offshore trusts have their situs in a single non-United States jurisdiction that has laws encouraging the creation of such trusts. The trusts are typically irrevocable and are usually created as "sprinkle" trusts, with the trustor and his or her family as potential beneficiaries. There may also be a reversion to the trustor after a period of time. In some cases, the trustor, although

not a trustee, continues to have a role in the operation of the trust as a "protector" or some other type of non-trustee fiduciary.

Legal Underpinning. In order to reach the assets in an effective offshore trust, a creditor must pursue an action under the local law of the situs country. If local law does not give full faith and credit, or, in the international context, comity, to the judgments of United States courts then the underlying cause of action must be re-litigated. Moreover, the foreign jurisdiction's fraudulent transfer laws are likely to be more "debtor friendly" and may have very short statutes of limitation. These trusts often contain other provisions designed to minimize the potential for a United States creditor to successfully attack the transfer. For example, such trusts may include a "flight" provision by which the trustee is able to remove the trust and its governing law to another jurisdiction if a creditor is making progress in attacking the transfer.

Tax Issues. These trusts are normally designed to be "tax neutral." That is, they are grantor trusts for United States income tax purposes, do not give rise to gift tax on creation and will be includible in the trustor's estate at death for estate tax purposes. There are, however, certain complexities in the tax treatment of these trusts that resulted from the Small Business Job Protection Act of 1996. Under that Act, most offshore trusts are classified as "foreign trusts," notwithstanding their status as grantor trusts, all of the income of which is reportable on a United States citizen's U.S. income tax returns. In order for a trust not to be a foreign trust, a United States court must be able to exercise primary jurisdiction over the trust and a United States fiduciary must have the authority to control substantial decisions over the trust. Because most offshore trusts avoid one or both of these characteristics (indeed, these features make them effective as asset protection vehicles), it appears that most will be classified as foreign trusts. Consequently, there are serious reporting requirements imposed on the creator of the foreign trust, the trustee and persons who receive distributions from the trust. There are severe penalties for failure to fulfill the reporting requirements.

Cook Islands Trusts. Although there are many foreign countries that have laws encouraging (deliberately or fortuitously) the use of such countries as "asset protection" havens, the country with laws most deliberately tailored for this purpose and which seems to get the most professional attention is that of the Cook Islands, which are located in the South Pacific near New Zealand. Those considering Cook Islands trusts should review the widely-reported decision of the High Court of the Cook Islands in *515 Orange Grove Owners Association v. Orange Grove Partners*, CKHC 1; 208.1994 (11 March 1995). The interlocutory nature of the proceeding coupled with the apparent settlement of the case prior to a substantive hearing may obscure the import of this decision. Nevertheless, some commentators have interpreted the High Court's opinion as a denunciation of the use of Cook Islands "International Trusts" to encourage fraud and deceit. In *dicta*, the High Court advised that it would not sanction abusive practices in creating these trusts. The legislature of the Cook Islands responded quickly, modifying the law governing these trusts in the International Trusts Amendment

Act 1996, which became effective on November 21, 1996. That Act changed the provisions of the prior law on which the High Court based its "creditor friendly" opinion and made several other changes.

While no publically-available records are kept, it is quite likely that many thousands, perhaps scores or thousands, of foreign asset protection trusts have been created and funded and certainly billions of dollars of wealth have been transferred into such trusts. That said, and notwithstanding the arguments in favor of using such trusts (*see, e.g.*, numerous articles written by Duncan E. Osborne, Esq. available at http://www.ohkslaw.com), it did not take long before those in a position to draft and effectuate statutory changes in the United States concluded that statutes could be written, based on the general concepts utilized in the foreign asset protection trust scheme, to create domestic self-settled asset protection trusts with greater accessibility for United States clients.

B. Domestic Trusts

In apparent response to the promulgation and extensive marketing of offshore trusts, it became apparent to some in the United States that if the Statutes of Henry, VII and Elizabeth could be so readily revoked in offshore jurisdictions, they should certainly be able to be revoked domestically. Beginning in 1997 with Alaska and Delaware, now seventeen American jurisdictions have adopted some form of self-settled asset protection vehicle over the past two decades. While each jurisdiction has its own peculiarities, there are common threads to most.

As the states compete to entice a potential trustor to create a self-settled asset protection trust in their jurisdictions, it is interesting to note that there are significant variations in the suggested or required contacts with the jurisdiction to establish situs. Notably, none of the seventeen jurisdictions require that the trustor be a resident of the state in order to avail himself or herself of the laws of the jurisdiction.

The legislatures have taken different approaches. The American College of Trust and Estate Counsel (ACTEC) Comparison of Domestic Asset Protection Trust Statutes Chart edited and maintained by ACTEC Fellow David G. Shaftel, Esq. provides an excellent summary of the various state statutes. A copy of the Chart is attached as Exhibit C. As noted by Mr. Shaftel, oftentimes the first statute enacted by a legislature may include minimal asset protection provisions. As time goes on, and as the legislature becomes increasingly comfortable with DAPTs, more protective provisions are often enacted in the form of amendments.

The ACTEC Comparison Chart evaluates the various statutes based on the following thirty-nine questions:

1. General Requirements. What requirements must the trust meet to come within protection of the statute? May a revocable trust be used for asset protection? What contacts with the state are suggested or required to establish situs?

2. Trustees. Who must serve as trustee to come within **the protection of the statute?** May non-qualified trustees serve? May the trust have a distribution advisor, investment advisor or trust protector? Does the statute provide that a trustee automatically ceases to act if a court has jurisdiction and determines that the law of the trust does not apply? Is the trustee given a lien against trust assets for costs and fees incurred to defend the trust?

3. State Laws. Has the state legislature consistently supported DAPTs and related estate planning by continued amendments? Have state limited partnership and LLC statutes been amended to provide maximum creditor protection? Does the state assert income tax against DAPTs formed by non-resident **trustor**s? Has the IRS challenged the transfer tax effects of a DAPT created under this state's law? Are there cases that have occurred in this state's courts which involve DAPT statutes, regardless of the DAPT state law involved? Are there cases involving this state's DAPT law, regardless of the state court where the case was heard? Are there cases that involve this state's asset protection laws which may affect the implementation of a DAPT?

4. Administration of Trust. What interests in principal and income may the **trustor** retain? What is the trustee's distribution authority? What powers may the **trustor** retain? Does the statute provide that express or implied understandings regarding distributions to the **trustor** are invalid? Does the statute authorize a beneficiary to use or occupy real property or tangible personal property owned by the trust, if in accordance with the trustee's discretion? May a trustee pay income or principal directly to a third party, for the benefit of a beneficiary, even if the beneficiary has an outstanding creditor?

5. Exception Creditors. Does the statute provide an exception (no asset protection) for a child support claim? Does the statute provide an exception (no asset protection) for alimony? Does the statute provide an exception (no asset protection) for property division upon divorce? Does the statute provide an exception (no asset protection) for tort claims? Does the statute provide other express exceptions (no asset protection)? Is a non-**trustor** beneficiary's interest protected from property division at divorce?

6. Other Characteristics of Trust. Does the statute prohibit any claim for forced heirship, legitime or elective share? Are there provisions for moving the trust to the state and making it subject to the statute? What is the allowable duration of the trust? Is the trustee given "decanting" authority to modify the trust? Is there

statutory authority supporting a trust's non-contestability clause even if probable cause exists for contest? Are due diligence procedures required by the statute? What is the procedure and time period for a trustee to provide an accounting and be discharged from liability? Does the statute provide protection for attorneys, trustees and others involved in the creation and administration of the trust?

7. Fraudulent Transfer Law. Are fraudulent transfers excepted from coverage? In a fraudulent transfer action, what is the burden of proof and statute of limitations? Has the state adopted the 2014 amendments and comments of the Uniform Fraudulent Transfers Act (UFTA), now the Uniform Voidable Transactions Act (UVTA)? Does the statute provide that a spendthrift clause is a transfer restriction described in section 541(c)(2) of the Bankruptcy Code?

Another popular ranking chart, the Annual Domestic Asset Protection Trust State Rankings Chart maintained by Steve Oshins, Esq. and available at https://www.oshins.com/state-rankings-charts, analyzes the following factors: (1) the state income tax laws; (2) the statute of limitations applicable to future creditors; (3) the statute of limitations applicable to pre-existing creditors; (4) whether the statute provides an exception for spousal and child support claims; (5) whether the statute provides an exception for tort claims or other creditors; (6) the ease of use of the statute, including whether a new affidavit of solvency is required with respect to each transfer to the trust; (7) the fraudulent transfer laws of the state; and (8) whether the state has a decanting statute.

III. TRANSFER TAX ASPECTS OF ASSET PROTECTION TRUSTS

After the Cook Islands enacted the first and most well-known foreign asset protection trust law some twenty-eight years ago, the professional and popular press focused almost exclusively on the protection of a trustor's assets from the claims of domestic creditors. As noted above in the general description of foreign asset protection trusts, in each of the relevant jurisdictions, the starting point is to provide that the assets in a properly written and implemented trust would not be available for claims by the trustor's creditors. However, it was clear from the earliest days of the foreign trusts that there are complex transfer tax and income tax issues that bear on these trusts as well. In fact, making a DAPT "work" for creditor purposes requires that it "work" for certain tax purposes as well.

A. General

Although the laws permitting the creation of both domestic and offshore asset protection trusts are designed largely to accomplish the goal of asset protection, there are, partly deliberately and partly, perhaps, by chance, a variety of tax consequences which must be considered. Some portion (perhaps few, perhaps most) of people interested in creating asset protection trusts are motivated not only by the desire to place their assets beyond the reach of future creditors, but also by the desire to make completed gifts and to remove the gifted assets from their taxable estates. For example, some people have been counseled, for estate planning purposes, to make completed gifts of assets (perhaps the applicable exclusion amount, currently $5,490,000 per person and $10,980,000 per married couple in 2017) to trusts for descendants and thus remove these amounts – and the income and appreciation on them after the dates of the gifts – from their estates. There is a certain sort of person who would consider making such a gift for tax planning purposes but is reluctant to give up control of the assets completely and too nervous that he or she may eventually need to ask for the return of the assets. For this type of person, an asset protection trust of which the trustor can remain a discretionary beneficiary makes a tax-motivated large gift more palatable, assuming that the creation of the trust will result in a completed gift and, more importantly, that the assets in the trust will not be included in the estate at the trustor's later death for estate tax purposes.

Where estate tax exclusion is a goal, the provisions of the trust may have to be more restrictive than is required to comply with the state statute authorizing the creation of such a trust. For example, the statutes of Alaska, Delaware, Nevada and Rhode Island all permit the trustor to retain a special (limited) power of appointment. However, as discussed below, retention of such a power by the trustor would cause the assets of the trust to be included in the trustor's estate under section 2038 of the Internal Revenue Code (the "Code"). Therefore to meet the tax goal, a trust must omit such an otherwise permissible power. Similarly, all DAPTs and most offshore statutes permit, even anticipate, the trustor to retain the right to the income of the trust. Retention of the right to income would cause the trust to be included in the trustor's estate under section 2036 of the Code, as discussed below. The number of U.S. trustors who have created such trusts and retained this right to income and/or other tax-sensitive powers suggests that for many trustors estate tax exclusion is a secondary (or no) consideration.

The principal provisions of the Code relevant to the consequences and opportunities available when creating asset protection trusts are sections 2511, concerning the making of a completed gift, and sections 2036 and 2038, concerning the inclusion in the trustor's estate of certain assets given away by the trustor but in which the trustor retained certain interests or over which the trustor retained certain powers. We discuss first the gift tax consequences and then the estate tax consequences of creating such trusts. Importantly, the provisions of state law that prevent creditors from reaching the assets of these types of trusts are particularly significant in determining whether the trustor's transfer to the trust is a completed gift, and whether the assets of the trust will be excluded from the trustor's taxable estate.

B. Gift Tax Issues

The first step in making a gift of property that will be excluded from one's estate is to ensure that at the time the gift is made the gift is **complete.** A completed gift is a necessary precondition (though not sufficient) to estate tax exclusion. If the donor has not made a completed gift – has not relinquished control of the assets – then neither the underlying assets nor the income and appreciation thereon can be excluded from the donor's estate.

The test for whether a trustor has made a completed gift is essentially whether the trustor has given up dominion and control of the assets. Section 2511 of the Code provides that a gift tax applies to any completed transfer "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 25.2511-2(b) of the regulations provides that whenever a donor has

> so parted with dominion and control as to leave no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

This section of the regulations goes on to specify that a trustor's transfer of property to a trust where the trustee has the discretion to pay income to the trustor or accumulate the income would be a completed gift if the trust provided specifically to whom the remainder would be paid. However, a similar trust would not be a completed gift where the trustor retained a limited or special power of appointment – the power to appoint by his or her will to whom the remainder of the trust shall ultimately be paid. Retaining this power is, in essence, retaining control of the ultimate disposition of the assets.

In Revenue Ruling 77-378, 1977-2 C.B. 347, the IRS determined that a trustor's transfer of approximately one-half of his assets to a trust from which the trustee had the power, but not the obligation, to distribute either principal or income to the trustor, was a completed gift. The IRS in essence applied a two-part test to determine whether or not the gift was complete:

1. First, had the trustor retained dominion and control over the assets by virtue of retaining an enforceable right to distributions of income or principal? The IRS held the trustor had no right to enforce any distributions.

2. Second, had the trustor retained dominion and control over the assets by retaining the ability to borrow funds (and thus, essentially live as if he or she had never given them up) and make the trust assets available to his or her creditors? **The IRS held that the trustor could not make the funds available to himself or herself where his or her creditors, under state law, would be unable to reach the assets.**

In addition to Revenue Ruling 77-378, a number of courts have recognized that a gift may be complete where a trustor transfers funds to a trust, despite the fact that he or she may receive distributions from the trust in the trustee's unfettered discretion. *See Herzog v. Commissioner*, 116 F.2d 591 (2d Cir. 1941). *See also Outwin v. Commissioner*, 76 T.C. 153 (1981); *Paolozzi v. Commissioner*, 23 T.C. 182 (1954); *Vander Weele v. Commissioner*, 254 F.2d 895 (6th Cir. 1958); Rev. Rul. 76-103, 1976-1 C.B. 293.

The possibility that a trustor's creditors may at some point be able to reach the assets of the trust can cause the transfer to fail to qualify as a completed gift. Here the intersection between the gift and estate tax goals and the provisions of state law that protect the assets from creditors is most significant. The IRS and the courts have generally concluded that where the trustor of a trust "cannot utilize the assets by going into debt and relegating the [trustor's] creditors to the trust" there is a completed gift. Rev. Rul. 77-378. By contrast, in *Paolozzi v. Commissioner*, 23 T.C. 182 (1954), the Tax Court held that where, under applicable state law the creditors of the trustor could reach the trust assets, "it follows that [the trustor] . . . could at any time obtain the enjoyment and economic benefit of the full amount of the trust income" and the court concluded that this prevented the trustor's gift from qualifying as a completed gift. *Accord, Outwin v. Commissioner*, 76 T.C. 153 (1981); *Vander Weele v. Commissioner*, 254 F.2d 895 (6th Cir. 1958); Rev. Rul. 76-103, 1976-1 C.B. 293.

Two private letter rulings reflect the IRS's evolving views regarding transfers to trusts where the local law is specifically structured to provide that a trustor's creditors may not attach the assets in self-settled trusts. In PLR 9332006, the IRS ruled that the creation of an offshore trust in a jurisdiction where the law provides that the trustor cannot make the trust assets available to his or her creditors by incurring debt, would be a

completed gift. Similarly in PLR 9837007, the IRS ruled that a transfer to an Alaska trust would be a completed gift. More recently, in 1999 the IRS declined to issue a ruling on whether a transfer to a Delaware trust created under the Delaware Qualified Dispositions in Trust Act is a completed gift or on whether the assets would be included in the trustor's estate. See the discussion below concerning the IRS's increasing unwillingness to grant a ruling on the estate tax inclusion of assets in such trusts.

C. Estate Tax Issues

Similar considerations, particularly as to the rights of creditors to reach the assets of the trust, apply to the determination of whether the assets of a trust must be included in the trustor's taxable estate for federal estate tax purposes. As noted above, although a completed gift is a necessary condition for the determination that assets transferred will not be in the trustor's estate, it is not sufficient. The IRS has engaged in a separate analysis of the estate tax provisions from the gift tax provisions, and rulings and court cases have been somewhat inconsistent in their results. For example, compare *Uhl v. U.S.*, 241 F. 2d 867 (7th Cir. 1957) (an estate tax case holding property in discretionary trust not included in estate where creditors could not reach asset under local law) with *Outwin v. Commissioner*, 76 T.C. 153 (1981) (a gift tax case holding no completed gift where trustor could relegate creditors to trust assets).

Under section 2038 of the Code, a transfer in trust will be included in the trustor's taxable estate where the trustor retains the power to "alter, amend, revoke or terminate" the enjoyment of the interests in the trust. As noted above, the state DAPT statutes may permit a trust that qualifies for protection from creditors to include a provision permitting the trustor to exercise a limited testamentary power of appointment over the remainder. However, where estate tax exclusion is a goal, the trustor must not retain a limited power of appointment, as this would clearly cause estate tax inclusion under section 2038 of the Code.

In Revenue Ruling 76-103 (1976-1 C.B. 293), the IRS addressed both the question of whether a transfer in trust was a completed gift, and the related question of whether the trust assets were includable in the trustor's estate under section 2038 of the Code, where creditors could reach the trust assets. The IRS reasoned that a trustor had not made a completed gift where the trustor "could effectively enjoy all the trust income by relegating the creditors to the trust for their claims." However, the IRS noted that the transfer would be a completed gift for gift tax purposes "if and when the [trustor's] dominion and control ceases, such as by a decision to move the situs of the trust to a State where the trustor's creditors cannot reach the trust assets." Further, the IRS ruled that the trust assets would be included in the trustor's taxable estate under section 2038 of the Code because of the trustor's "retained power to, in effect, terminate the trust by relegating the [trustor's] creditors to the entire property of the trust."

Most of the cases and rulings concerning whether assets transferred to a self-settled trust may be excluded from the trustor's estate concern section 2036 of the Code. Section 2036(a)(1) of the Code clearly requires inclusion in the trustor's estate of any

assets transferred to a trust where the trustor retains "the possession or enjoyment of, or the right to the income from, the property." A right to income from the trust must be avoided, even where permitted under state law, if estate tax exclusion is desired.

Absent facts that prove an agreement to actually distribute the income of the trust to the trustor, where the trustor is a discretionary beneficiary of the trust with no right to the income of the trust, but with only the possibility that he or she may receive income distributions as determined in the unfettered discretion of the trustee, the trustor has not retained a right to income or possession or enjoyment to cause estate tax inclusion under section 2036. *See Estate of German v. United States*, 85-1 U.S.T.C. ¶13610 (Cl. Ct. 1985); *Estate of Uhl v. Commissioner*, 241 F.2d 867 (7th Cir. 1957); *Estate of Wells v. Commissioner*, 42 T.C.M. 1305 (1981); PLR 9332006; PLR 8037116. *See also*, *Commissioner v. Irving Trust Company*, 147 F.2d 946 (2nd Cir. 1945).

As noted above, in PLR 9332006, the IRS ruled that a transfer to an offshore trust where the trustor retained no interest or power over the trust, but only a discretionary right to receive distributions from the trust, the transfer was a completed gift and the assets were not included in the trustor's estate for federal estate tax purposes under sections 2036, 2037 or 2038 of the Code. The IRS has become increasingly reluctant to give the kind of guidance given in PLR 9332006, particularly on the question of estate tax inclusion. In PLR 9837007, although the IRS ruled that a transfer to an Alaska trust would be a completed gift, the IRS declined to rule whether the assets would or would not be excluded from the trustor's estate. More recently, in 1999 the IRS declined to issue a ruling on whether a transfer to a Delaware trust created under the Delaware Qualified Dispositions in Trust Act is a completed gift or on whether the assets would be included in the trustor's estate.

There are essentially two lines of reasoning under which some authorities have concluded under specified circumstances that the assets of a trust in which a trustor has retained no express income interest but only a discretionary interest in the income or principal must be included in the trustor's estate under section 2036 of the Code.

1. First, where the trustor's creditors can reach the assets of the trust or the income of the trust as a result of the application of local law, authorities have held that the trustor essentially retained the possession and enjoyment of the assets, and the economic benefit of the assets. This is the "relegation of creditors" to the trust assets argument, also discussed above in connection with the gift tax.

2. Second, where the trustor and the trustee had an express or implied agreement or arrangement, despite the purely discretionary language of the trust instrument, assuring that the trustor would actually receive distributions, authorities have held the value of the assets includible in the trustor's estate under section 2036(a)(1) of the Code. One reason the IRS has been unwilling to rule in the estate tax area is that the facts necessary to determine whether or

not an "arrangement" exists between the trustor and the trustee to pay the income to the trustor for any period during trustor's life cannot be established or evaluated until the trustor's death, or at least until a substantial period of the administration of the trust has occurred.

Most of the significant cases and rulings regarding estate tax inclusion of discretionary self-settled trusts under section 2036(a)(1) of the Code relate to the question of creditors' ability to access the trust funds. By contrast, proof of an "arrangement" or agreement to make distributions requires specific factual determinations about the actual administration of the trust and other actions of specific actors, not relevant to drafting a trust or designing a state statute that permits the creation of a certain type of trust. However, the authorities that consider the consequences of the ability of some creditors to reach the trust assets are not altogether consistent or helpful.

