10 Domestic Asset Protection Trusts

KIM KAMIN
Gresham Partners, LLC
KRISTEN HOSACK PACE
Schiff Hardin LLP
Chicago

The contribution of Lucy DePree Bickford to previous editions of this chapter is gratefully acknowledged.

I. [10.1] INTRODUCTION

Historically, trusts have been among the most important, regularly used, and accepted asset protection tools when an individual sought to make assets available to a third-person beneficiary but wished to protect those transfers from the beneficiary's creditors. With respect to the transferor's creditors, in the past, trusts have not been viewed as a useful technique for creditor protection.

Several developments have changed this environment and have encouraged the use of trusts for protecting assets from the transferor's creditors while, in certain cases, retaining for the transferor the use of the transferred assets.

Initially, the attention was focused on offshore protection trusts. However, in 1997, both Alaska and Delaware enacted legislation permitting so-called domestic asset protection trusts (DAPTs). Since then, Hawaii, Michigan, Mississippi, Nevada, New Hampshire, Ohio, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming have enacted similar legislation, while Missouri has revised legislation enacted in 1986 to clarify that its laws provide spendthrift protection to settlors of certain irrevocable trusts. These 16 states are sometimes referred to as the DAPT states. Oklahoma enacted its own version of asset protection legislation in 2004. Some commentators also believe that Colorado may provide some form of spendthrift protection to settlors of irrevocable trusts. See §§10.2 – 10.83 below.

Of particular concern is whether a settlor who is not a resident of one of the states that allows either perpetual trusts or self-settled asset protection trusts can choose to have a trust governed by the laws of one of those states and whether a court in a state whose laws have not been so chosen to govern the trust would apply the laws of the chosen state to issues relating to trust validity, the validity of the transfer of property to the trust, the availability of trust assets to satisfy the settlor's creditors, and perpetuities. This chapter therefore examines choice-of-law provisions and conflict-of-laws principles as they relate to these provisions of trusts. See §§10.92 – 10.119 below.

II. [10.2] DOMESTIC ASSET PROTECTION TRUSTS

As a starting point and by way of background, almost every state's common law denies spendthrift protection to settlors of trusts. This is derived from the English Statute of Elizabeth, 13 Eliz., ch. 5 (1570), which was embodied in the RESTATEMENT (SECOND) OF TRUSTS §156 (1959):

> **(1) Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest.**
>
> **(2) Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.**

This provision of the RESTATEMENT has been applied in many reported cases and appears to be the commonly held view of estate planning professionals throughout the United States, although such view is not necessarily universal and there may be a number of exceptions to the rule. See, *e.g.,* Robert L. Manley, *Estate Planning with Self Settled Spendthrift Trusts: Steering Clear of Debts and Taxes*, SD36 A.L.I.-A.B.A. 91, 96 (1999). However, most practitioners advise their clients that a self-settled trust cannot insulate assets from the claims of the settlor's creditors as long as the settlor retains any interest in the trust, unless the state specifically adopts a statute to the contrary.

A. [10.3] Missouri: The First State To Offer Self-Settled Spendthrift Trust Protection

In 1986, Missouri amended its spendthrift statute to become the first state to permit settlors of trusts to obtain spendthrift protection if the transfer to the trust was not fraudulent. The statute provided that the settlor's creditors may satisfy claims from the trust assets to the extent of the settlor's beneficial interest therein if, at the time the trust was established or amended,

1. the settlor was the sole beneficiary of the trust or retained the power to revoke or amend the trust; or

2. the settlor was one of a class of beneficiaries and retained a right to receive a specific portion of the trust's income or principal. See Charles D. Fox IV and Michael J. Huft, *Asset Protection and Dynasty Trusts,* 37 Real Prop., Prob. & Tr.J. 287 (2002).

Attorneys in Missouri and other states quietly took advantage of this provision, although initially at least one court declared that the Missouri statute did not change the existing rule that prohibited self-settled spendthrift trusts. *See In re Enfield,* 133 B.R. 515, 519 (Bankr. W.D.Mo. 1991). More recently, the protections of the Missouri statute were validated in *In re Reuter,* 499 B.R. 655 (Bankr. W.D.Mo. 2013).

On July 9, 2004, the Missouri legislature enacted a version of the Uniform Trust Code, effective January 1, 2005. See Missouri Uniform Trust Code, Mo.Rev.Stat. §456.1-101, *et seq.* As part of this legislation, the spendthrift statute was clarified to state that with respect to an irrevocable trust with a spendthrift provision, the spendthrift provision will prevent a settlor's creditors from satisfying claims from the trust assets. Two exceptions, similar to the prior law, were included. Thus, spendthrift protection is not provided

1. if the transfer of assets to the trust was fraudulent; or

2. if the settlor is the sole beneficiary of the income or principal of the trust or retained the power to amend the trust or if the settlor is one of a class of beneficiaries and retained a right to receive a specific portion of the income or principal of the trust. See Mo.Rev.Stat. §456.5-505(3).

On July 8, 2011, the Missouri legislature amended its statute to provide that a settlor's creditors may not reach the settlor's trust interests regardless of any retained testamentary power of appointment that the settlor may exercise in favor of any appointees other than the settlor, the settlor's estate, the settlor's creditors, or the creditors of the settlor's estate. Mo.Rev.Stat. §456.5-505(4).

Thus, under Missouri law, if there is more than one beneficiary of a trust, the settlor is a discretionary beneficiary of the income or principal, and the trust contains a spendthrift provision, then spendthrift protection will be given to the settlor of the trust. The Missouri law is less restrictive than the laws in Alaska, Delaware, Hawaii, Michigan, Mississippi, Nevada, New Hampshire, Ohio, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming discussed in §§10.4 – 10.79 below. For example, a Missouri trustee is not required for the trust.

B. Domestic Asset Protection Trust States

1. [10.4] History and Common Concerns

In 1997, Alaska and Delaware enacted legislation to permit the settlor of a trust to remain a trust beneficiary but still obtain spendthrift protection. See §§10.5 – 10.15 below. Proponents of the Alaska and Delaware statutes assert that they offer the same opportunity to protect one's assets from creditors that is otherwise available only with offshore trusts created in certain debtor-friendly jurisdictions. In 1999, Nevada and Rhode Island enacted similar legislation. See §§10.29 – 10.34 and 10.45 – 10.49 below. In 2003, Utah enacted legislation to permit the settlor of a trust to obtain spendthrift protection as a beneficiary, but only with respect to personal property transferred to the trust. See §§10.60 – 10.64 below. In 2004, Oklahoma enacted legislation that is somewhat more restrictive. South Dakota enacted legislation effective July 1, 2005, to permit creditor protection for self-settled trusts. See §§10.50 – 10.54. This was followed by legislation in Wyoming, effective July 1, 2007; Tennessee, effective July 1, 2007; New Hampshire, effective January 1, 2009; Hawaii, effective July 1, 2010; Virginia, effective July 1, 2012; Ohio, effective March 27, 2013; Mississippi, effective July 1, 2014; West Virginia, effective June 8, 2016; and Michigan, effective March 8, 2017. These statutes were modeled on the Delaware statute.

Almost all of the states that have enacted domestic asset protection trust legislation either have abolished or created exemptions from the rule against perpetuities (Alaska, Delaware, Hawaii, Michigan, Missouri, New Hampshire, Oklahoma, Rhode Island, South Dakota, and Virginia) or have greatly extended it (Nevada (365 years), Tennessee (360 years), Utah (1,000 years), and Wyoming (1,000 years, except as to interests in real estate)). See Alaska Stat. §34.27.075; Del. Code Ann. tit. 25, §503; Haw.Rev.Stat. §525-4(6); Mich. Comp. Laws 700.1041 – 700.1050; Mo.Rev.Stat. §456.025; N.H.Rev.Stat.Ann. §547:3-k; R.I.Gen. Laws §34-11-38; S.D. Codified Laws §43-5-8; Va. Code Ann. §55-12.4; Okla.Stat. tit. 60, §75; Tenn. Code Ann. §66-1-202; Utah Code Ann. §75-2-1203; Wyo.Stat.Ann. §34-1-139(b)(ii). Notably, Mississippi, Ohio, and West Virginia retain the common-law rule against perpetuities. *See, e.g., Gill v. Gipson*, 982 So.2d 415 (Miss.App. 2007); Nev.Rev.Stat. §111.1031; Ohio Rev. Code Ann. §2131.08; W.Va. Code §§44D-5-503 through 44D-5-505.

While there is little caselaw interpreting the DAPT statutes, *Battley v. Mortensen (In re Mortensen)*, Bankruptcy No. A09-00565-DMD, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011), provides some guidance in the bankruptcy context. In that case, before filing for bankruptcy, the debtor, Mortensen, established a self-settled asset protection trust under Alaska law. "The express purpose of the trust was 'to maximize the protection of the trust estate or estates from creditors' claims of the Grantor or any beneficiary.' " 2011 WL 5025249 at *2. The bankruptcy trustee sought to set aside Mortensen's transfer under 11 U.S.C. §548(e), which provides that the trustee may avoid any transfer made on or within ten years of the filing date of the bankruptcy petition if (a) the transfer was made to a self-settled trust, (b) the transfer was by the debtor, (c) the debtor is a beneficiary, and (d) the debtor made the transfer with actual intent to hinder, delay, or defraud present or future creditors. 2011 WL 5025249 at *6. While "[u]nder Alaska law, 'a settlor's expressed intention to protect trust assets from a beneficiary's potential future creditors is not evidence of an intent to defraud' " (quoting Alaska Stat. §34.40.110(b)(1)), the bankruptcy court concluded that such an express intention can be evidence of an intent to defraud because §548(e) was "aimed at closing a loophole" created by the state laws that allow self-settled trusts, so state law was not determinative. 2011 WL 5025249 at **6 – 7. The court found that Mortensen's express purpose in transferring real estate into the trust was to hinder, delay, and defraud creditors. The court also considered additional evidence that Mortensen intended to defraud creditors; for example, he transferred $80,000 of a cash gift from his mother into the trust that he might have otherwise used to pay off his $49,711 – $85,000 credit card debt. 2011 WL 5025249 at *7. Mortensen claimed that his intent was to preserve the real estate in trust for his children's enjoyment, but the court concluded that the trust's activities — stock market investments and a car loan to an acquaintance — had no relationship to this alleged purpose. 2011 WL 5025249 at *8. Therefore, the transfer was voided.

Individuals contemplating an asset protection trust should be aware of *Mortensen.* Bankruptcy courts may follow this case and conclude that a particular state's statute limiting the evidentiary value of the settlor's express purpose is not determinative. However, in *Mortensen,* there was substantial additional evidence that Mortensen intended to defraud creditors. It is unclear how courts would resolve cases in the absence of such negative facts.

As of this publication, *Mortensen* does not have an official reporter citation and may have limited precedential value. Indeed, it has no precedential value outside of the bankruptcy context. Some practitioners have noted that under 11 U.S.C. §548(e), the statute of limitations on creditor claims against self-settled spendthrift trusts in bankruptcy cases is ten years. Accordingly, by establishing self-settled spendthrift trusts as soon as possible, settlors may avoid the negative impact of *Mortensen*. Settlors also may want to avoid filing for bankruptcy, if possible. Other practitioners also advise settlors of self-settled spendthrift trusts not to recite in the trust instrument that the trust's purpose is to protect assets from creditors. If the primary purpose is asset protection, a secondary purpose, such as estate planning, may not be enough to protect the trust's assets. Instead, settlors can establish clear evidence that estate planning is the dominant purpose of the trust by focusing on "the current use of the grantor's applicable exclusion amount, the preservation of trust assets for future generations, the use of professional asset management, and other similar estate planning goals." Howard M. Zaritsky, *Transferors With Creditor Problems,* TAX PLANNING FOR FAMILY WEALTH TRANSFERS: ANALYSIS WITH FORMS, 8.06 at *20 (2012); Deborah M. Beers, *Federal Bankruptcy Court Holds That Transfer to Self-Settled Spendthrift Trust May Be Set Aside in Bankruptcy: Bad Facts, or Bad Law?*, 37 Tax Mgmt.Est. Gifts & Tr.J. 167 (BNA) (Mar. 8, 2012). Further, settlors who have large amounts of debt presumably should not transfer substantially all of their assets into a self-settled spendthrift trust. Beers, *supra*. Because *Mortensen* was such a fact-specific case and because Mortensen had filed for bankruptcy, it is unclear whether future cases will be more favorable to settlors or to creditors. *Id*. This one unfavorable result may limit the use of self-settled spendthrift trusts under some circumstances, but it certainly "does not render them useless." Zaritsksy, *supra,* at *20.

The authors are aware of one case finding that a Nevada self-settled spendthrift trust was valid because it complied with the Spendthrift Trust Act of Nevada, Nev.Rev.Stat. §166.010, *et seq*. *Hagendorf v. Cleveland,* No. 02A452345 (Clark Cty., Nev. July 29, 2002). Another case has been cited as upholding DAPT protection, but that case is not actually on point because the creditor spouse claimed to have a beneficial interest in the trust, not that she was a third-party creditor. *See Dahl v. Dahl*, Civil No. 090402989 (Utah Cty. Utah 2011).

At least one suit challenging a Delaware self-settled spendthrift trust is being litigated now. In that case, the owner of a hedge fund liquidated his funds and formed an asset protection trust in Delaware because he anticipated an unfavorable judgment in a New York suit. The plaintiffs in the New York case filed suit against the trust in the Delaware Court of Chancery. For those interested in following the case, it is *Parrott v. Sasaki,* No. 7227 (Del.Ch. filed Feb. 7, 2012).

2. [10.5] Alaska Trusts

In apparent response to the high-profile discussion of offshore trusts in the asset protection arena (and perhaps because of the hesitance of many American practitioners and their clients to utilize the laws of an unfamiliar foreign country), Alaska's legislature enacted the so-called Alaska Trust Act (Alaska Act) in 1997, 1997 Alaska Sess. Laws, ch. 6 (H.B. 101). On July 10, 2003, legislation was approved that considerably increased creditor protection for both third-party beneficiaries and for asset protection trusts. 2003 Alaska Laws, ch. 138 (H.B. 212). The statute was amended again on June 9, 2010, to further strengthen creditor protection for settlors of Alaska asset protection trusts. 2010 Alaska Laws, ch. 65 (S.B. 63).

a. [10.6] Creditor Protection

The Alaska Trust Act allows a person to set up a self-settled spendthrift trust that is protected from most claims of the settlor's creditors. The Act provides that, outside of some specific situations discussed in §10.7 below, the assets of a trust governed by the Act are not subject to the claims of the settlor's creditors unless the creditor establishes by clear and convincing evidence that the original transfer to the trust was intended to defraud the settlor's known creditors. Alaska Stat. §34.40.110(b)(1). Thus, a settlor can transfer assets to an irrevocable Alaska trust and be a beneficiary to whom the trustee can distribute trust property and, if the trust is not obligated to distribute trust assets to the settlor, the assets will not be subject to creditors' claims. This protection applies even if the settlor is the only person to whom the trustee may distribute trust assets and income.

The settlor may retain certain rights and powers under the trust, including the power to veto a distribution from the trust; the right to remove a trustee, trust protector, or advisor and appoint a new trustee, trust protector, or advisor; and a lifetime or testamentary limited power of appointment. The settlor may also receive a percentage of the trust value each year, as provided in the trust instrument; receive discretionary income and principal; receive income or principal from a charitable remainder unitrust, charitable remainder annuity trust, grantor-retained unitrust, or grantor-retained annuity trust; receive income or principal to pay taxes on trust income; and use real property held in a qualified personal residence trust. Alaska Stat. §§34.40.110(b), 34.40.110(g), 34.40.110(m).

b. [10.7] Limitations

A creditor is able to reach the trust assets to the extent necessary to pay the creditor's claim if

1. the creditor can prove by clear and convincing evidence that the transfer was made with an intent to defraud that creditor (however, a settlor's express intention to protect trust assets from the beneficiaries' potential creditors is not evidence of an intent to defraud);

2. the settlor retains the power to revoke or terminate all or part of the trust without the consent of a person who has a substantial beneficial interest in the trust and the interest would be adversely affected by the exercise of the power held by the settlor to revoke or terminate all or part of the trust;

3. the trust requires that all or part of the trust's income or principal or both must be distributed to the settlor; or

4. at the time of the transfer, the settlor is in default by 30 or more days of making a payment due under a child support judgment or order. Alaska Stat. §34.40.110(b).

