Special Session III-B

Trust Asset Protection Through a Tri-Focal Lens

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Trust Asset Protection Through a Tri-Focal Lens

1. Background

1.1 This outline will address the "asset protection" (see below) afforded by various aspects of the trust structure as a basis for discussion of the unique and sometimes conflicting perspectives of:

1.1.1 The drafting attorney.

1.1.2 The trustees, and those other fiduciaries or quasi-fiduciaries administering the trust

1.1.3 Those creditors who may seek to reach the trust's assets.

1.2 What is asset protection?

1.2.1 "Asset protection" (and "asset protection planning") may be defined as the implementation of various advance planning techniques, including the use of a trust, which are intended to place assets beyond the reach of a person's creditors.

1.2.1.1 When such planning is undertaken to protect against one's own creditors in a jurisdiction that provides that such a trust might actually convey protection against the settlor's own creditors, the trust is called a "self-settled spendthrift trust" or an "asset protection trust". In such a situation, it is important that the creditors against whom protection is sought be limited to the settlor's "potential future creditors".

1.2.1.1.1 The phrase "potential future creditors" is a term of art referring to non-existent and as yet unanticipated creditors; for example, creditors with whom a person has not yet done (or even contemplated doing) business at the time of a transfer of property.

1.2.1.1.2 When this outline speaks to the possibility of a person using a trust to protect against such person's own creditors, the reference should be read as referring solely to such person's potential future creditors because a transfer of property to protect against either (i) one's own existing creditors, or (ii) one's own anticipated future creditors, would likely constitute a "fraudulent transfer" and, therefore, would probably be ineffective as well as illegitimate.

1.2.1.1.3 In contrast, a trust can legitimately be created to protect against a third-party beneficiary's creditors, even if such creditors are currently anticipated or even in existence.

1.3 What is a trust?

1.3.1 According to the Restatement Third, Trusts § 2, "[a] trust…is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of…one or more persons, at least one of whom is not the sole trustee."

1.3.1.1 Comment f to the Restatement Third, Trusts § 2, provides "[i]n the strict, traditional sense, a trust involves three elements: (1) a trustee, who holds the trust property and is subject to duties to deal with it for the benefit of one or more others; (2) one or more beneficiaries, to whom and for whose benefit the trustee owes the duties with respect to the trust property; and (3) trust property, which is held by the trustee for the beneficiaries."

1.3.2 Similarly, George G. Bogert & George T. Bogert, *The Law of Trusts and Trustees* § 1 (rev. 2d ed. 1984), provides that "[a] trust may be defined as a fiduciary relationship in which one person holds a property interest subject to an equitable obligation to keep or use that interest for the benefit of another."

1.3.2.1 As to what, exactly, is a "fiduciary relationship," comment b to the Restatement Third, Trusts § 2, provides that "[t]he trust relationship is one of many forms of fiduciary relationship…one characteristic is common to all [fiduciary relationships]: a person in a fiduciary relationship to another is under a duty to act for the benefit of the other as to matters within the scope of the relationship."

1.3.3 Stated most simply, when a person transfers property to another person "in trust" for one or more beneficiaries, or for a legally-acknowledged beneficial purpose, a "trust" is formed.

1.3.4 As shall be explored in greater detail in the immediately following section of this outline, the fact that a trustee is the actual legal owner of the trust property is a key concept from which follows the asset protection generally afforded to a beneficiary through the holding of property in trust.

1.4 Why are Trusts Used in Asset Protection Planning?

1.4.1 Obviously, trusts are so commonly used in asset protection planning because there is some feature inherent in the trust concept that should serve to protect the beneficiary's interest from his or her creditors. The two general bases upon which that protection lies are because the trust is a "spendthrift trust" and/or because the trust is a "discretionary trust".

1.4.2 Spendthrift Trusts

1.4.2.1 "Trusts in which a beneficiary cannot assign the interest, or that provide that creditors cannot reach it, are known as 'spendthrift trusts.'" SCOTT AND ASCHER ON TRUSTS § 15.2, Vol. 3 at 898 (5th ed. 2007).

1.4.2.1.1 "The term 'spendthrift trust' refers to a trust that restrains voluntary and involuntary alienation of all or any of the beneficiaries' interests." RESTATEMENT (THIRD) OF TRUSTS § 58, Vol. 2 at 355 (2003).

1.4.2.2 Spendthrift trusts are free from creditors' claims because the settlor has explicitly provided, through the incorporation of a spendthrift provision in the governing instrument, that the trust fund shall be exempt from the claims of the beneficiary's creditors. In other words, the policy underlying the spendthrift trust is that it carries out a stated intent of the settlor.

1.4.2.2.1 The maxim "*cujus est dare, ejus est disponere*," or "[w]hose it is to give, his it is to dispose" is frequently cited in connection with references to the validity of spendthrift trust restrictions.

1.4.2.2.2 "The validity of a spendthrift provision in a trust is predicated upon the [public policy] consideration that a person is free to make any desired disposition of his property." *Estate of Johnson*, 252 Cal.App.2d 923, 925 (1967). "[C]onsideration for the beneficiary does not even in the remotest way enter into the policy of the law; it has regard solely to the rights of the donor. Spendthrift trusts can have no other justification than is to be found in considerations affecting the donor alone." *Estate of Morgan*, 223 Pa. 228, 229, 72 A. 498, 499 (1909).

1.4.2.2.3 However, "[f]reedom of disposition in this country allows a property owner to impose conditions and limitations on beneficial interests he or she creates in a trust, but only to the extent they are not illegal or contrary to public policy." *Reporter's Notes on § 59 of the Restatement (Third) of Trusts, Comments a-a(2)*.

1.4.2.3 In addition, it is often said that the use of a spendthrift trust takes nothing from the beneficiary's creditor that he or she had previously.

1.4.2.3.1 "The doctrine that property may be made inalienable by such declaration of a [spendthrift] trust rests upon the theory that a donor has the right to give his property to another upon any conditions which he sees fit to impose, and that, inasmuch as such a gift takes nothing from the prior or subsequent creditors of the beneficiary to which they previously had the right to look for payment, they cannot complain that the donor has provided that the property or income shall go or be paid personally to the beneficiary and shall not be subject to the claims of creditors." *Parscal v. Parscal*, 148 Cal.App.3d 1098, 1102-1103.

1.4.2.4 How is a Trust Structured as a Spendthrift Trust?

1.4.2.4.1 Under § 502(b) of the Uniform Trust Code, "[a] term of a trust providing that the interest of a beneficiary is held subject to a "spendthrift trust," or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest."

1.4.3 Discretionary Trusts

1.4.3.1 A "discretionary" trust is a trust in which distributions to the beneficiary are left wholly within the discretion of the trustee, generally without regard to any ascertainable standard. RESTATEMENT (THIRD) OF TRUSTS § 58, Vol. 2 at 355 (2003).

1.4.3.2 The effect of a discretionary trust is to limit the extent of the beneficiary's interest in the trust so as to make it sufficiently tenuous so that it does not qualify as a property right which is subject to attachment by creditors. In effect, the beneficiary's interest will only come into existence when and to the extent that the trustee decides to make a distribution to the beneficiary.

1.4.3.2.1 "In a discretionary trust it is the nature of the beneficiary's interest rather than a provision forbidding alienation which prevents the transfer of the beneficiary's interest. The rule…is not dependent upon a prohibition of alienation by the settlor; but the transferee or creditor cannot compel the trustee to pay anything to him because the beneficiary could not compel payment to himself or application for his own benefit." *Restatement (Second) of Trusts §155, cmt. b. (1959).*

1.4.3.2.2 "A transferee or creditor of a trust beneficiary cannot compel the trustee to make discretionary distributions if the beneficiary personally could not do so." *Comment e to Restatement (Third) of Trusts § 60 (2003).*

1.4.3.2.3 Similarly, "[w]here by the terms of the trust a beneficiary is entitled only to so much of the income or principal as the trustee in his uncontrolled discretion shall see fit to give him, he cannot compel the trustee to pay to him or to apply for his use any part of the trust property. In such a case, an assignee of the interest of the beneficiary cannot compel the trustee to pay any part of the trust property, nor can creditors of the beneficiary reach any part of the trust property…If the beneficiary himself cannot compel the trustee to pay over any part of the trust fund, his assignee and his creditors are in no better position." *2A Scott & Fratcher, The Law of Trusts §155, at 154 (4th ed. 1989).*

1.4.3.3 In this regard, the courts will generally not substitute their judgment for the judgment of a trustee; provided, however, that the trustee exercises the trustee's judgment in good faith and within reasonable bounds. In general, a court will only interfere with a trustee's exercise or failure to exercise a discretionary distribution power, when an abuse of discretion has been shown to have occurred.

1.4.3.3.1 "At the heart of this issue, then, is the critical inquiry whether any court can substitute its discretion for that which a settlor has vested exclusively in the trustee, and thereby force the premature distribution of trust property by distributing same not to the beneficiary but to his seizing creditors. We are persuaded that question must be answered in the negative." *Read v. U.S. ex rel. Department of Treasury*, 169 F.3d 243, 254 (5th Cir. 1999).

1.4.4 Support Trusts as a Sub-Set of Discretionary Trusts

1.4.4.1 A "support trust" is one in which "…by the terms of the trust the amount to be paid to or applied for the beneficiary is limited to so much of the income or principal as is in fact necessary for his education or support." *Restatement (Second) of Trusts, § 154, Commend d.*

1.4.4.1.1 In essence, support trusts are a subset of discretionary trusts where the trustee's discretion to make a distribution to the beneficiary is limited to reasons of the beneficiary's support.