1. In *Estate of Uhl*, 241 F.2d 867 (7th Cir. 1957), the Court of Appeals reversed the Tax Court's determination that the assets of a trust should be included in the trustor's estate, because the Court of Appeals concluded that under Indiana law creditors of the trustor could not reach trust assets. Similarly, in *Estate of German v. United States*, 85-1 U.S.T.C. ¶13610 (Cl. Ct. 1985), the U.S. Claims Court determined that the IRS had not established that under Maryland law the trustor's creditors could reach the trust assets, and therefore held that the trust assets were not included in the trustor's taxable estate. By contrast, in *Estate of Paxton v. Commissioner*, 86 T.C. 785 (1986), the Tax Court held that trust assets were includable in the decedent's estate under section 2036(a)(1) of the Code in part because the trustor's creditors could reach such assets under applicable law.

2. In some instances, the courts and the IRS fail to analyze the ability of creditors under applicable law to reach the trust assets. For example, in PLR 9332006 it is stated, without any analysis, that the taxpayer has represented as a fact that under the applicable law of the jurisdiction creditors cannot reach the trust assets.

3. Although this is not always clear in the authorities, the origins of the doctrine that the ability of a creditor to reach trust assets gives rise to estate tax inclusion under section 2036 of the Code (or, as suggested in Rev. Rul 76-103, under section 2038 of the Code) is the notion that if creditors generally can reach trust funds, the trustor will be able to borrow funds and live as if he or she never gave the funds away, spending all of the borrowed funds and "relegating" the creditors to the trust assets for repayment. For example, in *Vander Weele v. Commissioner*, 254 F.2d 895 (1956), the Court of Appeals explained the effective retention of the

economic benefits of creating a trust that is accessible to one's own creditors as follows: "The trustor 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."

4. The Delaware DAPT statute, as originally enacted, contained an exception permitting a lender to reach the trust assets where it had made a loan to the trustor on the basis of the trustor's own representation that the assets of the trust were available to satisfy the trustor's debts. This provision was widely regarded as creating an estate tax problem under section 2036 of the Code, and was repealed in an amendment to the Delaware statute.

5. Increasingly it appears, however, that the IRS regards **any possibility** that any one of the trustor's creditors could reach the trust assets as sufficient to raise an estate tax inclusion issue under section 2036 of the Code, regardless of whether the trustor can truly be said to have retained the economic benefits of the assets. This position seems a stretch, as the claims of a potential creditor, such as a spouse or child, to support are not the type of obligations a trustor would voluntarily incur to manufacture a debt in order to enjoy the economic benefits of the trust assets. Nevertheless, if the ability of any creditor to reach the trust assets under any circumstances at any time caused inclusion under section 2036 of the Code, no asset protection trust created under the Delaware, Alaska or Rhode Island law, or the laws of other DAPT states that protect certain so-called "exception creditors," could reasonably hope to avoid estate tax inclusion. Under the laws of each such state, there are some creditors who can reach the trust assets. For example, these creditors might include creditors pursuing claims within four years (two years, under Nevada law) of the transfer and creditors with child support orders. A trust created under the Nevada statute would be in a stronger position only if it is true that Nevada trusts are not subject to claims for child support.

6. Notably, Alaska's narrow exception for child support orders that must have been in arrears more than 30 days at the time of the transfer, and Nevada's even more restrictive approach, may be wishful thinking. Recently enacted federal law not only requires states to give full faith and credit to child support orders in accordance with federal law, but also overrides the law of the forum with respect to any period of limitations in enforcing a child support order. *See* 28 U.S.C.A. §1738B. Note should also be taken of the provisions of the Child Support Recovery Act of 1992.

> In addition, from a policy standpoint, the claims of spouses and children may be held enforceable against self-settled trusts. *See J.B.G. v. P.J.G.*, 286 A.2d 256 (Del. Ch. 1971), *aff'd*, 306 A.2d 737 (Del. 1973), in which the Delaware courts avoided the provisions of the spendthrift trust statute where a spouse's claims were concerned.

The Service most recently addressed this line of reasoning in PLR 200944002, holding that the assets of self-settled trust created pursuant to the Alaska Trust Act would not be includable in the trustor's gross estate. In that Private Letter Ruling, the trustor proposed to create a trust for the benefit of himself, his wife and his descendants. Under the terms of the trust, the trustee could, but was not required, to accumulate all income or pay income and/or principal to one or more of the beneficiaries. The trustee was neither a related nor subordinate party within the meaning of section 672(c) with respect to the trustor, and the trustor (and certain others) were prohibited from serving as trustee. The trust contained certain transfer restrictions that prevented trust assets from being subjected to the claims of the trustor's creditors, but state law did permit certain creditors, including in the case of a fraudulent transfer, to reach trust assets.

The Service concluded that the trustee's authority to make discretionary distributions of principal and/or income to the trustor did not, by itself, cause trust principal to be includible in the trustor's estate under section 2036. Implicit in this conclusion is a recognition – analogous to that reached in the gift tax setting – that there is a distinction between a case in which general creditors may be able to reach trust assets, which is the classic relegation case and results in inclusion under section 2036, and a case in which certain limited creditors may be able to reach the assets of a trust, without resulting in inclusion under section 2036.

Notably, in PLR 200944002 the Service did caution that the discretion of the trustee, combined with other factors such as an understanding or preexisting arrangement between the trustor and the trustee regarding the exercise of discretion, may cause inclusion of the trust assets in the trustor's gross estate for federal estate tax purposes under section 2036. This issue is addressed later in this memorandum.

The author has seen through later requested ruling attempts that it is this concern about an understanding or preexisting arrangement between the trustor and trustee that has contributed to the Service's reluctance to issue private letter rulings in this area. As noted above, in the estate tax area, the facts necessary to determine whether or not an "arrangement" exists between the trustor and the trustee cannot be established or evaluated until the trustor's death, or at least until a substantial period of the administration of the trust has occurred.

IV. A DEARTH OF CASE LAW

Despite the existence of self-settled domestic asset protection trusts for the past twenty years, there is a death of case law interpreting such statutes, and none that address the gift and estate tax issues outlined above. The small handful of cases focus on peripheral issues, such as conflict of laws or the interplay with bankruptcy law, and are oftentimes distinguishable by bad facts.

The following is a summary of the relevant case law (categorized by the applicable state DAPT statute):

A. Alaska – *Battley v. Mortensen*, 2011 WL 5025288 (Bankr. D.C. Alaska 2011). Under the somewhat convoluted facts of this particular case, the United States Bankruptcy Court in Alaska found that the trustor's funding of a trust created under the Alaska Trust Act was a fraudulent transfer and thus voidable by the trustee in bankruptcy. The transfer to the trust fell within the 10-year look-back period applicable to self-settled trusts under section 548(e) of the Bankruptcy Code.

B. Alaska – *Waldron v. Huber (In re Huber)*, 493 B.R. 798 (Bankr. W.D. Wash. 2013). The United States Bankruptcy Court in Washington declined to apply Alaska law to a trust created under the Alaska Trust Act by a Washington debtor, citing Washington's strong public policy against self-settled asset protection trusts. The Court also found that section 548(e) of the Bankruptcy Code applied and that the trustor's transfers to the trust were made with the actual intent to delay, hinder or defraud creditors.

C. Delaware – *Trust Co. Bank v. Matthews*, 2015 WL 295373 (Del. Ch. 2015). The Delaware Court of Chancery engaged in a significant contacts test to determine the applicable statute of limitations period for alleged fraudulent transfers to a trust created under the Delaware Qualified Dispositions in Trust Act by a non-Delaware resident. The Court declined to determine whether the Delaware DAPT statute modified the general rule pertaining to the statute of limitations for actions against fraudulent transfers to Delaware trusts where there was a sufficient other basis to dismiss the claims at issue under general conflict of rules laws. Ultimately, the Delaware asset protection planning employed by the trustor was successful, but primarily because the Court rejected the creditor's claims under a laches (statute of limitations) defense.

D. Nevada – *Dahl v. Dahl*, 215 Utah 79 (Utah 2015). The Utah Supreme Court declined to apply Nevada law to a trust created under the Nevada Spendthrift Trust Act by a Utah resident where

the Court found that Utah's marital laws created a strong overriding public interest in seeing that its laws regarding the division of marital estates was respected. Interestingly, Utah has enacted a DAPT statute, but the Court was still unwilling to apply the Nevada DAPT statute. Commentators have suggested that in states that have **not** adopted a DAPT statute, the courts will be even less willing to apply another state's laws under its (the forum state's) conflict of law analysis.

E. Nevada – *Klabacka v. Nelson*, 133 Nev. Advance Opinion 24 (2017). The Nevada Supreme Court held that the assets in a trust created by husband under the Nevada Spendthrift Trust Act could not be reached for satisfaction of **future** child support and spousal support claims. The Court relied heavily upon the legislative history of the Nevada DAPT statute. The Court confirmed that Nevada does recognize spouses and domestic children in a domestic matter as exception creditors.

V. EVOLUTION OF OTHER PROTECTIONS

While much of the dialogue over the past twenty years has focused on DAPTs, the vast majority of estate planning clients do not even consider using these vehicles (although this is changing). Many of our clients' affairs will be governed by the statutory law and case law where they reside, focusing on the protections afforded in their jurisdictions. Consider, for example, the various protections provided through the homestead exemption and other exemptions for personal property, life insurance, annuities, income and retirement plans. Twenty-four states and the District of Columbia recognize tenants by the entireties between married persons in some form. Additional protections are afforded under the laws applicable to limited liability companies (LLCs) and limited partnerships (LPs).

The law continues to evolve. Consider the following "newer" asset protection planning techniques:

A. Inter Vivos QTIP Trusts. Take Florida for example. Florida currently does not have a self-settled asset protection statute; however, Florida recognizes certain protections with respect to the trustor of an inter vivos qualified terminable interest property (QTIP) trust.

In broad terms, the Florida inter vivos QTIP statute protects assets transferred by a trustor to an inter vivos QTIP trust for the benefit of the trustor's spouse from the trustor's creditors after the death of the spouse. After the death of the trustor's spouse, the assets remaining in the QTIP trust are considered to have been contributed by the spouse, and not by the trustor. As a result, the QTIP trust is not considered to be "self-settled" and so would not be available to satisfy creditors' claims against the trustor after the death of the trustor's spouse.

Florida is not alone in recognizing this concept. Arizona, Arkansas, Kentucky, Maryland, North Carolina, Oregon, South Carolina and Texas have enacted similar inter vivos QTIP trust statutes.

B. Entireties Trusts. Several states, including Delaware, Hawaii, Illinois, Indiana, Maryland, Missouri, North Carolina, Tennessee, Virginia and Wyoming, have passed laws allowing married couples to create a statutory tenancy by the entireties trust ("STET"). In general terms, a STET is a trust that continues to recognize the tenancy by the entirety character of property transferred by spouses to a trust. So long as the spouses owned the property as tenants by the entirety before transferring it to the trust, the spouses remain married for the duration of the trust, and both spouses are beneficiaries of the trust, the property will continue to

enjoy the same immunity from the spouses' separate creditors as if the spouses owned the property directly (free of trust) as tenants by the entirety. Essentially, these statutes allow spouses to transfer tenancy by the entireties property to a revocable trust during their lifetimes.

Unlike "true" tenancy by the entireties property, many STET statutes do not require the deceased spouse's interest in the property to pass automatically by operation of law to the surviving spouse. As a result, spouses using this technique can protect property both from their separate creditors during their lifetimes and, upon the death of the first spouse provided that the surviving spouse does not remain a beneficiary of the deceased spouse's share of the trust, from the creditors of the surviving spouse with respect to property passing as a result of the death of the first spouse to die.

C. Inherited IRAs. Another developing area of law pertains to inherited IRAs. A handful of states, including Florida, Ohio, Missouri, Alaska and Texas, have statutory creditor protection for inherited IRAs. In 2014, the United States Supreme Court held in *Clark v. Rameker*, 134 S. Ct. 2242 (2014), that inherited IRAs do not qualify as "retirement funds" under section 522(b)(3)(c) of the Bankruptcy Code and therefore are not exempt from the creditors of debtors using the federal exemptions in bankruptcy. Because *Clark* was decided based on the federal exemptions, debtors who are domiciled in states that recognize statutory creditor protection for inherited IRAs will not be impacted by the decision in *Clark* if they qualify to file for bankruptcy in their state of domicile (by having been domiciled in the state there for 730 days before filing a bankruptcy petition) and they "opt out" of the federal exemptions and elect into the state law exemptions. However, debtors who live in states that do not have statutes that protect inherited IRAs, or debtors who are domiciled in states that do have such statutes but have not lived there for 730 days and must file bankruptcy based upon a previous state of domicile, will not be able to exempt inherited IRAs as qualified "retirement funds" as a result of *Clark*.

D. 529 Plans. 529 plans are tax-advantaged educational savings plans operated by a state or educational institution. In the broadest sense, 529 plans are self-settled techniques. The donor to a 529 plan may withdraw contributed funds at any time, albeit subject to a 10% penalty with respect to federal income tax . The laws of Colorado, Florida, Illinois, Louisiana, New Jersey, Pennsylvania and other states protect plan asset from the creditors of the account owner and/or beneficiary of the plan in varying fashion. For example, in Pennsylvania, creditor protection is afforded to the

account owner and beneficiary of a 529 plan, but only with respect to a Pennsylvania-based plan. This limitation suggests that in this case the legislature was seeking to favor its own plans (and perhaps attract investments) rather than providing a general protection to all residents.

Summary. Does a state's adoption of one or more of these other asset protection planning techniques foreshadow its later adoption of a more robust domestic asset protection trust statute? Or is the adoption of these techniques simply the result of a growing demand for asset protection planning? If a state recognizes asset protection planning techniques like those described above, but has not enacted a domestic asset protection statute, is the state more likely to uphold DAPTs created by its residents using the laws of another state? See the discussion below regarding the choice of law provisions under the Uniform Voidable Transactions Act.

VI. IMPACT OF 2005 BANKRUPTCY ACT

As noted above, in order to be done properly and legally, asset protection planning must be done within the context of the fraudulent transfer laws and bankruptcy laws where applicable. Federal bankruptcy law provide statutory protections for creditors or bankruptcy trustees to satisfy claims against assets that a debtor has fraudulently transferred. The 2005 Bankruptcy Act added special provisions pertaining to self-settled asset protection trusts, both foreign and domestic.

Under the "new" section 548(e) of the Bankruptcy Act, a trustee in bankruptcy may look back ten years prior to the filing of a bankruptcy petition to void certain transfers to a self-settled trust. Section 548(e) provides in relevant part as follows:

> 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.

Since most asset protection trusts have a true asset protection purpose, and section 548 (e) includes an intent to hinder future, as well as existing, creditors, it may be difficult to avoid having such transfers brought back into the bankruptcy estate.

The *Battley v. Mortensen* and *In re Huber* cases, discussed above, are good reminders that self-settled asset protection trusts are not an appropriate vehicle for insolvent debtors.

VII. IMPACT OF UVTA AND THE NOTORIOUS COMMENTS

Although the number of jurisdictions that have enacted DAPT statutes has grown considerably over the past twenty years, the majority of the U.S. population resides in states that have not enacted such legislature. Only two of the ten most populated states (Ohio and Michigan) have enacted DAPT statutes. This begs the question of whether DAPTs "work" when the trust trustor does not reside in a DAPT state, but rather avails himself or herself to the laws of a DAPT state by satisfying the requirements of the particular statute (and establishing the requisite "sufficient contact" with the state).

This is where the overlay of the fraudulent transfer laws is important. As noted above, in order to be done properly and legally, asset protection planning must be done within the context of the fraudulent transfer laws. As discussed in more detail below, with the introduction of the Uniform Voidable Transactions Act and the subsequent adoption of the Act in whole or in part by a growing number of jurisdictions, perhaps conflict of law considerations are the next of area of development with respect to asset protection planning. What happens if the trustor of a domestic asset protection trust resides in a state that does not recognize domestic asset protection trusts and there is a conflict of law between the creditor rights laws of the trustor's state and the debtor protection laws of the DAPT state? Can the protections afforded by domestic asset protection trusts be reconciled with the fraudulent transfer laws?

Fraudulent Transfer Law – A Brief History. The Prefatory note to the Uniform Fraudulent Transfers Act that was adopted in 1984 provides:

> The Uniform Fraudulent Conveyance Act was promulgated by the Conference of Commissioners on Uniform State Law in 1918. The Act has been adopted in 25 jurisdictions, including the Virgin Islands . . . . The Uniform Act was a codification of the "better" decisions applying the Statute of 13 Elizabeth. The English statute was enacted in some form in many states, but, whether or not so enacted, the voidability of fraudulent transfers was part of the law of every American jurisdiction. Since the intent to hinder, delay, or defraud creditors is seldom susceptible of direct proof, courts had relied on badges of fraud. The weight given these badges varied greatly from jurisdiction, and the Conference sought to minimize or eliminate the diversity by providing that proof of certain fact combinations would conclusively establish fraud. In the absence of evidence of the existence of such facts, proof of a fraudulent transfer was to depend on the evidence of actual intent.

In 1979, the Conference appointed a committee to study the Uniform Fraudulent Conveyance Act ("UFCA") and to draft a revision. In 1984, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") approved the Uniform Fraudulent Transfer Act ("UFTA"). Currently, forty-five jurisdictions, including heavily populated states such as California, Connecticut, Florida, Georgia, Idaho, Illinois, North Carolina, New Jersey, Ohio, Oregon, Pennsylvania, Texas, Washington, and West Virginia, have adopted a version of UFTA.

Uniform Voidable Transactions Act. In 2014, the Uniform Law Commission amended UFTA for the first time since its creation in 1984. These changes address a few narrowly defined issues, and are not a comprehensive revision.

Most notably, the title of the Act is now the "Uniform Voidable Transactions Act" ("UVTA"). Many commentators felt that the original title was a misleading description because fraud was never a necessary element of a claim under the UFTA and the Act has always applied to the incurrence of obligations, as well as to transfer of property. Thus, the name change aims to clarify the purpose and application of the Act.

The principal features of the amendments include: (1) the addition of a choice-of-law rule for claims governed by the Act; (2) the addition of uniform rules allocating the burden of proof and defining the standard of proof with respect to claims and defenses under the Act; (3) the deletion of a special definition of "insolvency" applicable to partnerships; and (4) minor revisions relating to defenses under the Act.

The addition of the new choice-of-law provisions under UVTA has caught the eyes of many practitioners – perhaps unanticipated by the legislatures enacting such provisions. New section 10 of UVTA provides that "a claim for relief under [UVTA] 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." In other words, the governing law for determining a voidable transaction is the law of the debtor's domicile state. Historically, there had been a question as to which law governed – the law of the settlor/debtor's domicile state or the law of the situs of the debtor's assets, including the situs of the DAPT. Even if a court in the debtor's domicile state deemed the conveyance to be fraudulent or voidable, the debtor could look to the domestic asset protection trust state for protection under its law. Such state could then argue that the trust is valid in such state and that it would not afford full faith and credit to a judgment from the debtor's domicile state.

If a DAPT state adopts section 10 of UVTA, then it arguably would have a more difficult time not affording full faith and credit to the judgment of the debtor's domicile state.

In addition, new comment 8 to section 4 of UVTA states that if a resident of a non-DAPT state which has enacted UVTA creates a DAPT in a DAPT state, the transfer would be *per se* voidable.

More remains to be seen on this issue, and it is unclear whether lawmakers fully understand these issues or whether they are simply enacting a uniform law in its entirety. These tensions will need to be addressed by legislative fixes or through case law. As noted in *Dahl v. Dahl* (summarized above), and as noted in section 270(a) of the Restatement of Trusts dealing with inter vivos trusts, courts may look at whether the debtor's domicile state of residence has a "strong public policy" against the nature of the asset protection provided by the DAPT statute. However, as more and more states enact DAPT statutes or other asset protection planning techniques, the concept of what constitutes a "strong public policy" is unclear and evolving. Will we reach a "tipping

point" at which time DAPTs will be an accepted form of asset protection planning in all jurisdictions either directly or through recognition by another state and no longer be contrary to public policy.

VIII. CONCLUSIONS

As the authors have tried to demonstrate, there has been a rapid and important evolution in the laws governing the rights of debtors and creditors over the past two decades, an evolution marked by the movement of "asset protection planning" to the mainstream activities of trust and estate lawyers. What was, perhaps, only one of many relevant issues in all estate planning engagement through the 1990's has become a significant area of practice and even more significant area of client concern. The twenty years since the first DAPTs in 1997 have seen the expansion of DAPT legislation to twenty percent of the U.S. population and the parallel development and expansion of debtor-friendly legislation in many states. Ancient and hoary common law property rules have fallen by the wayside, along with the Rule Against Perpetuities. Commonly accepted legal tenets such as "you can't spendthrift yourself" seem arcane and indefensible. Legislatures have adopted new statutes, presumably against some headwind from creditor and family lawyers, that give individuals a greater power to protect assets while having the benefit of those same assets. ACTEC and the Real Property Trust and Estate Section of the ABA have devoted significant resources so that their members can join in the discussion of these issues and the impact on their practices.