Prior to the 2003 amendments to the Act, 2003 Alaska Laws, ch. 138 (H.B. 212), the assets of an irrevocable Alaska trust could be attached at any time by a creditor whose claim existed at the time the trust was settled, even if the claim was not known to the settlor at that time. The 2003 amendments prohibit such a preexisting creditor from attaching trust assets unless the creditor either (1) demonstrates that he or she asserted a specific claim against the settlor before the assets were transferred to the trust or (2) files a court action against the settlor within four years after the transfer of assets to the trust or, if later, within one year after the transfer reasonably could have been discovered, asserting an act or omission that occurred before the transfer. Creditors must bring claims that arise after the transfer within four years after the transfer. Alaska Stat. §34.40.110(d).

c. [10.8] Applicability of the Alaska Trust Act

To qualify a trust under the Alaska Trust Act, some or all of the trust assets must be deposited in Alaska, part or all of the trust administration must take place in Alaska, and the settlor must use an Alaska resident or an Alaska-headquartered bank or trust company as trustee or cotrustee. Alaska Stat. §§13.36.035(c)(1), 13.36.035(c)(2), 13.36.035(c)(4), 13.36.390(1). This trustee must have certain duties, including preparing or arranging for the preparation of fiduciary income tax returns and maintaining trust records. Alaska Stat. §13.36.035(c)(3).

d. [10.9] Rule Against Perpetuities

Alaska has eliminated the common law rule against perpetuities. See Alaska Stat. §34.27.075.

3. [10.10] Delaware Trusts

Long known as a trust-friendly jurisdiction based on a variety of other tax and legal rules, Delaware quickly responded to the Alaska legislation discussed in §§10.5 – 10.9 above. On July 9, 1997, the Governor of Delaware signed into law the Qualified Dispositions in Trust Act (Delaware Act), Del. Code Ann. tit. 12, §3570, *et seq.* The Act provides creditor protection and estate planning opportunities similar to those under the Alaska statute.

a. [10.11] Creditor Protection

Like the Alaska Trust Act, the Delaware Qualified Dispositions in Trust Act allows an individual to make a qualified disposition to a self-settled spendthrift trust that is protected from most claims of the settlor's creditors under Delaware law. The Delaware Act defines the creation of a "qualified disposition" as the creation of an irrevocable trust with a "qualified trustee" by means of a "trust instrument" that contains a spendthrift provision and expressly incorporates the laws of Delaware. See Del. Code Ann. tit. 12, §§3570(7), 3570(8), 3570(11). Thus, as in Alaska, a settlor can transfer assets to an irrevocable Delaware trust and be a beneficiary to whom the trustee can distribute trust property and, if the trust is not obligated to distribute certain trust assets to the settlor, the assets will not be subject to creditors' claims. This protection applies even if the settlor is the only person to whom the trustee may distribute trust assets and income.

The settlor may retain certain rights and powers under the trust, including the power to veto a distribution from the trust, the right to remove a trustee or advisor and appoint a new trustee or advisor, and a lifetime or testamentary limited power of appointment. The settlor may also receive discretionary income and principal; receive income or principal from a charitable remainder unitrust, charitable remainder annuity trust, grantor-retained unitrust, or grantor-retained annuity trust; receive income or principal to pay taxes on trust income; and use real property held in a qualified personal residence trust. The trust may also allow the trustee to pay the settlor's debts after the death of the transferor. Del. Code Ann. tit. 12, §3570(11).

b. [10.12] Limitations

Creditors are able to reach trust assets to the extent necessary to pay the creditor's claims and related costs (including attorneys' fees) if

1. the transfer was to defraud creditors;

2. the claim resulted from an agreement or a court order providing for alimony, child support, or property division; or

3. the creditor suffered death, personal injury, or property damage as a result of action by the settlor, directly or indirectly, before the date of the transfer for which the transferor is liable. Del. Code Ann. tit. 12, §§3536(a), 3572(a), 3573, 3574(a).

The Delaware Act's statute of limitations in Del. Code Ann. tit. 12, §3572(b), is identical to that under the Alaska Trust Act; *i.e.,* a claim must be brought within four years after the transfer or, if later, within one year after it could reasonably have been discovered. If the claim is based on constructive fraud, the statute of limitations is also four years. See Del. Code Ann. tit. 6, §1309. See also Del. Code Ann. tit. 6, §§1304 and 1305, for definitions of transfers in fraud of creditors.

c. [10.13] Applicability of the Delaware Qualified Dispositions in Trust Act

Similar to the Alaska requirements discussed in §10.8 above, to qualify a trust under the Delaware Qualified Dispositions in Trust Act, at least one trustee must be a Delaware resident or a corporate trustee authorized by Delaware law to act as a trustee and whose activities are subject to supervision by the Bank Commissioner of Delaware, the Federal Deposit Insurance Corporation, or the Comptroller of the Currency. Del. Code Ann. tit. 12, §3570(8). Furthermore, the trustee must "materially participate" in trust administration. Del. Code Ann. tit. 12, §3570(8)(b). The settlor may not serve as trustee or cotrustee. Del. Code Ann. tit. 12, §§3570(8)(d), 3570(8)(f).

d. [10.14] Rule Against Perpetuities

Delaware has eliminated the rule against perpetuities, except as to interests in real property. Interests in real property must terminate 110 years after the date the interests are transferred to the trust or the date the trust becomes irrevocable, whichever is later. Del. Code Ann. tit. 25, §§503(a), 503(b).

e. [10.15] Advantages of the Delaware Qualified Dispositions in Trust Act

One possible advantage of the Delaware Qualified Dispositions in Trust Act is the provision stating that the trustee of a Delaware asset protection trust automatically ceases to act if a non-Delaware court determines that a court has jurisdiction over either the trustee or the trust assets. Del. Code Ann. tit. 12, §3572(g). This may permit the creator of a Delaware trust to have the trust assets automatically moved to an offshore trustee if a non-Delaware court asserts jurisdiction. Other possible advantages include (1) a specific provision to address Rev.Rul. 2004-64, 2004-2 Cum.Bull. 7, mandating that the settlor of a Delaware trust may retain the ability to be reimbursed for income taxes payable on income attributable to a Delaware trust on a discretionary basis only (Del. Code Ann. tit. 12, §3570(11)(b)(9)); and (2) a provision that a Delaware asset protection trust cannot be reached by a surviving spouse to satisfy that surviving spouse's elective share (Del. Code Ann. tit. 12, §3573).

4. [10.16] Hawaii Trusts

On June 28, 2010, Hawaii enacted the Permitted Transfers in Trust Act, Haw.Rev.Stat. §554G-1, *et seq.,* which became effective July 1, 2011. The Act contains some unique provisions, but it is otherwise similar to other asset protection statutes.

a. [10.17] Creditor Protection

The Hawaii Permitted Transfers in Trust Act allows an individual to form a self-settled irrevocable trust that is protected from most claims of the settlor's creditors under Hawaii law. The settlor may retain certain rights and powers, including the power to veto a distribution from the trust, the right to remove a trustee or advisor and appoint a new trustee or advisor, and a testamentary limited power of appointment. The settlor may also receive up to five percent of the initial value of the trust annually, as provided in the trust instrument; receive discretionary income and principal; receive income or principal from a charitable remainder unitrust, charitable remainder annuity trust, grantor-retained unitrust, or grantor-retained annuity trust; receive income or principal to pay taxes on trust income; and use real property held in a qualified personal residence trust. The trust may also allow the trustee to pay the settlor's debts after the death of the transferor. Haw.Rev.Stat. §554G-5(c).

b. [10.18] Limitations

Creditors are able to reach trust assets to the extent of the creditor's claims and related costs (including attorneys' fees) if

1. the transfer was made with the actual intent to defraud, hinder, or delay the creditor;

2. the claim is for support, alimony, or a division of property owed to the transferor's spouse, former spouse, or children (excluding an elective share against the transferor's will);

3. the claim is for death, personal injury, or property damage on or before the transfer;

4. the claim is by a lender who extends a secured or collateralized loan based on the transferor's representation that the assets would be available as security against the loan in the event of default; or

5. the claim is by the State of Hawaii for outstanding tax liabilities. Haw.Rev.Stat. §§554G-8, 554G-9.

Under Hawaii's Permitted Transfers in Trust Act's statute of limitations, creditors must bring claims that arose concurrent with or after the transfer within two years after the transfer. Haw.Rev.Stat. §554G-8(b). Creditors must bring claims that arose before the transfer by the date of the transfer (and within the limitations imposed by the Hawaii Uniform Fraudulent Transfer Act, Haw.Rev.Stat. §651C-1, *et seq*.). *Id.* See Haw.Rev.Stat. §§651C-9, 651C-4, 651C-5.

c. [10.19] Applicability

To qualify under Hawaii's Permitted Transfers in Trust Act, a trust must always have at least one "permitted trustee," which is defined as a Hawaii resident (other than the settlor) or a bank or trust company with a principal place of business in Hawaii. The permitted trustee must maintain or arrange for custody of some or all of the trust property, maintain records for the trust, prepare fiduciary income tax returns (or arrange for them to be prepared), or otherwise materially participate in the administration of the trust. Haw.Rev.Stat. §§554G-4, 554G-2.

5. [10.20] Michigan Trusts

Michigan's Qualified Disposition in Trust Act became effective on March 8, 2017. Mich. Comp. Laws 700.1041, *et seq.* This makes Michigan the most recent state to enact legislation addressing domestic asset protection trusts.

a. [10.21] Creditor Protection

The Michigan Qualified Disposition in Trust Act allows an individual to form a self-settled irrevocable trust that is protected from most claims of the settlor's creditors under Michigan law. To qualify under the Michigan Qualified Disposition in Trust Act, the trust instrument must be irrevocable; expressly state that Michigan law governs the validity, construction, and administration of the trust; and contain a spendthrift provision. Mich. Comp. Laws 700.1042(aa). The settlor may retain certain rights and powers, including the power to veto a distribution from the trust, the right to remove a trustee or advisor and appoint a new trustee or advisor, and a testamentary limited power of appointment. The settlor may also receive up to five percent of the initial value of the trust annually, as provided in the trust instrument; receive income and principal in the trustee's discretion or pursuant to a support standard; receive income or principal from a charitable remainder unitrust, charitable remainder annuity trust, grantor-retained unitrust, or grantor-retained annuity trust; receive income or principal to pay taxes on trust income; and use real property held in a qualified personal residence trust. The trust may also allow the trustee to pay the settlor's debts after the death of the transferor. Mich. Comp. Laws 700.1044(2).

If assets are transferred to a trust more than 30 days before the transferor's marriage, or if the parties agree that the statute applies to the transfer, then the trust property will be protected from the transferor's spouse in a divorce or separation. Mich. Comp. Laws 700.1045(4)(b).

b. [10.22] Limitations

Creditors are able to reach qualified trust property if the settlor transferred property to the trust with the intent to defraud a creditor. Mich. Comp. Laws 700.1045. In addition, a transfer will not qualify for protection under the Michigan Qualified Disposition in Trust Act if at the time of the transfer the transferor is more than 30 days in arrears on a child support obligation. Mich. Comp. Laws 700.1042(p)(iii).

Creditors must bring claims that arose before the transfer within two years after the transfer or, if later, within one year after the creditor discovers or reasonably should have discovered the transfer. Creditors must bring claims that arise after the transfer within two years after the transfer. Mich. Comp. Laws 700.1045(3). Under the statute, creditors whose claims arise after a qualified disposition may only set aside transfers made by the transferor with actual intent to defraud the creditor. Mich. Comp. Laws 700.1045(2)(b).

c. [10.23] Applicability of the Michigan Statute

Under the Michigan Qualified Disposition in Trust Act, at least one trustee must be a "qualified trustee." A qualified trustee means a Michigan resident other than the settlor, or a corporate trustee whose activities are supervised by the department of insurance and financial services, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision. Mich. Comp. Laws 700.1042(r). The qualified trustee must maintain or arrange for the custody in Michigan of some or all of the trust property, and the qualified trustee's usual place of business must be in Michigan (for a corporate trustee, the primary trust officer's business location must be in Michigan). *Id.*

In addition, the settlor must provide an affidavit that states that the transferor has full right, title, and authority to transfer the property to the trust; the transfer of the property to the trust will not render the transferor insolvent; the transferor does not intend to defraud a creditor by transferring the property to the trust; the transferor does not know of or have reason to know of any pending or threatened court actions or administrative proceedings against the transferor, except for those specifically identified by the transferor; the transferor is not currently in arrears on a child support obligation by more than 30 days; the transferor does not contemplate filing for bankruptcy; and the property being transferred to the trust was not derived from unlawful activities. Mich. Comp. Laws 700.1046.

d. [10.24] Rule Against Perpetuities

The rule against perpetuities does not apply to trusts that hold personal property. The Uniform Statutory Rule Against Perpetuities applies to real estate owned directly by a trust.

6. [10.25] Mississippi Trusts

On April 23, 2014, Mississippi enacted the Mississippi Qualified Disposition in Trust Act, Miss. Code Ann. §91-9-701, *et seq.*, which became effective July 1, 2014. The Act is most similar to the Tennessee statute, with some unique features.

a. [10.26] Creditor Protection

The Mississippi Qualified Disposition in Trust Act allows an individual to form a self-settled qualified disposition trust that is protected from most claims of the settlor's creditors under Mississippi law. To qualify for protection under the Act, a qualified disposition trust must have a qualified trustee, be governed by Mississippi law, be irrevocable, and contain a spendthrift provision. Miss. Code Ann. §91-9-703(n).

The settlor may retain certain rights and powers, including the power to veto a distribution from the trust, the right to remove a trustee or advisor and appoint a new trustee or advisor who is not a related or subordinate party with respect to the transferor within the meaning of §672(c) of the Internal Revenue Code, 26 U.S.C. §672(c), and a testamentary limited power of appointment. The settlor may also receive up to five percent of the initial value of the trust annually, as provided in the trust instrument; receive income and principal in the trustee's discretion or pursuant to a standard; receive income or principal from a charitable remainder unitrust, charitable remainder annuity trust, grantor-retained unitrust, or grantor-retained annuity trust; receive income or principal to pay taxes on trust income; and use real property held in a qualified personal residence trust. The trust may also allow the trustee to pay the settlor's debts after the death of the transferor. Miss. Code Ann. §91-9-721.

b. [10.27] Limitations

A creditor may reach trust assets if the settlor is a beneficiary and

1. the transfer was fraudulent pursuant to the Mississippi Uniform Fraudulent Transfer Act, Miss. Code Ann. §15-3-101, *et seq.*, or the transfer was made with an actual intent to defraud a creditor whose claim arose after a qualified disposition;

2. the claim is for a payment owed by the settlor under a child support judgment or order;

3. the claim is for a payment owed by the settlor under a spousal support or alimony judgment or order; or

4. the claim is for death, personal injury, or property damage caused by the tortious act or omission of the settlor on or before the date a qualified disposition was made. Miss. Code Ann. §91-9-707.

Creditors must bring claims that arise concurrent with or before the transfer within two years after the transfer or if later, within six months after the creditor discovers or reasonably should have discovered the transfer. Creditors must bring claims that arise after the transfer within two years after the transfer. Miss. Code Ann. §91-9-707(b)(1)(A).

c. [10.28] Applicability of the Mississippi Qualified Disposition in Trust Act

The qualified trustee must be a resident of Mississippi or a corporation whose activities are supervised by the Mississippi Department of Banking and Consumer Finance, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision. Miss. Code Ann. §91-9-703(k). The qualified trustee must maintain records for the trust and participate in the administration of the trust. *Id*. Before making a qualified disposition, the settlor must execute a qualified affidavit stating that the settlor (1) has full right, title, and authority to transfer the assets to the trust; (2) will not be rendered insolvent by the transfer of the assets to the trust; (3) does not intend to defraud creditors by transferring the assets to the trust; (4) does not have pending or threatened court actions against him or her, except for those identified in the affidavit; (5) is not involved in any administrative proceedings, except for those identified in the affidavit; (6) does not contemplate filing for bankruptcy; (7) will not transfer to the trust assets derived from unlawful activities; and (8) is a named insured underneath a general liability insurance policy and, if applicable, a professional liability insurance policy, with policy limits of at least $1 million for each respective policy, and the transferor shall provide proof of such insurance to the qualified trustee on an annual basis. Miss. Code Ann. §91-9-705.