1.4.4.1.2 The legalistic distinction between "discretionary" trusts and "support" trusts is, however, disappearing: "…this Restatement Third does not attempt to draw a bright line between "discretionary" interests…and "support" interests…The so-called "support trust," for example, is viewed here as a discretionary trust with a support standard. This in turn requires asking and examining all of the questions that follow from that view, such as how a particular standard, in context, is to be interpreted and whether a beneficiary's other resources are to be taken into account in making a fiduciary judgment about appropriate distributions to the beneficiary." *Comment a, Restatement (Third) of Trusts, § 60.*

1.4.4.1.3 The Uniform Trust Code similarly provides but a single rule and a single section for all discretionary trusts, including ones in which the trustee's discretion is subject to a support standard.

1.4.5 Combined Discretionary and Spendthrift Trusts

1.4.5.1 "A spendthrift trust is to be distinguished from a discretionary trust but may or may not also contain discretionary interests…" RESTATEMENT (THIRD) OF TRUSTS § 58, Vol. 2 at 355 (2003).

1.4.5.2 Today, it would seem as though most trusts are both spendthrift *and* discretionary trusts.

1.4.5.3 Spendthrift trusts, discretionary trusts and combined discretionary spendthrift trusts, have the potential to afford a beneficiary a significant amount of creditor protection, even in some egregious circumstances. A trio of cases is instructive in this regard; they are:

1.4.5.3.1 *Nichols v. Eaton*, 91 U.S. 716 (1875).

1.4.5.3.2 *Sligh v. First National Bank of Holmes County*, 704 So. 2d 1020 (Miss. 1997).

1.4.5.3.3 *Scheffel v. Krueger*, 782 A.2d 410 (N.H. 2001).

1.4.5.3.4 *Gibson v. Speegal*, 1984 Del. Ch. LEXIS 475 (DE Ct. of Chancery, Sussex County, May 30, 1984).

1.4.5.4 *Nichols v. Eaton*, 91 U.S. 716 (1875)

1.4.5.4.1 It was actually not until the Supreme Court decision in *Nichols v. Eaton* in 1875 that a break with the English common law on spendthrift trusts was affected, and the validity of spendthrift trust protections became generally accepted throughout the United States.

1.4.5.4.2 The theoretical basis underlying the general acceptance of the validity of spendthrift trusts in the United States, as demonstrated by the Supreme Court's decision in *Nichols*, is the idea that an individual should be able to transfer property subject to certain limiting conditions upon which the property will be available to the beneficiary (and, thereby, indirectly to his or her creditors).

1.4.5.4.3 In *Nichols*, the trust in question was a testamentary trust established by a woman for one of her sons who had failed in business and who had assigned all of his property for the benefit of his creditors and then later filed for bankruptcy. The mother's will included a provision that stated that if any of her sons should "alienate or dispose of the income to which they were entitled under the trusts of the will, or if, by reason of bankruptcy or insolvency, or any other means whatsoever, said income could no longer be personally enjoyed by them respectively, but the same would become vested in or payable to some other person, then the trust expressed in said will concerning so much thereof as would so vest should immediately cease and determine. In that case, during the residue of the life of such son, that part of the income of the trust fund was to be paid to the wife and children, or wife or child, as the case might be, of such son, and in default of any objects of the last-mentioned trust, the income was to accumulate in augmentation of the principal fund." *Nichols* at 718.

1.4.5.4.4 In establishing the modern rule with regard to spendthrift trusts, the Supreme Court in *Nichols* stated that: "[w]e concede that there are limitations which public policy or general statutes impose upon all dispositions of property, such as those designed to prevent perpetuities and accumulations of real estate...We also admit that there is a just and sound policy...to protect creditors against frauds upon their rights...But the doctrine, that the owner of property...cannot so dispose of it, but that the object of his bounty...must hold it subject to the debts due his creditors...is one which we are not prepared to announce as the doctrine of this court." *Nichols* at 725.

1.4.5.5 *Sligh v. First National Bank of Holmes County*, 704 So. 2d 1020 (Miss. 1997)

1.4.5.5.1 The defendant in the underlying litigation to *Sligh v. First National Bank of Holmes County* was a beneficiary of two spendthrift trusts that had been established by the defendant's mother. The defendant was operating a motor vehicle while intoxicated and was involved in an accident with another vehicle which left the driver of the other vehicle ("plaintiff") paralyzed with the loss of the use of both legs, loss of all sexual function and loss of the ability to control bowel and urinary functions. The plaintiff won a $5 Million civil judgment against the defendant for compensatory and punitive damages and tried to collect the judgment against the two spendthrift trusts of which the First National Bank of Holmes County was the trustee, alleging that the defendant's mother had actual knowledge that the defendant was an alcoholic, and that the defendant's mother had created the trusts to shield the defendant's interests from the likely claims of involuntary tort creditors. The defendant had no other assets aside from his beneficial interests in the trusts.

1.4.5.5.2 The plaintiff alleged that it was a violation of public policy to enforce and give priority to spendthrift trust provisions over involuntary tort judgments against the beneficiary of the spendthrift trust, and urged the court to recognize and enforce a public policy exception to the spendthrift trust doctrine in favor of involuntary tort creditors. Although both the trial court and the initial appellate court found in favor of protecting the trust funds, the Mississippi Supreme Court ultimately allowed the plaintiff to collect against the trusts at issue by concluding that spendthrift protections should not extend to judgments for "gross negligence and intentional torts."

1.4.5.5.3 More significant, however, is the fact that the Mississippi legislature promptly negated the import of *Sligh* in future cases through enactment of the "Family Trust Preservation Act of 1998." Miss. Code Ann. §§ 91-9-501, *et seq.* (1998). That act provides that except in the case of a self-settled trust, a beneficiary's interest in a spendthrift trust may not be transferred nor subjected to a money judgment until paid to the beneficiary (i.e., notwithstanding the fact that the underlying judgment may be based upon gross negligence or an intentional tort).

1.4.5.6 *Scheffel v. Krueger*, 782 A.2d 410 (N.H. 2001)

1.4.5.6.1 In *Scheffel v. Krueger*, the defendant was a convicted child molester who was the beneficiary of a discretionary spendthrift trust established by his grandmother in 1985. The plaintiff filed suit in 1998 asserting tort claims against the defendant in connection with the molestation charges and seeking an attachment of the defendant's beneficial interest in the discretionary spendthrift trust. Under the terms of the trust, all income was to be distributed to the defendant annually and distributions of principal were to be made in the Trustee's discretion. The defendant had the power to invade the principal of the trust only following his fiftieth birthday.

1.4.5.6.2 The court found no basis for relief for the plaintiff and held that nothing in the language of the relevant statute suggested that the legislature intended to exempt a tort creditor from the protection afforded by a spendthrift provision.

1.4.5.6.3 The court also found that the defendant's ability to direct trust income and principal after attaining age fifty did not in and of itself disqualify the trust as a spendthrift trust.

1.4.5.7 *Gibson v. Speegle*, 1984 Del. Ch. LEXIS 475 (DE Ct. of Chancery, Sussex County, May 30, 1984).

1.4.5.7.1 In February, 1976, Gary Barwick pled guilty to several crimes, including arson, all of which resulted in damage to the Hawaiian Village Restaurant and Lounge in Delmar, Delaware, a property that Aetna insured and in connection with which Aetna paid out monies to the policyholder. At sentencing, Gary was ordered, *inter alia*, to pay restitution, including monies to Aetna.

1.4.5.7.2 Less than five months after Gary's sentencing, his mother, Virginia, executed a Last Will and Testament which included a discretionary spendthrift trust for Gary until he should reach the age of forty (40) years. Virginia then died and Aetna made claim against Gary's new trust.

1.4.5.7.3 Delaware Code § 3536(a) provides, in pertinent part, that "[a] creditor of a beneficiary of a trust shall have only such rights against such beneficiary's interest in the trust or the property of the trust as shall be expressly granted to such creditor by the terms of the instrument that creates or defines the trust or by the laws of [Delaware]. The provisions of this subsection shall be effective regardless of the nature or extent of the beneficiary's interest or of any action taken or that might be taken by the beneficiary. Every interest in a trust or in trust property or the income therefrom that shall not be subject to the rights of creditors of such beneficiary as provided herein shall be exempt from execution, attachment, distress for rent, foreclosure, and from all other legal or equitable process or remedies instituted by or on behalf of any creditor, including, without limitation, actions at law or in equity against a trustee or beneficiary that seeks a remedy that directly or indirectly affects a beneficiary's interest…"

1.4.5.7.4 The Delaware Court of Chancery stated: "I am not at all comfortable with the fact that Virginia Barwick, by use of a spendthrift trust, assisted her son in avoiding his obligation to pay for his crimes. However, it is not the Court's function to write the law but only to interpret it. The statute enacted by the General Assembly contains no exceptions."

1.4.6 Today, each of the fifty states and the District of Columbia recognizes the validity of spendthrift clauses to protect a third party beneficiary's interest from almost every type of creditor claim.

1.4.6.1 Similarly, Uniform Trust Code § 502(c) provides that "[a] beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this [article], a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary."

1.4.6.1.1 According to the Comment to Uniform Trust Code § 502, "[u]nless one of the exceptions under this article applies, a creditor of the beneficiary is prohibited from attaching a protected interest and may only attempt to collect directly from the beneficiary after payment is made."

1.4.6.2 Similarly, Restatement (Third) of Trusts § 58, provides that "…if the terms of a trust provide that a beneficial interest shall not be transferable by the beneficiary or subject to claims of the beneficiary's creditors, the restraint on voluntary and involuntary alienation of the interest is valid."

1.4.7 The protections afforded by spendthrift trusts have also long been recognized under federal bankruptcy law. In this regard, Bankruptcy Code § 541(c)(2) states that a "restriction on the transfer of a beneficial interest of a debtor in a trust that is enforceable under applicable nonbankruptcy law" is to be honored in bankruptcy.