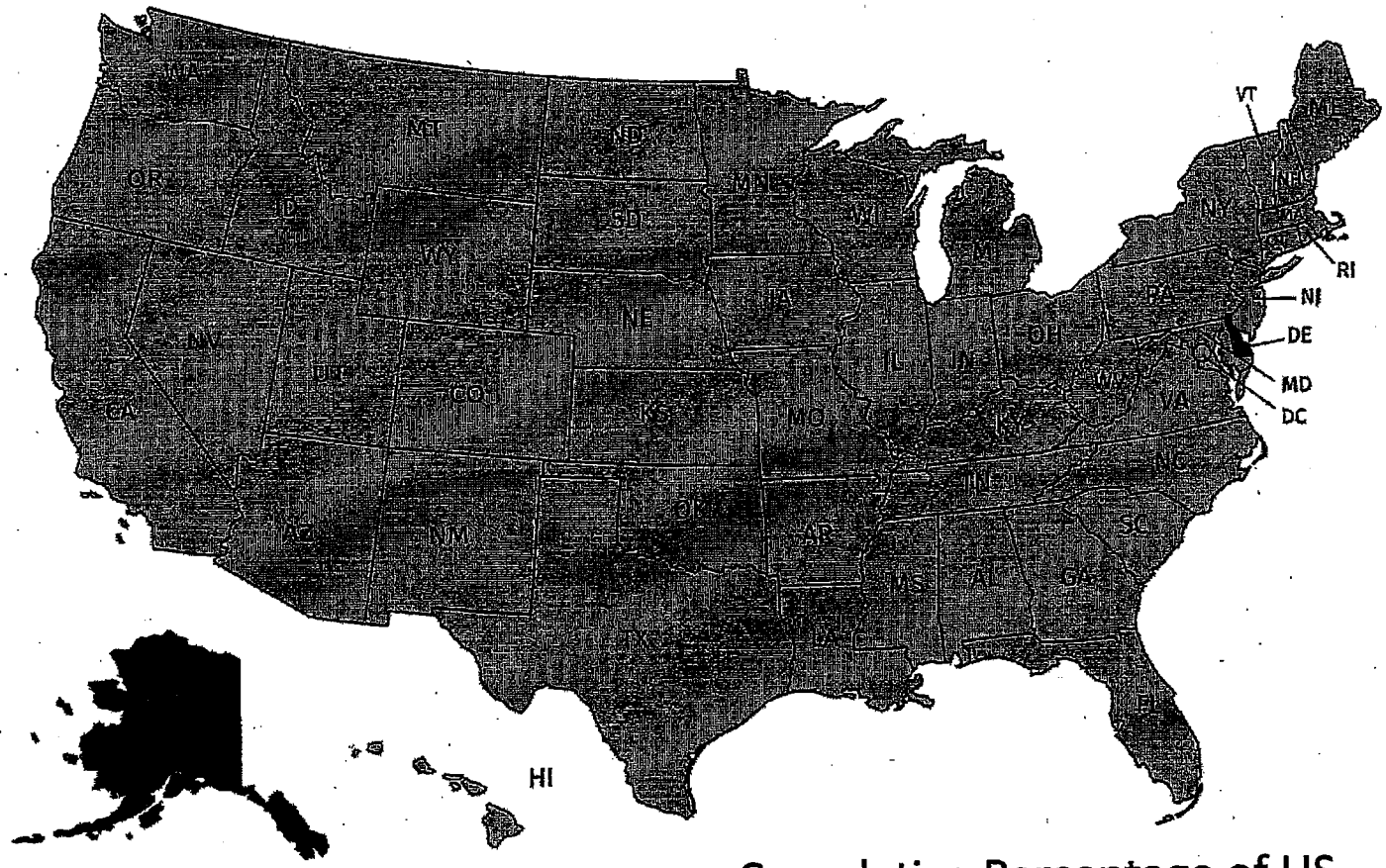
Is the end in sight? Probably not. There is no doubt that discussions are underway now in state capitals and bar groups regarding the need to adopt legislation to compete with sister states for trust and related business and the separate but related need to give their own citizens legal protections from creditors. The authors have not studied the legislative history behind the seventeen DAPT statutes and there are certainly varying reasons behind them in varying jurisdictions. What is certain is that some DAPT jurisdictions "market" their laws in the hopes of attracting business. That said, why wouldn't states without DAPTs consider doing the same? It is worth speculating as to why the Uniform Laws Commissioners have yet to create a committee to study whether there should be a Uniform DAPT law.

This paper does not address the matter of the obligation of trust and estate lawyers to consider the need for asset protection planning in virtually every planning engagement but will conclude with the following observation:

> Is it likely that a client, whose wealth is diminished or eliminated as a result of attachment by existing or foreseeable creditors, will seek to recover damages from the client's estate lawyer who by commission or omission missed a routine and easily implemented plan that would have protected those assets?

Exhibit A

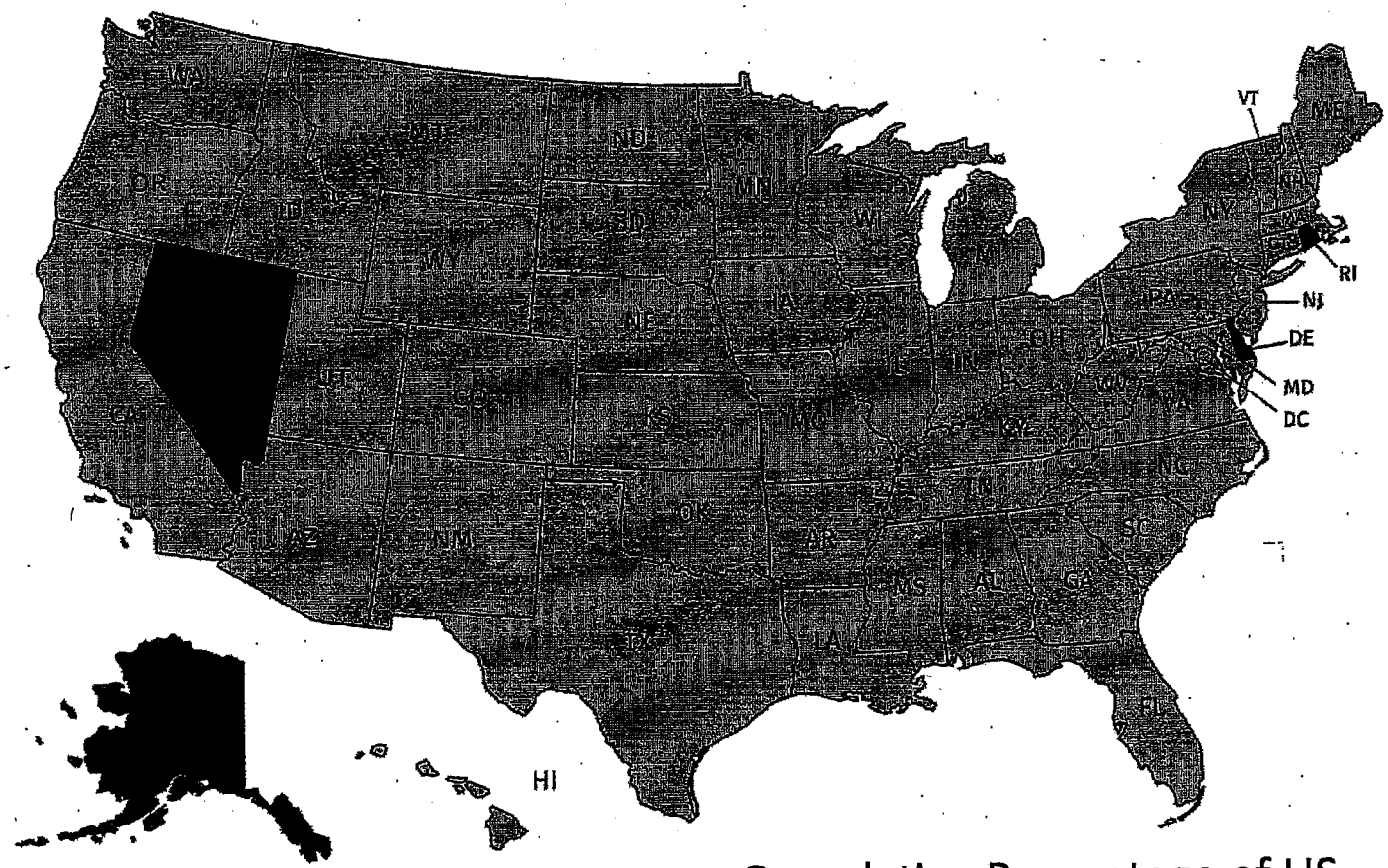
States Enacting DAPT Statutes - 1997



Cumulative Percentage of US Population: .48%

(2010 Census)

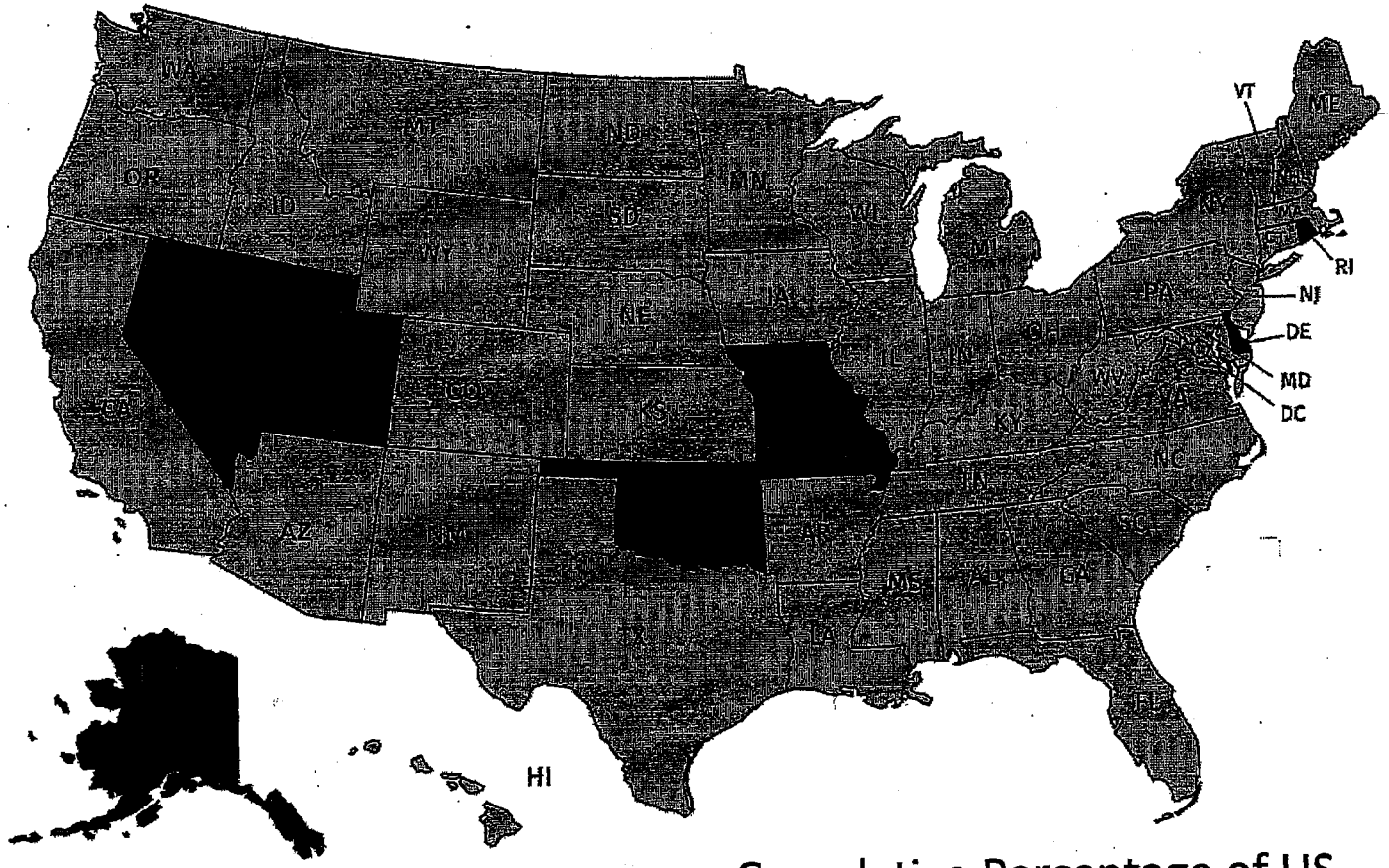
States Enacting DAPT Statutes - 1999



Cumulative Percentage of US Population: 1.70%

(2010 Census)

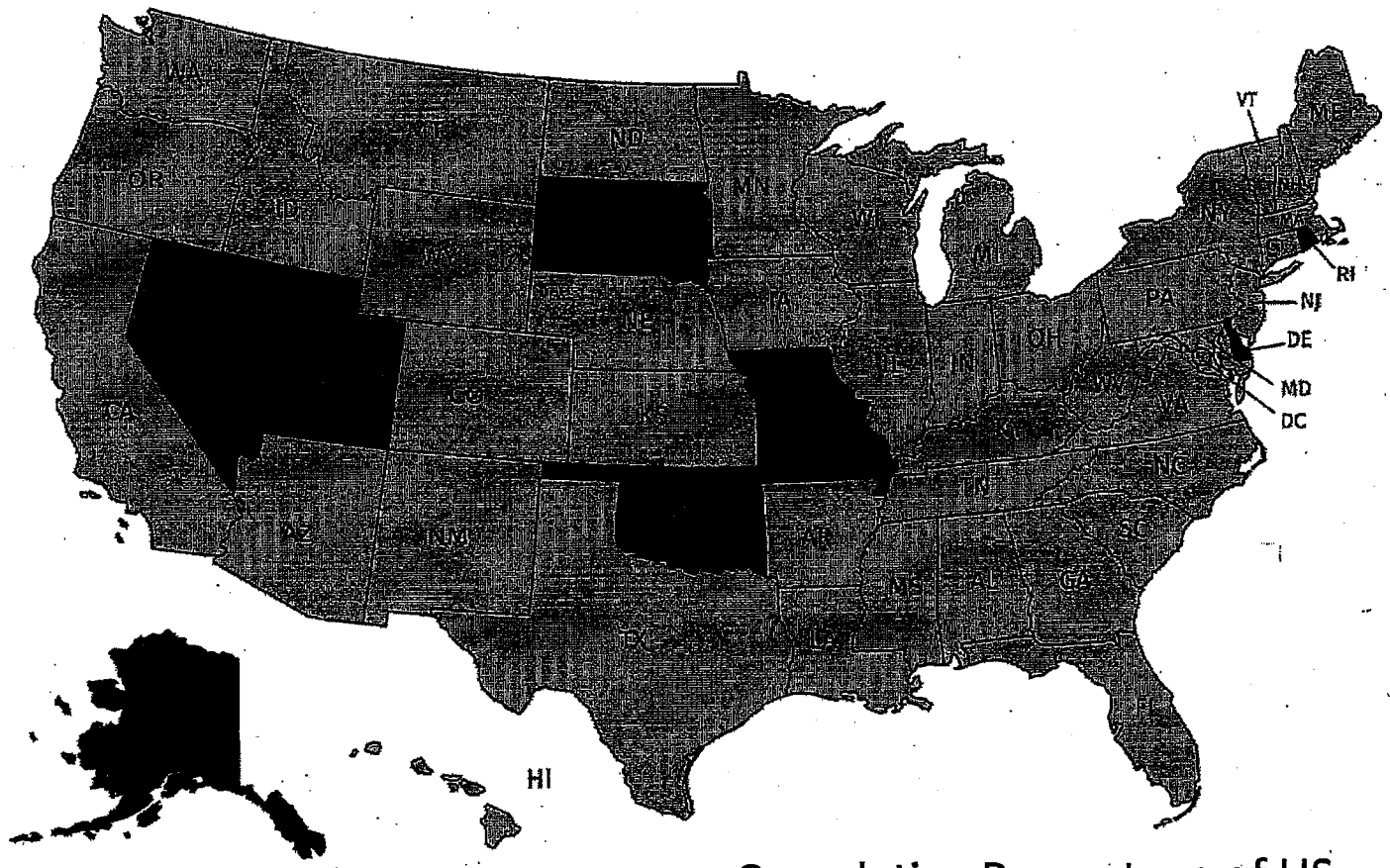
States Enacting DAPT Statutes - 2004



Cumulative Percentage of US Population: 5.75%

(2010 Census)

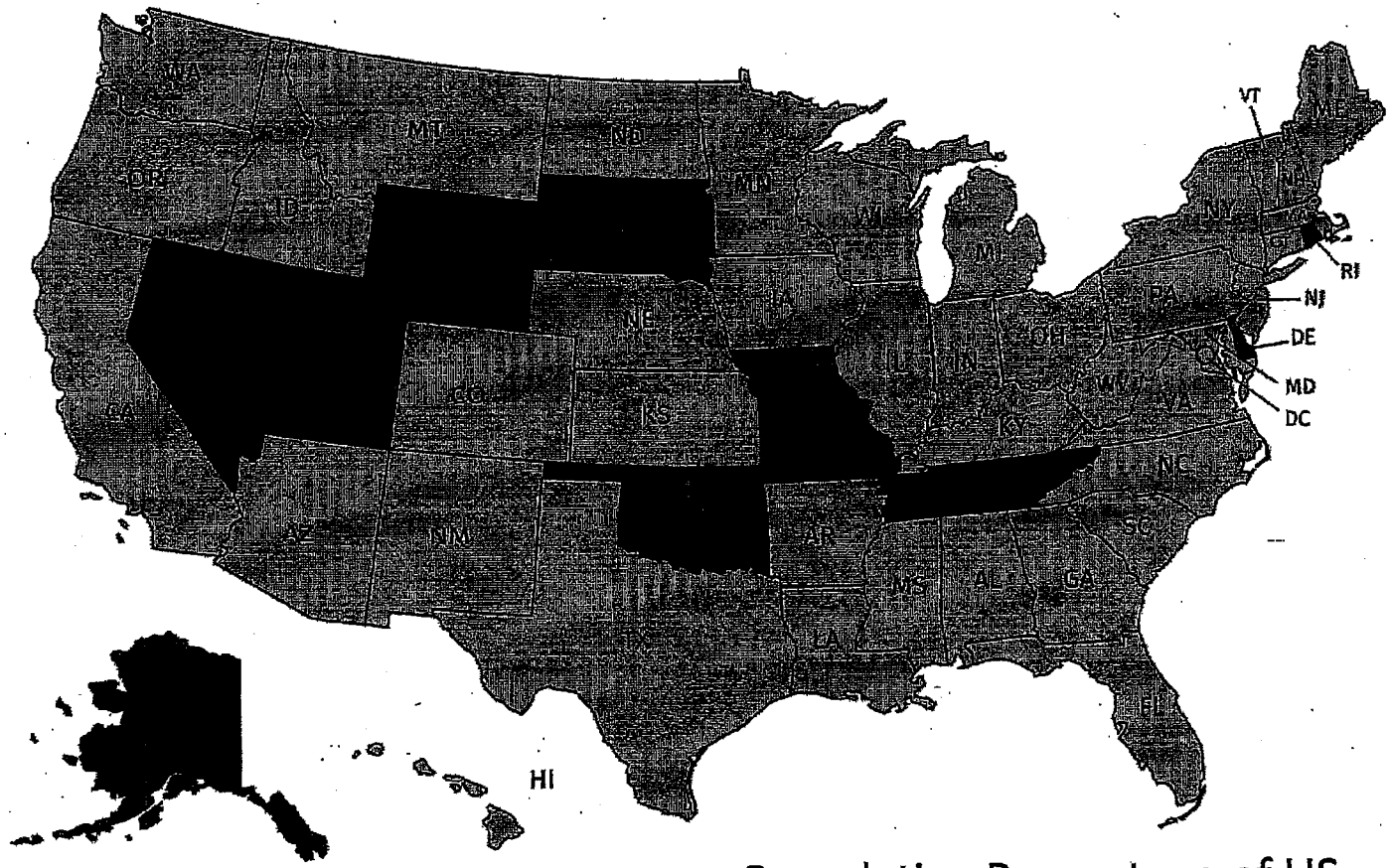
States Enacting DAPT Statutes - 2005



Cumulative Percentage of US Population: 6.01%

(2010 Census)