7. [10.29] Nevada Trusts

On October 1, 1999, Nevada enacted the Spendthrift Trust Act of Nevada, Nev.Rev.Stat. §166.010, *et seq.* The Act provides creditor protection and estate planning opportunities similar to those in the Alaska, Delaware, and Hawaii statutes described in §§10.5 – 10.19 above.

a. [10.30] Creditor Protection

The Spendthrift Trust Act of Nevada enables a person to establish a self-settled spendthrift trust that is protected from most claims of the settlor's creditors under Nevada law. The Act provides that, except in certain circumstances, the assets of a trust governed by the statute are not subject to the claims of the settlor's creditors unless the original transfer to the trust was intended to defraud the settlor's creditors. Thus, a settlor can transfer assets to an irrevocable Nevada trust and be a beneficiary to whom the trustee may distribute trust property, and if the trust is not obligated to distribute trust assets to the settlor, the assets will not be subject to creditors' claims. This protection applies even if the settlor is the only person to whom the trustee may distribute trust assets and income, may prevent distributions, has a special lifetime or testamentary power of appointment, receives discretionary income or principal, is a beneficiary of a charitable remainder trust, receives income or principal from a grantor retained annuity trust or unitrust, uses real property owned by the trust or held in a qualified personal residence trust, or is entitled to receive annually a percentage of the trust value not to exceed the trust's income. See Nev.Rev.Stat. §166.040.

b. [10.31] Limitations

There are limitations to the Spendthrift Trust Act of Nevada. A creditor is able to reach the trust assets to the extent necessary to pay the creditor's claim if the settlor is a beneficiary and

1. the transfer was intended to hinder, delay, or defraud known creditors;

2. the trust is revocable; and

3. the trust requires that any part of the trust's income or principal be distributed to the settlor. Nev.Rev.Stat. §166.040(1)(b).

Creditors must bring claims that arise concurrent with or before the transfer within two years after the transfer or, if later, within six months after the creditor discovers or reasonably should have discovered the transfer. Creditors must bring claims that arise after the transfer within two years after the transfer. Nev.Rev.Stat. §166.170.

c. [10.32] Applicability of the Spendthrift Trust Act of Nevada

To qualify a trust under the Spendthrift Trust Act of Nevada, all or part of the trust property must be located and administered in Nevada; the settlor of a personal property trust must be domiciled in Nevada; at least one trustee must have certain powers, including the power to prepare income tax returns for the trust and to maintain trust records; or at least part of the trust administration must be performed in Nevada. Nev.Rev.Stat. §166.015(1). At least one of the trustees must be a Nevada resident or a bank or trust company that maintains an office in Nevada for the transaction of business. Nev.Rev.Stat. §166.015(2).

d. [10.33] Advantage of the Spendthrift Trust Act of Nevada

One possible advantage of the Spendthrift Trust Act of Nevada has been the shorter limitations period discussed in §10.31 above. The Act states that a claim must be brought within two years after the transfer or six months after it could reasonably have been discovered. Nev.Rev.Stat. §166.170(1)(a). Many other domestic asset protection trust states have four-year and one-year limitations in the same situations. See §§10.6 and 10.12 above and 10.37 and 10.47 below. Other states like Mississippi now have similar statutes of limitations so Nevada is no longer unique in this regard.

e. [10.34] Miscellaneous

Klabacka v. Nelson, 394 P.3d 940 (Nev. 2017), addressed child support and spousal support claims in relation to Nevada domestic asset protection trusts. *Klabacka* held that a husband's domestic asset protection trust assets could not be reached to satisfy future child support or spousal support claims. This decision was made based on the legislative history of the statute and expressly rejected the position of §59 of the RESTATEMENT (THIRD) OF TORTS (2003). In the case, the court confirmed that Nevada does not have "exception creditors" like spouses or dependent children.

8. [10.35] New Hampshire Trusts

On July 11, 2008, the New Hampshire legislature adopted the Qualified Dispositions in Trust Act, N.H.Rev.Stat.Ann. §564-D:1, *et seq*., to, inter alia, permit domestic asset protection trusts to be created in New Hampshire on and after January 1, 2009. In 2017, New Hampshire repealed the Qualified Dispositions in Trust Act and replaced it with a new statutory section that provides similar creditor protections. N.H.Rev.Stat.Ann. 564-B:5-501, *et seq.*

a. [10.36] Creditor Protection

The New Hampshire statute allows an individual to set up a self-settled spendthrift trust that is protected from most claims of the settlor's creditors. The trust must be irrevocable and contain a spendthrift clause. The statute places no limitations on the powers the settlor may retain. The statute provides that a creditor may not compel the settlor to exercise any right or power the settlor retains under the terms of the trust, including any power of appointment; any power to direct or veto a distribution; any power to reacquire trust property by substituting other property of an equivalent value; any power to appoint or remove a trustee, trust advisor, or trust protector; or any right to receive reports, notices, or other information concerning the trust. N.H.Rev.Stat.Ann. 564-B:5-505A.

b. [10.37] Limitations

Two types of claims are exempt from the provisions protecting trust assets:

1. claims stemming from child support obligations; and

2. claims stemming from alimony or spousal support. N.H.Rev.Stat.Ann. 564-B:5-505A(q).

Creditors can also reach the trust property if the transfer of property to the New Hampshire trust was a fraudulent transfer under the New Hampshire Uniform Fraudulent Transfer Act, N.H.Rev.Stat.Ann. §545-a:1, *et seq*. Creditors' claims must be brought within four years after the transfer is made or if the creditor or assignee is a creditor or assignee of the settlor when the transfer is made, one year after the creditor or assignee discovers or reasonably should have discovered the transfer, if later. N.H.Rev.Stat.Ann. 564-B:5-505A(f).

c. [10.38] Applicability of the New Hampshire Qualified Dispositions in Trust Act

The trust must contain a spendthrift provision and incorporate the laws of New Hampshire. N.H.Rev.Stat.Ann. §564-B:1-102(b).

d. [10.39] Rule Against Perpetuities

New Hampshire preserves the rule against perpetuities but provides an exception for trusts created after December 31, 2003, if the instrument expressly exempts the trust from the rule against perpetuities and the trustee has the power to sell, mortgage, or lease property for any period of time that is required for an interest created under the governing instrument to vest in order to be valid under the rule against perpetuities. N.H.Rev.Stat.Ann. §564:24.

9. [10.40] Ohio Trusts

Effective March 27, 2013, Ohio enacted the Ohio Legacy Trust Act, which permits irrevocable trusts that provide spendthrift protection. Ohio Rev. Code Ann. §5816.01, *et seq*.

a. [10.41] Creditor Protection

The Ohio Legacy Trust Act allows an individual to establish a trust to protect his or her assets from most claims of the settlor's creditors. The trust must be irrevocable, incorporate Ohio law to govern its validity, construction, and administration, and be subject to a spendthrift provision. The settlor may retain certain rights and powers, including the power to veto a distribution from the trust, the right to remove a trustee or advisor and appoint a new trustee or advisor, and a lifetime or testamentary limited power of appointment. The settlor may also withdraw up to five percent of the initial value of the trust annually, receive income and principal in the trustee's discretion or pursuant to a standard, receive income or principal from a charitable remainder unitrust or charitable remainder annuity trust, receive income or principal to pay taxes on trust income, and use real property held in a qualified personal residence trust. The trust may also allow the trustee to pay the settlor's debts after the death of the transferor and may include a provision that, upon the happening of a defined event, results in the termination of a transferor's right to mandatory income or principal. Ohio Rev. Code Ann. §5816.05.

b. [10.42] Limitations

Creditors may reach qualified trust property if the settlor had a specific intent to defraud a creditor. In addition, the following claims are exempted from protection:

1. a child support claim under a judgment or court order; or

2. a spousal support or alimony claim under a judgment or court order. Ohio Rev. Code Ann. §5816.03(C).

Creditors must bring claims that arise before the transfer within 18 months after the transfer or if later, within 6 months after the creditor discovers or reasonably should have discovered the transfer. Creditors must bring claims that arise after the transfer within 18 months after the transfer. Ohio Rev. Code Ann. §5816.07(B).

c. [10.43] Applicability of the Ohio Legacy Trust Act

Under the Ohio Legacy Trust Act, at least one trustee must be a qualified trustee. A qualified trustee means an Ohio resident other than the settlor or an authorized trust company whose activities are supervised by the Ohio Superintendent of Banks, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision. Ohio Rev. Code Ann. §5816.02(S). The qualified trustee must maintain records and participate in the administration of the trust. *Id.* The settlor must sign a notarized affidavit stating that (1) the property being transferred was not derived from unlawful activities; (2) the settlor has full right, title, and authority to transfer the property to the legacy trust; (3) the settlor will not be rendered insolvent immediately after the transfer of the property to the legacy trust; (4) the settlor does not intend to defraud any creditor by transferring the property to the legacy trust; (5) there are no pending or threatened court actions against the settlor, except for any identified by the affidavit; (6) the settlor is not involved in any administrative proceeding, except for any identified by the affidavit; and (7) the settlor does not contemplate at that time filing for relief under the Bankruptcy Code, 11 U.S.C. §101, *et seq.* Ohio Rev. Code Ann. §5816.06.

d. [10.44] Rule Against Perpetuities

Ohio retains the common-law rule against perpetuities. However, a settlor may opt out of the rule if the trust instrument specifically states that the rule against perpetuities does not apply and the trustee (or one or more persons) has the unlimited power to sell all of the trust assets or to terminate the trust. Ohio Rev. Code Ann. §2131.09(B)(1).

10. [10.45] Rhode Island Trusts

On July 3, 1999, Rhode Island enacted the Qualified Dispositions in Trust Act, R.I.Gen. Laws §18-9.2-1, *et seq.,* which provides creditor protection and estate planning opportunities almost identical to those in the Delaware Qualified Dispositions in Trust Act described in §§10.10 – 10.15 above.

a. [10.46] Creditor Protection

Like the Delaware Qualified Dispositions in Trust Act, the Rhode Island Qualified Dispositions in Trust Act allows an individual to make a qualified disposition to a self-settled spendthrift trust that is protected from most claims of the settlor's creditors under Rhode Island law. The Rhode Island Act defines a "qualified disposition" as the creation of an irrevocable trust with a qualified trustee by means of a trust instrument that contains a spendthrift provision and incorporates the laws of Rhode Island. See R.I.Gen. Laws §§18-9.2-2(6), 18-9.2-2(10). Except for some specific situations discussed in §10.47 below, the assets in trust are not subject to the claims of the settlor's creditors in the courts of Rhode Island. Thus, as in Delaware, a settlor can transfer assets to an irrevocable Rhode Island trust and be a beneficiary to whom the trustee can distribute trust property, and, if the trust is not obligated to distribute trust assets to the settlor, the assets will not be subject to creditors' claims. This protection applies even if the settlor has certain rights and powers, including the power to veto distributions, has a limited testamentary power of appointment, has a right to receive income (including from a charitable remainder unitrust or charitable remainder annuity trust), receives up to five percent of the initial value of the trust annually, receives trust principal in the trustee's discretion or subject to a standard (as long as the standard does not confer upon the transferor a substantially unfettered right to the receipt or use of the principal), uses real property held in a qualified personal residence trust, has the right to remove a trustee or advisor and appoint a new trustee or advisor, and receives income or principal to pay taxes on trust income. R.I.Gen. Laws §18-9.2-2(10)(ii).

b. [10.47] Limitations

A creditor is able to reach the trust assets to the extent necessary to pay the creditor's claims and related costs (including attorneys' fees) if

1. the transfer was to defraud creditors;

2. the claim resulted from an agreement or a court order providing for alimony, child support, or property division; or

3. the creditor suffered death, personal injury, or property damage as a result of action by the settlor, directly or indirectly, before the date of the transfer for which the transferor is liable. R.I.Gen. Laws §§18-9.2-6(a), 18-9.2-4(a), 18-9.2-5.

Creditors must bring claims that arose before the transfer within four years after the transfer or if later, within one year after the creditor discovers or reasonably could have discovered the transfer. Creditors must bring claims that arise after the transfer within four years after the transfer. R.I.Gen. Laws §18-9.2-4(b).

c. [10.48] Applicability of the Rhode Island Qualified Dispositions in Trust Act

Under the Rhode Island Qualified Dispositions in Trust Act, at least one trustee must be a qualified trustee. A qualified trustee means a Rhode Island resident other than the settlor or an authorized trust company whose activities are supervised by the department of business regulation, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision. R.I.Gen. Laws §18-9.2-2(9)(i). The qualified trustee must maintain trust records and materially participate in the administration of the trust. R.I.Gen. Laws §18-9.2-2(9)(ii).

d. [10.49] Rule Against Perpetuities

Rhode Island abolished the rule against perpetuities in 1983. See R.I.Gen. Laws §34-11-38.

11. [10.50] South Dakota Trusts

On March 2, 2005, South Dakota enacted the Qualified Dispositions in Trust Act (South Dakota Act), S.D. Codified Laws §55-16-1, *et seq.,* to permit a settlor to transfer property to a trust created on or after July 1, 2005, and obtain spendthrift protection. S.D. Codified Laws §55-16-11. This statute was modeled closely on the Delaware Qualified Dispositions in Trust Act discussed in §§10.10 – 10.15 above.

a. [10.51] Creditor Protection

Like the Delaware Qualified Dispositions in Trust Act, the South Dakota Qualified Dispositions in Trust Act allows an individual to set up a self-settled spendthrift trust that is protected from most claims of the settlor's creditors. The trust must be irrevocable, have a "qualified person" as trustee, contain a spendthrift provision and incorporate the laws of South Dakota. Except for some specific situations discussed in §10.52 below, the assets in the trust are not subject to the claims of the settlor's creditors under South Dakota law. Thus, as in Delaware, the settlor can transfer assets to an irrevocable South Dakota trust and be a beneficiary to whom the trustee can distribute trust property, and, if the trust is not obligated to distribute trust assets to the settlor, the assets will not be subject to creditors' claims. This protection applies even if the settlor has certain rights and powers, including the right to veto a distribution from the trust; a limited inter vivos or testamentary power of appointment; the right to receive trust income or a unitrust amount; the right to receive discretionary principal; the power to remove and replace a trustee, protector or advisor; the right to use real property held under a qualified personal residence trust; the ability to receive income or principal to pay taxes on trust income; and the inclusion of a provision that pours some or all of the trust assets into the settlor's will or revocable trust. S.D. Codified Laws §55-16-2(2).

In addition, the statute was amended in 2014 to provide that a settlor's marital property that is transferred to a spendthrift trust will be protected in a divorce if the settlor's spouse receives specific statutory notice of the transfer or provides written consent to the transfer.

b. [10.52] Limitations

A creditor is able to reach the trust assets to the extent necessary to satisfy the transferor's debt to the creditor if

1. the transfer was to defraud creditors; or

2. the claim resulted from an agreement or court order providing for alimony, child support, or property division. S.D. Codified Laws §§55-16-9, 55-16-15, 55-16-16.

Creditors must bring claims that arose before the transfer within two years after the transfer or if later, within six months after the creditor discovers or reasonably could have discovered the transfer. Creditors must bring claims that arise after the transfer within two years after the transfer. S.D. Codified Laws §55-16-10.

c. [10.53] Applicability of the South Dakota Qualified Disposition in Trust Act

Under the South Dakota Qualified Dispositions in Trust Act, at least one trustee must be a "qualified person." A qualified person means a South Dakota resident other than the settlor, a trust company whose principal place of business is South Dakota, or a bank or savings association authorized to conduct trust business, whose principal place of business is South Dakota and whose deposits are insured by the Federal Deposit Insurance Corporation. S.D. Codified Laws §§55-16-3, 55-3-41. The trustee must maintain or arrange for custody in South Dakota of some or all of the property and administer the trust wholly or partly in South Dakota. S.D. Codified Laws §§55-16-3, 55-3-39.

d. [10.54] Rule Against Perpetuities

South Dakota has eliminated the rule against perpetuities. S.D. Codified Laws §43-5-8.