1.4.8 Exception Creditors

1.4.8.1 Exception creditors are creditors whose claims are "excepted" from *spendthrift* trust protections under certain circumstances. Exception creditors sometimes include:

1.4.8.1.1 Creditors with claims for necessaries provided to the beneficiary.

1.4.8.1.2 Creditors with claims for services to protect the beneficiary's interest in the trust.

1.4.8.1.3 Claims by a governmental entity (i.e., for taxes).

1.4.8.1.4 (Sometimes) spouses with support claims.

1.4.8.1.5 (More often) children with child support claims.

1.4.8.1.6 (Very rarely) involuntary tort creditors.

1.4.9 Exception creditors obviously vary based on the applicable law.

1.4.9.1 Uniform Trust Code § 503(b) provides for the following exception creditors (by providing that "[a] spendthrift provision is unenforceable against...):

1.4.9.1.1 A beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance. Uniform Trust Code § 503(b)(1).

1.4.9.1.2 A judgment creditor who has provided services for the protection of a beneficiary's interest in the trust. Uniform Trust Code § 503(b)(2).

1.4.9.1.3 A claim of the state or the United States to the extent a statute of the state or federal law so provides. Uniform Trust Code § 503(b)(3).

1.4.9.2 A claimant against whom a spendthrift provision cannot be enforced may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary. The court may limit the award to such relief as is appropriate under the circumstances. Uniform Trust Code § 503(c).

1.4.10 Importantly, whether or not a trust contains a spendthrift provision, Uniform Trust Code § 504(b), which speaks to discretionary trusts, provides that a creditor of a beneficiary generally may not compel a distribution from a discretionary trust, even if the discretion is expressed in the form of a standard of distribution, and even if the trustee has abused the discretion.

1.4.10.1 As per the comment to Uniform Trust Code § 504, the power to force a distribution due to an abuse of discretion or failure to comply with a standard belongs solely to the beneficiary.

1.4.10.2 Notwithstanding the foregoing, however, under Uniform Trust Code § 504(c), to the extent that a trustee has not complied with a standard of distribution, or has abused a discretion, a distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary's child, spouse, or former spouse, and the court shall direct the trustee to pay to the child, spouse, or former spouse such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion.

2. Implications Based Upon Fiduciary and Quasi-Fiduciary Roles

2.1 The Beneficiary as Trustee

2.1.1 A beneficiary is often named as the trustee of a trust created for his or her benefit or, alternatively, as a co-trustee of such trust with one or more other "independent" or "disinterested" trustees. Typically, this is done in order to give the beneficiary a say in the administration of his or her trust, including a say in the making of distributions.

2.1.2 A beneficiary's ability, as trustee, to exercise discretion in making distributions to himself or herself may cause a creditor to be able to reach the trust property subject to such discretion (which, as an aside, may also then cause the trust property to be includable in the beneficiary's taxable estate for estate tax purposes).

2.1.2.1 Comment (b)(1) to Section 1 of The Restatement Third, Trusts, § 58, provides that "…a spendthrift clause is ineffective to the extent the trust is or becomes either passive (whether or not subject to a statute of uses, see § 6) or subject to the doctrine of merger because the debtor or assignor is both sole beneficiary and sole trustee (see § 69). Except in this latter situation, a spendthrift provision is not invalid with respect to a beneficiary's interest(s) merely because the beneficiary is also the trustee or a co-trustee.

2.1.2.2 The Restatement Third, Trusts § 60, provides that "…if the terms of a trust provide for a beneficiary to receive distributions in the trustee's discretion, a transferee or creditor of the beneficiary is entitled to receive or attach any distributions the trustee makes or is required to make in the exercise of that discretion after the trustee has knowledge of the transfer or attachment. The amounts a creditor can reach may be increased where the beneficiary…holds the discretionary power to determine his or her own distributions."

2.1.2.3 The Restatement Third, Trusts § 60, provides the following examples in this regard:

2.1.2.3.1 "S's will leaves his residuary estate to his daughter D, as trustee, "to pay income or principal to or for the benefit of anyone or more of D, her children, and their issue in such amounts, if any, as the trustee deems appropriate and desirable for the particular beneficiary's support, education, and care, taking account of the beneficiary's other resources if and to whatever extent the trustee deems appropriate. D's creditors may reach the maximum amount of trust funds that she may, without abuse of her discretion, distribute to herself for the authorized purposes…without reduction for other resources available to her for those purposes, but subject to a possible reservation the court may make for D's actual support needs." Restatement Third, Trusts § 60, cmt. g, illustration 9.

2.1.2.3.2 If, however, "…T serves as co-trustee with D, and they together hold the discretionary power to determine trust distributions ….[t]he special rule of this Comment does not apply." Restatement Third, Trusts § 60, cmt. g, illustration 10.

2.2 The Beneficiary as Protector

2.2.1 A trust can be drafted to provide the settlor, a beneficiary or a third party with the power to remove and replace the trustees. Often, the person given this power is called, in this capacity, the "protector".

2.2.2 Tax Perspective as Background For Creditor Protection

2.2.2.1 Subject to certain limitations, the settlor can retain the right to remove and replace the trustee without such power having the effect of including the trust property in the settlor's taxable estate for estate tax purposes.

2.2.2.2 In *Estate of Wall v. Commissioner*, 101 T.C. 300 (1993), the decedent, Helen S. Wall, established three *inter vivos* irrevocable trusts; one for the benefit of her daughter, Kathryn Barth, and one for the benefit of each of her two granddaughters. In all three trusts, the trustee was given wide discretion to manage the trust and distribute income to the beneficiaries. In the trust for Kathryn, each of the settlor and Kathryn had the power to remove the Trustee on written notice and to appoint a successor Trustee. However, any successor Trustee had to be a corporation qualified to conduct trust business in the United States and had to be completely independent from the settlor. In the trusts for the granddaughters, a similar power existed, except that such power existed solely in the settlor, and the successor trustee could not be the settlor, or any firm or corporation in which the settlor had an interest, and also had to be, in all events, an independent corporate trust company.

2.2.2.2.1 Following Mrs. Wall's death almost nine years after establishing the trusts, the Internal Revenue Service sought to have each of the three trusts included in her taxable estate for estate tax purposes. The court formulated the dispositive question as "[w]hether this power [to remove and replace the trustee] was such that it could affect the enjoyment of the property [under either §§ 2036(a)(2) or 2038(a)(1)]."

2.2.2.2.2 The *Wall* court looked to whether the settlor had any legal right to influence trustee behavior, and stated that "[t]he trustee has a duty to administer the trust in the sole interest of the beneficiary, to act impartially if there are multiple beneficiaries, and to exercise powers exclusively for the benefit of the beneficiaries." Holding that the trustee would breach these duties if, in response to pressure from the settlor, the trustee were to take any action regarding the beneficial enjoyment of any trust property that otherwise would not have been taken in the absence of such pressure, the court concluded that the mere retention of a trustee replacement power could not constitute a legal right to control trust operation.

2.2.2.3 In *Estate of Vak v. Commissioner*, 973 F.2d 1409 (8th Cir., 1992), the decedent had created a trust and appointed family members as the trustees with discretionary powers of distribution. The decedent reserved the right to remove and replace the trustees with successor trustees who were not related or subordinate to the decedent. The decedent was also a discretionary distributee of the trust. Three years later, the trust was amended to eliminate both the decedent's power to remove and replace the trustees and the decedent's eligibility to receive discretionary distributions.

2.2.2.3.1 The issue considered in *Estate of Vak* was whether the decedent's gift in trust was complete when the decedent created the trust and transferred the property to it or, instead, when the decedent relinquished the removal and replacement power and his eligibility to receive discretionary distributions. The Eighth Circuit concluded that the decedent had not retained dominion and control over the transferred assets by reason of his removal and replacement power. Accordingly, the court held that under Treas. Reg. § 25.2511-2(c) the gift was complete when the decedent created the trust and transferred the assets to it.

2.2.2.4 In *Rev. Rul. 95-58*, 1995-2 C.B. 191, the IRS finally accepted the combined position expounded in *Wall* and *Vak*, and adopted the independence standard utilized in *Vak*, stating that "[e]ven if the decedent had possessed the power to remove the trustee and appoint an individual or corporate successor trustee that was not related or subordinate to the decedent (within the meaning of § 672(c)), the decedent would not have retained a trustee's discretionary control over trust income."

2.2.3 Creditor Protection Perspective

2.2.3.1 The question as to whether the beneficiary, including a settlor/beneficiary, can also be the protector without negatively impacting the trust's asset protection, however, is not quite as clear.

2.2.3.2 In the Bankruptcy context, § 541(b)(2) of the Bankruptcy Code provides that "[p]roperty of the estate does not include any power that the debtor may exercise solely for the benefit of any entity other than the debtor." By implication then, a power that the debtor may exercise in whole or in part in favor of the debtor *might* render the property subject to the power includible in the bankruptcy estate.

2.2.3.2.1 In at least one case, *In re Cattafi*, 237 B.R. 853 (Bankr. M.D. Fla., 1999), it was held that a broad power to remove the trustee was sufficient control to compel inclusion of the trust's assets in the bankruptcy estate.

2.2.3.2.2 However, in a second case, *In re Parrish*, 11 B.R. 65 (Bankr. N.D. Tx, 1981), it was held that the power to remove the trustee was not a power that "conferred a benefit upon the beneficiary".

2.2.3.3 Again in the Bankruptcy context, § 541(c)(2) of the Bankruptcy Code provides that "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."