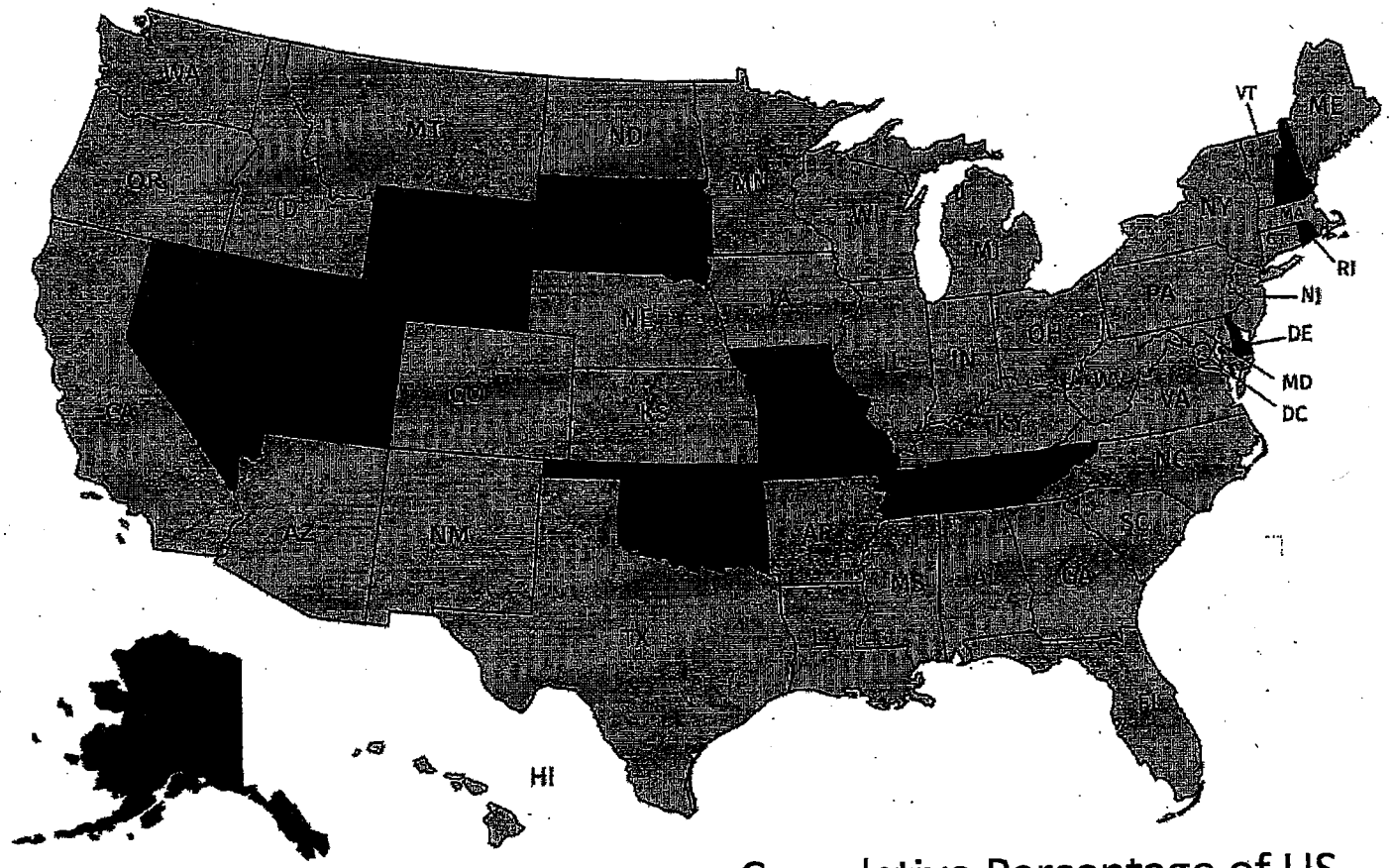
States Enacting DAPT Statutes - 2007



Cumulative Percentage of US Population: 8.25%

(2010 Census)

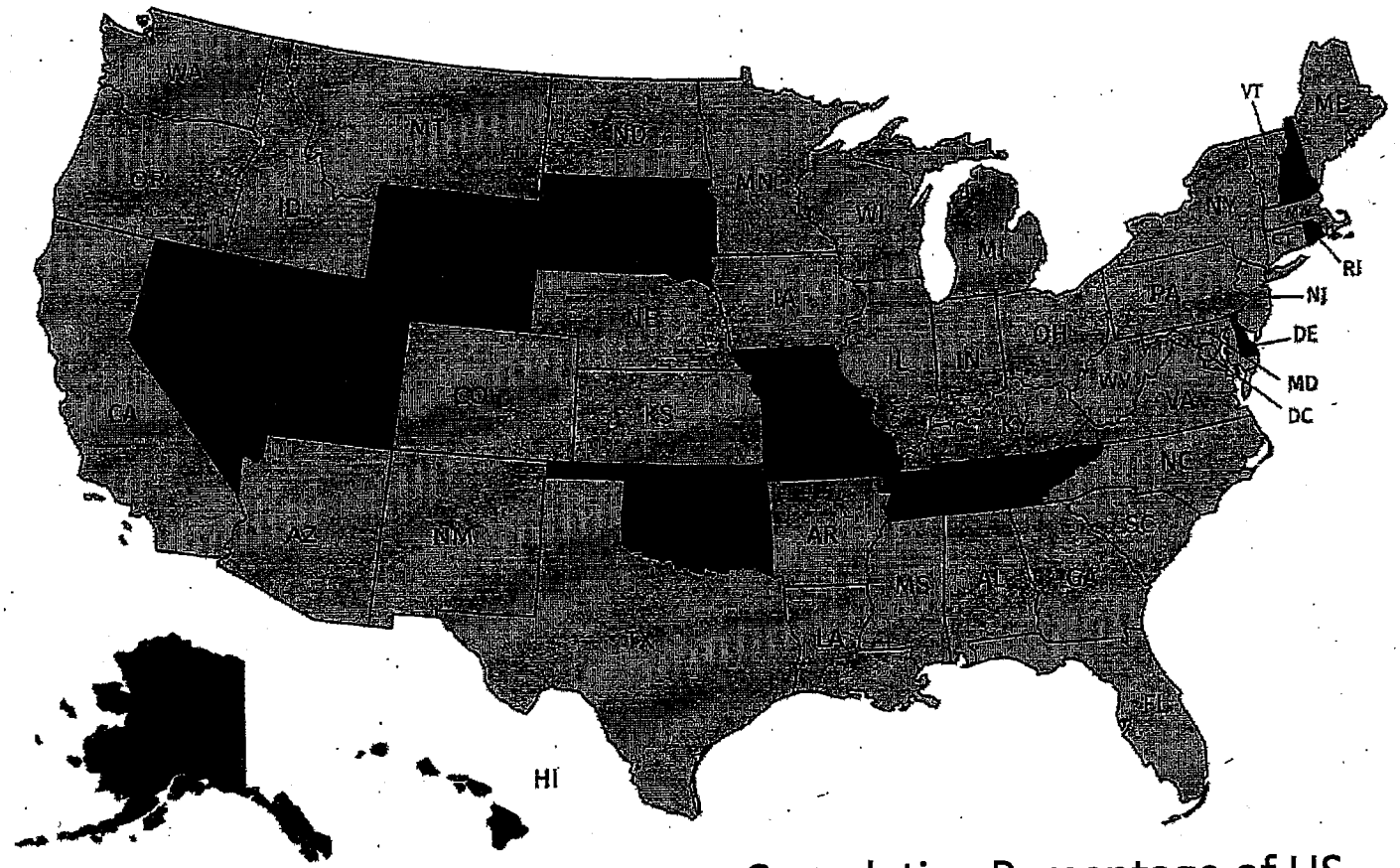
States Enacting DAPT Statutes - 2009



Cumulative Percentage of US Population: 8.68%

(2010 Census)

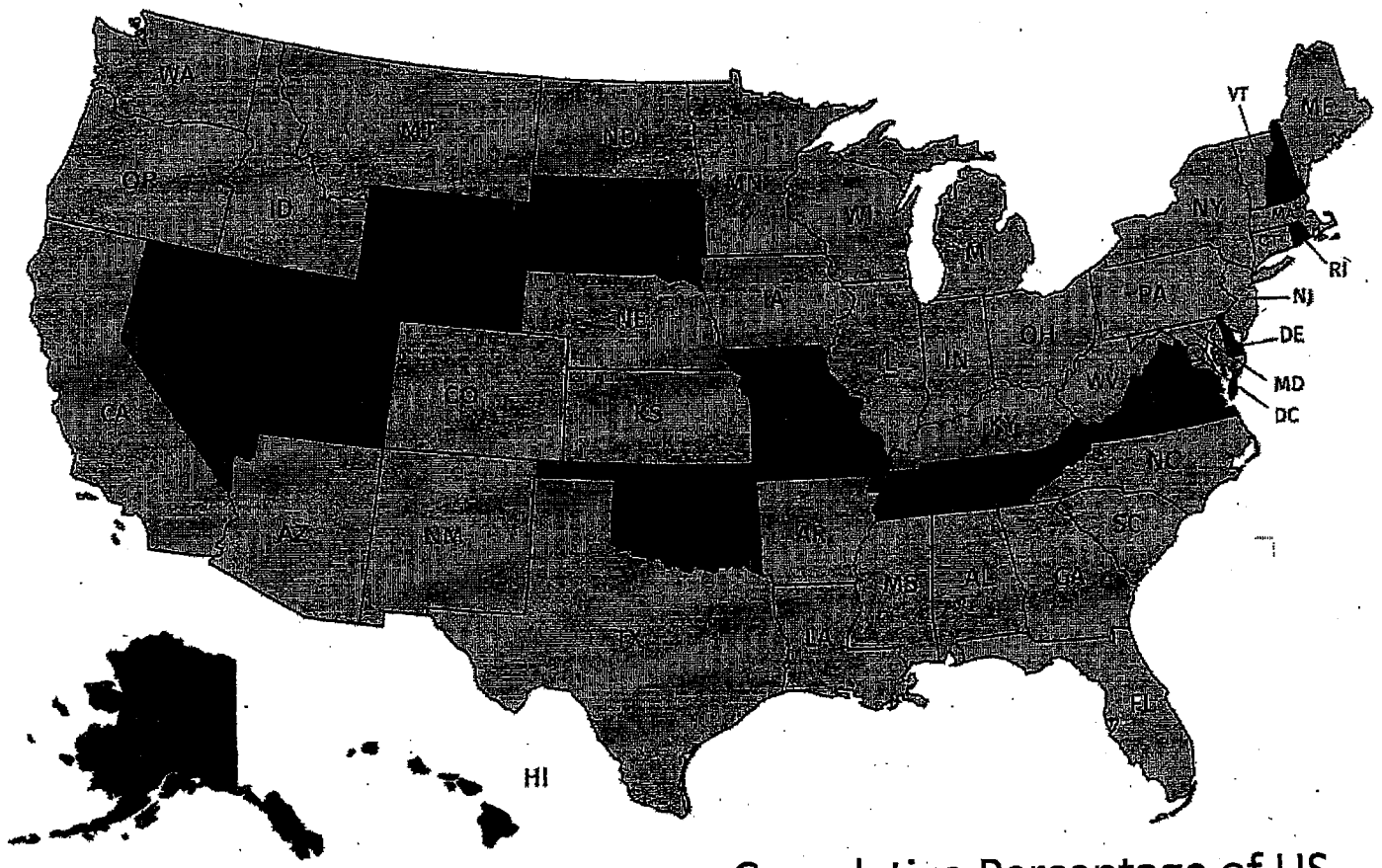
States Enacting DAPT Statutes - 2010



Cumulative Percentage of US Population: 9.12%

(2010 Census)

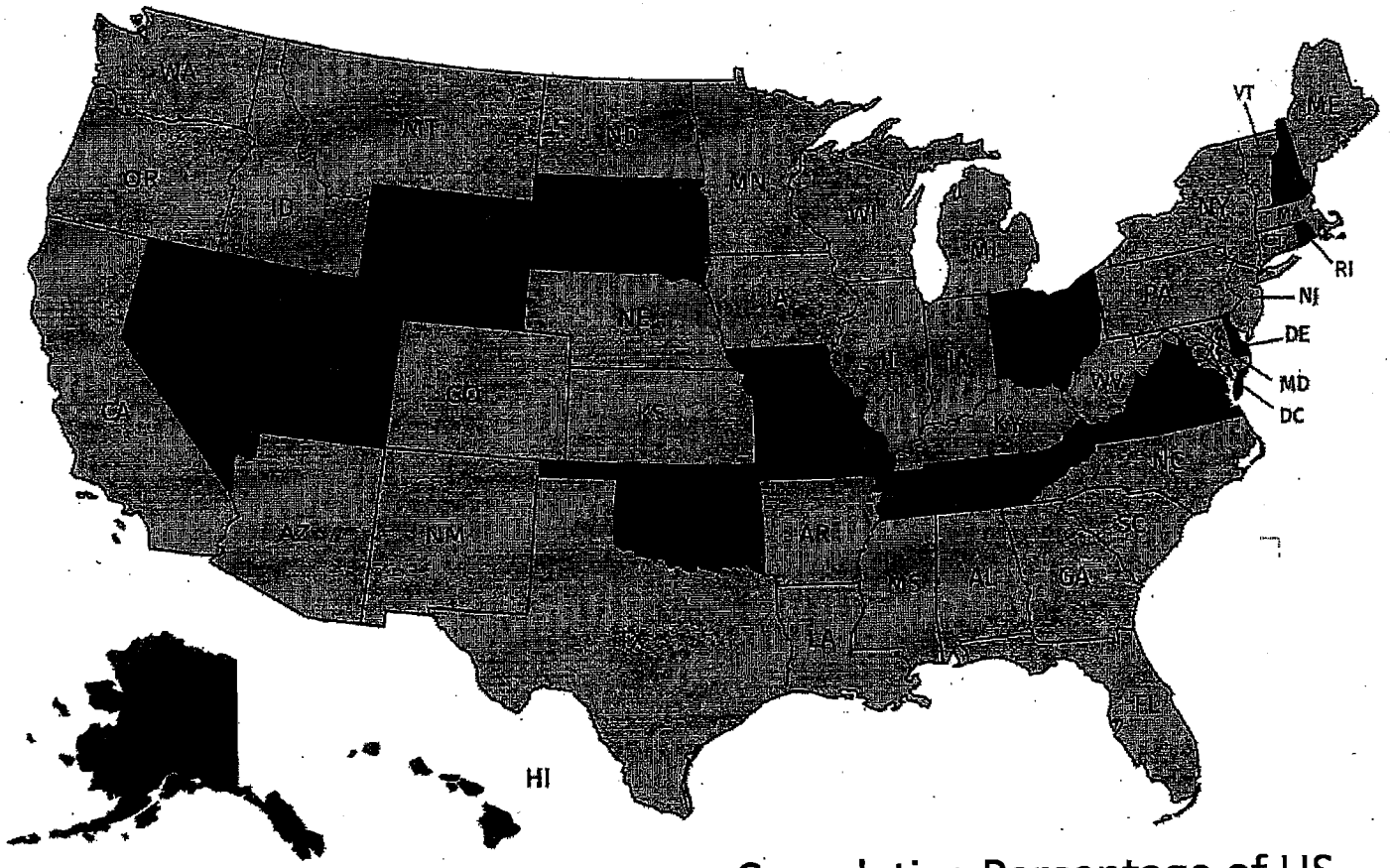
States Enacting DAPT Statutes - 2012



Cumulative Percentage of US Population: 11.71%

(2010 Census)

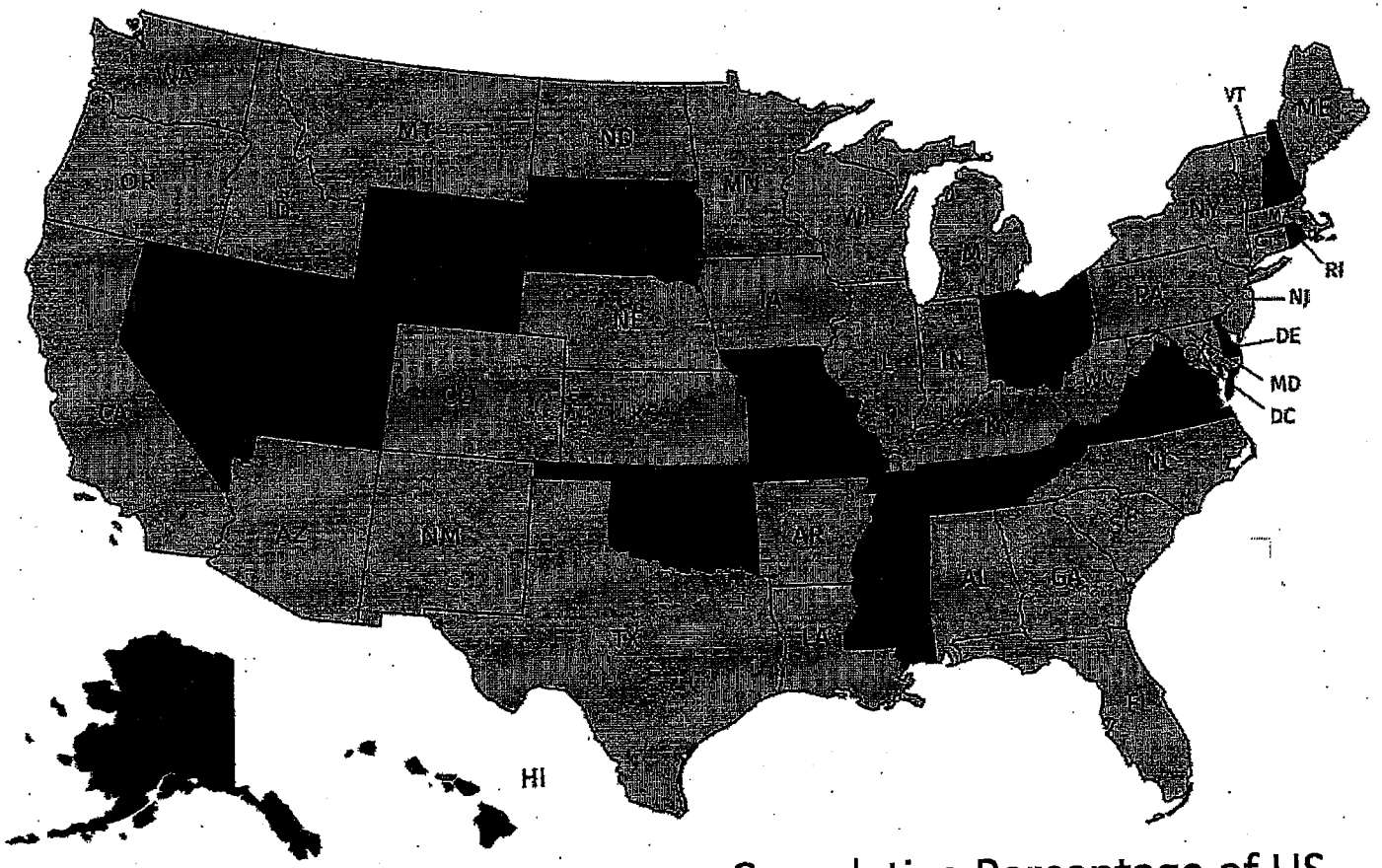
States Enacting DAPT Statutes - 2012



Cumulative Percentage of US Population: 15.45%

(2010 Census)

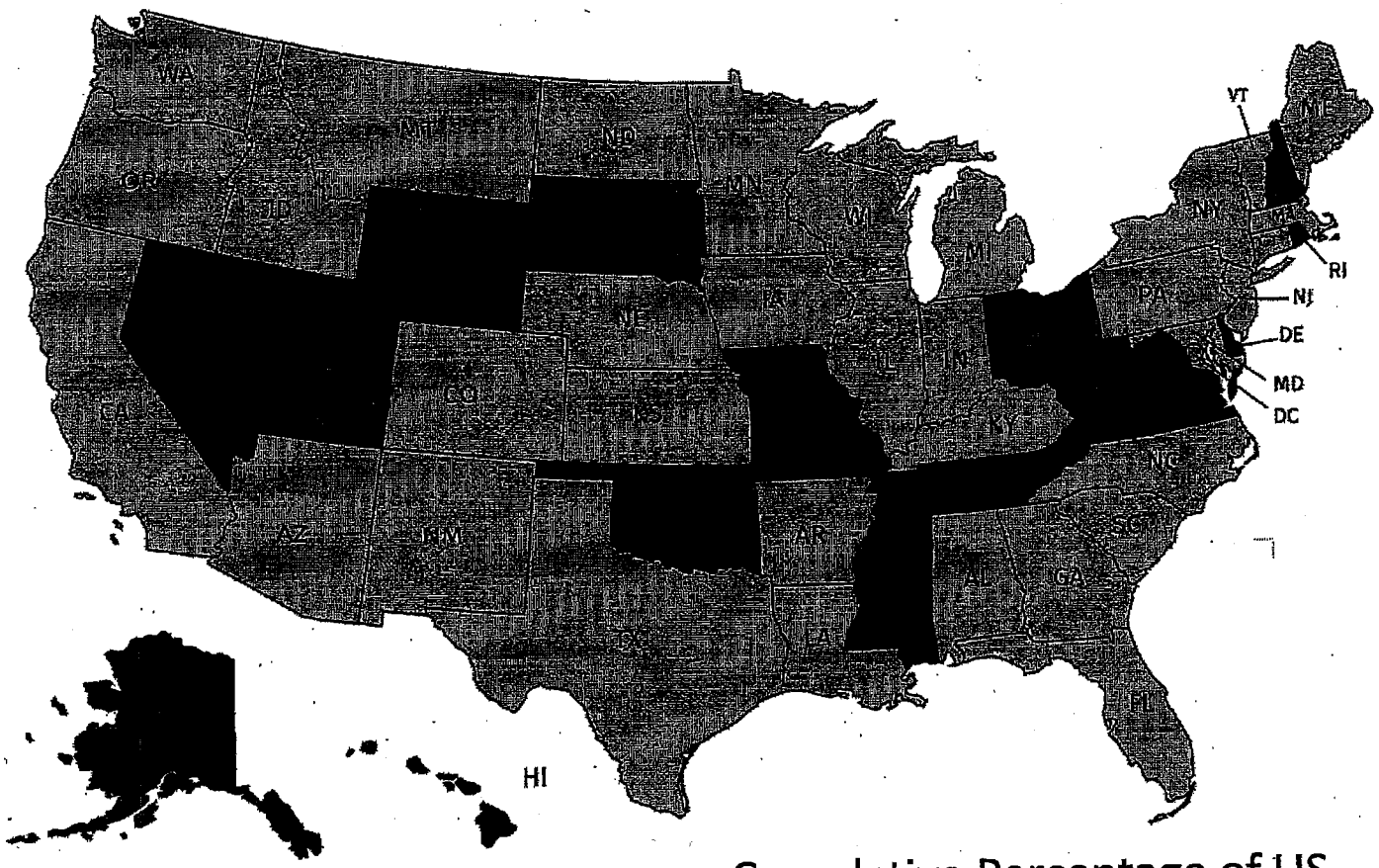
States Enacting DAPT Statutes - 2013



Cumulative Percentage of US Population: 16.41%

(2010 Census)