12. [10.55] Tennessee Trusts

On May 10, 2007, Tennessee enacted the Tennessee Investment Services Act of 2007. Tenn. Code Ann. §35-16-101, *et seq.* The Act permits the creation of domestic asset protection trusts (called "investment services trusts") in Tennessee. Tenn. Code Ann. §35-16-104. The Tennessee legislature amended the Act in 2013, which further strengthened the protections against creditors. The asset protection trust provisions for the Act are similar to the Wyoming legislation and, in many ways, follow the Delaware legislation. Because the statute permits complying trusts previously established in other states to move to Tennessee and obtain the benefits of the statute, one reason given for the legislation is that it may bring back to Tennessee trusts created by Tennessee residents in other states.

a. [10.56] Creditor Protection

The Tennessee Investment Services Act allows an individual to establish a self-settled, irrevocable spendthrift trust that is protected from most claims of the settlor's creditors under

Tennessee law. The settlor may retain certain rights and powers, including the power to veto a distribution from the trust, the right to remove a trustee or advisor and appoint a new trustee or advisor who is not a related or subordinate party with respect to the transferor within the meaning of §672(c) of the Internal Revenue Code, 26 U.S.C. §672(c), the right to act as an investment advisor, and a lifetime or testamentary limited power of appointment. The settlor may also receive up to five percent of the initial value of the trust annually, as provided in the trust instrument, receive income and principal in the trustee's discretion or pursuant to a standard, receive income or principal from a charitable remainder unitrust or charitable remainder annuity trust, receive income or principal to pay taxes on trust income, and use real property held in a qualified personal residence trust. The trust may also allow the trustee to pay the settlor's debts after the death of the transferor. Tenn. Code Ann. §§35-16-102(7), 35-16-111, 35-16-109.

b. [10.57] Limitations

Creditors can reach the trust property if

1. the transfer of property was a fraudulent transfer under the Tennessee Uniform Fraudulent Transfer Act, Tenn. Code Ann. §66-3-301, *et seq.* (and, in the case of a creditor whose claim arose after a qualified disposition, unless the qualified disposition was also made with actual intent to defraud such creditor); or

2. the claim resulted from an agreement or court order providing for alimony, child support, or property division. Tenn. Code Ann. §35-16-104.

Creditors must bring claims that arose before the transfer within two years after the transfer or if later, within six months after the creditor discovers or reasonably could have discovered the transfer. Creditors must bring claims that arise after the transfer within two years after the transfer. Tenn. Code Ann. §35-16-104(b).

c. [10.58] Applicability of the Tennessee Investment Services Act of 2007

Under the Tennessee Investment Services Act, at least one trustee must be a "qualified trustee." A qualified trustee means a Tennessee resident other than the settlor, or a corporate trustee whose activities are supervised by the Tennessee Department of Financial Institutions, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision. Tenn. Code Ann. §35-16-102(12). The trust must contain a spendthrift provision and incorporate the laws of Tennessee. Tenn. Code Ann. §35-16-102(7). The trustee must maintain or arrange for custody in Tennessee of some or all of the property, retain records for the trust, prepare or arrange for the preparation of fiduciary income tax returns, or otherwise materially participate in the administration of the trust. Tenn. Code Ann. §35-16-102(12). The settlor must provide a solvency affidavit. Tenn. Code Ann. §§35-16-102(10), 35-16-103.

d. [10.59] Rule Against Perpetuities

Tennessee amended its rule against perpetuities to extend the period to 360 years for trusts that are created or become irrevocable after June 30, 2007. Tenn. Code Ann. §66-1-202(f).

13. [10.60] Utah Trusts

On March 22, 2003, Utah added §25-6-14 to its Uniform Fraudulent Transfer Act, Utah Code Ann. §25-6-1, *et seq.* The Act was amended in 2003 and now permits a settlor to obtain spendthrift protection for personal property transferred to a trust created on or after December 31, 2003. See 2003 Utah Laws 2nd Sp.Sess. Ch. 3 (H.B. 2003). Utah further amended the Act in 2013 and changed the name of the Uniform Fraudulent Transfer Act to the Uniform Voidable Transactions Act. See Utah Code Ann. §25-6-101, *et seq.*

a. [10.61] Creditor Protection

For irrevocable trusts created on or after December 31, 2003, a settlor may provide that the income or principal interest of the settlor, as the beneficiary of the trust, will be protected from creditors. Utah Code Ann. §25-6-502. The trust may not provide for mandatory distributions of income or principal to the settlor unless specifically authorized by the statute. Utah Code Ann. §25-6-502(5)(e). The settlor may retain a power to veto a distribution from the trust, may have a testamentary special power of appointment over the trust, and may have the power to appoint non-subordinate advisors or trust protectors who can remove and appoint trustees, who can direct, consent to, or disapprove distributions, or who can serve as investment directors or appoint an investment director. The settlor may also receive a percentage of the initial value of the trust annually, as provided in the trust instrument (but not to exceed the trust's income), receive income and principal in the trustee's discretion or pursuant to an ascertainable standard, receive income or principal from a charitable remainder unitrust or charitable remainder annuity trust, and use real property held in a qualified personal residence trust. Utah Code Ann. §25-6-205(7).

b. [10.62] Limitations

Creditors are able to reach the trust assets if, at the time the settlor transferred any assets to the trust, he or she intended to hinder, delay, or defraud a known creditor. Utah Code Ann. §25-6-502(5)(j). The statute of limitations in Utah is two years after the transfer was made or one year after it could reasonably have been discovered. Utah Code Ann. §25-6-502(9)(a). The settlor may shorten this limitations period to 120 days by sending notice to known creditors or by publishing notice in a newspaper of general circulation in the county in which the settlor lives for unknown creditors. Utah Code Ann. §25-6-502(9)(b).

c. [10.63] Applicability of the Utah Statute

To qualify a trust under Utah Code Ann. §25-6-502, the settlor must use as a trustee a Utah resident or a Utah trust company. The following are considered Utah trust companies: (1) a Utah depository institution or its wholly owned subsidiary; (2) an out-of-state depository institution authorized to engage in business as a depository institution in Utah or its wholly owned subsidiary; (3) a corporation, including a credit union service organization, owned entirely by one or more federally insured depository institutions; (4) a direct or indirect subsidiary of a depository institution holding company that also has a direct or indirect subsidiary authorized to engage in business as a depository institution in Utah; or (5) any other corporation continuously and lawfully engaged in the trust business in Utah since before July 1, 1981. Utah Code Ann. §§25-6-502, 7-5-1(1)(d).

d. [10.64] Rule Against Perpetuities

Utah has established a 1,000-year rule against perpetuities. Utah Code Ann. §75-2-1203.

14. [10.65] Virginia Trusts

Effective October 1, 2012, Virginia enacted legislation allowing self-settled asset protection trusts.

a. [10.66] Creditor Protection

The Virginia statute allows an individual to form a self-settled irrevocable trust that is protected from most claims of the settlor's creditors under Virginia law. The trust must be irrevocable and include a spendthrift provision, it must be created during the settlor's lifetime, and there must be at least one beneficiary in addition to the settlor. Va. Code Ann. §64.2-745.2(A). This protection against creditors applies even if the settlor has a limited testamentary power of appointment, may receive distributions of income and principal in the discretion of an independent trustee, may receive distributions pursuant to an ascertainable standard, receives income from a charitable remainder unitrust or annuity trust, has the right to receive annually up to five percent of the initial value of the trust, uses real property held in the trust, receives a qualified annuity interest, and receives trust property to pay income taxes due on trust income. The trustee also may have the ability to pay the settlor's debts outstanding at his or her death from trust assets. Va. Code Ann. §64.2-745.2(D). However, creditor protections will not apply if the settlor has the right to disapprove distributions from the trust. Va. Code Ann. §64.2-745.2(A). If a beneficiary may withdraw his or her entire interest from the trust, he or she will be treated as the settlor of that property once the withdrawal right has lapsed or been released by the beneficiary. Va. Code Ann. §64.2-745.2(E).

b. [10.67] Limitations

Creditors are able to reach trust assets to the extent of the creditor's claims and related costs if the transfer is fraudulent. Va. Code Ann. §64.2-745.1(C). In addition, a settlor's child who has a judgment or court order against the beneficiary for support or maintenance, or a judgment creditor who has provided services for the protection of a settlor's interest in the trust, may attach present or future distributions to or for the benefit of the settlor. Va. Code Ann. §64.2-744(B).

Under the Virginia Act, a creditor must bring a claim that arose before the transfer within five years after the transfer. Va. Code Ann. §64.2-745.1(D).

c. [10.68] Applicability of the Virginia Act

Virginia requires a trust to always have at least one trustee that is a Virginia resident or a legal entity authorized to engage in trust business in Virginia, and that trustee must materially participate in trust administration. Va. Code Ann. §64.2-745.2(A). The protection against creditors only applies to the settlor's right to receive distributions of income and principal. *Id.*

d. [10.69] Rule Against Perpetuities

Virginia's Uniform Statutory Rule Against Perpetuities does not apply to interests in personal property held in trust if the trust instrument provides that it shall not apply. Va. Code Ann. §55-12.4.

15. [10.70] West Virginia Trusts

Effective June 8, 2016, West Virginia began permitting self-settled spendthrift trusts.

a. [10.71] Creditor Protection

The West Virginia statute allows an individual to form a self-settled irrevocable trust that is protected from most claims of the settlor's creditors under West Virginia law. The trust must be irrevocable, include a spendthrift provision, be created during the settlor's lifetime, and have at least one beneficiary in addition to the settlor. W.Va. Code Ann. §44D-5-503b(d).

This protection against creditors applies even if the settlor has a limited testamentary power of appointment, may receive distributions of income and principal in the discretion of an independent trustee, may receive distributions pursuant to an ascertainable standard, receives income from a charitable remainder unitrust or annuity trust, has the right to receive a specified percentage (not to exceed five percent) of the initial value of the trust, may use real property held in the trust, receives a qualified annuity interest, receives trust property to pay income taxes due on trust income, may remove and replace a qualified trustee, and if the trustee may pay the settlor's debts outstanding at his or her death from trust assets. W.Va. Code Ann. §44D-5-503c(c). However, creditor protections will not apply if the settlor has the right to disapprove distributions from the trust. W.Va. Code Ann. §44D-5-503b(d). If a beneficiary may withdraw his or her entire interest from the trust, he or she will be treated as the settlor of that property once the withdrawal right has lapsed or been released by the beneficiary. W.Va. Code Ann. §44D-5-503c(d).

b. [10.72] Limitations

The West Virginia statute does not protect fraudulent transfers from creditor claims. W.Va. Code §§44D-5-503a(c), 44D-5-503b(e). In addition, a spendthrift provision is unenforceable against (1) a grantor's child who has a judgment or court order against the grantor for child support, (2) a judgment creditor who has provided services for the protection of the grantor's interest in the trust and (3) a claim of State of West Virginia to the extent a West Virginia or federal statute so provides. W.Va. Code Ann. §44D-5-503(b). Although the statute does not provide an exception for alimony or property division upon divorce, the grantor's "qualified affidavit" must address these issues. W.Va. Code §44D-5-503b(e)(7).

A creditor must bring a claim against a trust for a fraudulent transfer within four years after the date of the transfer to the trust. W.Va. Code §44D-5-503a(d).

c. [10.73] Applicability of the West Virginia Statute

Under the statute, the trust must always have at least one "qualified trustee." W.Va. Code Ann. §44D-5-503b(d)(4). A "qualified trustee" means a natural person residing in West Virginia or a legal entity authorized to engage in trust business in West Virginia. W.Va. Code Ann. §44D-5-503b(a). The protection against creditors only applies to the settlor's right to receive distributions of income and principal in the sole discretion of an independent qualified trustee. An "independent qualified trustee" is a trustee other than the grantor or the grantor's spouse, parent, descendant, or sibling. W.Va. Code Ann. §44D-5-503b(b).

d. [10.74] Rule Against Perpetuities

West Virginia has adopted the Uniform Statutory Rule Against Perpetuities. W.Va. Code Ann. §36-1A-1(a).

16. [10.75] Wyoming Trusts

On February 28, 2007, Wyoming amended its law to permit settlors to establish asset protection trusts in Wyoming. Such trusts are designated as qualified spendthrift trusts and receive protection from creditors when certain conditions are met. Wyo.Stat.Ann. §§4-10-510 through 4-10-523. The Wyoming statutes were amended in 2011 and are based on the Delaware Qualified Dispositions in Trust Act. The Wyoming statutes have since been further amended, effective July 1, 2013. Wyo.Stat.Ann. §§4-10-506, 4-10-510.

a. [10.76] Creditor Protection

The Wyoming statute allows an individual to form a self-settled irrevocable trust that is protected from most claims of the settlor's creditors under Wyoming law. The trust must state that it is a qualified spendthrift trust, be irrevocable, include a spendthrift provision and incorporate the laws of the state of Wyoming to govern the validity, construction, and administration of the trust. Wyo.Stat.Ann. §§4-10-510. However, the statute protects nonfraudulent transfers to irrevocable discretionary trusts regardless of whether the trust includes spendthrift language. Wyo.Stat.Ann. §§4-10-504, 4-10-506.

The settlor may retain certain rights and powers, including the power to veto a distribution from the trust, an inter vivos or testamentary general or limited power of appointment, and the right to act as an investment advisor to the trust. The settlor may also receive up to five percent of the initial value of the trust annually, receive income from a charitable remainder unitrust or annuity, receive discretionary principal, use real property held in a qualified personal residence trust, add or remove a trustee, and receive income and principal from a grantor retained annuity trust or unitrust. Wyo.Stat.Ann. §4-10-510(a)(iv). Even though the settlor may possess a general power of appointment under a qualified spendthrift trust, creditors may reach the property that is subject to that power. Wyo.Stat.Ann. §4-10-505.1.

b. [10.77] Limitations

Creditors are able to reach the trust assets if

1. the purpose of the transfer was to defraud creditors;

2. the claim resulted from a child support order; or

3. the trust property is listed on an application or financial statement used to obtain or maintain credit. Wyo.Stat.Ann. §4-10-520.

The statute of limitations in Wyoming is four years after the transfer was made or one year after it could reasonably have been discovered for claims of actual intent to defraud. Wyo.Stat.Ann. §34-14-210. Claims based on a transfer that rendered the settlor insolvent or were made when the settlor was already insolvent and that were not for a reasonable value in exchange must be brought within four years after the transfer was made. *Id*. Claims that the transfer was to an insider for an antecedent debt, the debtor was insolvent, and the insider had reasonable cause to believe the debtor was insolvent must be brought within one year after the transfer. Wyo.Stat.Ann. §§4-10-514, 34-14-210.

c. [10.78] Applicability of the Wyoming Act

At least one of the trustees must be an individual who is a resident of Wyoming or a Wyoming corporate fiduciary that maintains or arranges for the custody of some or all of the trust property in Wyoming, maintains records for the trust, prepares or arranges for the preparation of fiduciary income tax returns for the trust, or otherwise materially participates in the administration of the trust. Wyo.Stat.Ann. §4-10-103(a)(xxxv).

At the time of creation, the settlor must furnish a solvency affidavit and affirm that the settlor is not in default of any child support obligation and does not contemplate filing for bankruptcy. Additionally, the settlor must affirm that the settlor maintains personal liability insurance of the lesser of $1 million or the total value of the property transferred by the settlor to all Wyoming qualified spendthrift trusts for his or her benefit. Wyo.Stat.Ann. §4-10-523(a)(ix). This requirement only applies to qualified spendthrift trusts and not to discretionary trusts.

d. [10.79] Rule Against Perpetuities

Wyoming has established a 1,000-year rule against perpetuities for personal property if a specific decision is made to opt out of the rule against perpetuities. Wyo.Stat.Ann. §34-1-139(b)(ii).

C. [10.80] Oklahoma Trusts

The Governor of Oklahoma signed the Family Wealth Preservation Trust Act, Okla.Stat. tit. 31, §10, *et seq.*, into law on June 9, 2004; it was subsequently amended effective June 8, 2005 (2005 Okla.Sess. Law Serv., ch. 438 (S.B. 573)) and again effective November 1, 2014 (2013 Bill Text OK S.B. 1904, §1, *et seq.*).