2.2.3.3.1 In the matter of *In re Herzig*, 167 B.R. 707 (Bankr. Mass. 1994), the debtor was the beneficiary of an ostensibly spendthrift trust established for his benefit under New York law pursuant to the terms of his mother's will. The will named the debtor's brother as trustee, but gave the debtor the power to require his brother's resignation as trustee, in which case the debtor's wife would become the successor trustee provided that she was living with debtor at such time. Although the *Herzig* court noted that neither the debtor's brother nor his wife could "…be considered an alter ego of the Debtor nor under his control," on the basis that the "…Debtor could…take up residence elsewhere, require [his brother] to resign, refuse to agree to the appointment of a successor to [his brother], and [thereby] obtain the Trust assets…" the spendthrift aspect of the Trust was destroyed and the trust was available to the debtor's creditors.

2.2.3.4 Similarly, in *In re Baldwin*, 142 B.R. 210 (Bankr. S.D. Ohio 1992), the debtor-beneficiary's right to remove and replace the trustee of a trust otherwise purporting to be a spendthrift trust was held to constitute a level of dominion and control over the trust assets such that the spendthrift clause was held invalid because the right to remove and replace the trustee with a "corporate trustee" was not limited to bank and trust companies.

2.2.3.5 Outside of Bankruptcy, in the case of *FTC v. Affordable Media, LLC,* 179 F.3d 1228 (9th Cir. 1999), the U.S. District Court for the District of Nevada had held the settlors in contempt of court for failing, pursuant to a preliminary injunction, to repatriate trust assets that had been invested offshore in the name of the foreign co-trustee of an offshore asset protection trust. In large part, that determination was based upon the fact that the settlors were the protectors of the trust. In an appeal of the district court's determination to hold the settlors in contempt, the Ninth Circuit Court of Appeals stated that: "The provisions of the trust … make clear that the [settlors'] position as protectors gives them control over the trust…[T]he trust agreement [also] makes clear that the [settlors], as protectors, have the power to determine whether or not an event of duress [which would negate the foreign co-trustee's obligation to act pursuant to the settlors' direction] has occurred…[I]t is clear that the [settlors] could have ordered the trust assets repatriated simply by certifying to the trustee that in their opinion, as protectors, no event of duress had occurred." *Id*. at 1243.

2.2.3.6 Conversely, in *United States v. Grant*, 2008 BL 317381 (S.D. Fla. May 27, 2008), the District Court held that the protector-beneficiary of a foreign trust could not be held in civil contempt for failing to repatriate the trust's assets pursuant to a court order because she had established that, notwithstanding her authority as protector, she was unable to effect the repatriation of the trust's assets. Specifically, each of the two offshore asset protection trusts at issue gave Arline Grant, the spouse of the settlor and a beneficiary of each trust, the power to "discharge an existing or acting Trustee … and to appoint such other Trustee in any jurisdiction throughout the world as [s]he may in her sole and unreviewable discretion determine." A magistrate judge originally had held that "by giving Arline Grant total unreviewable authority over discharge and appointment of the trustees, she in actuality controls the corpus of each trust." The District Court, however, held that Arline Grant's efforts to repatriate the funds, although ineffective, were sufficient to negate the suggestion of control.

2.2.3.7 Finally, in *Simpson v. Department of Social Rehabilitation Services*, 21 Kan. App.2d 680 (1996), the beneficiary of a discretionary trust held a power to remove the trustee without cause, and such power was determined to be sufficient control over the trust's assets to deny the beneficiary financial assistance for medical costs under a Kansas needs based benefit program.

3. Implications Based upon Terms of Trust

3.1 Trustee (Distribution) Discretion Subject to a Standard

3.1.1 As previously noted, Section 504(b) of the Uniform Trust Code provides that "[e]xcept as otherwise provided in subsection (c), whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if: (1) the discretion is expressed in the form of a standard of distribution; or (2) the trustee has abused the discretion."

3.1.1.1 And, again, as previously noted, Section 504(c) of the Uniform Trust Code provides that "[t]o the extent a trustee has not complied with a standard of distribution or has abused a discretion: (1) a distribution may be ordered by the court to satisfy a judgment or court order against the beneficiary for support or maintenance of the beneficiary's child, spouse, or former spouse; and (2) the court shall direct the trustee to pay to the child, spouse, or former spouse such amount as is equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary had the trustee complied with the standard or not abused the discretion."

3.1.2 Moreover, Section 504(e) of the Uniform Trust Code clarifies that even "[i]f the trustee's or cotrustee's discretion to make distributions for the trustee's or cotrustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee or cotrustee."

3.1.3 Outside of a Uniform Trust Code jurisdiction, however, an argument can be made that where a trustee "shall" may distributions for the beneficiary's support or maintenance (or any standard for that matter), the trustee does not actually have discretion, but rather that the trustee must make distributions if, objectively, the standard is met.

3.1.3.1 In CCA 200036045, the IRS determined that a taxpayer had an identifiable property interest in a trust to which a federal tax lien could attach where the trust provided that the trustee "…shall pay to or apply for the benefit of [the taxpayer], as much of the net income [or, if the trustee should determine that the income payments are insufficient, so much of the principal, as well] as the trustee, in the trustee's discretion, shall deem necessary for [the taxpayer's] proper health, maintenance, support, and education." In so ruling, the IRS stated that "[w]e believe that, here, the taxpayer has, at a minimum, the right to an amount necessary for his health, maintenance, support, and education, as provided in the trust and that that right is subject to collection."

3.1.3.2 In that regard, in *United States v. Taylor*, 254 F.Supp. 752 (N.D. Cal. 1966), the trust provided that the trustees "shall pay" to the beneficiary so much of the income from the trust as the trustees deemed necessary for the proper care, maintenance, and support of the beneficiary and the court held that: "The taxpayer has a lifetime, enforceable, equitable right to support from the income of the trust. The discretionary feature is limited to the trustees' determining the amounts they deem 'necessary' for the taxpayer's proper care, maintenance, and support. The provision that the 'trustees shall pay' is *mandatory* and conveys the intent of the testator that his son is to receive support payments from the net income of the trust if he needs support. If the trustees refuse to act or act unreasonably, a court of competent jurisdiction may be invoked to obtain an order compelling the trustees to act in the exercise of discretion." *Id.* at 755.

3.1.3.3 Similarly, in *Wright v. United States*, No. 88-2655, Slip op. (N.D. Tex. Aug. 11, 1989) the IRS was permitted to levy on trust assets where trust contained a discretionary distribution authority tied to an ascertainable standard.

3.1.3.3.1 But see *First of America Trust Co. v. U.S.*, 93-2 USTC ¶50,507 (C.D. Ill. 1993), which held that the trust was discretionary notwithstanding language that the trustee "shall" pay the income and so much of the principal as the trustee in the exercise of sole discretion should deem necessary for the beneficiary's support, comfort, and welfare.

3.1.3.4 Another case in this area is *Duckett v. Enomoto*, 117 A.F.T.R.2d 2016-1358 (D. AZ 2016), which hinged on the existence of a quasi-HEMS standard in the trust as follows: "… so much or all of the net income and principal of the trust as in the sole discretion of the Trustee may be required for support in the beneficiary's accustomed manner of living, for medical, dental, hospital, and nursing expenses, or for reasonable expenses of education, including study at college and graduate levels." The court interpreted the language to establish that the beneficiary's right to the trust funds was a right to payments, the withholding of which would constitute an abuse of discretion in applying an ascertainable standard.

3.1.4 Avoiding use of the word "shall" in favor of the word "may" would seem to be an easy step to take in drafting, but some settlors might be unhappy with giving the trustee discretion to withhold distributions that are objectively required for the beneficiary's support or maintenance.

3.1.5 Furthermore, consider whether even a distribution provision without an express standard becomes something less than absolute discretion where the trustee is required to consider the other available assets of the beneficiary in determining whether or not to exercise the trustee's discretion to make a distribution to the beneficiary.

3.1.6 Separately, consider whether it might be helpful for the trust to have more than one beneficiary since the trustee's discretion in connection with a trust with but a single beneficiary might be argued to be discretion as to the timing of distributions, rather than discretion over whether or not the beneficiary will ultimately receive distribution of the trust property.

3.1.6.1 For example, In *In re McCoy, 274 B.R. 751*, Bankr. N.D. Ill. 2002, *aff'd* 2002 WL 1611588, an income beneficiary-trustee held a power to invade principal as he "determines to be required or desirable for his health, maintenance and support," but was not required to "consider the interests of any other beneficiary," and was, therefore, held to be "…bound by no ascertainable standard" but rather had "unfettered discretion" and "complete dominion and control over the corpus." *Id.* at 764.

3.1.7 Consider, also the effect of state statutes that remove the trustee's discretion in favor of a court under certain circumstances.

3.1.7.1 In *Pratt v. Ferguson*, 206 Cal.Rpt.3d 895, 3 Cal.App. 5th 102, (Cal.App. 4 Dist., 2017), the applicable provision of the California statute provided that, whether or not the beneficiary has the right to compel the trustee to pay income or principal for the beneficiary, the court may require the trustee to pay support payments from the trust as an exercise of the trustee's discretion to make payments to the beneficiary, and that this applies notwithstanding any provision in the trust instrument. The trust contained a "shut down" clause to the effect that periodic installments of principal (to be made a certain ages) became inoperative during any period when they would be subject to enforceable claims of creditors of the beneficiary. The court said the shutdown clause was not enforceable against the support payments, in part because of the "notwithstanding" language of the statute, but also in more significant part because that language did not affect the discretion the trustee had to pay income and principal to the beneficiary prior to those ages. Thus, the trustee's "discretion" became an enforceable right with regard to support payments under the statute. This result is likely limited to states which have language similar to the California statute.

3.1.7.1.1 See also New York EPTL § 7-1.6, which provides that the court may direct a trustee to make principal payments to an income beneficiary if the court determines, in its exercise of discretion, that the income beneficiary's support or education is not sufficiently provided for, whether or not the beneficiary is ultimately entitled to all or some portion of the trust principal, so long as the court is satisfied that the original purpose of the trust cannot be carried out without such allowance.