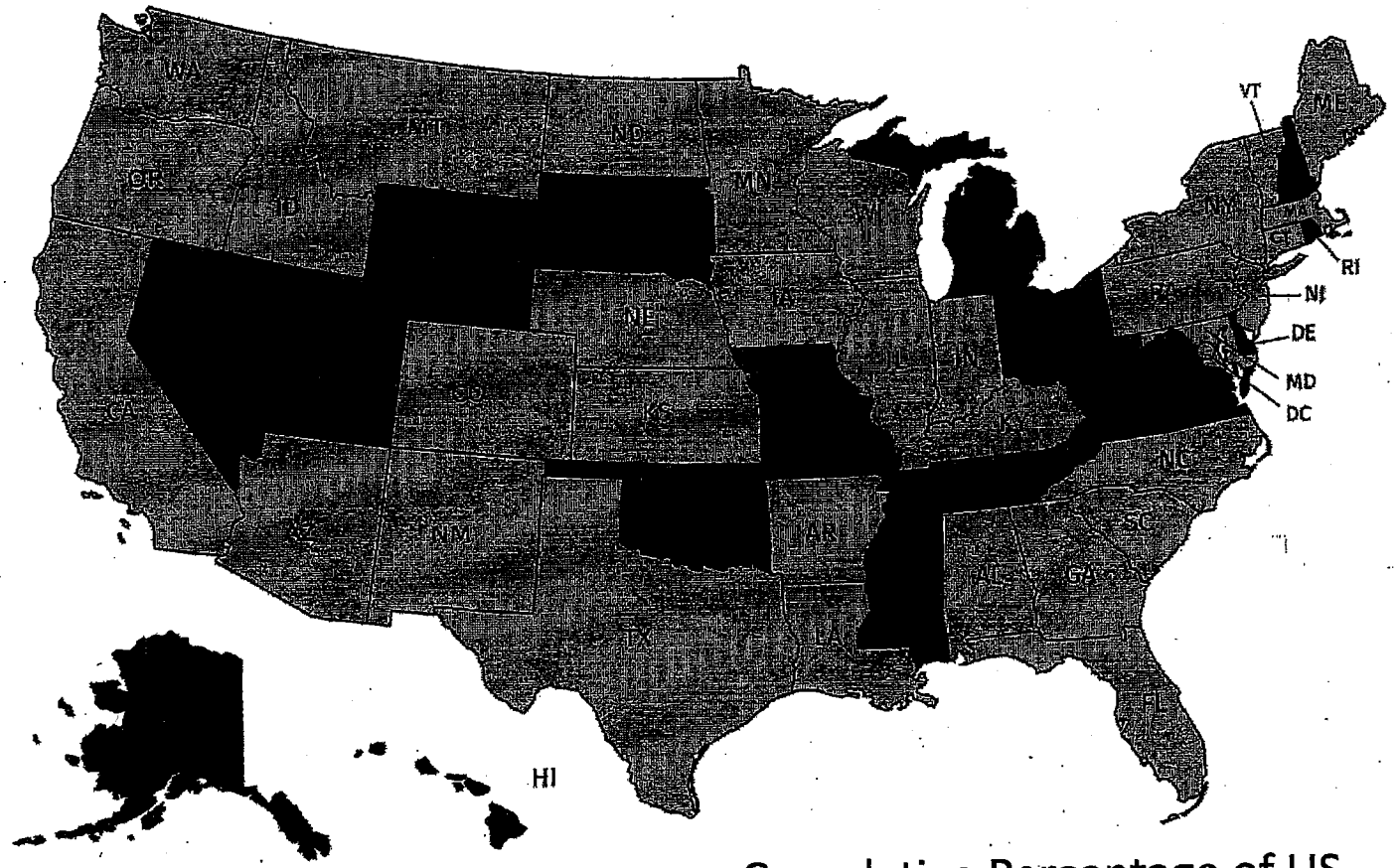
States Enacting DAPT Statutes - 2014



Cumulative Percentage of US Population: 17.01%

(2010 Census)

States Enacting DAPT Statutes - 2016

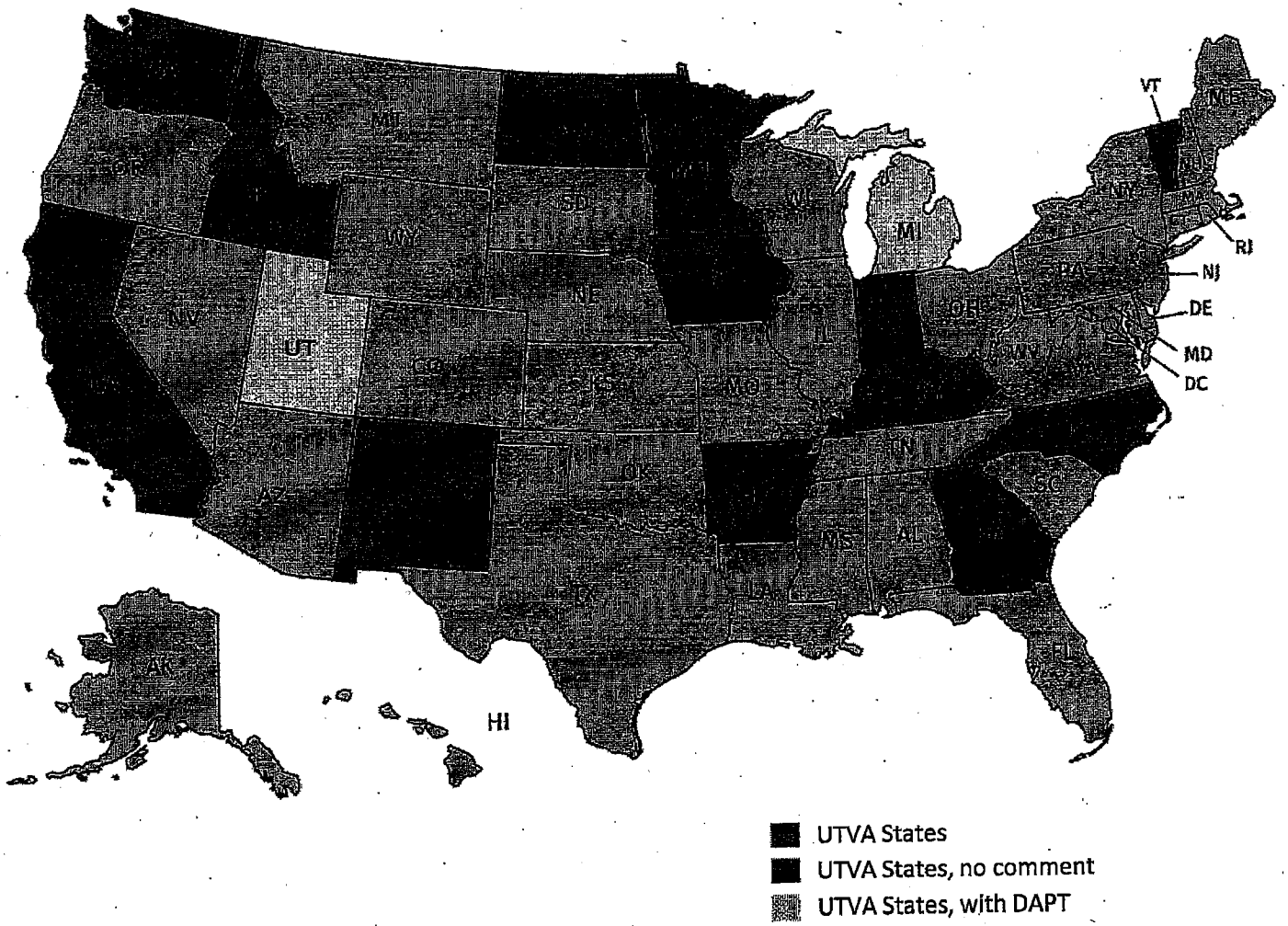


Cumulative Percentage of US Population: 20.21%

(2010 Census)

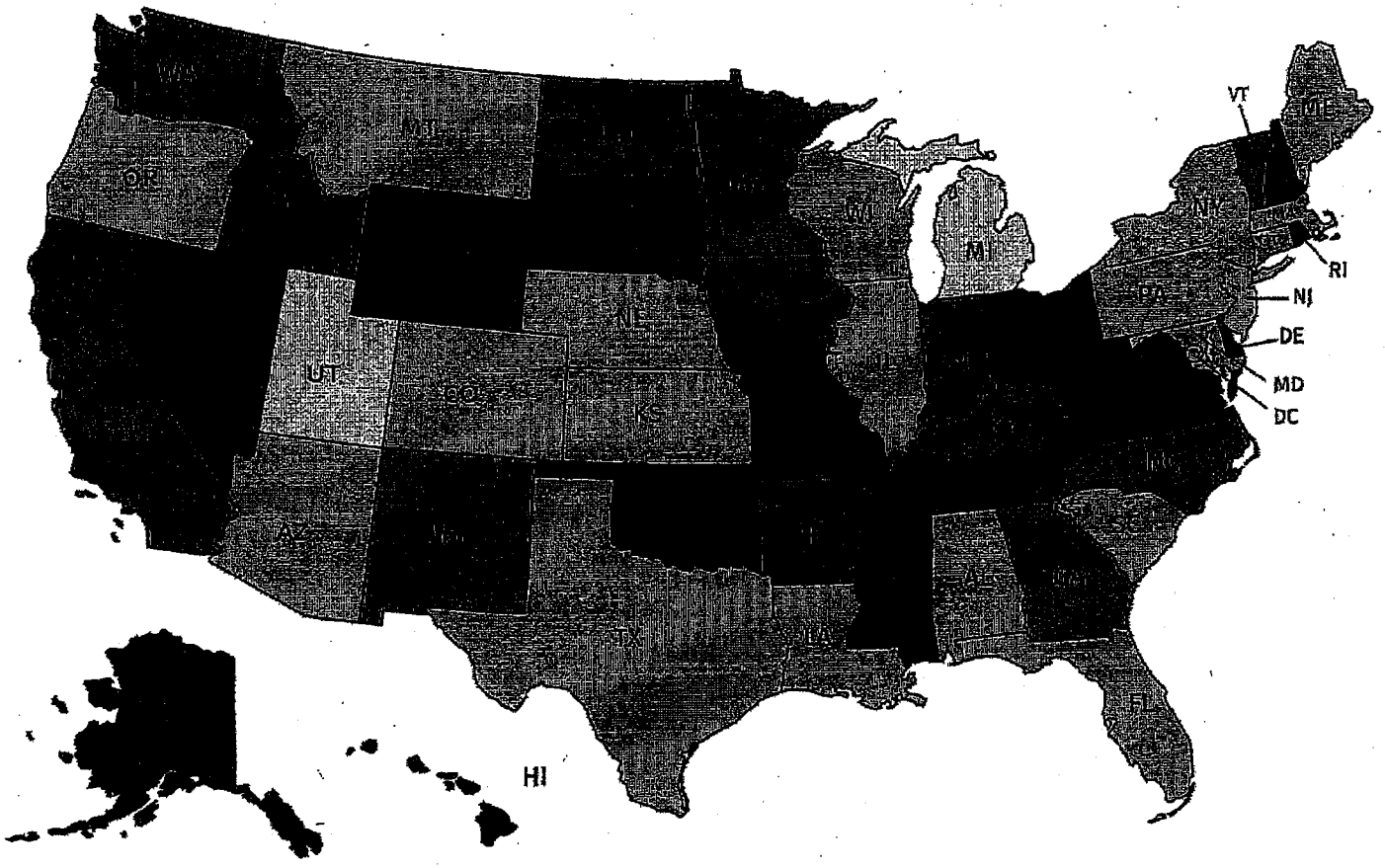
WHO'S NEXT?

States Enacting UVTA 2015-2017

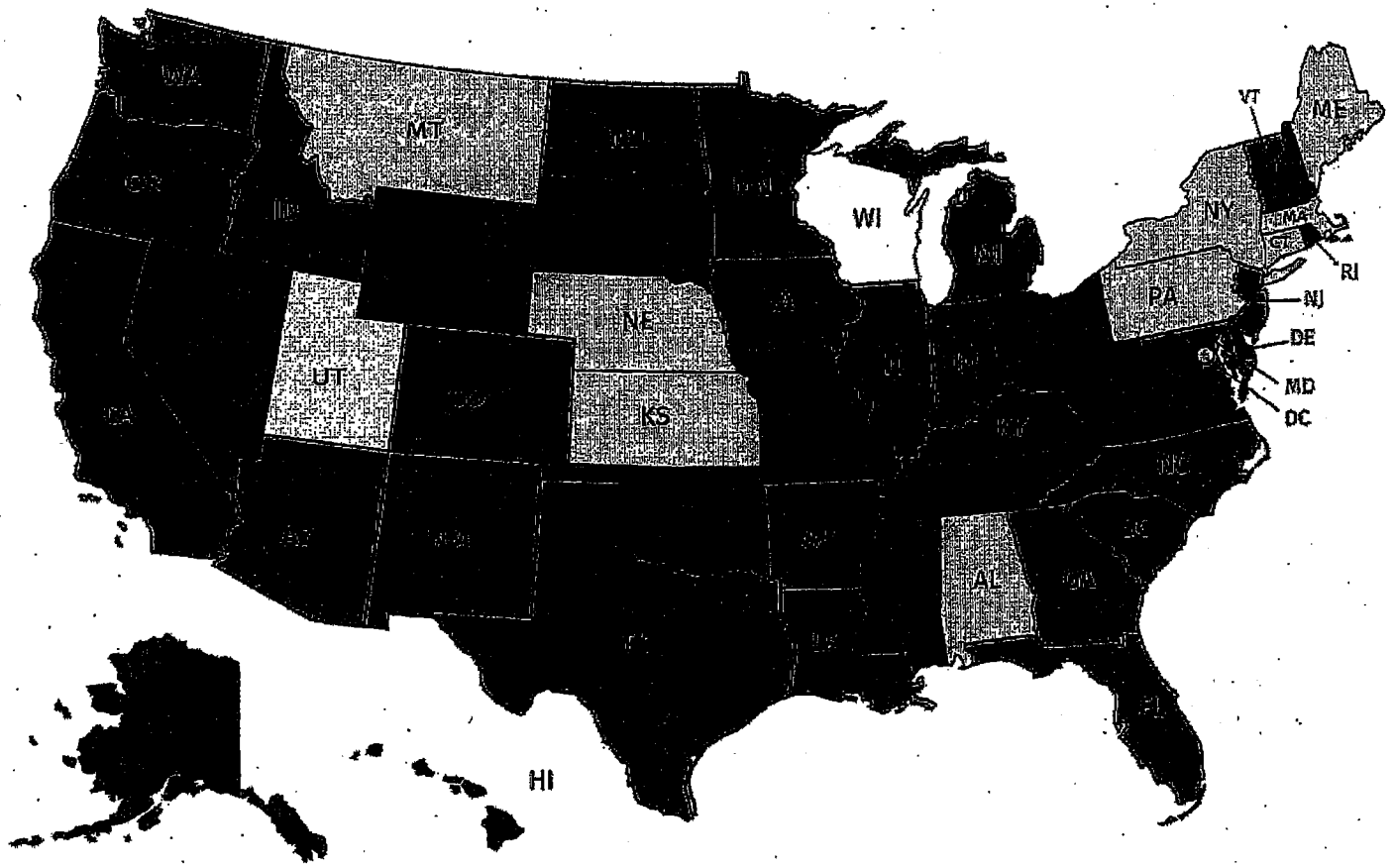


*Alabama is enacting UTVA effective as of January 1, 2018.

Putting It All Together



Another Layer



- UTVA States
- UTVA States, no comment
- UTVA States, with DAPT
- DAPT States
- States with Self-Settled Techniques

Exhibit B

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Estates, Gifts and Trusts Journal
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26 Estates, Gifts and Trusts Journal 123

Domestic Asset Protection Trusts Work—Should They?

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It is not my interest to pay the principal nor my principle to pay the interest.

—Richard Brinsley Sheridan

The tension between debtor and creditor is much older than Sheridan's witticism. To see how the relationship of debtor and creditor connects with the law of trusts, it is useful to consider the development of trusts. We may, for example, go back to the end of the first millennium, when the English monarch was Ethelred II (Ethelred the Unready) of distant memory. It is inconceivable that any of the king's subjects, and subject they were, could have foreseen the changes in the millennium ahead. At the end of the first millennium, trusts did not exist. Indeed, the recognizable beginnings of trusts were several centuries in the future, and even the defeat of Harold by William was more than six decades distant. The concept of an asset protection trust, had anyone thought to advance it, would doubtless have been more alien than the concept of an airplane. As the second millennium began, human flight was known, at least in mythological terms, but there were few assets to protect, and the king owned almost all of those. From this starting point, it may be useful to consider the changes in law and society that have occurred since the end of the first millennium and how those changes affected modern trust law and led to, among many other developments, the asset protection trust.

Historical Background

For a considerable period of time after William's defeat of Harold, English law was essentially feudal. In the feudal system, the king owned all the land, which was the principal form of wealth. Of course, feudal law was largely concerned with service, particularly military service, and it was through this feudal land system that various rights in land moved down from the king and various forms of service moved up to the king. It was from a desire to avoid some of the obligations of service that trusts eventually developed.

Of course, as King John learned, when one is dependent upon others for service, particularly military service, there is little to be done but accede to the will of the service providers if they will not otherwise obey. Thus, over the centuries, the power of the monarch was reduced. The Magna Charta was granted in 1215. The Statute Quia Emptores, which increased the rights of certain tenants, was passed in 1290.

A desire to avoid the service incident to various forms of land tenure resulted in the creation of many so-called uses. Some commentators and historians believe that a substantial portion of English land came to be held by way of use, that is, a certain land would be held by A "for the use of B." The problem, at least from the king's standpoint, was that B owed service to no one. Moreover, by means of other arrangements, A was often a person who owed no service with respect to the land held as a use.

Uses expanded to the great displeasure of the king. Henry VIII waged intermittent warfare against the French king, Francis I, that ended—at least for Henry—inconclusively due in part to Henry's inability to raise sufficient money and men to continue the war. A clear victory for Henry—or even a clear defeat—would likely have changed the course of European, and perhaps Western, history. Instead, amidst a host of troubles that were either set upon or unleashed by (depending upon one's historical perspective) Henry, he was subsequently able to persuade Parliament to enact the Statute of Uses in 1535.

Although it might be supposed that the Statute of Uses would have simply banned uses, for such was the king's desire, the statute did no such thing. Rather, it provided that the use would be executed so that in the example above, B became owner of the particular interest in land and became obliged to render the service incident to such tenure. Needless to say, the Statute of Uses was not wildly popular with many of the king's subjects. This negative reaction resulted in two major developments that would provide relief from some of the effects of the Statute of Uses. First, in 1540, Parliament enacted the Statute of Wills, which allowed some interests in land to

pass by will rather than by the somewhat modified feudal system of inheritance. Second, and most important for our purposes, the equity courts eventually provided relief from the Statute of Uses by holding that various forms of trust were not subject to the statute. This development made trusts forever a ward of equity courts and led directly to modern forms of trust. In this regard, the basic concept of a trust that we accept without a second thought evolved from a kind of asset protection device, or, more precisely, a service avoidance device.

Other laws sought to restrain service avoidance devices. An early English statute provided that "[a]ll deeds of gift of goods and chattels, made or to be made by in trust to the use of that person or persons that made the same deed of gift be void and of none effect." 3 Hen. VII ch. 4 (1487). A later Statute of Elizabeth, 13 Eliz. ch. 5 (1571), was of similar effect. The principles in these statutes found their way into American law regarding fraudulent transfers and, in particular, gave rise to the familiar principle of trust law that one could not spendthrift oneself.

As the British Empire expanded to the point where it was said that the sun never set upon it, English law went with the expansion to places such as Gibraltar, the Bahamas, and even the Cook Islands, and though the extent of English rule is much diminished, the English system of law, including the recognition of trusts, remains. Most important from our standpoint is that the English law came to the United States through the original 13 colonies. There would, of course, be many changes, particularly after the separation of the United States from the English king.

Although the events discussed thus far might be seen as quaint curiosities of a long-ago time, those long-ago events all relate to the present subjects. It was the Statute of Uses that led to the modern trust, and it was the equity courts' protection of trusts that, at least in some jurisdictions, aided the growth in use of trusts. It is the complete or partial dismantling of the Statute of Henry and the Statute of Elizabeth that allows the asset protection trust. This much-abbreviated look at history shows that some of the concepts of trust current today have enjoyed general, and perhaps unquestioned, acceptance for a very long time. That such acceptance has continued almost to the end of the second millennium is doubtless testimony to the durability of such concepts, but there is little in the history of such concepts to suggest that they would continue in use for so long. The old concepts have simply done so. However, it may be that the profound changes in society, economics and government that have taken place since the old concepts first appeared suggest that asset protection trusts may not only work, but may also be as appropriate to the current era as the trust itself when it appeared centuries ago.

Asset Protection Trusts—Matters of Policy

Asset protection trusts may be the most radical of several 20th-century departures from trust law as it previously existed. Thus, it is appropriate to consider whether legislated asset protection trusts are sensible public policy, whether they will really work, and if so, how they will work.

Legislative authorization of asset protection trusts marked a major change in centuries-old law. There is anecdotal evidence that suggests that many persons, including estate and trust practitioners, are uneasy, if not offended, by the existence of asset protection trusts. The misgivings of this group of persons raise the question whether asset protection trusts have any useful role in the legal system.