1. [10.81] Creditor Protection

Under the Oklahoma Family Wealth Preservation Trust Act, it is possible for a revocable trust to receive creditor protection. Okla.Stat. tit. 31, §13. To achieve creditor protection, the trust must be established under Oklahoma law and must have an Oklahoma-based bank or an Oklahoma-based trust company as a trustee or cotrustee. Okla.Stat. tit. 31, §§11(3) – 11(5). The only permissible beneficiaries of the trust are

a. the lineal ancestors and lineal descendants of the grantor or the grantor's spouse, including adopted lineal descendants if they were under the age of 18 at the time of the adoption,

b. the spouse of the grantor,

c. a nonprofit organization qualified under the provisions of the Internal Revenue Code of 1986, 26 U.S.C. §501(c)(3), or

d. a trust settled for the sole benefit of one or more qualified beneficiaries. Okla.Stat. tit. 31, §11(6).

The trust must have "a majority in value of its assets comprised of Oklahoma assets" (Okla.Stat. tit. 31, §11(5)d), which include (a) stocks, bonds, debentures, membership interests, partnership interests, and other equity or debt interests issued by an Oklahoma-based company; (b) bonds or other obligations issued by the State of Oklahoma, an Oklahoma governmental agency, or an Oklahoma county, municipality, or school district; (c) an account in an Oklahoma-based bank; (d) real or tangible personal property, or any interest therein, located in the State of Oklahoma; (e) any security backed exclusively by promissory notes if at least a majority in value of the promissory notes are secured by real or tangible personal property located in Oklahoma; and (f) mutual funds that meet certain specified requirements. Okla.Stat. tit. 31, §11(2). An "Oklahoma-based company" includes a corporation, limited liability company, limited partnership, limited liability partnership, or other legal entity formed or qualified to do business in, and having its principal place of business in, Oklahoma. Okla.Stat. tit. 31, §11(4).

The trust must also recite in its terms that the income generated from the corpus of the trust is subject to the income tax laws of Oklahoma. Okla.Stat. tit. 31, §11(5)e.

If all of the requirements are met, the principal and income of an Ohio preservation trust are exempt from creditors of the grantor. Okla.Stat. tit. 31, §12. In addition, any incremental growth derived from the income retained by the trustee of an Ohio preservation trust is also protected. *Id.*

2. [10.82] Limitations

Creditors may reach the trust assets if

a. the transfer was fraudulent under the Oklahoma Uniform Fraudulent Transfer Act, Okla.Stat. tit. 24, §112, *et seq.;* or

b. the claim is to satisfy a child support judgment. Okla. Stat. tit. 31, §12.

A claim under the Uniform Fraudulent Transfer Act must be brought within four years after the transfer or within one year after the transfer was or could reasonably have been discovered for claims of actual fraud. Okla.Stat. tit. 24, §§121, 116.

Oklahoma's statute is different than the other states' statutes mentioned in this chapter due to its protection of revocable trusts, its limitation of the permissible beneficiaries, and its requirement that a bank or trust company trustee serve as trustee.

D. [10.83] Colorado Trusts

Some commentators believe that Colorado law offers a certain degree of asset protection to settlors of trusts. See Barry S. Engel et al., ASSET PROTECTION PLANNING GUIDE, ¶1125.05 (2000). They point to Colo.Rev.Stat. §38-10-111, which states:

> **All deeds of gift, all conveyances, and all transfers or assignments, verbal or written, of goods, chattels, or things in action, or real property, made in trust for the use of the person making the same shall be void as against the creditors existing of such person.**

This statute is read as denying spendthrift protection with respect to creditors that existed at the time the spendthrift trust was created and if the transfer was made fraudulently. *Fulton Inv. Co. v. Smith,* 27 Colo.App. 279, 149 P. 444 (1915), *aff'd,* 64 Colo. 33 (1918). In *Campbell v. Colorado Coal & Iron Co.,* 9 Colo. 60, 10 P. 248 (1886), the Colorado Supreme Court held that this statute does not apply unless the principal purpose of the trust is for the use of the grantor. Thus, if the trust is not for the principal use of the grantor, spendthrift protection may be available for the grantor as well as the other beneficiaries of the trust.

In addition, in *In re Baum,* 22 F.3d 1014 (10th Cir. 1994), an individual experiencing marital difficulties transferred assets, including his residence, into trusts to preserve the separate property for his children from prior marriages. The settlor reserved the right to live in the residence. The settlor later filed for bankruptcy, and the bankruptcy trustee attempted to set aside the trusts. When the bankruptcy trustee attempted to treat the trusts as void under Colorado law, the appellate court found that since the creditors did not exist at the time the trusts were created, the trusts were valid. The court allowed the bankruptcy trustee to reach the value of the right of the settlor to live in the house during his lifetime, subject to the Colorado homestead exemption.

The Colorado Supreme Court has since called *Baum* into question. In *In re Cohen,* 8 P.3d 429, 433 (Colo. 1999), a lawyer discipline case, the court concluded that, contrary to the parties' understanding of *Baum,* the oral irrevocable spendthrift trust at issue "did not protect the settlor-beneficiary from future creditors." A Colorado bankruptcy court later relied on *Cohen* to conclude that Colo.Rev.Stat. §38-10-111 was not determinative and that under Colorado law, a spendthrift trust that names the settlor as a beneficiary is invalid. *Peters v. Bryan (In re Bryan),* 415 B.R. 454, 471 – 472 (Bankr. D.Colo. 2009) (*Bryan I*), *aff'd in relevant part sub nom. Peters v. Bryan,* Civil Action No. 09-cv-1366, 2010 WL 3894035 (D.Colo. Sept. 29, 2010) (*Bryan II*). In *Bryan II,* the debtors had repeatedly quitclaimed the trust property to themselves and back to the trust again, borrowing against the property for personal purposes each time. The debtors ignored trust formalities and treated trust property as their own, and the trustee had the authority to grant trust property as security for the debtor’s personal debts. 2010 WL 3894035 at *8. While this case is factually unfavorable, the court’s conclusion is that all Colorado spendthrift trusts with settlor beneficiaries are invalid.

A related case clarified that a creditor with an outstanding claim against a debtor need not reduce the claim to judgment for the conveyance to be considered existing and the phrase “shall be void” means voidable, not void ab initio. *In re Bryan,* 495 Fed.Appx. 884 (10th Cir. 2012).

Because of the unfavorable nature of the protection offered by the Colorado law, one is better off looking to states that have specific asset protection trust statutes.

E. [10.84] State Income Tax Considerations

As with perpetuities trusts, the selection of a state in which to establish an asset protection trust may depend, in part, on how that state taxes trust income. The income tax provisions for the asset protection states are summarized below.

Alaska. Alaska does not tax trust income.

Delaware. There is no tax on income allocable to nonresident trust beneficiaries. Delaware taxes income when the trust is created by a Delaware resident, the sole trustee is a resident or has an office in Delaware, a corporate trustee has an office in Delaware, or all trustees are individuals and at least half are residents. Del. Code Ann. tit. 30, §§1601, 1631, *et seq.*

Hawaii. Hawaii taxes income of resident trusts and income of nonresident trusts that is derived from sources in Hawaii. Haw.Rev.Stat. §235-4. Income from interest and dividends is excluded to the extent that the beneficial interest is held by out-of-state beneficiaries. Haw.Rev.Stat. §235-4.5.

Michigan. Michigan taxes income of resident trusts and income of nonresident trusts that is derived from sources in Michigan. Mich. Comp. Laws 206.315(1).

Mississippi. Mississippi does not tax grantor trusts established by nonresident settlors.

Missouri. Missouri taxes the income of a trust that was created by, or consists of property contributed by, a person domiciled in Missouri on the date the trust became irrevocable if, on the last day of the taxable year, at least one income beneficiary of the trust is a resident of Missouri. Mo.Rev.Stat. §143.341, *et seq.*

Nevada. Nevada does not tax trust income.

New Hampshire. New Hampshire does not tax trust income.

Ohio. Ohio does not tax trust income unless the settlor becomes a resident and at least one beneficiary resides in Ohio. Ohio Rev. Code Ann. §5747.01(I)(3)(a)(ii).

Oklahoma. Oklahoma taxes trust income. Okla.Stat. tit. 31, §11(5)e.

Rhode Island. Rhode Island does not tax income allocated to nonresident beneficiaries. It does tax income allocated to resident beneficiaries of a trust created by a resident but only while the creator continues as a resident or after death if the creator is then a resident. R.I.Gen. Laws §44-30-2, *et seq.*

South Dakota. South Dakota does not tax trust income.

Tennessee. Tennessee taxes the dividend and interest income of trusts received by trustees "for the benefit of" resident beneficiaries. Tenn. Code Ann. §67-2-110(a).

Utah. Utah taxes income of resident trusts and income of nonresident trusts that is derived from sources in Utah. Utah Code Ann. §59-10-201, *et seq.*

Virginia. Virginia taxes the income of trusts. Va. Code Ann. §58.1-360.

West Virginia. West Virginia taxes income of resident trusts and income of nonresident trusts that is derived from sources in West Virginia. W.Va. Code §11-21-51.

Wyoming. Wyoming does not tax trust income.

F. [10.85] Estate and Gift Tax Consequences of Domestic Asset Protection Trusts

Several commentators have taken the position that if creditors cannot reach the trust property, as will be the case if the domestic asset protection state statutes prove effective, the trust property will not be includable in the settlor's gross estate even though the settlor is a discretionary beneficiary of the trust. Richard Covey, PRACTICAL DRAFTING ¶4891 (1997); Douglas J. Blattmachr and Jonathan G. Blattmachr, *A New Direction in Estate Planning: North to Alaska,* 123 Tr. & Est., No. 10, 50 (Sept. 1997). Instead, a completed gift will occur upon the transfer of the property to the domestic asset protection trust. The result is a freeze transaction. The settlor would incur gift tax upon funding of the trust and would continue to enjoy the property as a discretionary beneficiary of the trust; however, the trust would not be taxed in the settlor's estate under either 26 U.S.C. §2036(a)(1) or 26 U.S.C. §2038.

EXAMPLE: *A* creates a DAPT in Alaska in 2012 and funds it with $5 million. *A* and his children are discretionary beneficiaries of the trust. The gift is sheltered from gift tax with *A*'s $5 million lifetime applicable exclusion amount. Because creditors cannot reach the assets in the trust, the gift is complete. *A* dies in 2020, when the assets in the trust are worth $7 million. Up until the time of his death, *A* had been a discretionary beneficiary and received distributions from the trust. By using a DAPT, according to its proponents, the $2 million of appreciation after the funding of the trust will escape estate taxation.

1. [10.86] Gift Tax Concerns

To obtain the favorable tax treatment noted in §10.85 above, there first must be a completed gift for purposes of 26 U.S.C. §2511. To have a completed gift, the settlor's creditors should not be able to look to the settlor's domestic asset protection trust for the payment of debts.

Commissioner v. Vander Weele, 254 F.2d 895 (6th Cir. 1958); *Outwin v. Commissioner,* 76 T.C. 153 (1981), *acq.,* 1981-2 Cum.Bull. 1; *Estate of Paxton v. Commissioner,* 86 T.C. 785 (1986). A gift should become complete when the period specified under the law of the jurisdiction for a creditor to reach the property in the trust ends.

In a 1992 Private Letter Ruling involving an offshore trust, Pvt.Ltr.Rul. 9332006 (Aug. 13, 1993), the Internal Revenue Service found that neither the settlor nor the settlor's creditors could compel distribution of the trust assets. Therefore, the gift was complete and the trust was not subject to estate tax. Later, in 1998, the IRS ruled in Pvt.Ltr.Rul. 9837007 (Sept. 11, 1998) that a transfer to an Alaskan DAPT in which the settlor was a discretionary beneficiary was a completed gift.

If a taxable gift occurs upon creation of the DAPT, one question is the amount of the taxable gift. If other family members are beneficiaries, under 26 U.S.C. §2702, the settlor's possibility of receiving trust distributions is not a qualified interest and is valued at zero. Thus, the gift to the family is the entire amount of the property transferred. In a situation in which the trustee can make distributions to both the settlor and nonfamily members, it is likely that the IRS would determine that the taxable gift is the value of all of the property transferred to the trust. See, *e.g.,* Rev.Rul. 76-491, 1976-2 Cum.Bull. 301. In this ruling, which was made pursuant to 26 U.S.C. §2512 and not 26 U.S.C. §2702, the IRS determined that the full value of property conveyed to a trust in exchange for an annuity was a gift when the donor's adult child had a power of appointment, exercisable at any time, over the trust property and the trustee could not look to any property other than trust property for payment of the annuity and had no liability if the property was insufficient to make an annuity payment. Under these circumstances, the annuity had no fair market value.

In some situations, a settlor may not want to pay gift tax while still wanting to insulate the trust from creditors. Under 26 C.F.R. §25.2511-2(b), the settlor could retain a special testamentary power of appointment to descendants, provided that the trustee's discretionary powers are broad and are not limited by an ascertainable standard. In such a case, discretionary distributions to other beneficiaries should be treated as completed taxable gifts in the year in which they are made and could be structured to qualify for the gift tax annual exclusion. 26 C.F.R. §25.2511-2(f). Each state DAPT statute envisions the settlor retaining such interests while still accomplishing the creditor protector goal.

2. [10.87] Estate Tax Concerns

Both 26 U.S.C. §§2036 and 2038 deal with retained powers and enjoyment of the trust assets. These retained powers or enjoyment will exist when a creditor can reach the assets in a trust. 26 C.F.R. §20.2036-1(b)(2); *In re Estate of Uhl,* 241 F.2d 867 (7th Cir. 1957); *Estate of Paxton v. Commissioner,* 86 T.C. 785 (1986). However, the settlor will be deemed to have relinquished his or her powers and enjoyment when the gift is complete (assuming that the gift to a domestic asset protection trust is ever complete). A completed gift, in the eyes of many commentators, should keep the assets out of the settlor's estate. See, *e.g.,* Joseph Kartiganer et al., Completed Gifts to Offshore Trusts and the Three-Year Rule, 1 J. Asset Protection, No. 4, 19 (Mar. – Apr. 1996).

Several cases and rulings appear to support the estate tax result as shown in the following chart. Some of these cases and rulings are cited in the order in which they appear in Jonathan G.

Blattmachr and Howard M. Zaritsky, *Made in the U.S.A. — Estate Planning with Alaska Trusts,* 32 U. Miami Sch.L. Philip E. Heckerling Inst. on Est.Plan., Special Session Materials, II-B-17 (1998). Some of the commentary is based on Jeffrey N. Pennell, *Recent Wealth Transfer Tax Developments,* 19 Ann. Duke U.Est.Plan.Conf. §4.3 (Oct. 1997).

Case or Ruling	Decision	Comments
Rev.Rul. 77-378, 1977-2 Cum.Bull. 347	A settlor transferred half of his income-producing assets to an irrevocable trust with a corporate trustee, which could pay income and principal in its absolute discretion to the settlor during his lifetime. The IRS ruled that the transfer was incomplete for gift tax purposes.	Reached expected result since creditors could reach the property.
Rev.Rul. 76-103, 1976-1 Cum.Bull. 293	A settlor created a trust for the benefit of himself and his family. The trustee had absolute discretion to distribute income to the settlor and to change the trust situs. The IRS ruled that a gift is complete for federal estate tax purposes when creditors cannot reach trust assets. In dicta, the IRS said that 26 U.S.C. §2038 would apply if the settlor died before the gift became complete.	Examined gift tax consequences, but did not focus on estate tax consequences. Estate tax discussion of 26 U.S.C. §2038 is dicta, and there is no discussion of inclusion under 26 U.S.C. §2036 because the settlor had access to income only.
Paolozzi v. Commissioner, 23 T.C. 182 (1954)	A settlor created an irrevocable Massachusetts trust that could pay as much of the net income as the trustee, in its absolute discretion, deemed best. The IRS argued that the gift to the trust was complete. The court held that the right of the settlor's creditors to reach the income of the trust made the gift incomplete.	Gift tax case, not estate tax case. Inclusion under 26 U.S.C. §2038(a)(1) when there are no creditors' rights was not addressed.
Outwin v. Commissioner, 76 T.C. 153 (1981), *acq.,* 1981-2 Cum.Bull. 1	A transfer to a trust in which a trustee, with the approval of an adverse party, could distribute income and principal to the settlor was not a completed gift because the settlor's creditors could reach the trust funds. In a footnote, the court discussed the possibility that creditors' ability to reach assets could cause inclusion under either 26 U.S.C. §2036(a)(1) or 26 U.S.C. §2038.	Gift tax case, not estate tax case. Estate tax inclusion was addressed only in a footnote.