3.2 The Inclusion of a Power of Appointment

3.2.1 As defined by Black's Law Dictionary, a power of appointment is "[a] power created or reserved by a person having property subject to disposition, enabling the donee of the power to designate transferees of the property or shares in which it will be received..." Black's Law Dictionary (10th ed. 2014).

3.2.2 In general, there are two classes of powers of appointment, "general" powers of appointment and "non-general" (also sometimes called "special" or "limited") powers of appointment.

3.2.2.1 A general power of appointment is "[a] power of appointment by which the donee can appoint — that is, dispose of the donor's property — in favor of anyone at all, including oneself or one's own estate." Black's Law Dictionary (10th ed. 2014).

3.2.2.2 In contrast, a limited power of appointment is "[a] power of appointment that either does not allow the entire estate to be conveyed or restricts to whom the estate may be conveyed; esp., a power by which the donee can appoint to only the person or class specified in the instrument creating the power, but cannot appoint to oneself or one's own estate." Black's Law Dictionary (10th ed. 2014).

3.2.3 The distinction between general and non-general powers of appointment is extremely important for asset protection purposes since property subject to a non-general power of appointment will not be subject to the claims of the donee's creditors while property subject to a general power of appointment *may* be subject to the claims of the donee's creditors.

3.2.4 Non-general Powers of Appointment

3.2.4.1 Property subject to a non-general power of appointment is not subject to creditor claims because the donee of the power has no beneficial interest in the property subject to the power.

3.2.4.1.1 "If the power is a special power, i.e., a power to appoint only among a group of persons other than the donee, the donee's creditors cannot, of course, reach the trust property." Scott, Fratcher, & Ascher, Scott and Ascher on Trusts § 14.11.3 at 888 (5th ed. 2010).

3.2.4.2 It is sometimes provided by statute that a non-general power of appointment shall not subject the property covered by the power to the claims of the donee's creditors.

3.2.4.2.1 For example, § 10-7.1 of the New York Estates, Powers and Trusts Law provides that "[p]roperty covered by a special power of appointment…is not subject to the payment of the claims of creditors of the donee, his estate or the expenses of administering his estate."

3.2.4.2.2 Similarly, for purposes of federal bankruptcy law, Bankruptcy Code § 541(b)(1) provides that "[p]roperty of the [bankruptcy] estate does not include…any power that the debtor may exercise solely for the benefit of an entity other than the debtor."

3.2.5 General Powers of Appointment

3.2.5.1 The historic rule is that absent a statute to the contrary, not even property subject to a general power of appointment can be reached by the donee's creditors until the power is actually exercised by the donee.

3.2.5.1.1 "[I]t is insisted, that, conceding it to be a mere naked power of appointment in favor of himself, in favor of creditors he should be compelled by a court of equity to so appoint, or be treated as the owner, and the property subjected to the payment of his debts. The doctrine has been long established in the English courts, that the courts of equity will not aid creditors in case there is a non-execution of the power…No title or interest in the thing vests in the donee of the power until he exercises the power. It is virtually an offer to him of the estate or fund, that he may receive or reject at will, and like any other offer to donate property to a person, no title can vest until he accepts the offer, nor can a court of equity compel him to accept the property or fund against his will, even for the benefit of creditors…Until accepted, the person to whom the offer is made has not, nor can he have, the slightest interest or title to the property. So the donee of the power only receives the naked power to make the property or fund his own. And when he exercises the power, he thereby consents to receive it, and the title thereby vests in him, although it may pass out of him eo instante, to the appointee." *Gilman v. Bell*, 99 Ill. 144, at 149-150 (1881).

3.2.5.1.2 It should be noted this rule does not apply to a general power of appointment that an individual might create in himself or herself. See, e.g., New York's Estates, Powers & Trusts Law § 10-7.4 which provides that "[p]roperty covered by a general power of appointment which, when created, is not presently exercisable is subject to the payment of the claims of creditors of the donee, his estate and the expenses of administering his estate…[i]f the power was created by the donee in favor of himself..."

3.2.5.2 The historic rule concerning general powers of appoint is no longer universally applied. Instead, many authorities now conclude that, in contrast to a limited power of appointment, since the donee of a general power of appointment can grant himself or herself, or his or her estate, a beneficial interest in the property subject to the power, the property subject to the general power of appointment should be subject to the claims of the donee's creditors.

3.2.5.2.1 "If the power is a general power, i.e., a power to appoint to anyone, including the donee or the donee's estate, the situation is very different [from that of a special power of appointment]. There is authority for the proposition that if the donee of a general power exercises it, and if the donee's other assets are insufficient to pay the donee's debts, the donee's creditors can reach the appointed property, but there is also authority to the contrary." 3 Scott and Ascher on Trusts § 14.11.3 at 888–889.

3.2.5.2.2 According to the Restatement Third, Trusts § 58, cmt. b(1), "…if an income beneficiary…holds a presently exercisable general power of appointment (that is, a power currently to compel distribution of trust property to the power holder), a spendthrift restraint will not prevent the beneficiary's creditors or transferees from reaching the property that is subject to the power."

3.2.5.2.3 This reflects a change from the American Law Institute's prior position enunciated in Restatement of Property § 337 and Restatement Second of Property (Donative Transfers), § 13.2, which required the exercise of a general power of appointment before creditors could to reach the subject property, unless a statute required otherwise.

3.2.5.3 In addition, a number of states have abrogated the historic rule and now provide by statute that creditors of a donee can reach the property that is subject to an unexercised general power of appointment.

3.2.5.3.1 For example, New York's Estates, Powers and Trusts Law § 10-7.2 provides that "[p]roperty covered by a general power of appointment…which is presently exercisable, or of a postponed power which has become exercisable, is subject to the payment of the claims of creditors of the donee, his estate and the expenses of administering his estate. It is immaterial whether the power was created in the donee by himself or some other person, or whether the donee has or has not purported to exercise the power."

3.2.5.3.2 Similarly, Tennessee Code § 66-1-106 provides that "[w]hen the unlimited power of disposition, qualified or unqualified, not accompanied by any trust, is given expressly, in any written instrument, to the owner of any particular estate for life or years, legal or equitable, such estate is changed into a fee absolute as to right of disposition, and rights of creditors and purchasers."

3.2.5.4 Similarly, since Bankruptcy Code § 541(a)(1) provides that the bankruptcy estate consists of "all legal or equitable interests of the debtor in property as of the commencement of the case," a donee's general power of appointment makes the property subject to the power available to the donee's creditors in bankruptcy.

3.2.5.4.1 *See, e.g., In re Shurley*, 171 B.R. 769 (Bankr. W.D. Tex. 1994) (because a general power of appointment can be exercised for the benefit of the donee herself, it is included in the donee's bankruptcy estate), rev'd on other grounds, 115 F.3d 333 (5th Cir. 1997).

3.2.5.5 The power of a trustee (or, perhaps, a trust protector), to grant a general power of appointment, or to change a limited power of appointment into a general power of appointment (in either such case as might be desirable to substitute estate tax inclusion for the imposition of a generation-skipping transfer tax), is only a general power once such discretion is exercised by the trustee (or trust protector). Restatement Third of Property, §17.3, Comment d and Illustration 4.

3.2.5.6 In addition, a power to appoint to oneself, even if the consent of a third party is required, remains a general power of appointment available to creditors, provided that the third party is not a person who has a substantial beneficial interest in the trust or other property arrangement that would be adversely affected by the exercise or nonexercise of the power in favor of the donee, the donee's estate, or the creditors of either (i.e., an "adverse party"). See, Restatement Third of Property, §17.3, Comment e and Illustration 6.

3.2.6 Asset Protection Planning With Powers of Appointment

3.2.6.1 Certain states have negated the application of the "relation back" doctrine, as it applies to powers of appointment, whereby the exercise of the power would be regarded as a part of the instrument creating the power and, thus, the appointee would be said to have taken the property from the donor rather than from the donee. See, e.g., Simes, Lewis M., Handbook of the Law of Future Interests, 128 (2d ed. 1966). In such states, a limited power of appointment can be granted by the donor to his or her spouse, who then exercises the limited power of appointment to place the property subject to the power in trust for the benefit of the donor, and the resultant trust should not be treated as a self-settled trust available to the donor's creditors.

3.2.6.1.1 *See*, *e.g.*, Arizona Statutes § 14-10505(E)(5), which provides that "…amounts and property contributed to the following trusts are not deem*ed to have been contributed by the settlor, and a person who* would otherwise be treated as a settlor or a deemed settlor of the following trusts shall not be treated as a settlor…[a]n irrevocable trust for the benefit of a person to the extent that the property of the trust was subject to a general power of appointment in another person."

3.2.6.1.2 *See also*, Texas Trust Code § 112.035(d)(2), which provides that "…[a] settlor is not considered a beneficiary of a trust solely because…the settlor's interest in the trust was created by the exercise of a power of appointment by a third party."

3.2.7 Powers of Withdrawal (Being a Form of General Power of Appointment)

3.2.7.1 Section 505 (b)(1) of the Uniform Trust Code provides that **"…**during the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power…"

3.2.7.1.1 In this regard, as one might well imagine, "[d]uring the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors." UTC § 505(a)(1).

3.2.7.2 The commonly used right of withdrawal in a beneficiary upon attaining one or more designated ages (i.e., 25, 30 and 35), or alternatively a 5 & 5 withdrawal right intending to avoid gift tax consequences pursuant to Code § 2514(e) if permitted to lapse, is a general power of appointment that is presently exercisable upon the beneficiary's attaining of such ages which may subject the property to the claims of the creditors of a beneficiary who has attained such age(s). For example, Restatement Third, Trusts § 58, cmt. 1(b)(1), illustration 9, provides as follows:

3.2.7.2.1 S transfers property to T in trust to pay the income to B for life and to distribute the principal on B's death to R or R's issue. The terms of the trust provide that the interests of the beneficiaries cannot be transferred by them or reached by their creditors. The trust is a spendthrift trust, and B cannot assign his right to the trust income, nor can the creditors of B reach the trust income before it is distributed to him. R also has no power to transfer her remainder interest, and her creditors cannot reach it.