Misgivings about asset protection trusts—and other forms of liability avoidance—find voice in a recent article in the *Yale Law Journal*. LoPucki, "The Death of Liability," 106 *Yale L. J.* 1 (1996). In "The Death of Liability," Professor LoPucki begins with the premise that "[l]iability is crucial because it is one of only two principal means by which governments enforce laws." *Id.* at 3. Professor LoPucki goes on to declare that "[t]he system by which money judgments are enforced is beginning to fail," but notes that "only tort and statutory liability are at the risk of death." *Id.* at 4, 7. The depth of Professor LoPucki's concern about the death of liability can be seen in the comment that "[t]hreatening to seize and incarcerate nonpaying debtors probably would be an effective means for the system to coerce the payment of liability," which is only partly tempered by the observation that imprisonment for debt remains wildly unpopular in the United States. *Id.* at 9.

There is little doubt that at least to some extent, Professor LoPucki's assessment of reduced liability is correct. However, there may be both a corollary and a counterpoint in the ongoing reduction of an individual's responsibility for that individual's own conduct. Consider the case of *Uniroyal Goodrich Tire Co. v. Martinez*, 977 S. W.2d 328 (1998). Martinez was injured while attempting to mount a tire on a wheel rim. As the opinion states at its beginning, the tire contained the following warnings:

DANGER

NEVER MOUNT A 16" SIZE DIAMETER TIRE ON A 16.5" RIM. Mounting a 16" tire on a 16.5" rim can cause severe injury or death.

NEVER inflate a tire which is lying on the floor or other flat surface.

NEVER inflate to seat beads without using an extension hose with gauge and clip on chuck.

NEVER stand, lean or reach over the assembly during inflation.

There was also a pictograph for those unable to read, but Martinez conceded that he had read the warnings.

After noting the existence of the warnings, the Texas Supreme Court made the following statement with respect to Martinez's conduct: "Unfortunately, Martinez ignored every one of these warnings." 977 S.W.2d at 332. Given this beginning to the opinion, one might be inclined to conclude that Martinez's suit against Uniroyal was not successful. It was. The court stated that it must "decide whether a manufacturer who knew of a safer alternative design is liable in strict products liability for injuries caused by the use of a product that the user could have avoided by following the product's warnings." *Id.* at 331. Having thus framed the issue, the court decided that the manufacturer was liable regardless of the warnings.

Lest anyone too quickly conclude that *Martinez* is simply a crackpot decision of a plaintiff-friendly court, it should be noted that the court found strong support in the *Restatement (3d) of Torts: Products Liability* (1998). Although the earlier *Restatement* contained a comment that "[w]here warning is given, the seller may reasonably assume that it will be read and heeded; and a product bearing such a warning, which is safe for use if it is followed, is not in defective condition, nor is it unreasonably dangerous," *Restatement (2d) of Torts* §402A, cmt. j (1965), the more recent *Restatement* states that "[w]arnings are not, however, a substitute for the provision of a reasonably safe design." *Restatement (3d) of Torts: Products Liability* §2, cmt. 1 (1998).

In a system where persons such as Martinez are apparently unwilling to accept responsibility for their own actions, why should Professor LoPucki or anyone else wonder why there is also some number of persons unwilling to accept responsibility for their own liabilities? To this extent, the asset protection trust is not so much a cause of change in the relations of debtor and creditor as a symptom of the change in the law of liability that has been wrought by the judicial system, which may or may not reflect the views of society. At the end of "The Death of Liability," Professor LoPucki muses that the death of liability "may not be such a bad thing" if it is replaced by information systems sufficient to enable persons in possession of the information to avoid injury. Since this possibility is expressly rejected by *Martinez* in that the information (warnings) were held to be ineffective, Professor LoPucki concludes that, as is the case with imprisonment for debt, it would take a major change in the legal system to make the replacement work. 160 *Yale L. J.* at 91-98.

It might reasonably be suggested that the breakdown of the tort system (particularly with so-called "strict liability" situations and those resulting in extraordinary punitive damages) ought to be fixed within the tort system itself. For example, efforts have been made to "reform" the tort system through limitations in damages awards. For one reason or another, these efforts do not appear to have succeeded, perhaps because of the efforts of those who depend on the current state of affairs for their livelihood or perhaps because the society believes that the system must continue to exist in its present form to deter unwanted conduct. For better or worse, the prevailing view of many lawyers and their clients is that the liability system is out of control and constitutes a threat to the economic survival of many individuals. Such a view leads lawyers and their clients to seek the shelter of such arrangements as the asset protection trust.

Characteristics of Asset Protection Trusts

Asset protection trusts have a relatively short history, particularly in the United States. Although Missouri amended its spendthrift trust statute in 1986 in a way that permits the creation of trusts that might offer asset protection, the wording of the statute and the virtual absence of information about the intent of the statute caused many to wonder if the Missouri statute would ultimately prove to be an effective asset protection trust statute. Thus, it was the 1997 adoption of asset protection statutes by Delaware and Alaska that generated great interest in domestic asset protection trusts. In 1999, Nevada and Rhode Island enacted asset protection trust legislation that seemed intended to have an effect similar to the Alaska and Delaware legislation. Indeed, the Rhode Island legislation is a virtual replication of the Delaware statute prior to adoption of amendments by Delaware in 1998, 1999 and 2000.

Experience to date shows that the prospective trustors of a domestic asset protection trust understandably have a keen interest in the effectiveness of such trusts. In this regard, the most significant concerns appear to be whether the trust will really be effective to protect assets from claims of creditors and whether the trustor will be assured of distributions from the trust in the event that some financial misfortune greatly diminishes or elimnates the trustor's assets that are outside the trust. A few, but by no means all, of the prospective trustors of a domestic asset protection trust have an estate planning goal. These prospective trustors are interested in removing the assets held in the asset protection trust from their estates.

It will be observed that the first two goals—protection of the trust assets and certainty of trust distributions should need arise—ought to be compatible. However, the third goal—estate tax exclusion—appears to be compatible with the goal of asset protection but is likely to be in conflict with the goal of assuring the trustor's right to distributions from the trust. Beginning with creditor protection, this article considers how a domestic asset protection trust will work in meeting the three possible goals.

On their face, each of the Delaware, Alaska, Nevada and Rhode Island statutes would appear to provide substantial protection against claims of creditors, particularly claims of creditors whose claims arise after the transfer in trust ("future creditors"). The Delaware, Alaska, Nevada and Rhode Island statutes adopt an approach that is common in those offshore jurisdictions that allow asset protection trusts. Delaware, Alaska, Nevada and Rhode Island create a "tail" period following the transfer in trust and provide that upon expiration of the tail period, virtually all claims of future creditors are barred.

The Missouri statute does not employ a tail period. Instead, Missouri provides that claims are barred—period—unless the transfer "was intended to hinder, delay or defraud creditors." Although in theory this approach could make the Missouri statute as good or possibly even better than the other state statutes, it seems more likely to render the statute useless as courts may tend to conclude that the very concept of an "asset protection" trust is fraudulent. In this scenario, the newer state statutes would, for example, be clearly superior, for the effect of those newer statutes is that even though a transfer might otherwise be fraudulent, recovery against the trust assets will not be possible after expiration of the tail period.

The Nevada statute has a somewhat peculiar structure. A person must "bring" an action "with respect to a transfer of property to a spendthrift trust" within two years if that person was not a creditor at the time of transfer; however, if brought by a person who was a creditor at the time of transfer, an action could be brought within the later of two years or six months after discovery of the transfer. Nev. Rev. Stat. §166.170. However, in the statute that enacted this provision it was elsewhere stated that "except as otherwise provided in [§166.170], an action for fraudulent transfer is 'extinguished' unless brought within the later of four years after the transfer or one year after discovery." Nev. Rev. Stat. §112.230. Perhaps these provisions can be harmonized by a reading that simply would give a creditor bringing an action with respect to a spendthrift trust one-half the time such a creditor would otherwise have, but the use of different terms in the two sections tends to make the situation answer somewhat unclear. In any event, an action to enforce a judgment of another state may be brought within six years, and the six-year period may be measured from the time of the judgment. Nev. Rev. Stat. §11.190. As is subsequently discussed, the enforcement of judgments of other states is an issue of great importance, and the failure of the Nevada statute to address the issue clearly may suggest a "go slow" policy in considering use of the Nevada statute.

The Rhode Island statute has many similarities to the Delaware statute so that its provisions are not always given particular mention in this article. However, the Rhode Island statute does not incorporate numerous amendments to the Delaware statute made in 1998, 1999 and 2000. For example, Rhode Island does not apply the four-year tail period to judgments against the trustee, does not permit retention of the right to income, and offers little protection to attorneys or others involved in the creation of asset protection trusts.

A tabular comparison of some of the features of the statutes of Alaska, Delaware, Nevada and Rhode Island, as well as the New York legislative proposal, appears at the end of this article. Using the Delaware statute as a basis for comparison, this article considers the structure of asset protection trusts.

The Delaware statute is known as the Qualified Dispositions in Trust Act ("QDTA"). Unlike the statutes in Alaska and Nevada, the Qualified Dispositions in Trust Act was first adopted as a separate subchapter to the Delaware Code rather than as a series of amendments to existing statutes. However, in largely copying the Delaware statute as it existed in early 1998, Rhode Island adopted the statute as a single chapter.

The basic requirement of the QDTA is that there be a transfer in trust by means of a trust instrument. 12 *Del. C.* §3570(6). At least one trustee must be either a Delaware resident individual or a Delaware bank or trust company. 12 *Del. C.* §3570(9). Recently enacted legislation clarifies that if there is more than one trustee, only one must be a Delaware resident or a Delaware bank or trust company. *Id.* Both Nevada and Alaska appear to permit the use of a nonresident trustee if there is more than one trustee. Of course, as is noted below, use of a nonresident trustee is more likely to make the trust subject to jurisdiction outside of Delaware and increase the risk that some law other than Delaware law will be applied. This risk might be reduced by the use of direction and consent advisers rather than co-trustees, and the QDTA clearly permits such advisers, including nonresident advisers. 12 *Del. C.* §3570(9)c. *See* 12 *Del. C.* §3313.

The trustee of the QDTA must conduct some minimal level of activity in Delaware on behalf of the trust. 12 *Del. C.* §3570(9)b. This activity may be if the trustee:

(a) maintains or arranges for custody of some or all of the trust assets;

(b) maintains trust records;

(c) prepares or arranges for fiduciary income tax returns; or

(d) otherwise "materially participates" in the trust administration.

The QDTA requirement of a trust instrument is met by an instrument that expressly provides that Delaware law governs the validity, construction and administration of the trust. The trust must also be irrevocable and must contain a spendthrift provision. 12 *Del. C.* §3570(10).

The trust instrument will not fail to be irrevocable even if the trustor retains a special testamentary power of appointment, the right to veto trust distributions, the right to receive income, or the right to receive principal in the discretion of the trustee. The trustor may also retain an interest in a charitable remainder trust and a percentage interest (not to exceed 5%) in a so-called total return trust. 12 *Del. C.* §3570(10)b.

Of course, the most significant feature is that the trustor may retain the right to receive the income of the trust and that the trustee may, in the trustee's sole discretion, distribute income or principal to the trustor. 12 *Del. C.* §§3570(10)b, 3571. Also, there is nothing in the QDTA that precludes the trustor from being the sole beneficiary during the trustor's lifetime.

It is not necessary to have a trust provision that states that the trust is an "asset protection trust," and the advantage, if any, of such a declaration is probably outweighed by the admission that the trust is intended to impede creditors, albeit in an authorized manner.

The Alaska statute is similar to that of Delaware in its requirements for Alaska asset protection trusts. Thus, at least one of the trustees must be an Alaska resident, and the Alaska trustee must conduct at least a minimal level of activity in Alaska. AS §13.36.035. The trust instrument must be irrevocable, but the interest that the trustor can retain is more limited than Delaware. AS §34.40.110. However, as with Delaware, there is no prohibition against the trustor being the sole beneficiary during the trustor's lifetime. The Nevada statute is also similar but provides that the trust instrument may not require distributions to the trustor. Nev. Rev. Stat. §166.040. The Rhode Island statute does not permit the trustor to retain the right to income and permits principal to be distributed to the trustor only in the sole discretion of the trustee, who must not be a subordinate person within the meaning of §672(c) of the Internal Revenue Code (the "Code"). R. I. Gen. Laws §18-9.2-2(9)(B).

Both Delaware and Alaska have virtually eliminated the Rule Against Perpetuities in the case of asset protection trusts so that an asset protection trust could also be a so-called dynasty trust. 25 *Del. C.* §503; AS §34.27.050. The Nevada statute does not eliminate the Rule Against Perpetuities. 1999 Nev. Stat. Ch. 299, §4.

The Delaware statute bars actions by creditors whose claims arose before the transfer in trust ("existing creditors") unless the creditor's action is brought within four years of the transfer or, if later, within one year after the transfer could have reasonably been discovered by the creditor. This provision suggests that it may be advisable to notify existing creditors of the transfer, particularly if there is no dispute with such creditors at the time of transfer. In the case of future creditors, the action must be brought within four years of the transfer without regard to the creditor's knowledge of the transfer. 12 *Del. C.* §3572.

Delaware presently has two exceptions to the bar of actions by creditors. 12 *Del. C.* §3573. These exceptions are (a) claims for alimony and child support, but a spouse or former spouse must have been married to the transferor at or before the time of the qualified disposition; and (b) claims arising from torts committed before the transfer. The second exception seems not to be so much of an exception as a clarification because such creditors would almost certainly have the status of existing creditors (rather than future creditors) whose claims would not be automatically barred at the expiration of the four-year tail.

Alaska has similar provisions with respect to the bar of claims by existing and future creditors. AS §34.40.110(d). However, the Alaska statute expressly admits of only one exception, that is, at the time of transfer, the trustor cannot be in default by more than 30 days of a child support order. AS §34.40.110(b)(4). The Nevada statute does not appear to have an exception for child support. Whether Alaska and Nevada asset protection trusts are really resistant to child support claims seems problematic for reasons discussed later in this article in connection with the estate planning aspects of asset protection trusts.

The Delaware QDTA has some additional features that limit the ability of creditors to reach the trust assets. The QDTA provides that a qualified disposition will be avoided only to the extent necessary to satisfy the trustor's debt to the creditor who brought the action. 12 *Del. C.* §3574(a). This compels creditors to litigate each individual claim. Moreover, distributions made to a beneficiary can be retained by such beneficiary unless it appears that the beneficiary acted in bad faith. 12 *Del. C.* §3574(b)(2). Also, in the absence of bad faith, the trustee has a paramount claim for amounts due the trustee and for the costs, including attorney fees, of defending the action. 12 *Del. C.* §3574(b)(1). The Rhode Island statute contains similar provisions.

Because it was perceived that an unhappy creditor, unable to collect from the debtor, the trust, or the trustee, would look about for others to sue, the Delaware QDTA now protects not only the trustee and trust adviser, but also any person involved in the "counseling, drafting, preparation, execution or funding of a trust that is the subject of a qualified disposition." 12 *Del. C.* §3572(d). There is a similar statutory provision in Alaska but not in Nevada or Rhode Island. AS §34.40.110(f).

In terms of its statutory operation, the Delaware QDTA bars "actions." The QDTA bars actions of any kind, including actions to enforce judgments of any jurisdiction, after expiration of the four-year tail. 12 *Del. C.* §3572 (a). The Rhode Island statute is identical. On the other hand, the Alaska statute also bars actions, but this bar may address only actions with respect to claims brought under Alaska's statute concerning fraudulent conveyances. AS §34.40.110(d). The Nevada statute also bars actions but appears to have a longer tail for actions to enforce a judgment from another state than it does for an action that directly attacks the trust.

Except in the special case of certain domestic relations situations, none of Alaska, Delaware, Nevada and Rhode Island creates any special rights for contract creditors (as opposed to tort creditors). However, the proposed New York statute, similar in most other respects to the Delaware statute as it existed prior to the 1998, 1999 and 2000 amendments, provides that the statutory time limits do not apply to any creditor who relied upon an express written statement of the transferor that any property that was the subject of the qualified disposition thereafter remained the property of the transferor and was available to satisfy any debt to such creditor incurred by the transferor. This provision is similar to one which was originally part of the Delaware Act but was removed by subsequent amendment, probably because of concern over the impact of such a provision on the transfer tax treatment of these trusts.

Of course, an asset protection trust is useful only to the extent that it withstands or appears to withstand attacks from creditors. Such attacks are all but certain, and, in addition, there are some creditors who have granted exceptions from the application of asset protection trust statutes. Delaware, Alaska and Rhode Island have statutory exceptions to their asset protection trust statutes. In all three states, existing creditors will not have their claims barred by the four-year tail unless they had notice of the transfer. All three states also make some exception for creditors with claims in the nature of child support. 12 *Del. C.* §3573; AS §34.40.110; R. I. Gen. Laws §18-9.2-5(A). Nevada has a similar structure, except for child support, but the length of the tail is somewhat uncertain.

It may be tempting to speculate that a creditor may be able to reach trust assets by attacking the validity of the statute in one of the states that has authorized such trusts. One presumes that such an attack would be based on a theory that the asset protection trust statutes are so violative of public policy that they should be voided. After all, the argument would go, the asset protection trust statutes change the law as it has been since the Statute of Henry VII. *See Restatement (2d) of Trusts* §156 (1959). However, the asset protection trust statutes are so new that the tail period has not yet expired in any state so that any challenge rests somewhere in the future.

At least in Delaware, there is little reason to believe that such an attack would succeed. For a variety of reasons, Delaware has a long history as a jurisdiction friendly to trusts as well as corporations, and the courts have shown little inclination to invalidate trust legislation on purely policy grounds. [1] Thus, in *Gibson v. Speegle*, C.A. No. 134 (Del. Ch., May 30, 1984), the court refused to permit a creditor of a trust beneficiary to reach the beneficiary's interest in a spendthrift trust even though the beneficiary had committed a willful tort against the creditor. In similar fashion, in *Parsons v. Mumford*, C.A. No. 9077 (Del. Ch., June 14, 1989), the court refused to grant a tort creditor an "equitable lien" over the trust property. *Compare Sligh v. First National Bank of Holmes County*, 704 So.2d 1020 (Miss. 1997), in which the court permitted a tort creditor of a spendthrift trust beneficiary (who was not the settlor) to reach the trust assets.

[1] While some states were reluctant to maintain a Court of Chancery because of its close association with the crown, Delaware has chosen to maintain a separate Court of Chancery to the present day. Moreover, the jurisdiction of the Delaware Court of Chancery is determined by reference to the jurisdiction of the Lord Chancellor on July 4, 1776, as subsequently modified by constitution or statute. *See First National Bank v. Andrews*, 28 A.2d 676 (Del. Ch. 1942).

There may be other hurdles that a creditor would have to clear if the trustee of the asset protection trust were a bank. For example, Delaware law exempts banks "from the operation of the attachment laws." 10 *Del. C.* §3502. This has been held to apply to funds held by a bank as trustee. *Provident Trust Co. v. Banks*, 9 A.2d 260 (Del. Ch. 1939). *But see J.B.G. v. P.J.G.*, 286 A.2d 256 (Del. Ch. 1971), *aff'd*, 306 A.2d 737 (Del. 1973), in which, in a case involving a claim in the nature of alimony, the court held that 10 *Del. C.* §3502 did not bar an action in sequestration.

Of course, it is possible that the creditor could obtain a judgment against the debtor/trustor in a state other than the situs state of the asset protection trust. In such an action, the creditor may have convinced the local court that the law of the forum regarding fraudulent conveyances, rather than the law of the trust situs, ought to apply. However, the creditor would then be obliged to seek enforcement of the judgment against the trust.

Enforcement against the trust might be easier in Alaska than in Delaware, Rhode Island or Nevada. At least on its face, the Alaska statue does not preclude the enforcement of foreign judgments as the Alaska statute bars creditors whose claims are beyond the tail period from bringing a claim under the Alaska fraudulent conveyance law and says nothing about the enforcement of foreign judgments. Delaware and Rhode Island, on the other hand, bar actions, including actions to enforce judgments, after the expiration of the four-year tail. Nevada appears to have a six-year tail for this purpose.

A second and more disturbing possibility is that a creditor will obtain a judgment *against the trustee* or against the debtor and the trustee in the creditor's local jurisdiction. In such a case, the result is more unpredictable as a matter of law, and, in addition, practical considerations begin to take on a larger role. If there are no trust assets in the creditor's jurisdiction, it may still be necessary for the creditor to seek enforcement of the judgment in Alaska, Delaware, Nevada or Rhode Island, and such enforcement is problematic. If, on the other hand, there are trust assets in the creditor's jurisdiction, the debtor/trustor may be left with nothing more than a rear-guard defense of those assets.

Even in the absence of trust assets in the jurisdiction, the court may believe that it has sufficient jurisdiction to compel the trustee to deliver the trust assets to the court. Court action of this kind may put the trustee in a quandary. The trustee could contest the court's jurisdiction, but if that were not successful, the trustee might be faced with default or contempt, or both, if it declined to turn over the trust assets. On the other hand, compliance with an order to turn over the trust assets might well bring an action for breach of duty resulting from a failure to follow the governing law, be that Alaska, Delaware, Nevada or Rhode Island.

If any state with an asset protection trust statute does not provide a strong defense against the judgment of another state court against the trustee, the state without such protection has what might be described as a Maginot Line problem, and trusts created in such a jurisdiction are likely to fare no better than the hapless

There are also provisions of federal law, particularly the U.S. Constitution, that must be taken into account in considering the effectiveness of domestic asset protection trusts against attacks by creditors. The provisions of primary relevance appear to be the Full Faith and Credit Clause, the Contract Clause, and the Bankruptcy Code.

Article IV, §1, of the U.S. Constitution provides in part that "[f]ull Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State." A concern is that the Full Faith and Credit clause would require Delaware, Alaska, Nevada or Rhode Island to recognize and thus enforce a judgment against the debtor, not to mention the trustee, obtained in another state.