Case or Ruling	Decision	Comments
Estate of German v. United States, 7 Cl.Ct. 641 (1985)	A settlor created irrevocable trusts under Maryland law and named himself the discretionary beneficiary of income and principal, with the consent of an adverse party. No gift tax was paid upon creation, and the trust was not included on the settlor's estate tax return. The court denied the government's summary judgment motion arguing that the assets should be included in the settlor's estate.	Gift tax case, not estate tax case. The government failed to establish whether creditors could reach the settlor's interest. The settlor's estate conceded that it owed gift tax upon creation of the trust. The issue of inclusion if creditors cannot reach assets in the trust was not addressed.
Paxton, supra	A settlor transferred all of his assets to a trust on which no gift tax was paid upon creation and no estate tax was paid at the settlor's death. The court held that trust property was included in the settlor's gross estate under 26 U.S.C. §2036(a)(1) because of (a) an implied understanding that the settlor could receive income or principal upon request and (b) the ability of the settlor's creditors to compel distributions.	26 U.S.C. §2036(a)(1) does not apply to a retained right to corpus. The case could have been argued under 26 U.S.C. §2038 as a power to terminate the trust by relegating it to creditors. The issue of inclusion if creditors cannot reach the trust was not addressed.
Herzog v. Commissioner, 116 F.2d 591 (2d Cir. 1941)	The Second Circuit held that creditors could not reach assets under the precursor of 26 U.S.C. §2036(a)(1) when the settlor was the income beneficiary with his wife and, after his wife's death, with his children, since there were multiple beneficiaries and the trustee had discretion.	New York law changed after this decision; therefore, it may no longer be reliable as precedent.

Case or Ruling	Decision	Comments
Uhl, supra	In an Indiana trust, a settlor retained the right to receive $100 per month and additional amounts in the trustee's discretion. The court held that the trust was not includable in the settlor's gross estate beyond the amount necessary to produce $100 per month since under Indiana law, creditors could not reach those additional funds. Gift tax was paid on the excess principal.	The court accepted the argument that estate tax and gift tax should be consistent (which most courts reject). The government failed to prove the rights of creditors under Indiana law. The court failed to equate the rights of creditors with the enjoyment of property by the settlor, which could support inclusion.
Estate of Wells v. Commissioner, 42 T.C.M. (CCH) 1305 (1981)	A settlor could receive income and principal of an irrevocable trust in the trustee's absolute discretion. No income was actually paid. The court excluded the assets from the settlor's estate because the taxpayer was able to show that there was no understanding that the trustee would actually pay income to the settlor. Thus, there was no inclusion under 26 U.S.C. §2036 because the settlor had not retained that right.	The creditors' rights issue was never addressed. The decedent used the $30,000 lifetime exemption to avoid gift tax. The government failed to argue that the decedent retained all of the income for life and thereby caused inclusion under 26 U.S.C. §2036(a)(1). Mere receipt of all income does not show retention (which is shown by an agreement).
Vander Weele v. Commissioner, 27 T.C. 340 (1956), *acq.,* Rev.Rul. 62-13, 1962-1 Cum.Bull. 180	A settlor created an irrevocable trust in Michigan and authorized the payment of as much of income and principal as the trustees deemed appropriate for the settlor's comfort. The court held that the transfer was incomplete for gift tax purposes since the creditors could reach the assets.	Gift tax case; does not discuss estate tax inclusion.

Case or Ruling	Decision	Comments
Pvt.Ltr.Rul. 9332006 (Aug. 13, 1993)	Relying on Rev.Rul. 76-103, the IRS held that, in an offshore trust, a trustee's ability to make discretionary distributions to the settlor and other family members was a completed gift and not retained interest because under the law governing the trust, creditors could not attack trust assets.	May carry holding of Rev.Rul. 76-103 too far since that ruling did not conclude that 26 U.S.C. §2036 did not apply and the discussion of 26 U.S.C. §2038 is dicta. The government may have wanted to impose gift tax because of the risk of an inability to collect estate tax from an offshore trust.
Pvt.Ltr.Rul. 8037116 (June 23, 1980)	A nonresident alien created an irrevocable trust with discretionary income and principal provisions. The IRS relied on *Uhl, supra,* and *Herzog, supra,* to conclude that 26 U.S.C. §2036(a)(1) was not applicable.	It is unclear whether *Uhl* and *Herzog* are good precedent.
Pvt.Ltr.Rul. 9837007 (Sept. 11, 1998)	A transfer to an Alaskan trust in which the settlor was a discretionary beneficiary was held to be a completed gift. However, the IRS specifically declined to rule as to whether the trust property would be excluded from the testator's estate.	The IRS obviously did not want to address the estate exclusion issue.

3. [10.88] Arguments for Estate Tax Inclusion

If one assumes that creditors cannot reach the domestic asset protection trust, will the mere right of the settlor to receive discretionary distributions of income and principal cause inclusion under 26 U.S.C. §2036(a)(1)? One commentator believes that the creditors' rights test may lack validity because of the enactment of the Alaska and Delaware DAPT statutes, as well as the Missouri, Rhode Island, Utah, and South Dakota statutes. Jeffrey N. Pennell, *Recent Wealth Transfer Tax Developments*, 19 Ann. Duke U.Est.Plan.Conf. §4.3 (Oct. 1997).

The estate tax and gift tax do not always interrelate. Even if a gift tax is paid, it is possible that property in a trust will be included in a settlor's estate because of a retained interest at a later date, subject to a credit for any gift tax paid under 26 U.S.C. §2012. 26 U.S.C. §§2035 and 2038 may require inclusion of the trust assets in the settlor's gross estate for three years after the statutory period during which creditors can reach the assets of an Alaska trust. For more discussion of this in an offshore context, see Joseph Kartiganer et al., *Completed Gifts to Offshore Trusts and the Three-Year Rule*, 1 J. Asset Protection, No. 4, 19, 21 (Mar. – Apr. 1996). This assumes that subsequent creditors can reach the property under either Alaska or Delaware law. If a creditor with a right arising after the creation of the trust has the right extinguished when the statute of limitations expires, then that could be the same as a settlor releasing a retained right over the trust. This is probably a difficult threshold to cross. This assumes that any 26 U.S.C. §§2036 and 2038 rights are extinguished when the rights of creditors to reach trust assets end. *White v. United States,* 881 F.Supp. 688 (D.Mass. 1995); Tech.Adv.Mem. 9127008 (July 5, 1991).

4. [10.89] Practice Pointers

The use of an estate freeze may be possible under the domestic asset protection trust statutes. There is a great deal of uncertainty about this, however, and any attempt to do a freeze will certainly invite IRS scrutiny. Moreover, if the IRS loses in court, it may seek remedial legislation that would permit 26 U.S.C. §2036 inclusion merely if a settlor was a discretionary beneficiary of the trust. Of course, those settlors who establish DAPTs prior to the date of any such remedial legislation will presumably be grandfathered.

For clients who are comfortable with risk, the freeze technique may be appropriate. The client must be comfortable with gift tax liability and the loss of basis step-up for appreciated assets transferred to the trust. One could minimize exposure to tax by (a) using the gift tax applicable exclusion and/or (b) using *Crummey* powers to qualify gifts to the trust for the annual exclusion. *See Crummey v. Commissioner,* 397 F.2d 82 (9th Cir. 1968).

If an estate freeze is possible, one could presumably establish an irrevocable perpetuities trust under state domestic asset protection law with a perpetual life and have the settlor be a discretionary beneficiary. To avoid gift tax, it should be funded with no more than the donor's applicable lifetime gift tax exclusion amount ($11.18 million for 2018). 26 U.S.C. §2010(c)(3)(C). For very wealthy clients, the retention of a right to be a discretionary beneficiary will not be important. They can make gifts without worrying about future access to the property. This technique works best for those moderately wealthy clients who would like to get property out of the hands of creditors and can afford to make gifts but still want to have possible access to the property in the future.

If a settlor wishes to fund a DAPT with an amount greater than the gift tax applicable exclusion amount, the settlor should consider creating two separate trusts. The first would be funded with $5 million and would escape estate taxation at the settlor's death. The second would be funded with the excess over $5 million. The settlor will be given a testamentary special power of appointment that makes the gift incomplete and will cause the property in the second trust to be included in the settlor's estate. If distributions from the second trust are made to beneficiaries other than the settlor during the settlor's life, these will be treated as gifts by the settlor to the other beneficiaries. These gifts, if distributions are outright, should qualify for the gift tax annual exclusion ($15,000 for 2018). 26 U.S.C. §2503(b).

G. [10.90] Federal Income Tax Consequences of Domestic Asset Protection Trusts

For income tax purposes, under 26 U.S.C. §677, a domestic asset protection trust should be treated as a grantor trust if either the grantor or the grantor's spouse is a discretionary beneficiary of income. 26 U.S.C. §677(a) states that a grantor owns, for income tax purposes, any portion of a trust that can be distributed to the grantor, regardless of whether it is actually distributed. If the grantor does not want to be taxed on income he or she does not receive, the trust could require the consent of a beneficiary with a substantial adverse interest in the payment of the income, such as a vested remainderperson. However, payment of the income tax by way of a deliberately defective grantor trust is a way to make additional gifts to the beneficiaries of the trust.

H. [10.91] Impact of Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

The revisions to the federal Bankruptcy Code made by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub.L. No. 109-8, 119 Stat. 23, reduced the effectiveness of certain techniques. With respect to homestead exemptions, the revisions put time limits on residency for a particular state's homestead exemption to be effective.

The provisions also created uncertainty with respect to self-settled spendthrift trusts under which a settlor, if the trust meets certain requirements, can be a beneficiary and enjoy spendthrift protection. Under the BAPCPA, if a debtor declares bankruptcy within ten years of creating a self-settled spendthrift trust, the bankruptcy trustee can void the trust if "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." 11 U.S.C. §548(e)(1)(D). Although the legislation appears to have been aimed at so-called corporate criminals, it is not limited to those specific instances. Thus, the scope of the legislation will undoubtedly be litigated in the future. See the discussion of *Battley v. Mortensen (In re Mortensen),* Bankruptcy No. A09-00565-DMD, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011), in §10.4 above; the discussion of *Waldron v. Huber (In re Huber),* 493 B.R. 798 (Bankr. W.D.Wash. 2013), in §10.119 below; and *Gordon v. Harman (In re Harman),* 512 B.R. 321 (Bankr. N.D.Ga. 2014) (bankruptcy trustee stated sufficient claim that debtor had fraudulently transferred assets into self-settled trust under Georgia law).

For individuals interested in self-settled trusts, the BAPCPA may encourage them to create such trusts sooner rather than later to avoid the impact of the ten-year rule.

Moreover, the rule applies only if the settlor declares bankruptcy, which can occur either voluntarily or involuntarily. If an individual creates a self-settled trust, he or she may examine ways in which to avoid a bankruptcy filing if that ever becomes a possibility and the ten-year period has yet to end.

III. CONFLICT OF LAWS PRINCIPLES RELATING TO PERPETUITIES AND DOMESTIC ASSET PROTECTION TRUSTS

A. [10.92] Potential Conflict of Laws

Since most states do not permit self-settled spendthrift trusts, there exists a potential conflict of laws issue when a settlor from one of these states creates a self-settled spendthrift trust in a state that does authorize such trusts. A conflict of laws exists when the application of the laws of different jurisdictions would not result in the same result. See Meaghan R. Hogan, *Once More unto the Breach: Planning for a Conflict of Laws with Alaska and Delaware Self-Settled Spendthrift Trusts,* 14 Prob. & Prop., No. 2, 27, 28 (Mar. – Apr. 2000). When a settlor transfers assets into a self-settled spendthrift trust and a creditor later seeks to reach those funds, two basic conflict of laws issues may arise. First, there is the question of which state's law should be applied to determine whether the transfer was fraudulent. Second, assuming that the transfer was not fraudulent, there is the further issue of which state's law should be applied to determine whether the spendthrift trust itself is valid. See Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?*, 85 Cornell L.Rev. 1035, 1075 (2000); Karen Gebbia-Pinetti, *As Certain as Debt and Taxes: Estate Planning, Asset-Protection Trusts, and Conflicting State Law,* SC60 A.L.I.-A.B.A. 179, 237 (1998).

B. [10.93] Domestic Asset Protection Trust States' Choice-of-Law Provisions

The asset protection statutes in some domestic asset protection trust states seek to compel the application of their own state's law to any creditors' challenges to the self-settled spendthrift trusts that these statutes authorize. See §§10.94 – 10.109 below.

1. [10.94] Alaska

Alaska's statute governing jurisdiction over trusts allows a settlor to provide in the trust agreement that Alaska law will govern the validity, construction, and administration of the trust provided that the trust meets certain conditions. See Alaska Stat. §§13.36.035(a), 13.36.035(c), 13.36.035(d). A settlor's choice-of-law clause is valid, effective, and conclusive for the trust if (a) some or all of the trust assets are deposited in Alaska; (b) a trustee is an Alaska resident or an Alaska-headquartered bank or trust company; (c) the powers of the trustee include maintaining trust records and preparing, or arranging for the preparation of, the trust's income tax return; and (d) part or all of the trust administration occurs in Alaska. See Alaska Stat. §§13.36.035(c), 13.36.390. However, one bankruptcy court has held that Alaska law was not determinative and allowed the bankruptcy trustee to avoid the settlor's transfer to a spendthrift trust even though it relied on evidence that would not have been considered under Alaska law. See the discussion of *Battley v. Mortensen (In re Mortensen),* Bankruptcy No. A09-00565-DMD, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011), in §10.4 above.

2. [10.95] Delaware

Delaware's asset protection statute contains choice-of-law provisions similar to those of Alaska's asset protection statute discussed in §10.94 above. However, while a choice-of-law clause is optional in an Alaska asset protection trust, it is mandatory in a Delaware asset protection trust. For a transfer of assets to satisfy the requirements of a qualified disposition under Delaware law, the trust instrument must expressly incorporate Delaware law to govern the validity, construction, and administration of the trust. See Del. Code Ann. tit. 12, §3570(11)a. Delaware law governs not only these internal affairs of a trust but also, if the trust contains a choice-of-law clause and satisfies the other requirements of a qualified disposition, whether a particular asset transfer into such a trust was fraudulent. See Del. Code Ann. tit. 12, §3572(a) ("no action of any kind . . . shall be brought . . . for an attachment or other provisional remedy against property that is the subject of a qualified disposition or for avoidance of a qualified disposition unless such action shall be brought pursuant to" Delaware's fraudulent transfer law). The other requirements of a qualified disposition are that (a) the trust is irrevocable; (b) the trust contains a spendthrift clause; (c) the settlor uses a Delaware resident or a corporate trustee authorized by Delaware law to act as a trustee and whose activities are subject to supervision by the Bank Commissioner of Delaware, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision; and (d) this trustee materially participates in trust administration. See Del. Code Ann. Tit. 12, §§3570(7), 3570(8), 3570(11).

3. [10.96] Hawaii

A Hawaii self-settled spendthrift trust must expressly incorporate Hawaii law governing the validity, construction, and administration of the trust. Haw.Rev.Stat. §554G-5(a). Only claims based on an actual intent to defraud creditors are allowed against such a trust. Haw.Rev.Stat. §554G-8(a). If a court declines to apply Hawaii law to determine the validity, construction, or administration of a trust, the trustee immediately ceases to be a trustee and the successor trustee becomes the trustee. Haw.Rev.Stat. §554G-5(f).

4. [10.97] Michigan

A Michigan self-settled spendthrift trust must expressly incorporate the laws of Michigan to govern the validity, construction, and administration of the trust. Mich. Comp. Laws §700.1042(aa)(i).

5. [10.98] Mississippi

A Mississippi self-settled spendthrift trust must expressly incorporate Mississippi law governing the validity, construction, and administration of the trust. Miss. Code Ann. §91-9-703(n)(1). Mississippi's statute also requires that all actions for an attachment or other provisional remedy against property that is the subject of a qualified disposition or for the avoidance of a qualified disposition be brought pursuant to the provisions of Mississippi's Uniform Fraudulent Transfer Act. Miss. Code Ann. §91-9-707(a).