3.2.7.2.2 The facts are the same as in Illustration 1, except that B is also granted the power at any time after reaching age 30 to withdraw all or any part of the principal and thereby terminate the trust in whole or in part. Although the restraint on alienation of B's interest is initially valid, once B reaches age 30 the spendthrift provision is no longer effective because he has the equivalent of complete ownership of the entire trust estate (compare § 29, Comment *g*, on the rule against perpetuities). This does not invalidate spendthrift restraints with respect to the interests of other beneficiaries; but under the rule of § 25(2) and its Comment *e* (and also see § 56, Comment *b*), once B reaches age 30 the remainder interests in this Illustration have little substance and, for creditor purposes, are treated in the same manner as if they were bare expectancies of devisees under a will.

3.2.7.3 In addition, Section 505(b)(2) of the Uniform Trust Code provides that "…upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust…"

3.2.7.3.1 However, this is the not the case as regard the amount specified in Section 2041(b)(2) or 2514(e) of the Internal Revenue Code of 1986, or Section 2503(b) of the Internal Revenue Code of 1986.

3.2.7.4 The same result follows under the Restatement Third, Trusts § 58, Illustration 11, which provides as follows:

3.2.7.4.1 W and H (a married couple) transfer $20,000 to T in trust to pay the income to their grandchild, G, for life and to pay the principal at G's death to his then living issue. The trust instrument gives G the right to withdraw the $20,000, and also the right thereafter to withdraw any additional contributions anyone might make to the trust; any power of withdrawal is to expire at the end of the calendar year in which the transfer to the trust occurs. The terms of the trust also include a spendthrift clause applicable to all beneficiaries. The spendthrift restraint is valid with respect to the interests of G's issue but not with respect to G's income interest, because (i) he has the equivalent of ownership until his withdrawal power lapses and because (ii) he becomes settlor of the trust thereafter. The same result will apply to each of the contributions H and W make, as they contemplate doing in subsequent years.

3.2.7.5 But see, *University National Bank v. Rhoadarmer*, 827 P.2d 561 (Colo.App.1991), wherein a "5 or 5" withdrawal power under a spendthrift trust was held not reachable by the creditor under the historic rule that an unexercised general power of appointment is "neither property nor a property right" but "a mere right or power, a personal privilege or authority." *Id*. at 562.

4. Implications Based Upon the Types of Trust

4.1 Reciprocal Trusts

4.1.1 "Reciprocal" or "crossed" trusts (also sometimes called "parallel" trusts), would seem not to be protective of the beneficiary's interest where the settlor of the first trust is a beneficiary of the second trust and *vice versa*. This is because the trusts, when uncrossed, are effectively "self-settled" trusts and, in most jurisdictions, the trust would be available to the creditors of the individual who is effectively the settlor of that trust.

4.1.1.1 "S transfers $500,000 to T in trust to pay the income to S's brother B for life, remainder to B's issue. At about the same time, pursuant to their prearrangement, B creates a similar trust, also of $500,000, for S and her family. Each trust contains a spendthrift clause. Nevertheless, as settlor of the trust ostensibly created for her by B, she can transfer her interest, and her creditors can reach that interest...." Restatement Third, Trusts, §58, Comments, Illustration 9.

4.1.1.1.1 But see Ariz. Rev. Stat. §14-10505(E)(4), which appears to protect reciprocal trusts from creditors when the settlor and the settlor's spouse are the creators of such trusts. That statute provides that "…amounts and property contributed to the following trusts are not deemed to have been contributed by the settlor, and a person who would otherwise be treated as a settlor or a deemed settlor of the following trusts shall not be treated as a settlor…4. An irrevocable trust for the benefit of a person, the settlor of which is the person's spouse, regardless of whether or when the person was the settlor of an irrevocable trust for the benefit of that spouse."

4.1.2 It should, of course, be noted that the reciprocal trust doctrine has actually developed as a tax construct for the purpose of preventing a form over substance avoidance of the estate tax. While there is apparently no case law stating that reciprocal trusts are to be deemed "self-settled" for asset protection purposes, consider that most reciprocal trust cases find for inclusion in the deceased settlor's taxable estate pursuant to Internal Revenue Code § 2036(a)(1) as a transfer of property with a retained interest.

4.1.3 One can likely avoid creating reciprocal or crossed trusts for estate tax inclusion purposes by varying certain terms of each trust; for example, by adding additional permissible beneficiaries to one trust, but not to the other, by having different lifetime powers in each trust, by having differing trustees in each trust, and/or by adding a power of appointment to one trust, but not the other. Whether variation of such terms would be as effective for avoiding a reciprocal trust finding for asset protection purposes, as it may be for estate tax purposes, is unclear.

4.1.3.1 Alternatively, one might consider creating such trusts in a jurisdiction that permits self-settled spendthrift trusts, so that even a finding of reciprocal trusts should not expose the trust assets to creditors as a self-settled trust.

4.2 Self-Settled Spendthrift Trusts

4.2.1 Restatement Third, Trusts § 58(2) provides that "A restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid."

4.2.2 Uniform Trust Code Section 505(2) provides that "With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit..."

4.2.2.1 Similarly, the Comment to Section 502 of the Uniform Trust Code provides that whether the trust contains a spendthrift provision or not, a creditor of the settlor may reach the maximum amount that the trustee could have paid to the settlor-beneficiary. If the trustee has discretion to distribute the entire income and principal to the settlor, the effect is to place the settlor's creditors in the same position as if the trust had not been created.

4.2.3 The rule that a self-settled trust is not protective even when the trust contains a spendthrift clause is the historic self-settled trust rule. And, when it comes to this historic application of the self-settled trust rule, to the effect that a creditor of the settlor-beneficiary may reach the maximum amount that the trustee could have paid to the settlor-beneficiary, none of the following points matter in the slightest:

4.2.3.1 Whether the settlor is the sole beneficiary, or but one beneficiary out of a large number of discretionary beneficiaries.

4.2.3.2 Whether the settlor has received large, frequent distributions from the trust, or has never received any distributions from the trust.

4.2.3.3 Whether the sole trustee of the trust is a close friend or relative of the settlor, subject to the settlor's influence and/or obviously under the settlor's control, or is a large bank or institutional trust company over which the settlor has not a whit of influence.

4.2.3.4 Whether the settlor had existing creditors at the time that the trust was established, or whether the settlor had no creditors, and no reasonable anticipation of any creditors, at the time that the trust was established.

4.2.3.5 Whether the settlor funded the trust with all or nearly all of the settlor's assets, or whether the settlor funded the trust with an inconsequential amount relative to the settlor's retained assets.

4.2.4 Since 1997, however, the following sixteen states have enacted legislation extending spendthrift protections even to a settlor-beneficiary of a discretionary spendthrift trust (provided only that the transfer by the settlor to the trustee was not a fraudulent transfer). As noted previously, such trusts are called "self-settled spendthrift trusts" or "asset protection trusts". The sixteen states are:

4.2.4.1 Alaska

4.2.4.2 Delaware

4.2.4.3 Hawaii

4.2.4.4 Michigan

4.2.4.5 Mississippi

4.2.4.6 Missouri

4.2.4.7 Nevada

4.2.4.8 New Hampshire

4.2.4.9 Ohio

4.2.4.10 Rhode Island

4.2.4.11 South Dakota

4.2.4.12 Tennessee

4.2.4.13 Utah

4.2.4.14 Virginia

4.2.4.15 West Virginia

4.2.4.16 Wyoming

4.2.4.17 In addition, Oklahoma, pursuant to the Family Wealth Preservation Trust Act of June 9, 2004 (O.S. § 10, Title 31), permits an individual to create a trust with a bank or trust company located in Oklahoma (but not an individual resident of Oklahoma), for the benefit of his or her spouse, descendants and any one or more Internal Revenue Code § 501(c)(3) charities, and to retain the right to revoke the trust, without causing the trust to thereby be available to creditors. However, this is not technically a "self-settled spendthrift trust" since the settlor is not also a beneficiary of the trust.

4.2.5 What then should be the creditor protection effect of a trust where the creditor of a settlor living in a state that does not recognize self-settled spendthrift trust protections as being valid under its own law seeks to enforce a claim against a self-settled spendthrift trust validly established and existing under the law of another state?

4.2.5.1 The Restatement (Second) of Conflict of Laws § 273 (1971), speaks to the efficacy of a purported restraint on alienation of beneficial trust interests. It provides that: "Whether the interest of a beneficiary of [an inter-vivos] trust of movables is assignable by him and can be reached by his creditors is determined…by the local law of the state, if any, in which the settlor has manifested an intention that the trust is to be administered, and otherwise by the local law of the state to which the administration of the trust is most substantially related."

4.2.5.2 Similarly, "[i]f the settlor creates a trust to be administered in a state other than that of his domicil, the law of the state of the place of administration, rather than that of his domicil, ordinarily is applicable. Thus a settlor domiciled in one state may create an inter vivos trust by conveying property to a trust company of another state as trustee and delivering the property to it to be administered in that state. In that case the law of that state will be applicable as to the rights of creditors to reach the beneficiary's interest. This permits a person who is domiciled in a state in which restraints on alienation are not permitted, to create an inter vivos trust in another state where they are permitted and thereby take advantage of the law of the latter state." 5A ASTON W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS § 626, at 419 (4th ed. 1989).

4.2.5.3 In fact, in some jurisdictions a settlor's ability to designate the law of a particular jurisdiction as the governing law of the trust is expressly provided for by statute.