The Delaware and Rhode Island statutes anticipate an attack based on the Full Faith and Credit Clause. Thus, for example, the Delaware QDTA is intended to operate upon actions rather than mere claims and to bar all actions, including actions to enforce judgments, unless brought within the appropriate period allowed by Delaware law. 12 *Del. C.* §3572(a).

There is authority for the validity of the approach taken in the Delaware statute. In *Matanuska Valley Lines, Inc. v. Molitor*, 365 F.2d 358 (9th Cir. 1965), it was held that statutes limiting the time in which actions to enforce judgments may be brought are procedural, and a time limitation on such actions does not violate the Full Faith and Credit Clause. In *Watkins v. Conway*, 385 U.S. 188, 87 S. Ct. 357 (1966), the Supreme Court upheld a Georgia statute that denied enforcement of a Florida judgment. The Supreme Court did so even though the Georgia statute applied only to judgments of other states because it found that the judgment had also expired and could no longer be revived in Florida. However, in a dictum appearing in a footnote, the Supreme Court remarked that it would have faced a different question if the judgment could have been revived in Florida. 87 S. Ct. at 358, n. 4.

The implication of the Supreme Court's footnote in *Watkins* is that Georgia would not have been permitted to deny enforcement to the Florida judgment if it was enforceable, or could have been made enforceable, in Florida. However, Georgia's refusal to enforce a valid Florida judgment of a given date, when at the same time it would enforce a Georgia judgment of the same date as the Florida judgment, would afford the foreign judgment less credit than its own in apparent violation of the Full Faith and Credit Clause.

On the other hand, Delaware makes no distinction in the QDTA between its own judgments and those of other states. No action to enforce any judgment, Delaware or otherwise, may proceed unless brought within the appropriate period prescribed by the QDTA. Unless the Full Faith and Credit Clause is held to stand for the proposition that a state is required to operate its judicial system with multiple procedures, one for its own citizens and others to match the procedures available in other jurisdictions, the provisions of the Delaware QDTA should not be found to violate the Full Faith and Credit Clause. The Nevada and Rhode Island approaches to this critical issue seem similar to that of Delaware.

As subsequently discussed, the Full Faith and Credit Clause may prove to be a benefit as well as a burden, for it also requires that such full faith and credit be given to "acts" of each state. Thus, while a court in the United States may treat the legislation of the Cook Islands willy-nilly, the court is required to be more respectful of the legislative acts of Delaware and the other states that have adopted asset protection legislation.

Article I, §10, of the U.S. Constitution provides in part that no state shall pass any law "impairing the Obligation of Contracts." It has been suggested that this clause may invalidate the Alaska and Delaware statutes. *See* Giordani and Osborne, "Will the Alaska Trusts Work?" *J. of Asset Protection*, 13 (Sept./Oct. 1997); Osborne, Giordani, and Catterall, "Asset Protection and Jurisdiction Selection," 33 *U. Miami Instit. on Est. Plan.* 14 (1999). If so, the recent Nevada and Rhode Island legislation would appear to be equally invalid.

The application of the Contract Clause to state asset protection trust statutes seems tenuous. The constitutional prohibition is one against the impairment of contracts, which must mean existing contracts. The Contract Clause has generally not been applied so as to prohibit prospective modification of contracts, and there is little or no authority for the proposition that the Contract Clause (as distinguished from other constitutional provisions of potential application) applies to contracts that are not in existence at the time the state law is enacted. *See* Rotunda and Novak, *Treatise on Constitutional Law* §158 (2d ed. 1992).

None of the statutes of Delaware, Rhode Island or Alaska would seem to have an effect on contracts existing at the time the respective statutes were enacted. Under the Delaware, Rhode Island and Alaska statutes, claims of existing creditors with respect to whom a trust would be a fraudulent conveyance would be barred only if those creditors received notice of the transfer. Moreover, none of the Delaware, Rhode Island or Alaska statutes purports to be effective with respect to trusts created before the statute. Virtually any debt that would be affected by the statutes of these three states would arise under a contract that was entered into after the statutes became part of the body of law existing at the time of contract. The Nevada statute purports to apply to creditors existing at the time of transfer but allows such creditors additional time in which to bring an action with respect to the transfer. Nev. Rev. Stat. §166.170. This approach seems more problematic than that of Delaware or Alaska.

Because federal law, the Bankruptcy Code, governs the obligations of debtor and creditor in case of a bankruptcy, the possible role of the U.S. Bankruptcy Courts must also be considered. Of course, not every contest between a creditor and a debtor who is a trustor of an asset protection trust will be adjudicated in a Bankruptcy Court, but some disputes may be, and the possibility merits consideration.

Upon initial examination, it would appear that the Bankruptcy Code addresses this matter in a manner favorable to asset protection trusts. Section 541(c)(2) of the Bankruptcy Code exempts a bankrupt's interest in a trust that is subject to restrictions on transfer to the extent that such restrictions are enforceable under "applicable nonbankruptcy law." In other words, a debtor's interest in a trust should be exempt property to the extent that the debtor is prohibited from transferring the debtor's interest under Delaware, Alaska, Nevada or Rhode Island law, as the case may be. Indeed, the Delaware QDTA states that it is intended to constitute a restriction on the transferor's interest "enforceable under applicable nonbankruptcy law within the meaning of §541(c)(2) of the Bankruptcy Code." 12 *Del. C.* §3570(10)c.

Although the Delaware (and Rhode Island) QDTA and spendthrift trust statutes, 12 *Del. C.* §3536, are perhaps clearer on the point than the Alaska statute, AS §§13.36.310, 34.40.110, both Delaware and Alaska require a transfer restriction in order to create an asset protection trust. Nevada also requires a transfer to a spendthrift trust. In each case, the restriction on transfer should be sufficient to secure the exemption in a bankruptcy proceeding.

While the possibility that a judge in a bankruptcy proceeding will refuse to apply Delaware, Alaska, Nevada or Rhode Island law on some nebulous policy basis cannot be eliminated, the statutes of these states should qualify as applicable nonbankruptcy restrictions. There can be no doubt that Delaware, Alaska, Nevada and Rhode Island each definitely decided to permit trustors to retain limited rights in trust property without subjecting that property to the claims of creditors for the full duration of the trustor's interest. The apparent purpose of Bankruptcy Code §541(c)(2) is to preserve rights to property the debtor may have under state law, not to expand the rights of creditors to reach property in bankruptcy that would be unreachable in a nonbankruptcy proceeding in state court. The fact that the trustor may have an interest in the property held in the asset protection trust should not alter the result. However, there are surely courts that have been hostile to the right of debtors to retain assets that may be used for their benefit. See, for example, the very hostile opinion in *In re Kaplan*, 162 B.R. 684 (Bkrtcy. E.D. Pa. 1993), which makes the questionable holding that the interest of a shareholder/employee is not "ERISA qualified" and thus unprotected by the Supreme Court's decision in *Patterson v. Shumate*, 504 U.S. 733, 112 S. Ct. 2242 (1992).

Domestic and Offshore Trusts—Some Comparisons

At this point, some may ask whether a domestic asset protection trust will work as well as an offshore trust in terms of protection from creditors. At first impression, the answer would appear to be that domestic trusts are unlikely to work as well as offshore trusts in protecting trust assets from creditors. A creditor faces numerous difficulties in pursuing an action against an offshore trust that would not be faced in an action against a domestic trust, not the least of which is that the action will probably have to be brought in an offshore place, sometimes far offshore. Other difficulties that have to be faced include a shorter tail period than four years, a refusal to enforce the judgment of a U.S. state or federal court, high burdens of proof, the obligation to pay attorney fees under the English rule, unavailability of contingent fees, and, in smaller jurisdictions, difficulty in retaining counsel. However, the first impression on this point may be incorrect.

Although domestic trusts may not present as many obstacles to a creditor as an offshore trust, there is little reason to believe that domestic trusts will be entirely ineffective. Moreover, offshore trusts bring some burdens along with their benefits. One such burden is an ever more punitive system of taxation for U.S. beneficiaries as well as increased tax regulation of offshore trusts. Another is the uncertainty that comes from the fact that the rule of law may not be as well rooted in some offshore jurisdictions as it is in the United States. These circumstances have alone been enough to discourage some prospective trustors of asset protection trusts from proceeding in offshore jurisdictions, and the ability to establish such trusts in jurisdictions where the U.S. flag flies atop the local courthouse does much to relieve concern.

In *FTC v. Affordable Media*, 179 F.3d 1228 (9th Cir. 1999), the Ninth Circuit took drastic action against the settlors of an offshore asset protection trust. Indeed, the court ordered the settlors to be imprisoned for civil contempt as a result of (a) the court's refusal to accept the settlors' argument that they could not reach the assets of their Cook Islands asset protection trust and (b) the settlors' refusal to comply with the court's order to have the trust asset repatriated.

For proponents of asset protection trusts, the facts in *Affordable Media* were about as bad as could be imagined. The settlors, Denyse and Michael Anderson, were involved in the telemarketing of various products, including water-filled dumbbells. As part of the operation, the Andersons sold "media units" to investors. Each media unit, which cost $5,000, entitled the investor to $7.50 for each product (the dumbbells, talking pet tags, and like merchandise) sold during 201 commercials shown on late night television. Investors were promised a 50% return in 60 to 90 days.

As the reader may have guessed, the Andersons were engaged in a classic Ponzi scheme. Much of the reported case is devoted to the Andersons' efforts to avoid the FTC's own efforts to enjoin the Andersons' activity. The fact that makes the case relevant to our discussion is that the Andersons had the prescience to establish a Cook Islands trust in 1995, some two years before their involvement in the Ponzi scheme and three years before the FTC filed its complaint.

The Andersons attempted to defend themselves against civil contempt by contending that it was impossible for them to comply with the court's order. The Andersons had thoughtfully inserted a so-called duress clause into

their trust so that when, in response to the injunction, the Andersons directed the repatriation of the trust assets, the trustee removed the Andersons as co-trustees and thereafter refused to comply with their demands for an accounting and repatriation.

The court brushed aside the Andersons' defense of impossibility. In one of the more troubling statements in the court's opinion, the court stated that in view of the fact that the Andersons' inability to repatriate the funds was self-induced, "we are not certain that the Andersons' inability to comply in this case would be a defense to a finding of contempt." 179 F.3d at 1239. In another troubling statement, the court declared that "[g]iven 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." 179 F.3d at 1240. However, the court left this point undecided because it concluded that the Andersons had not met their burden of demonstrating impossibility.

In deciding against the Andersons, the court remarked that "[w]hile 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." 179 F.3d at 1241. As it turned out, the court's skepticism, at least with respect to the Andersons, was not misplaced. Even after they ceased to be co-trustees, the Andersons remained as trust protectors. While the exact extent of the Andersons' powers as protectors was disputed, there does not appear to have been a dispute over the protectors' ability to determine the existence of an event of duress. Also, at some point the Andersons succeeded in obtaining $1 million from the trust, and this event deepened the court's skepticism about the Andersons' claim of impossibility. Thus, in a scary footnote, the court remarked that "[a]lthough 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." 179 F.3d at 1243, n.11.

In the following remarkably prophetic passage from "The Death of Liability," Professor LoPucki considered a situation similar to the one before the court in *Affordable Media*:

In response to the doctor's deployment of such strategies, it is possible to imagine the U. S. judge abandoning on equitable grounds the principle of enforcement only against property. The court might determine the trust to be invalid and the doctor to be the owner of the assets, and then order the doctor to surrender them to a sheriff within the jurisdiction of the court. Absent compliance, the U. S. court might order the doctor imprisoned for contempt of court. The doctor's defense would be that he was not in contempt because from the time he was served with the court's order, he lacked the ability to comply with it. As previously noted, the typical asset protection trust contains a duress provision, barring the trustee from acceding to the settlor's demands for distributions ordered by a court. The Cook Islands trustee would almost certainly comply with the trust document and refuse to surrender the assets. 160 Yale L. J. at 37. (citations omitted)

Maybe, just maybe, the Andersons would have been better off, both in fact and in law, with a domestic asset protection trust. First of all, it will be observed that the court gave no consideration to any law of the Cook Islands that would have precluded repatriation to pay a claim that arose after the creation of the trust. A court in the United States may ignore the law of the Cook Islands, but, in most instances, the court will not be able to ignore completely the law of one of the United States. It is at this point that the Full Faith and Credit Clause, long viewed as a sword in the hands of creditors, may prove to be a shield to the debtor. Thus, it should also be noted that a court would not be able to say of domestic asset protection trusts, as the *Affordable Media* court said of Cook Islands trusts, that they operate by frustrating the jurisdiction of courts in the United States. Jurisdiction—or a lack thereof—is not the kingpin of the domestic asset protection trust vessel. Rather, it is a federal system that largely leaves the matter of debtor-creditor relations to the individual states.

The Andersons might have had better facts to present to the court with a domestic asset protection trust. For example, in Delaware the trustor may not be a trustee and may be an advisor/protector only with respect to investment decisions. Control by the trustor is simply not permitted, and in the wake of the Andersons' disastrous performance, one can expect that the asset protection trust states may "clarify" that their laws do not permit the kind of control that the court found to exist in *Affordable Media*. Delaware has recently enacted just such a provision. 12 *Del. C.* §3571.

In re Lawrence, 238 B.R. 498 (Bkrtcy. S.D. Fla. 1999), is another recent and troubling case. In *Lawrence*, the debtor was not a Ponzi scheme operator but had amassed a substantial margin deficit in his account with Bears Stearns that eventually resulted in a $20 million arbitration award against Lawrence. Lawrence subsequently set up an asset protection trust in Jersey and later moved the trust to Mauritius.

Lawrence did little to ingratiate himself with the Bankruptcy Court in that he failed to comply with various discovery orders and offered false and incomplete testimony. Still, the case contains some remarkable pronouncements by the court, including a ruling that Lawrence could not rely on the impossibility defense because he had created the impossibility. 238 B.R. at 501 (Bkrtcy. S.D. Fla. 1999).

The court in *Lawrence* had earlier ruled that the debtor's rights and obligations would be governed by Florida and federal bankruptcy laws and not by the law of Mauritius. *In re Lawrence*, 227 B.R. 907, 917 (Bkrptcy. S.D. Fla. 1999). Once again, the possible advantage of a domestic trust appears. The court in *Lawrence* could ignore the law of Mauritius in a way that it could not ignore the law of Delaware, Alaska or another state. Thus, for example,

Delaware QDTA states that it is intended to constitute an "applicable non-bankruptcy" restriction. 12 *Del. C.* §3570(10)c.

It is possible that in trying to afford protection to persons such as the Andersons, the reach of a typical asset protection trust statute exceeds its grasp. In this regard, the attempt to obtain federal estate tax exclusion for an asset protection trust may have become an albatross about the necks of all such trusts. One can hardly expect a court to be sympathetic to Ponzi scheme operators. Thus, when originally adopted in 1997, the Delaware QDTA had an exception for certain acts of deliberate fraud, as does the New York legislative proposal, but the Delaware exception was quickly removed in 1998 due to concern that the exception would preclude an asset protection trust from federal estate tax exclusion. Whether or not such exclusion is available is likely to remain unresolved for a while in view of the IRS's reluctance to address the issue, and, in the meantime, we can expect asset protection trusts to take some hits from the judiciary to the extent that the settlors of such trusts are Ponzi scheme operators—or perhaps of even worse character.

An asset protection trust may be relocated. For example, the QDTA makes provision for the relocation of trusts in that the QDTA provides for "tacking" the period the trust existed outside of Delaware to the period after which it became a Delaware trust even if the trust does not expressly refer to Delaware law. 12 *Del. C.* §3572(c). Moreover, because there is no requirement that an asset protection trust contain a declaration that it is such, it may be possible to convert an existing trust that is not an asset protection trust by relocating the trust.

Not all trusts can be moved from one jurisdiction to another. In some cases, a requirement that the asset protection trust expressly declare the governing law will be an obstacle; however, there is no such requirement applicable to a "migratory" trust under the Delaware statute. 12 *Del. C.* §3572(c). While many modern trusts permit the trust to be relocated and provide that the governing law will change with the relocation, or that the governing law can be changed by action of the trustee or an adviser/protector, many older trusts lack such features. Relocation of such trusts as asset protection trusts may require court action, if indeed relocation is possible.

The small amount of empirical evidence on domestic asset protection trusts that has been gathered to date suggests that trustors may be concerned about their ability to receive distributions from the trust in the event that financial misfortune creates a need for funds in order to maintain an accustomed standard of living. At present, Nevada, Alaska and Rhode Island do not permit a trustor to retain the income of the trust, and these states do not permit a trustor to receive income or principal in accordance with an ascertainable standard, such as support and maintenance, that would require distributions to the trustor. Of course, many offshore trust jurisdictions permit such provisions.

Delaware now permits a trustor to retain the right to income, as well as a percentage interest in a charitable remainder or total return trust. 12 *Del. C.* §3570 (10)b. However, the retention of the right to income would certainly cause the trust to be included in the trustor's estate under Code §2036(a), but this is a matter of indifference to some trustors. Of course, retention of, for example, the right to income will make it easier for an aggressive and vigilant creditor to reach the income as soon as it reaches the trustor's hands (if it does), but the option to retain such an interest would add to the utility of a domestic asset protection trust.

Even though the trustor of a Nevada, Rhode Island or Alaska asset protection trust may retain nothing more of direct benefit than the ability to receive distributions in the sole discretion of the trustee, that limitation should not eliminate such jurisdictions from consideration unless the trustor is determined to retain some interest as a matter of right.

Any trustee is obliged not to abuse that trustee's discretion. Thus, it is doubtful that a trustee could refuse to make distributions to a trustor who was truly in need of funds to maintain an accustomed standard of living. This would be particularly true if the trustor were the sole beneficiary during the lifetime of the trustor. A trustee may be guilty of abusing discretion if it clearly appears that the trustee is "paying the beneficiary less than any reasonable person would give [the beneficiary] under the circumstances." Scott and Fratcher, *The Law of Trusts* §187.2 (4th ed. 1988). Moreover, the trustor can retain the right to veto distributions and leave the trustee with no choice but to make some distribution to the trustor or accumulate all income.

Despite the provisions of the Delaware statute permitting the settlor to retain certain interests and the provisions of all four of the statutes permitting the settlor to be a permissible recipient of discretionary principal and income distributions, it is nevertheless critical for the settlor to understand that there can be no "hidden understanding" with the trustee that the trust will be terminated in the settlor's favor when the creditor crisis blows over. Although, as is noted above, the trustee cannot ignore the settlor's legitimate needs, the trustee also cannot ignore the existence of other beneficiaries and/or the standards of invasion, if any. Imagine that a corporate trustee of one of these trusts asks for your opinion regarding the proposed termination of a trust in one of these jurisdictions in favor of the settlor. Although courts will only very rarely intervene in a case involving the exercise of discretion by a trustee, can the rights of other current and future beneficiaries simply be ignored?

Gift and Estate Tax Consequences

Some percentage (perhaps few, perhaps most) of people interested in creating asset protection trusts are motivated not only by the desire to place their assets beyond the reach of future creditors, but also by the desire to remove the assets from their taxable estates. For example, some people have been counseled, for estate

$675,000 per person and $1,350,000 per couple) to a trust for descendants and thus remove this amount—and the income and appreciation on it after the date of the gift—from their estates. There is a certain sort of person who would consider making such a gift for tax planning purposes but is reluctant to give up control of the assets completely and too nervous that he or she may someday need to ask for the return of the assets. For this type of person, an asset protection trust of which the trustor can remain a discretionary beneficiary makes the tax-motivated large gift more palatable.

Where estate tax exclusion is a goal, the provisions of the trust may have to be more restrictive than is required to comply with the state statute authorizing the creation of such a trust. For example, the statutes of Alaska, Delaware, Nevada and Rhode Island all permit the trustor to retain a special (limited) power of appointment. However, as discussed below, retention of such a power by the trustor would cause the assets of the trust to be included in the trustor's estate under §2038 of the Code. Therefore, to meet the tax goal, a trust must omit such an otherwise permissible power. Similarly, Delaware and a number of offshore jurisdictions permit the trustor to retain the right to the income of the trust. Retention of the right to income would cause the trust to be included in the trustor's estate under §2036 of the Code, as discussed below. The number of U.S. trustors who have created such trusts and retained this right to income and/or other tax-sensitive powers suggests that, for many trustors, estate tax exclusion is a secondary (or no) consideration.

The principal provisions of the Code relevant to the consequences and opportunities available when creating asset protection trusts are §§2511, concerning the making of a completed gift, and 2036 and 2038, concerning the inclusion in the trustor's estate of certain assets given away by the trustor but in which the trustor retained certain interests or over which the trustor retained certain powers. We discuss first the gift tax consequences and then the estate tax consequences of creating such trusts. The provisions of state law that prevent creditors from reaching the assets of these types of trusts are particularly significant in determining whether the trustor's transfer to the trust is a completed gift and whether the assets of the trust will be excluded from the trustor's taxable estate.

Gift Tax

The first step in making a gift of property that will be excluded from one's estate is to assure that at the time of the gift, the gift is **complete.** A completed gift is a necessary precondition (though not sufficient) to estate tax exclusion. If the donor has not made a completed gift—has not relinquished control of the assets—then neither the underlying assets nor the income and appreciation thereon can be excluded from the donor's estate.

The test for whether a trustor has made a completed gift is essentially whether the trustor has given up dominion and control of the assets. Section 2511 of the Code provides that a gift tax applies to any completed transfer "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." Regs. §25.2511-2(b) provides that whenever a donor has:

so parted with dominion and control as to leave no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case. Accordingly, in every case of a transfer of property subject to a reserved power, the terms of the power must be examined and its scope determined.