6. [10.99] Nevada

The choice-of-law provisions of Nevada's asset protection statute are not as extensive or protective of settlors as those of Alaska, Delaware, Hawaii, and Mississippi as discussed in §§10.94 – 10.98 above. Nevada's statute provides that unless the trust instrument declares otherwise, Nevada law governs the construction, operation, and enforcement of all spendthrift trusts created in or outside Nevada if certain conditions are met. See Nev.Rev.Stat. §§166.015(1), 166.015(2). These conditions are that (a) all or part of the trust property is located and administered in Nevada and (b) the settlor uses a Nevada resident or a bank or trust company that maintains an office in Nevada for the transaction of business as trustee or cotrustee. See Nev.Rev.Stat. §§166.015(1), 166.015(2).

7. [10.100] New Hampshire

New Hampshire provides that the "meaning and effect" of the terms of a trust are determined by the law of the state specified in the trust "unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue." N.H.Rev.Stat.Ann. §564-B:1-107(a)(1). If a trust does not specify which law governs, then "the law of the jurisdiction having the most significant relationship to the matter at issue" will apply. N.H.Rev.Stat.Ann. §564-B:1-107(a)(2). New Hampshire will be the state with the most significant relationship to a matter involving the validity, construction, or administration of a trust if the trust provides that New Hampshire law governs or if the trust has its principal place of administration in New Hampshire. N.H.Rev.Stat.Ann. §564-B:1-107(b).

8. [10.101] Ohio

Ohio provides that the trust instrument must expressly incorporate Ohio law regarding the validity, construction, and administration of the trust. Ohio Rev. Code Ann. §§5816.02, 5816.10.

9. [10.102] Oklahoma

Oklahoma's Family Wealth Preservation Trust Act states that a trust instrument must expressly state that Oklahoma law governs. Okla. Stat. tit. 31 §11.

10. [10.103] Rhode Island

Rhode Island's asset protection statute resembles Delaware's asset protection statute (see §10.95 above) in that it requires settlors of self-settled spendthrift trusts to expressly incorporate Rhode Island law as governing the validity, construction, and administration of the trust. See R.I.Gen. Laws §§18-9.2-2(6), 18-9.2-2(10)(i). Rhode Island's trust laws further provide that Rhode Island law governs the validity, construction, effect, and administration of all trusts holding personal property if the trust instrument contains a Rhode Island choice-of-law clause and either (a) the personal property was located in Rhode Island when the trust was created and the trust is administered in Rhode Island, (b) a trustee is a Rhode Island resident or a domestic corporation or national bank located in Rhode Island and authorized to act as a trustee and the trust is administered in Rhode Island, or (c) the trust was created by a Rhode Island resident. See R.I.Gen. Laws §§18-1-1, 18-1-2, 18-1-3.

11. [10.104] South Dakota

South Dakota's asset protection statute contains choice-of-law provisions similar to those of Delaware's asset protection statute discussed in §10.95 above. A South Dakota trust must expressly incorporate South Dakota law to govern the validity, construction, and administration of the trust. See S.D. Codified Laws §55-16-2(1).

In 2017, South Dakota added the following language to its choice of law provisions: "This section and §§55-16-9, 55-16-11 to 55-16-13, inclusive, are inseparably interwoven with substantive rights that a deprivation of legal rights would result if another jurisdiction's laws and regulations to the contrary are applied to a claim or cause of action described therein." S.D. Codified Laws §55-16-10.

12. [10.105] Tennessee

Tennessee's asset protection statute specifically provides that a Tennessee trust must incorporate Tennessee law to govern the validity, construction, and administration of the

Tennessee trust. Tenn. Code Ann. §35-16-102(7)(A). A fraudulent transfer claim must be brought pursuant to the Tennessee Uniform Fraudulent Transfer Act. Tenn. Code Ann. §35-16-104(a). If any court declines to apply Tennessee law, the trustee is immediately removed, and the only step that the removed trustee can take is to transfer the assets to the new trustee. Tenn. Code Ann. §35-16-104(g).

13. [10.106] Utah

Utah provides that its courts have exclusive jurisdiction over any action brought under its asset protection statute. Utah Code Ann. §25-6-502(11).

14. [10.107] Virginia

A Virginia self-settled spendthrift trust must expressly incorporate the laws of Virginia to govern the validity, construction, and administration of the trust. Va. Code Ann. §64.2-745.2(A).

15. [10.108] West Virginia

A West Virginia self-settled spendthrift trust must expressly incorporate the laws of West Virginia to govern the validity, construction, and administration of the trust. W.Va. Code §§44D-5-503b(d)(5).

16. [10.109] Wyoming

Wyoming law specifically provides that a qualified spendthrift trust must incorporate Wyoming law to govern the validity, construction, and administration of a Wyoming trust. Wyo.Stat.Ann. §4-10-510(a)(ii). A fraudulent transfer claim must be brought pursuant to the Wyoming Uniform Fraudulent Transfer Act, Wyo.Stat.Ann. §34-14-201, *et seq*. Wyo.Stat.Ann. §4-10-514. If any court declines to apply Wyoming law, the trustee is immediately removed, and the only step that the removed trustee can take is to transfer the assets to the new trustee. Wyo.Stat.Ann. §4-10-522.

C. [10.110] Conflict of Laws Principles Governing Trusts Under the RESTATEMENT

The majority of states have adopted the RESTATEMENT (SECOND) OF CONFLICT OF LAWS (1971). See Meaghan R. Hogan, *Once More unto the Breach: Planning for a Conflict of Laws with Alaska and Delaware Self-Settled Spendthrift Trusts*, 14 Prob. & Prop., No. 2, 27, 30 (Mar. – Apr. 2000). The general rules contained in the RESTATEMENT focus on the significance of a state's contacts to the trust and on the settlor's intention concerning the law that should govern the trust. Conflict of laws principles relating to trusts are contained in Chapter 10 of the RESTATEMENT. The Introductory Note to Chapter 10 states that "[t]he chief purpose in making decisions as to the applicable law is to carry out the intention of the [settlor]. It is important that his intention . . . not be defeated, unless this is required by the policy of a state which has such an interest in defeating his intention, as to the particular issue involved, that its local law should be applied."

1. [10.111] Distinctions

The RESTATEMENT (SECOND) OF CONFLICT OF LAWS (1971) makes several distinctions in applying conflict of laws principles that must be kept in mind when determining which state's law a court would apply to any particular issue.

Real property versus personal property. The primary distinction made is between interests in real property and interests in personal property (which the RESTATEMENT refers to as movables and which includes chattels; rights embodied in documents, such as bonds or shares of stock; and rights not so embodied). The state in which real property is located (the situs of the property) is often treated as having a sufficient interest in issues relating to the property so that the law of the situs is applied to such issues. Such considerations are less important in determining which state's laws to apply to interests in movables.

Secondary distinctions. Within each of the primary categories of interests in land and interests in movables, the RESTATEMENT discusses separately conflict of laws principles applicable to (a) issues arising under the administration of a trust, (b) the validity of a trust, (c) the construction of a trust instrument, and (d) restraints on the alienation of a beneficiary's interest under a trust. See §§10.112 – 10.115 below.

2. [10.112] Issues Relating to Validity

The law that would be applied by the courts of the situs determines the validity of a trust of an interest in land. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS §278 (1971). In most situations, the courts of the state of the situs will apply local law. See RESTATEMENT §278, cmt. a.

An inter vivos trust holding movables is valid if it is valid

> **(a) under the local law of the state designated by the settlor to govern the validity of the trust, provided that this state has a substantial relation to the trust and that the application of its law does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship . . . or**
>
> **(b) if there is no such effective designation, under the local law of the state with which, as to the matter at issue, the trust has its most significant relationship.** RESTATEMENT §270.

A state has a substantial relation to a trust if

a. it is the state, if any, that the settlor designated as the state in which the trust is to be administered;

b. it is the state in which the trustee has its domicile or its place of business at the time of the creation of the trust;

c. it is the state in which the trust assets are located at the time of the creation of the trust;

d. it is the state of domicile of the settlor at the time of the creation of the trust; or

e. it is the state of domicile of the beneficiaries. RESTATEMENT §270, cmt. b.

The commentary under RESTATEMENT §270 states that, as to most grounds for invalidity, the trust will be upheld if valid under the local law of the state of the place of administration. However, when the purpose of the settlor in creating an inter vivos trust is to avoid claims of the settlor's spouse or family (for example, under the state's forced share statute), the trust will be held invalid if it is invalid under the local law of the settlor's domicile. Although there are no reported cases on this issue relating to domestic self-settled spendthrift trusts, the possibility exists that a court may extend this principle to apply to the claims of the settlor's creditors. The following observations should be kept in mind, however:

a. Transfers to a trust to avoid claims by a surviving spouse or family members, or creditors' claims, are not themselves ordinarily issues of trust validity. Thus, if a trust is valid under the laws of the settlor's domicile, a court in that state should find the trust valid even if it finds that transfers have been made for purposes that are improper under that state's laws.

b. Even if a court extends the principle of RESTATEMENT §270 to apply to the claims of the settlor's creditors, the fraudulent conveyance statutes are not significantly different in the states permitting self-settled asset protection trusts from those in other states. Thus, if a settlor makes a transfer to an asset protection trust in a domestic asset protection trust state that does not violate the fraudulent conveyance statute in that state, it probably would not do so in the state of the settlor's domicile. A court in the state of the settlor's domicile should therefore find that such a transfer is not of the type that would permit it to apply that state's laws to issues of trust validity.

The rule of RESTATEMENT §270 is applicable to questions involving the rule against perpetuities. As to this issue, "the trust will be upheld if the settlor has manifested an intention that it should be administered in a particular state, and if under the local law of that state the trust would be valid, even though the settlor was domiciled in a state in which it would be invalid." RESTATEMENT §270, cmt. d.

3. [10.113] Issues Arising Under Trust Administration

"Issues arising under trust administration" refers to matters relating to the execution and carrying out of the trust, such as the duties and powers of the trustee, including the exercise of discretionary powers. On the other hand, questions relating to the identity of beneficiaries and the extent of their interests are matters of construction. See §10.114 below.

"The administration of a trust of an interest in land is determined by the law that would be applied by the courts of the situs as long as the land remains subject to the trust." RESTATEMENT (SECOND) OF CONFLICT OF LAWS §279 (1971). In most situations, the courts of the state of the situs will apply local law. But if the settlor provides that the local law of some other state shall be applied to govern the administration of the trust, or certain issues of administration, the courts of the situs will apply the designated law as to issues that can be controlled by the terms of the trust. RESTATEMENT §279, cmt. b.

The administration of a trust of interests in movables is governed as to matters that can be controlled by the terms of the trust

(a) by the local law of the state designated by the settlor to govern the administration of the trust, or

(b) if there is no such designation, by the local law of the state to which the administration of the trust is most substantially related. RESTATEMENT §272.

4. [10.114] Issues Relating to Trust Construction

An instrument creating an interest in property, whether of land or of movables, is construed in accordance with the rules of construction of the state designated for this purpose in the instrument. In the absence of such a designation, the instrument is construed (a) in the case of interests in land, in accordance with the rules that would be applied by the courts of the situs; and (b) in the case of an interest in movables, in accordance with the rules of construction of the state whose local law governs the administration of the trust as to matters pertaining to administration or of the state that the settlor would probably have desired to be applicable as to matters not pertaining to administration. RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§268, 277 (1971).

5. [10.115] Conflict of Laws Principles Governing Anti-Alienation Clauses

Whether the interest of a beneficiary of a real property trust is assignable by the beneficiary and can be reached by his or her creditors is determined by the law that would be applied by the courts of the situs as long as the land remains subject to the trust. RESTATEMENT (SECOND) OF CONFLICT OF LAWS §280 (1971). These courts would apply their own local law to determine this question. RESTATEMENT §280, cmt. a.

Whether the interest of a beneficiary of a personal property trust is assignable by the beneficiary and can be reached by his or her creditors is determined

a. in the case of a testamentary trust, by the local law of the testator's domicile at death, unless the testator has manifested an intention that the trust be administered in another state, in which case it is governed by the local law of that state; and

b. in the case of an inter vivos trust, by the local law of the state, if any, in which the settlor has manifested an intention that the trust be administered, and otherwise by the local law of the state to which trust administration is most substantially related. RESTATEMENT §273.

D. [10.116] Application of Conflict of Laws Principles to Claims That Asset Transfer Was Fraudulent

If an action challenging a transfer of assets into a domestic asset protection trust is brought in another state's court, the forum state must decide whether to apply the law of the asset protection state, the law of the forum state, or the law of another state. See Karen Gebbia-Pinetti, *As Certain as Debt and Taxes: Estate Planning, Asset-Protection Trusts, and Conflicting State Law,* SC60 A.L.I.-A.B.A. 179, 242 – 243 (1998). Several commentators have concluded that trust conflict of laws principles do not apply in determining what law governs a fraudulent transfer claim because this type of claim is unrelated to trust validity, construction, or administration. See Jeremy M. Veit, Notes, *Self-Settled Spendthrift Trusts and the Alaska Trust Act: Has Alaska Moved Offshore?*, 16 Alaska L.Rev. 269, 286 (1999); Gebbia-Pinetti, *supra,* p. 246. Rather, the fraudulent transfer cause of action is described as a tort (or quasi-tort) claim because the creditor is challenging the transfer of assets into the trust and not the internal affairs of the trust itself. See Gebbia-Pinetti, p. 247. Furthermore, they concluded that settlors of a trust cannot bind third-party creditors to the settlors' choice of law. See Meaghan R. Hogan, *Once More unto the Breach: Planning for a Conflict of Laws with Alaska and Delaware Self-Settled Spendthrift Trusts,* 14 Prob. & Prop., No. 2, 27 (Mar. – Apr. 2000); Gebbia-Pinetti, *supra,* p. 247; Veit, *supra.*

The bankruptcy court in *Battley v. Mortensen (In re Mortensen),* Bankruptcy No. A09-00565-DMD, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011), did not apply Alaska law in its determinations of fraud. See the discussion in §10.4 above. The court reasoned that because the federal bankruptcy law had been enacted to close a loophole in state laws allowing self-settled spendthrift trusts, the state law did not apply.

1. [10.117] Enforceability of Settlor's Choice of Law

Since the choice-of-law clauses authorized or mandated by asset protection states provide generally that the law of the asset protection state governs only the validity, construction, or administration of the spendthrift trust, a forum court likely will not enforce settlors' choice-of-law clauses in cases involving fraudulent transfer claims. Although Delaware's asset protection statute specifically states that fraudulent transfer claims can be brought against a qualified disposition only pursuant to Delaware's fraudulent transfer law (see §10.95 above), a court in another state may refuse to enforce this provision based on the theory that settlors cannot bind third-party creditors to the settlors' choice of law.

2. [10.118] Resolution of Conflict of Laws Issue

Assuming that the forum court will reject the settlor's choice of law in a fraudulent transfer claim, commentators have concluded that the court will most likely apply the law of the state that has the most significant relation to the issue of whether the asset transfer to the trust is voidable under fraudulent transfer law. See Karen Gebbia-Pinetti, *As Certain as Debt and Taxes: Estate Planning, Asset-Protection Trusts, and Conflicting State Law,* SC60 A.L.I.-A.B.A. 179, 250 (1998); Jeremy M. Veit, Notes, *Self-Settled Spendthrift Trusts and the Alaska Trust Act: Has Alaska Moved Offshore?,* 16 Alaska L.Rev. 269, 285 – 286 (1999).

The RESTATEMENT (SECOND) OF CONFLICT OF LAWS (1971) sets out the following factors that are used to determine the jurisdiction with the most significant relationship to the contract: (a) the place of contracting; (b) the place of contract negotiation; (c) the place of performance; (d) the location of the contract's subject matter; and (e) the domicile, residence, nationality, place of incorporation, and place of business of the parties. See RESTATEMENT §188.

It may be likely that the home state of a settlor who does not reside in an asset protection state will be the jurisdiction with the most significant relationship to the contract. See Veit, *supra,* p. 291. In any event, the critical issue for settlors of asset protection trusts is that the forum court is not bound to apply the law that the settlor has chosen. See Gebbia-Pinetti, *supra,* p. 251.