4.2.5.3.1 For example, Section 7-1.10 of New York's Estates, Powers and Trusts Law provides that: "Whenever a person, not domiciled in this state, creates a trust which provides that it shall be governed by the laws of this state, such provision shall be given effect in determining the validity, effect and interpretation of the disposition in such trust..."

4.2.5.3.2 Interpreting a prior version of this statute, New York's highest court stated that "[t]he statute makes [a settlor's] express declaration of intention [of controlling law] conclusive..." Hutchison v. Ross, 262 N.Y. 381, 187 N.E. 65, 71, 89 A.L.R. 1007 (1933).

4.2.5.4 Furthermore, although the prima facie ability of a New York domiciliary settlor to create a valid trust governed by the laws of a foreign jurisdiction is not expressly conferred by this statute, it is either set forth under existing case law or can be logically inferred.

4.2.5.4.1 For example, see In re New York Trust Co., 87 N.Y.S.2d at 792 ("It is inconceivable that a state committed to [the policy of ESTATES, POWERS AND TRUSTS LAW § 7-1.10] would deny its own residents the corresponding right to establish trusts in other states...[U]nder the law of this state, a New York resident may choose another state as the situs of a trust as freely as a non-resident may create a trust in New York.").

4.2.5.5 A strong argument can also be made that principles of judicial comity require that a settlor's designation of controlling law be respected by the court. See generally 17 C.J.S. § 12(1).

4.2.6 The Restatement (Second) of Conflict of Laws § 270 (1971), however, provides that "[a]n inter vivos trust of interests in movables is valid if valid...under the local law of the state designated by the settlor to govern the validity of the trust, provided...that the application of its law does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6."

4.2.6.1 Section 270 of the Restatement (Second) of Conflict of Laws has been cited by more than one court dealing with the question of the validity of self-settled spendthrift trusts, to the effect that the validity of a self-settled spendthrift trust should not be upheld. See, e.g., In re Portnoy, 201 B.R. 685 (Bankr. S.D.N.Y. 1996); In re Brooks, 217 B.R. 98 (Bankr. D. Conn. 1998); In re Lawrence, 227 B.R. 907 (Bankr. S.D. Fla. 1998).

4.2.6.2 In contrast, see Riechers v. Riechers, 178 Misc. 2d 170, 679 N.Y.S.2d 233, 1998 N.Y. Slip. Op. 98522 (1998), aff'd, 267 A.D.2d 445, 701 N.Y.S.2d 113, 1999 N.Y. Slip. Op. 11143 (1999), a New York case which actually involved self-settled spendthrift trust in a matrimonial action. In Riechers, following the defense of several medical malpractice suits, the settlor, Dr. Riechers, established a self-settled spendthrift trust under the law of the Cook Islands ostensibly to guard against the likelihood of future medical malpractice claims. At the same time, Dr. Riechers and his wife were having marital difficulties, but Mrs. Riechers was alleged to have been aware that the trust was being established. Two years later, Mrs. Riechers commenced an action for divorce and sought to have the trust included in computing an equitable distribution award. The New York State Supreme Court noted that since the trust was established "for the legitimate purpose of protecting family assets" the court did not have jurisdiction over the trust and that issues such as whether the wife would be entitled to any trust property should be left to a Cook Islands court to decide. Id.

4.2.6.3 In any event, query whether the requirement under § 270 of the Restatement (Second) of Conflict of Laws that the court find that the application of the law of the non-forum state would violate a strong public policy of the forum state can exist where the self-settled spendthrift trust was established prior to the marriage.

4.2.7 The (Potential) Impact of the Uniform Voidable Transactions Act

4.2.7.1 Section 10(b) of the Uniform Voidable Transactions Act (the "UVTA"), provides that "[a] claim for relief in the nature of a claim for relief under this [Act] is governed by the local law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred." Section 10(a) of the UVTA. Section 10(a)(1) of the UVTA provides that "[a] debtor who is an individual is located at the individual's principal residence."

4.2.7.2 Comment 8 to Section 4 of the UVTA provides that "[b]ecause the laws of different jurisdictions differ in their tolerance of particular creditor-thwarting devices, choice of law considerations may be important in interpreting § 4(a)(1) as in force in a given jurisdiction. For example, as noted in Comment 2, the language of § 4(a)(1) historically has been interpreted to render voidable a transfer to a self-settled spendthrift trust. Suppose that jurisdiction X, in which this Act is in force, also has in force a statute permitting an individual to establish a self-settled spendthrift trust and transfer assets thereto, subject to stated conditions. If an individual Debtor whose principal residence is in X establishes such a trust and transfers assets thereto, then under § 10 of this Act the voidable transfer law of X applies to that transfer. That transfer cannot be considered voidable in itself under § 4(a)(1) as in force in X, for the legislature of X, having authorized the establishment of such trusts, must have expected them to be used. (Other facts might still render the transfer voidable under X's enactment of § 4(a)(1).) By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has no legislation validating such trusts, and if Debtor establishes such a trust under the law of X and transfers assets to it, then the result would be different. Under § 10 of this Act, the voidable transfer law of Y would apply to the transfer. If Y follows the historical interpretation referred to in Comment 2, the transfer would be voidable under § 4(a)(1) as in force in Y."

5. Implications Based Upon Classification of Creditor

5.1 United States Government Claimant

5.1.1 The United States federal government has status as a so-called "super creditor" and, thus may be able to reach assets held in a spendthrift and/or a discretionary trust that the law would place beyond the reach of other creditors.

5.1.2 Spendthrift Trusts

5.1.2.1 As noted, the Uniform Trust Code provides in Section 503 that: "(b) a spendthrift provision is unenforceable against . . . (3) a claim of this State or the United States to the extent a statue of this State or federal law so provides."

5.1.2.1.1 The Comments to Section 503 of the UTC provide that: "Federal preemption guarantees that certain federal claims, such as claims by the Internal Revenue Service, may bypass a spendthrift provision no matter what this Code might say…Regarding claims by state governments, this subsection recognizes that States take a variety of approaches with respect to collection, depending on whether the claim is for unpaid taxes, for care provided at an institution, or for other charges. Acknowledging this diversity, subsection (c) does not prescribe a rule, but refers to other statutes of the State on whether particular claims are subject to or exempted from spendthrift provisions."

5.1.2.2 Since, as noted *supra*, the legal basis upon which rests the protection sometimes afforded by a spendthrift trust is that of public policy, an exception for "a claim of this State or the United States" (or, indeed, any exception to spendthrift trust protections) is, therefore, best understood as being based upon a competing public policy that outweighs the right of a person to make any desired disposition of his or her property, including one intended to avoid the claims of the beneficiary's creditors.

5.1.3 Discretionary Trusts

5.1.3.1 When considering access of a preferred creditor, such as the US government, to the assets of a discretionary trust, however, the inquiry focuses on whether the beneficiary has an enforceable right to a distribution or payment.

5.1.3.2 If the interest of a beneficiary of a discretionary trust does not, in the first instance, qualify as a property right, even preferred creditors can be precluded from accessing a discretionary trust in satisfaction of their claims against the beneficiary. *First Northwestern Trust Co. of South Dakota v. IRS*, 622 F.2d 387 (8th Cir. 1980).

5.1.4 Where the Debt is a Tax Lien

5.1.4.1 26 U.S.C. §6321 provides that "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."

5.1.4.2 Obviously, the statute does not define the scope of the phrase "all property and rights to property." However, in this regard the Internal Revenue Manual §5.17.2.5 (3-27-2012) provides, in pertinent part, that: "The federal tax lien attaches to all property and rights to property of the taxpayer. This is a very broad concept and includes not only items which are typically thought of as property, e.g., tangible items and "things," but also intangible items and "rights" which a taxpayer may have, but are not necessarily marketable..."

5.1.4.3 The courts have interpreted this very broad language to include property of greatly varying natures, as well as future interests, contingent interests, and executory contracts.

5.1.4.3.1 Future interests. The fact that a taxpayer's enjoyment of a "right to property" may be postponed does not prevent attachment. If a taxpayer has an unqualified fixed right, under trust or a contract, to receive periodic payments or distributions of property, a lien attaches to the taxpayer's entire right regardless of when the payments or distributions will be made. Rev. Rul. 55-210, 1955-1 C.B. 544.

5.1.4.3.2 Contingent interests. These are interests which a party will receive only if certain circumstances or events occur. See Fouts v. United States, 107 F.Supp.2d 815, 817 (W.D. Mich. 2000) (under state law an expectant beneficiary of an inter vivos trust has a present interest in property that is attachable). But see Dominion Trust Co. of Tennessee v. United States, 7 F.3d 233 (unpublished table decision) (6th Cir. 1993) (under state law a contingent remainder person did not have an interest in property).

5.1.4.3.3 The Internal Revenue Manual § 5.17.2.5.1 (1-08-2016) provides, in pertinent part, that: "State law is very significant when considering the property and rights to property to which the federal tax lien attaches. The Government looks to state law to determine a taxpayer's rights in a particular piece of property, but federal law determines whether such interests qualify as property or rights to property. "[One] look[s] to state law to determine what rights the taxpayer has in the property the Government seeks to reach, then to federal law to determine whether the taxpayer's state-delineated rights qualify as 'property' or 'rights to property' within the compass of federal tax lien legislation." United States v. Craft, 535 U.S. 274 (2002); Drye v. United States, 528 U.S. 49, 58 (1999). State law does not determine whether something is property under the Internal Revenue Code. For example, in many states a liquor license is not property. Under the Internal Revenue Code, however, the question is whether the taxpayer has rights under state law. Because the taxpayer does have rights under state law, the liquor license is property under the Internal Revenue Code. See Drye, 528 U.S. at 58-59.