The same regulation goes on to specify that a trustor's transfer of property to a trust where the trustee has the discretion to pay income to the trustor or accumulate the income would be a completed gift if the trust provided specifically to whom the remainder would be paid. However, a similar trust would not be a completed gift where the trustor retained a limited or special power of appointment—the power to appoint by his or her will to whom the remainder of the trust shall ultimately be paid. Retaining this power is, in essence, retaining control of the ultimate disposition of the assets.

In Rev. Rul. 77-378, 1977-2 C.B. 347, the IRS determined that a trustor's transfer of approximately one-half of his assets to a trust from which the trustee had the power, but not the obligation, to distribute either principal or income to the trustor was a completed gift. In essence, the IRS applied a two-part test to determine whether or not the gift was complete.

First, had the trustor retained dominion and control over the assets by virtue of retaining an enforceable right to distributions of income or principal? The IRS held that the trustor had no right to enforce any distributions. Second, had the trustor retained dominion and control over the assets by retaining the ability to borrow funds (and thus, essentially live as if he or she had never given them up) and make the trust assets available to his or her creditors? The IRS held that the trustor could not make the funds available to himself or herself where his or her creditors, under state law, would be unable to reach the assets.

In addition to Rev. Rul. 77-378, a number of courts have recognized that a gift may be complete where a trustor transfers funds to a trust, despite the fact that he or she may receive distributions from the trust in the trustee's unfettered discretion. *See Herzog v. Comr.*, 116 F.2d 591 (2d Cir. 1941). *See also Outwin v. Comr.*, 76 T.C. 153 (1981); *Paolozzi v. Comr.*, 23 T.C. 182 (1954); *Vander Weele v. Comr.*, 254 F.2d 895 (6th Cir. 1958); Rev. Rul. 76-103, 1976-1 C.B. 293.

The possibility that a trustor's creditors may at some point be able to reach the assets of the trust can cause the transfer to fail to qualify as a completed gift. Here the intersection between the gift and estate tax goals and the provisions of state law that protect the assets from creditors is most significant. The IRS and the courts have generally concluded that where the trustor of a trust "cannot utilize the assets by going into debt and relegating the [trustor's] creditors to the trust," there is a completed gift. Rev. Rul. 77-378. By contrast, in *Paolozzi v. Comr.*, the Tax Court held that where, under applicable state law, the creditors of the trustor could reach the trust assets, "it follows that [trustor] ... could at any time obtain the enjoyment and economic benefit of the full amount of the trust income," and the court concluded that this prevented the trustor's gift from qualifying as a completed gift. *Accord Outwin v. Comr.*; *Vander Weele v. Comr.*; Rev. Rul. 76-103.

Two private letter rulings reflect the evolving views of the IRS regarding transfers to trusts where the local law is specifically structured to provide that a trustor's creditors may not attach the assets in self-settled trusts. In PLR 9332006, the IRS ruled that the creation of an offshore trust in a jurisdiction where the law provides that the trustor cannot make the trust assets available to his or her creditors by incurring debt would be a completed gift. Similarly, in PLR 9837007, the IRS ruled that a transfer to an Alaska trust would be a completed gift. More recently, the IRS declined in 1999 to issue a ruling on whether a transfer to a Delaware trust created under the Delaware QDTA is a completed gift or on whether the assets would be included in the trustor's estate. As subsequently discussed, the IRS has demonstrated an increasing unwillingness to grant a ruling on the estate tax inclusion of assets in such trusts.

Similar considerations, particularly as to the rights of creditors to reach the assets of the trust, apply to the determination of whether the assets of a trust must be included in the trustor's taxable estate for federal estate tax purposes. As noted above, although a completed gift is a necessary condition for the determination that assets transferred will not be in the trustor's estate, it is not sufficient. The IRS has engaged in a separate analysis of the estate tax provisions from the gift tax provisions, and rulings and court cases have been somewhat inconsistent in their results. For example, compare *Uhl v. U.S.*, 241 F. 2d 867 (7th Cir. 1957) (an estate tax case holding property in discretionary trust not included in estate where creditors could not reach asset under local law) with *Outwin v. Comr.* (a gift tax case holding no completed gift where trustor could relegate creditors to trust assets).

Estate Tax

Under §2038 of the Code, a transfer in trust will be included in the trustor's taxable estate where the trustor retains the power to "alter, amend, revoke or terminate" the enjoyment of the interests in the trust. As noted above, the state statutes may permit a trust that qualifies for protection from creditors to include a provision permitting the trustor to exercise a limited testamentary power of appointment over the remainder. However, where estate tax exclusion is a goal, the trustor must not retain a limited power of appointment as this would clearly cause estate tax inclusion under §2038.

In Rev. Rul. 76-103, 1976-1 C.B. 293, the IRS addressed both the question of whether a transfer in trust was a completed gift and the related question of whether the trust assets were includible in the trustor's estate under §2038 if creditors could reach the trust assets. The IRS reasoned that a trustor had not made a completed gift where the trustor "could effectively enjoy all the trust income by relegating the creditors to the trust for their claims." However, the IRS noted that the transfer would be a completed gift for gift tax purposes "if and when the [trustor's] dominion and control ceases, such as by a decision to move the situs of the trust to a State where the trustor's creditors cannot reach the trust assets." Further, the IRS ruled that the trust assets would be included in the trustor's taxable estate under §2038 because of the trustor's "retained power to, in effect, terminate the trust by relegating the [trustor's] creditors to the entire property of the trust."

Most of the cases and rulings that address whether assets transferred to a self-settled trust may be excluded from the trustor's estate relate to §2036 of the Code. Section 2036(a)(1) clearly requires inclusion in the trustor's estate of any assets transferred to a trust where the trustor retains "the possession or enjoyment of, or the right to the income from, the property." A right to income from the trust must be avoided, even where permitted under state law, if estate tax exclusion is desired.

Absent facts that prove an agreement actually to distribute the income of the trust to the trustor, where the trustor is a discretionary beneficiary of the trust with no right to the income of the trust but with only the possibility that he or she may receive income distributions as determined in the unfettered discretion of the trustee, the trustor has not retained a right to income or possession or enjoyment to cause estate tax inclusion under §2036. *See German Est. v. U.S.*, 85-1 USTC ¶13610 (Cl. Ct. 1985); *Uhl Est. v. Comr.*, 241 F.2d 867 (7th Cir. 1957); *Wells Est. v. Comr.*, 42 T.C.M. 1305 (1981); PLRs 9332006, 8037116; *See also Comr. v. Irving Trust Co.*, 147 F.2d 946 (2d Cir. 1945).

As noted above, in PLR 9332006, the IRS ruled that a transfer to an offshore trust where the trustor retained no interest or power over the trust but only a discretionary right to distributions from the trust, the transfer was a completed gift, and the assets were not included in the trustor's estate for federal estate tax purposes under §§2036, 2037 or 2038 of the Code. The IRS has become increasingly reluctant to give the kind of guidance given in PLR 9332006, particularly on the question of estate tax inclusion. In PLR 9837007, the IRS ruled that a transfer to an Alaska trust would be a completed gift but declined to rule whether the assets would or would not be excluded from the trustor's estate. However, the IRS subsequently declined to issue a ruling on whether a

transfer to a Delaware trust created under the Delaware QDTA is a completed gift or on whether the assets would be included in the trustor's estate.

There are essentially two lines of reasoning under which some authorities have concluded under specified circumstances that the assets of a trust in which a trustor has retained no express income interest but only a discretionary interest in the income or principal must be included in the trustor's estate under §2036 of the Code.

First, where the trustor's creditors can reach the assets of the trust or the income of the trust as a result of the application of local law, authorities have held that the trustor essentially retained the possession and enjoyment of the assets and the economic benefit of the assets. This is the "relegation of creditors" to the trust assets argument, also discussed above in connection with the gift tax. Second, where despite the purely discretionary language of the trust instrument, the trustor and the trustee had an express or implied agreement or arrangement that assured that the trustor would actually receive distributions, authorities have held the value of the assets includible in the trustor's estate under §2036(a)(1). One reason the IRS has been unwilling to rule in the estate tax area is that the facts necessary to determine whether or not an "arrangement" exists between the trustor and the trustee to pay the income to the trustor for any period during trustor's life cannot be established or evaluated until the trustor's death, or at least until a substantial period of the administration of the trust has occurred.

Most of the significant cases and rulings regarding estate tax inclusion under §2036(a)(1) of discretionary self-settled trusts relate to the question of creditors' ability to access the trust funds. By contrast, proof of an "arrangement" or agreement to make distributions requires specific factual determinations about the actual administration of the trust and other actions of specific actors not relevant to drafting a trust or designing a state statute that permits the creation of a certain type of trust. However, the authorities that consider the consequences of the ability of some creditors to reach the trust assets are not altogether consistent or helpful.

In *Uhl Est.*, the Court of Appeals reversed the Tax Court's determination that the assets of a trust should be included in the trustor's estate because the Court of Appeals concluded that, under Indiana law, creditors of the trustor could not reach trust assets. Similarly, in *German Est. v. U.S.*, the U.S. Claims Court determined that the IRS had not established that the trustor's creditors could reach the trust assets under Maryland law; therefore, the court held that the trust assets were not included in the trustor's taxable estate. By contrast, in *Paxton Est. v. Comr.*, 86 T.C. 785 (1986), the Tax Court held trust assets included in decedent's estate under §2036(a)(1) in part because the trustor's creditors could reach such assets under applicable law.

In some instances, the courts and the IRS fail to analyze the ability of creditors under applicable law to reach the trust assets. For example, it is stated without analysis in PLR 9332006 that the taxpayer has represented as a fact that under the applicable law of the jurisdiction, creditors cannot reach the trust assets. Although not always clear in the authorities, the basis of the argument that the ability of a creditor to reach trust assets gives rise to estate tax inclusion under §2036 (or, as suggested in Rev. Rul. 76-103, under §2038) is the notion that if creditors generally can reach trust funds, the trustor will be able to borrow funds and live as if he or she never gave the funds away, spending all of the borrowed funds and "relegating" the creditors to the trust assets for repayment. For example, in *Vander Weele v. Comr.*, 254 F.2d 895 (1956), the Court of Appeals explained the effective retention of the economic benefits of creating a trust that is accessible to one's own creditors as follows: "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 Delaware statute, as originally enacted, contained an exception permitting a lender to reach the trust assets where it had made a loan to the trustor on the basis of the trustor's own representation that the assets of the trust were available to satisfy the trustor's debts. This provision was widely regarded as creating an unquestionable estate tax problem under §2036 and was repealed in an amendment to the Delaware statute. However, the New York legislation now under consideration contains a similar broad exception that virtually creates the very problem contemplated in the cases under §2036: the trustor retains the power, by making representations about the trust that enable him or her to borrow funds, to enjoy the economic benefits of the property he or she has purportedly given away.

Increasingly, it appears that the IRS regards **any possibility** that any one of the trustor's creditors could reach the trust assets as sufficient to raise an estate tax inclusion issue under §2036, regardless of whether the trustor can truly be said to have retained the economic benefits of the assets. This position seems a stretch; the claims of a potential creditor, such as the support claims of a spouse or child, are not the type of obligations a trustor would voluntarily incur to manufacture a debt in order to enjoy the economic benefits of the trust assets. Nevertheless, if the ability of any creditor to reach the trust assets under any circumstances at any time caused inclusion under §2036, no asset protection trust created under the Delaware, Alaska, Nevada or Rhode Island law could reasonably hope to avoid estate tax inclusion. Under the laws of each state, there are some creditors who can reach the trust assets. These creditors include creditors pursuing claims within four years (two years under Nevada law) of the transfer and creditors with child support orders. A trust created under the Nevada statute would be in a stronger position only if it is true that Nevada trusts are not subject to claims for child support.

Notably, Alaska's narrow exception for child support orders that must have been in arrears more than 30 days at the time of the transfer, and Nevada's even more restrictive approach, may be wishful thinking. Recently enacted

law, but also overrides the law of the forum with respect to any period of limitations in enforcing a child support order. 28 USCA §1738B. Note should also be taken of the provisions of the Child Support Recovery Act of 1992. In addition, from a policy standpoint, the claims of spouses and children may be held enforceable against self-settled trusts. See *J.B.G.*, in which the Delaware courts avoided the provisions of the spendthrift trust statute where a spouse's claims were concerned.

Conclusions and Summary

Domestic asset protection trusts should work. If the statutory requirements are followed, a future creditor will find it difficult or impossible to reach assets in a domestic asset protection trust. Offshore asset protection trusts, because of foreign law/foreign location practicalities, may create logistical barriers against some creditors in some circumstances, but *Affordable Media* shows that courts are likely to view offshore trusts with great antipathy. Thus, for trustors who are reluctant to move assets offshore, domestic asset protection trusts provide a highly useful alternative to offshore trusts.

In most cases, it should be possible to avoid the application of Code §2036 with either a domestic or offshore asset protection trust, but the issue is clouded by numerous poorly reasoned and inconsistent decisions and rulings. Pending some definitive resolution of the issues involved, trustors whose primary goal is estate tax avoidance would do well to consider other forms of transfer in trust.

This article began by considering the policy implications of asset protection trusts. It is unlikely that such trusts will ever gain universal acceptance as a matter of policy, and many persons may hold to the view that such trusts are bad policy. Even so, account must be taken of the fact that there are likely to be clients in need of such trusts and that such trusts may be effective. While offshore and domestic asset protection trusts each have their own advantages and disadvantages, both real and imagined, the potential efficacy of the domestic asset protection trust is not to be overlooked.

	Delaware	Rhode Island	Alaska	Nevada	New York Proposed
Citation and Effective Date	12 Del C. §3570 et seq.; July 1, 1997.	R.I. Gen. Laws §18-9, 2-1 et seq.; July 1, 1999.	As §34.40.110; April 2, 1997.	13 Nev. Rev. Stat. §166.010 et seq.; October 1, 1999	Proposed.
What requirements must a trust meet to come within the protection of the statute?	The trust instrument must be irrevocable; must expressly state that Delaware law governs the validity, construction and administration of the trust (unless the trust is being transferred to a qualified trustee from a nonqualified trustee); and must contain a spendthrift clause. The trust must have a qualified trustee.	The trust instrument must be irrevocable; must expressly state that Rhode Island law governs the validity, construction and administration of the trust; and must contain a spendthrift clause.	The trust instrument must be irrevocable; must expressly state that Alaska law governs the validity, construction and administration of the trust; and must contain a spendthrift clause. The trust must have a qualified trustee.	The trust instrument must be irrevocable. In addition, all or part of the corpus of the trust must be located in Nevada, the domicile of the trustor must be in Nevada, or the trust must have a qualified trustee.	Same as Rhode Island.
What interests in principal and income of the trust may the trustor retain?	The trustor may retain the right to receive (1) income, (2) an annual unitrust distribution not to exceed 5% of the value of the trust, or (3) an annual unitrust distribution from	The trustor may be a potential distributee of income and principal in the discretion of the trustee, who may not be a related or subordinate person within	The trustor may be a potential distributee of income and principal in the discretion of the trustee. The statute does not explicitly prevent a related or	The trustor may be a potential distributee of income and principal in the discretion of the trustee. The statute does not explicitly prevent a related or	Same as Rhode Island.

	a charitable remainder unitrust or an annuity from a charitable remainder annuity trust as defined in IRC §664. In addition, the trustor may be a potential distributee of income or principal in the sole discretion of a qualified trustee or qualified trustees or of principal pursuant to an ascertainable standard contained in the trust instrument.	the meaning of IRC §672(c). The trustor may retain the power to veto a distribution from the trust and a special testamentary power of appointment over the trust assets.	subordinate person from making a distribution decision. The trustor may retain the power to veto a distribution from the trust and a special testamentary power of appointment over the trust assets.	subordinate person from making a distribution decision. The trustor may retain the power to veto a distribution from the trust and a special power of appointment over the trust assets.	
	The trustor may retain the power to veto a distribution from the trust and a special testamentary power of appointment over the trust assets.				
Who must serve as trustee to come within the protection of the statute?	A resident individual or a corporation whose activities are subject to supervision by the Delaware Bank Commissioner, the FDIC, the Comptroller of the Currency or the Office of Thrift Supervision.	A resident individual or a corporation whose activities are subject to supervision by the Rhode Island Department of Business Regulation, the FDIC, the Comptroller of the Currency, or the Office of Thrift Supervision.	A resident individual or a trust company or bank that possesses trust powers and has its principal place of business in Alaska.	A resident individual or a trust company or bank that maintains an office in Nevada.	Same as Rhode Island.
May nonqualifying trustees serve?	The statute specifically provides that nonqualifying co-trustees may serve.	It is unclear whether nonqualifying co-trestees may serve.	Nonqualifying co-trustees may serve.	Nonqualifying co-trustees may serve.	Same as Rhode Island
May the trust have a distribution advisor or an investment advisor?	The trust may have one or more advisors (other than the trustor) who may remove	There are no provisions regarding the appointment of a distribution advisor or an	There are no provisions regarding the appointment of a distribution advisor or an	There are no provisions regarding the appointment of a distribution advisor or an	Same as Rhode Island.

	and appoint qualified trustees or trust advisors or who have the authority to direct, consent or disapprove distributions from the trust. The trust may have an investment advisor, including the trustor.	Investment advisor.	Investment advisor.	investment advisor.	
What responsibilities must the (qualified) resident trustee have?	The qualified trustee must: (1) have custody of some or all of the corpus; (2) maintain records of the trust on an exclusive or non-exclusive basis; (3) prepare or arrange for the preparation of fiduciary income tax returns; or (4) otherwise materially participate in the administration of the trust.	Same as Delaware.	Some or all of the trust assets must be deposited in Alaska. In addition, the trustee must maintain records of the trust on an exclusive or non-exclusive basis; the trustee must prepare or arrange for the preparation of fiduciary income tax returns on an exclusive or non-exclusive basis; and part or all of the administration must occur in Alaska, including physically maintaining trust records in Alaska.	The trustee must have powers that include maintaining records and preparing income tax returns for the trust. All or part of the administration must be performed in Nevada.	Same as Delaware/Rhode Island.
What is the statute of limitations as to claims existing on the date of the transfer?	The period of time prescribed by 6 Del. C. §1309 in effect on the later of the date of the qualified disposition or August 1, 2000. Currently, 6 Del. C. §1309 provides that the statute of limitations shall be the later of four years after the transfer or one year after the transfer was or could	The later of four years after the transfer and one year after the transfer was or could reasonably have been discovered by the creditor. The statute bars enforcement of a judgment obtained in another jurisdiction.	The later of four years after the transfer or one year after the transfer was or could reasonably have been discovered by the creditor. The statute does not appear to bar enforcement of a judgment obtained in another jurisdiction.	The later of two years after the transfer or six months after the transfer was or could reasonably have been discovered by the creditor. The statute appears to allow an action to be brought on a judgment from another state within six years after the entry of the judgment.	Same as Rhode Island.

	been discovered by the creditor.				
	The statute bars enforcement of a judgment obtained in another jurisdiction.				
	The burden to prove the transfer fraudulent is on the creditor and is by clear and convincing evidence.				
What is the statute of limitations as to claims arising after the date of the transfer?	Four years after the transfer. The burden to prove the transfer fraudulent is on the creditor and is by clear and convincing evidence.	Four years after the transfer.	Four years after the transfer.	Two years after the transfer.	Same as Rhode Island.
May spouses or children of the trustor proceed against the trust?	Yes. Creditors whose claims result from the trustor's breach of an agreement or court order as to child support, alimony or equitable distribution may proceed against the trust but (in the case of alimony or equitable distribution) only if the ex-spouse was married to the trustor before or on the date of the transfer.	Yes. Creditors to whom the trustor was indebted on or before the date of the transfer on account of an agreement or court order as to child support, alimony or equitable distribution may proceed against the trust.	Yes. A creditor due child support may proceed against the trust if at the time of the transfer the trustor was 30 days or more in default of making a payment under a child support judgment or order.	No.	Same as Rhode Island.
May tort creditors proceed against the trust?	Yes. Creditors whose claims arise as a result of death, personal injury or property damage, occurring before or on the date of the transfer, for which the trustor was liable either directly or through vicarious liability, may	Same as Delaware.	No. Presumably, however, a tort creditor as of the date of the transfer would be able to proceed against the trust, subject to the statute of limitations provisions set forth above.	No. Presumably, however, a tort creditor as of the date of the transfer would be able to proceed against the trust, subject to the statute of limitations provisions set forth above.	Same as Delaware/Rhode Island.

	proceed against the trust.				
Are there any other circumstances under which a creditor may proceed against the trust?	No.	No.	No.	No.	A creditor may proceed against the trust if the creditor relied on an express written statement of the trustor that any property transferred to the trust was available to satisfy the trustor's debt to the creditor.
Are there provisions for moving a trust to the state and making it subject to the statute?	Yes. A trust may become subject to the statute if moved to Delaware, provided that the trust meets the other requirements of the statute (irrevocability, spendthrift clause, qualified trustee), except that the trust instrument does not have to state that Delaware law applies. If a trust is moved from another jurisdiction, for purposes of the statute of limitations, the transfer shall be deemed to have been made on the date the property was originally transferred in trust, whether before or after the effective date of the Delaware statute.	No.	Yes, provided that the trust meets all other requirements of the statute, presumably including specific reference to the laws of Alaska, and a qualified person serves as trustee.	No.	No.

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Exhibit C

(available at https://www.actec.org/assets/1/6/Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust-Statutes.pdf)