E. [10.119] Application of Conflict of Laws Principles to Claim That Spendthrift Trust Is Invalid

Unlike the fraudulent transfer challenge, a claim that the spendthrift trust is invalid does relate to the internal affairs of the trust. See Karen Gebbia-Pinetti, *As Certain as Debt and Taxes: Estate Planning, Asset-Protection Trusts, and Conflicting State Law,* SC60 A.L.I.-A.B.A. 179, 258 (1998). Therefore, conflict of laws principles regarding trusts in general and anti-alienation clauses in particular would likely be applicable to determine which state's law governs the validity of a spendthrift trust.

The RESTATEMENT (SECOND) OF CONFLICT OF LAWS (1971) provides that the law of the situs of real property generally governs questions concerning the validity of the trust as well as the ability of a spendthrift clause to prevent creditors from reaching the beneficiary's interest. See RESTATEMENT §§278, 280. If the real property that is held by a self-settled spendthrift trust is located in an asset protection state, the validity of the trust should be determined according to the laws of that state. See Meaghan R. Hogan, *Once More Unto the Breach: Planning for a Conflict of Laws with Alaska and Delaware Self-Settled Spendthrift Trusts,* 14 Prob. & Prop., No. 2, 27, 31 (Mar. – Apr. 2000). However, if the trust owns property outside the asset protection state, then forum courts may apply the laws of the situs state, and the trust may thereby be deemed invalid. *Id.*

Conflict of laws issues pertaining to personal property held in trust are more complicated than those concerning real property held in trust. The RESTATEMENT provides that the issue of whether a beneficiary's interest in a personal property trust can be reached by his or her creditors is determined, in the case of an inter vivos trust, by the local law of the state in which the settlor has manifested an intention that the trust be administered, and otherwise by the local law of the state to which trust administration is most substantially related. See RESTATEMENT §273. Since the asset protection states all require some degree of in-state trust administration, this conflict of laws principle would support a forum court's application of the law of an asset protection state. See Gebbia-Pinetti, *supra,* p. 258. However, the conflict of laws principles governing the validity of trusts in general is not as favorable to the settlor's choice of law. The RESTATEMENT provides that an inter vivos personal property trust is valid if it is valid under the local law of the state designated by the settlor, but only if this state has a substantial relation to the trust and if the application of its law does not violate a strong public policy of the state with which the trust has its most significant relationship. See RESTATEMENT §270.

The commentary to RESTATEMENT §270 provides that a state has a substantial relation to a trust when it is the state, if any, that the settlor designated as that in which the trust is to be administered, the place of business or domicile of the trustee at the time of the trust's creation, the location of the trust assets at that time, the settlor's domicile at that time, or the beneficiaries' domicile. RESTATEMENT §270, cmt. b. Many self-settled spendthrift trusts likely will satisfy this requirement because most asset protection statutes permit or require the settlor to designate the asset protection state as the one in which part or all of the trust administration will take place and/or require the trustee to be a resident of the state. See Hogan, *supra,* p. 30.

The commentary to RESTATEMENT §270 provides that the local law of the designated state will not be applied if this would violate a strong public policy of the state with the most significant relationship to the trust on the issue involved. See RESTATEMENT §270, cmt. b. This requirement may be the most difficult for asset protection trusts to meet. See Hogan, *supra,* p. 30; Jeremy M. Veit, Notes, *Self-Settled Spendthrift Trusts and the Alaska Trust Act: Has Alaska Moved Offshore?,* 16 Alaska L.Rev. 269, 291 (1999). One commentator has concluded that courts have virtually never applied the law of the trust's situs or the law expressly chosen by the settlor when the settlor chose the situs or the law to evade a strong public policy of the settlor's domicile. See Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?,* 85 Cornell L.Rev. 1035, 1086 (2000). States that are hostile to self-settled spendthrift trusts thus would be unlikely to enforce the spendthrift provisions in self-settled asset protection trusts based on the theory that such enforcement would violate strong public policies in the forum states against self-settled spendthrift trusts. See Sterk, p. 1089.

Waldron v. Huber (In re Huber), 493 B.R. 798 (Bankr. W.D.Wash. 2013), is the first self-settled asset protection trust conflicts of law case. The court applied Washington law to an Alaska trust, allowing the settlor's creditors to reach the trust assets. After encountering significant financial problems, Huber, a Washington resident and real estate developer, created an Alaska self-settled asset protection trust in the fall of 2008. 493 B.R. at 805. Huber transferred almost all of his property and real estate interests into the trust, and then he filed for bankruptcy two and one-half years later. 493 B.R. at 805 – 806. The bankruptcy trustee sought to invalidate the transfers. Applying RESTATEMENT §270, the court held that Washington law governed (despite Huber's designation of Alaska law in the trust instrument) because the trust had a more substantial relation to Washington than Alaska: Huber resided in Washington when the trust was created; all of the trust assets except a $10,000 certificate of deposit had been located in Washington; and all the beneficiaries resided in Washington. 493 B.R. at 808 – 809. Further, Huber's creditors and the attorney who prepared the trust documents and transferred the assets were in Washington. The trust's only relation to Alaska was that the trust was supposed to be administered there and one of the trustees was an Alaska trust company. Additionally, Washington has a strong public policy against self-settled asset protection trusts. Therefore, the court applied Washington law.

Because Washington law expressly does not protect assets transferred to self-settled trusts against creditors, Huber's transfers were void. 493 B.R. at 809; Wash.Rev. Code Ann. §19.36.020. Also, the court found inferences of fraudulent intent in violation of 11 U.S.C. §548(e) and actual fraudulent intent under Washington law. 493 B.R. at 811 – 816.

Huber reminds us that a court in an unfavorable jurisdiction may find that the trust has a more significant relation to that state than to the state the settlor designates in the trust instrument. However, in *Huber,* there was substantial evidence of an intent to defraud creditors, and courts may or may not be more likely to apply the settlor's choice of law under different circumstances.

Toni 1 Trust, by Tangwall v. Wacker, No. S-16153, 2018 WL 1125033 (Alaska Mar. 2, 2018), addresses conflicts of law in the context of domestic asset protection trusts. In 2007, Donald Tangwall sued William and Barbara Wacker in Montana state court. The Wackers counterclaimed against Donald, his wife, Barbara, his mother-in-law, Toni, and various family entities. The Montana state court entered several default judgments against Donald and his family. In 2010, before the last such judgment was entered, Toni and Barbara transferred several parcels of Montana real estate to an Alaska self-settled trust, named the Toni 1 Trust. The Wackers filed suit in Montana state court and claimed that the transfers were fraudulent under Montana law. The court again entered default judgments against the Tangwalls. After these judgments were issued, Toni filed for bankruptcy in Alaska. The bankruptcy trustee brought a fraudulent transfer claim against Donald, as trustee of the Toni 1 Trust, and a default judgment was entered against Donald, as trustee. Donald then brought suit in Alaska state court and claimed that Alaska Stat. 34.40.110 granted Alaska courts exclusive jurisdiction over any fraudulent transfer actions against the Toni 1 Trust. 2018 WL 1125033 at *2. Alaska Stat. 34.40.110(b)(1) provides that a creditor of the settlor of a self-settled spendthrift trust may reach trust property if the settlor's transfer to the trust was fraudulent. 2018 WL 1125033 at *3. Alaska Stat. 34.40.110(k) then provides that a creditor may only bring a fraudulent transfer claim under Alaska Stat. 34.40.110(b)(1) and that Alaska courts have exclusive jurisdiction over any cause of action or claim that is based on a transfer of property to an Alaska self-settled trust. *Id.* Accordingly, Donald argued, the federal bankruptcy court and the Montana state court did not have subject-matter jurisdiction over the fraudulent transfer actions (and Alaska's statute of limitations barred the Wackers from bringing suit under Alaska law).

The Alaska Supreme Court relied on a 1914 United State Supreme Court case, *Tennessee Coal, Iron & R. Co. v. George,* 233 U.S. 354, 58 L.Ed. 997, 34 S.Ct. 587 (1914), in which the United States Supreme Court held that states are not constitutionally required to respect other states' attempts to limit their jurisdiction over transitory actions (transitory actions relate to a transaction that could have taken place anywhere, whereas local actions relate to a transaction that could have only happened in a particular place, such as a transaction involving real property). 2018 WL 1125033 at *4. The Alaska Supreme Court explained that a fraudulent transfer claim is a transitory action and as a result, Alaska could not deprive other states of jurisdiction over all fraudulent transfer actions concerning Alaska trusts. *Id.* The Alaska Supreme Court also relied on the holding in *Marshall v. Marshall,* 547 U.S. 293, 164 L.Ed.2d 480, 126 S.Ct. 1735 (2006), in which the United States Supreme Court confirmed that the *Tennessee Coal* holding also applies to claims of exclusive state jurisdiction asserted against federal courts. 2018 WL 1125033 at **6 – 7.

At its essence, *Toni 1 Trust* is a case about jurisdiction. It confirms the longstanding rule that one state cannot deprive another state or federal court of jurisdiction by claiming the exclusive right to hear certain matters. That is, if a state or federal court has personal jurisdiction over the parties and the subject matter of the claim, then that claim may be properly brought in such a court, notwithstanding another state's statute to the contrary. The forum state then must decide which state's law to apply, using the principles discussed above.

IV. PRACTICAL PROBLEMS WITH RESPECT TO DOMESTIC ASSET PROTECTION TRUSTS

A. [10.120] Enforceability of Foreign Judgments

Most of the many articles addressing the domestic asset protection trusts consider the issue of enforceability of foreign judgments. The most detailed analysis is contained in Leslie C. Giordani and Duncan E. Osborne, *Will the Alaska Trusts Work?,* 3 J. Asset Protection, No. 1, 7 (Sept. – Oct. 1997).

One often repeated advantage of foreign asset protection trusts is the fact that in most applicable jurisdictions, local law specifically prohibits the automatic enforcement of foreign judgments. In the Cook Islands, for example, a judgment of a non-Cook Islands court has no legal significance. As a result, the underlying cause of action must itself be relitigated in the foreign jurisdiction. Such relitigation may be impeded by circumstances such as the unavailability of witnesses, a "loser pays" fee environment, and a lack of local legal talent. These impediments do not exist in the case of the onshore DAPTs given the requirement under the United States Constitution that each state give "Full Faith and Credit" to judgments handed down by courts in all of the states. U.S.CONST. art. IV, §1. Accordingly, once the creditor reduces a claim to judgment in any United States court, there is no need to relitigate the underlying cause of action in the state where assets are held in trust. In effect, the successful creditor will bring an action to enforce the judgment with respect to the assets in the onshore DAPT, either in the state where the creditor and debtor reside (typically the same jurisdiction as that of the underlying judgment) or in the state where the trust has its situs.

1. [10.121] Enforcement in Original Forum

With respect to an enforcement action brought in the original forum or elsewhere other than where the trust has its situs, Leslie C. Giordani and Duncan E. Osborne suggest that the courts may ignore the law of the trust situs and apply their own self-settled trust rules; in such a case, the judgment being taken to the domestic asset protection trust state for enforcement is not the underlying judgment on the dispute between the parties but a judgment requiring that the trust assets be turned over to the creditor. Leslie C. Giordani and Duncan E. Osborne, *Will the Alaska Trusts Work?,* 3 J. Asset Protection, No. 1, 7 (Sept. – Oct. 1997). This result runs contrary to the general rule that the law governing the interpretation of a trust is the law of the trust's situs. In Austin Wakeman Scott and William Franklin Fratcher, THE LAW OF TRUSTS (multivolume set, year varies by volume) (Scott), Professors Scott and Fratcher include a lengthy analysis of these conflicts issues. In pertinent part, they indicate:

> **Where the settlor creates a trust to be administered in the state of his domicil[e], the law of that state is applicable in determining whether the interest of a beneficiary can be reached by his creditors. This is clearly so where a proceeding is brought by**

> **a creditor in that state. It would seem that the same principle would apply where a proceeding is brought in some other state to reach the beneficiary's interest. The court, if it has jurisdiction and chooses to exercise it, will apply the law of the state of the situs of the trust.**
>
> **If the settlor creates a trust to be administered in a state other than that of his domicil[**e**], the law of the state of the place of administration, rather than of his domicil[**e**], ordinarily is applicable.** Scott §626(2) (4th ed. 1989).

Although this discussion pertains to third-party beneficiaries, it is equally applicable to the DAPT situations in which the self-settled trust rule is replaced for certain settlor beneficiaries. Accordingly, although it is possible that the original jurisdiction will apply its own self-settled trust rules in support of its own public policy, such a decision would itself run contrary to long-standing conflict principles and should not be relied on by a creditor seeking to enforce a judgment without additional precedent.

Such precedent arguably exists in Illinois, where the Illinois Supreme Court held in *Rush University Medical Center v. Sessions*, 2012 IL 112906, 980 N.E.2d 45, 366 Ill.Dec. 245, that the common-law rule voiding transfers to self-settled trusts as to a settlor's creditors was not abrogated by the Illinois Uniform Fraudulent Transfer Act, 740 ILCS 160/1, *et seq*. Therefore, the creditor in *Sessions* was able to reach the settlor's offshore asset protection trust to satisfy its claim. The trust was held in the Cook Islands, but the same argument could potentially be raised in the DAPT context.

2. [10.122] Enforcement in Jurisdiction Where the Trust Has Its Situs

Usually, a creditor will bring an enforcement action in the state where the trust has its situs, and the creditor then will be required to rely on the state's domestic asset protection statute itself for relief. This would include the applicable fraudulent conveyance laws of those states as well as the exceptions contained in the statutes themselves. See the discussion of *Battley v. Mortensen (In re Mortensen)*, Bankruptcy No. A09-00565-DMD, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011), and *Hagendorf v. Cleveland*, No. 02A452345 (Clark Cty., Nev. July 29, 2002), in §10.4 above and *Waldron v. Huber (In re Huber)*, 493 B.R. 798 (Bankr. W.D.Wash. 2013), in §10.119 above.

B. [10.123] Judgment Against Trust and Not Settlor

Many commentators believe that if an enforcement action were brought only against the settlor of a trust in a domestic asset protection trust state, courts would protect the trust assets when asked to enforce the judgment of another state.

Another question is whether the domestic asset protection state courts would enforce the judgment of another state, not against the settlor, but against the trustee and the trust assets. Supporters of the state asset protection statutes point to two cases that show the limitations of this approach.

In *Hanson v. Denckla,* 357 U.S. 235, 2 L.Ed.2d 1283, 78 S.Ct. 1228 (1958), the United States Supreme Court upheld the decision of a Delaware trustee to refuse to enforce the order of a Florida court. In *Hanson,* a Pennsylvania resident established a trust, naming a Delaware trustee, and later moved to Florida. The settlor then attempted to exercise certain powers of appointment over the trust, appointing $200,000 to each of two trusts she established for two daughters. After the settlor's death, her daughters disputed the validity of the exercise of the powers, and the Florida court entered an order modifying the exercise of the powers. The daughters then went to Delaware to have the order enforced. The Delaware trustee declined, arguing that the Full Faith and Credit Clause of the United States Constitution, art. IV, §1, was inapplicable since the Florida court lacked jurisdiction over both the Delaware trustee and the trust assets.

In *Baker v. General Motors Corp.,* 522 U.S. 222, 139 L.Ed.2d 580, 118 S.Ct. 657 (1998), the United States Supreme Court held that Missouri courts were not bound to enforce a Michigan judgment prohibiting testimony from a particular witness when the parties to the Missouri action had no connection to the Michigan courts. For more discussion of this case, see Kaleen S. Hasegawa, *Re-Evaluating the Limits of the Full Faith and Credit Clause After* Baker v. General Motors Corporation, 21 U.Haw.L.Rev. 747 (1999).

V. [10.124] CONCLUSION

At the time of this writing, *Battley v. Mortensen (In re Mortensen),* Bankruptcy No. A09-00565-DMD, 2011 WL 5025249 (Bankr. D. Alaska May 26, 2011), discussed in §10.4 above, and *Waldron v. Huber (In re Huber),* 493 B.R. 798 (Bankr. W.D.Wash. 2013), discussed in §10.119 above, may be the only fully developed court opinions addressing the effectiveness of the onshore asset protection trust legislation. However, creditors have made claims against the assets held in domestic asset protection trusts. According to informal discussions with different trustees, these claims have been settled in a way favorable to the settlors of the trusts. Thus, while the insulation provided by DAPTs in these situations is not absolute, it can nonetheless be beneficial to the settlors.