5.1.4.3.4 The Internal Revenue Manual §5.17.2.5.3.3 (3-27-2012) speaks to "Trusts and Beneficial Interests" and provides, in pertinent part, that: "If the taxpayer is the beneficiary of a trust, a federal tax lien will attach to the taxpayer's beneficial interest in the trust. This determination is made by reference to the trust instrument itself, with the appropriate state law governing construction of the terms of the instrument or the resolution of any ambiguities in the instrument. In some cases the lien will attach to the corpus of the trust and the income payable to the beneficiary. In other cases the lien will attach only to the income as it becomes payable to the beneficiary, and in a few cases it may not attach to either the income or the corpus. The latter situation may arise where the trustee has the unrestricted power of disposition of the trust income; i.e., where he/she may legally refuse to make any further distribution to the taxpayer-beneficiary and instead make the distribution to other beneficiaries or simply accumulate the income. The trust instrument can only determine the property right of the beneficiary (e.g., the taxpayer) in the trust corpus and income; the trust instrument itself cannot determine the effect of the federal tax lien upon that right. Thus, a so-called "spendthrift" trust may by its terms confer certain specific benefits upon a beneficiary and then purport to restrict the rights of creditors to reach those benefits. Such restrictions are not effective to remove those benefits from the reach of the federal tax lien, regardless of whether under the appropriate state law a "spendthrift" trust is regarded as valid in all respects. Bank One Ohio Trust Co. v. United States, 80 F.3d 173 (6th Cir. 1996). In any case where doubt exists as to the rights of a beneficiary of any of the many forms of trusts, the opinion of Area Counsel should be sought."

5.1.4.4 As per the Internal Revenue Service manual, spendthrift trusts have been found to be ineffective against the federal tax lien in all states where the issue has been litigated. See, e.g., *In re Orr*, 180 F.3d 656 (5th Cir. 1999); *First Nw. Trust Co. v. Internal Revenue Service*, 622 F.2d 387, 390 (8th Cir. 1980); *United States v. Rye*, 550 F.2d 682, 685 (1st Cir. 1977); *Leuschner v. First W. Bank & Trust*, 261 F.2d 705, 708 (9th Cir. 1958).

5.1.4.5 In contrast, a discretionary trust may or may not be subject to a federal tax lien. With a discretionary trust, the issue turns upon whether or not the beneficiary's interest rises to the point where it could be found to qualify as 'property' or a 'right to property' within the meaning of 26 U.S.C. § 6321.

5.1.5 Federal Debt Collection Procedure

5.1.5.1 28 U.S.C. §3001(a) provides for the exclusive civil procedures for the United States to recover a judgment on a debt; or to obtain, before judgment on a claim for a debt, a remedy in connection with such claim.

5.1.5.2 For purposes of determining the property of the debtor subject to the claims of the United States for collection of a debt, 28 U.S.C. § 3002(12) defines the term "property" as including: "…any present or future interest, whether legal or equitable, in real, personal (including choses in action), or mixed property, tangible or intangible, vested or contingent, wherever located and however held (including community property and property held in trust (including spendthrift and pension trusts)).

5.1.5.2.1 Significantly, note the express reference to trusts, and specifically the reference to "spendthrift and pension trusts," and not all types of trusts.

6. Special Concerns from the Trustee's Perspective

6.1 Accepting Self-Settled Spendthrift Trusts

6.1.1 The use of self-settled spendthrift (or "asset protection") trusts has become very popular in the United States over the past 20 years since the enactment of self-settled spendthrift trust legislation by Alaska and Delaware in 1997.

6.1.2 Clients that are in high risk occupations or professions are interested in creating an irrevocable trust whereby the client retains a beneficial interest in the trust, transfers a portion of the client's net worth to the trust and prevents the client's creditors from reaching the assets of the trust.

6.1.3 There are, however, several issues a trustee faces when determining whether to accept a self-settled spendthrift trust.

6.1.3.1 Fraudulent Transfers

6.1.3.1.1 One of the largest concerns a trustee faces is whether the client is making a fraudulent transfer by engaging in the planning process and transferring assets to the self-settled spendthrift trust.

6.1.3.1.2 In order to determine whether a client has made a fraudulent transfer it is helpful to review the provisions of the Uniform Voidable Transfers Act as well as the laws of the jurisdiction where the trust is being established. Ultimately, the laws of the jurisdiction where the trust is being established should govern whether the client engaged in a fraudulent transfer by creating and funding the self-settled spendthrift trust.

6.1.3.2 Section 4 of the Uniform Voidable Transfers Act (the "UVTA"), formerly the Uniform Fraudulent Transfers Act, specifies when a transfer or obligation is voidable as to a present or future creditor. Section 4(a) of the UVTA provides that a transfer made or obligation incurred by a debtor is voidable as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

6.1.3.2.1 With actual intent to hinder, delay, or defraud any creditor of the debtor; or

6.1.3.2.2 Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the donor: (i) was engaged or was about to engage in a business or transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or (ii) intended to incur, or believed or reasonably should have believed the debtor would incur, debts beyond the debtor's ability to pay as they became due.

6.1.3.3 Section 4(b) of the UVTA provides that in determining actual intent under subsection (a)(1), consideration may be given, among other factors, to whether:

6.1.3.3.1 The transfer or obligation was to an insider;

6.1.3.3.2 The debtor retained possession or control of the property transferred after the transfer;

6.1.3.3.3 The transfer or obligation was disclosed or concealed;

6.1.3.3.4 Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

6.1.3.3.5 The transfer was of substantially all of the debtor's assets;

6.1.3.3.6 The debtor absconded;

6.1.3.3.7 The debtor removed or concealed assets;

6.1.3.3.8 The value of the consideration received by the debtor was reasonably equivalent to the value of the assets transferred or the amount of the obligation incurred;

6.1.3.3.9 The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

6.1.3.3.10 The transfer occurred shortly before or shortly after substantial debt was incurred; and

6.1.3.3.11 The debtor transferred the essential assets of the business to a lienor that transferred the assets to an insider of the debtor.

6.1.3.4 Section 4(c) of the UVTA provides that a creditor making a claim for relief under subsection (a) has the burden of proving the elements of the claim for relief by a preponderance of the evidence.

6.1.3.5 Section 5 of the UVTA provides when a transfer or obligation is voidable as to a present creditor.

6.1.3.5.1 Section 5(a) of the UVTA provides that a transfer made or obligation incurred by a debtor is voidable as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at the time or the debtor became insolvent as a result of the transfer or obligation.

6.1.3.5.2 Section 5(b) of the UVTA provides that a transfer made by a debtor is voidable as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at the time, and the insider had a reasonable cause to believe that the debtor was insolvent.

6.1.3.5.3 Section 5(c) of the UVTA provides that a creditor making a claim for relief under subsection (b) has the burden of proving the elements of the claim for relief by a preponderance of the evidence.

6.1.3.6 A key component in determining whether a transfer is voidable and whether the debtor has engaged in a fraudulent transfer is whether the debtor was insolvent at the time the transfer was made.

6.1.3.7 Section 2 of the UVTA contains a definition of insolvency. Section 2 of the UVTA provides as follows:

6.1.3.7.1 A debtor is insolvent if, at a fair valuation, the sum of a debtor's debts is greater than the sum of the debtor's assets.

6.1.3.7.2 A debtor that is generally not paying the debtor's debts as they become due other than as the result of a bona fide dispute is presumed to be insolvent. The presumption imposes on the party against which the presumption is directed the burden of proving that the nonexistence of insolvency is more than its existence.

6.1.3.8 Approximately eight states have adopted the UVTA, as amended in 2014. For those jurisdictions that have not adopted the UVTA it is necessary to look to the particular jurisdiction's laws for determining whether a debtor is making a fraudulent transfer.

6.1.3.9 Fraudulent transfers within the context of a self-settled asset protection trust:

6.1.3.9.1 Delaware is one of several jurisdictions that has enacted self-settled spendthrift trust legislation. Delaware's self-settled spendthrift trust statute is known as the Delaware Qualified Dispositions in Trust Act, 12 Del. C. § 3570, et seq. (the "Act").

6.1.3.9.2 The Act, like the UVTA, addresses the fraudulent transfer concept in the context of creating and funding a self-settled asset protection trust.

6.1.3.10 The Act permits the following creditors to reach the assets of a self-settled asset protection trust if a fraudulent transfer is made to the trust:

6.1.3.10.1 A creditor whose claim arose before the creation of the trust provided the claim is brought within four years after the creation of the trust or, if later, within one year after the creditor discovered (or should have discovered the trust), and the creditor proves, by clear and convincing evidence, that the creation of the trust was a fraudulent transfer. 12 Del. C. § 3572(b)(1).

6.1.3.10.2 A creditor whose claim arose after the creation of the trust provided the claim is brought within four years after the creation of the trust and the creditor proves, by clear and convincing evidence, that the creation of the trust was a fraudulent transfer. 12 Del. C. § 3572(b) (2).

6.1.3.11 The Act does not define the term "fraudulent transfer". Instead, it is necessary to look to other provisions of the Delaware Code to determine whether a fraudulent transfer has been made.

6.1.3.11.1 Delaware has adopted the predecessor to the UVTA, known as the Uniform Fraudulent Transfers Act. 6 Del. C. § 1301, et seq.

6.1.3.11.2 Delaware's fraudulent transfer statutes contain a similar definition to insolvency as that contained in the UVTA. 6 Del. C. § 1302.

6.1.3.11.3 The key component in determining whether a grantor made a fraudulent transfer thereby allowing a creditor access to the trust is whether the grantor rendered himself or herself insolvent by virtue of the transfer.

6.1.4 Is there any Protection for a Fiduciary that Participates in a Fraudulent Transfer?

6.1.4.1 The Act provides some protection for a trustee of a Delaware self-settled asset protection trust for participating in the creation of the trust, provided the trustee has acted in good faith. 12 Del. C. § 3574(b).

6.1.4.2 The Act provides that if the court is satisfied that a trustee has not acted in bad faith in accepting or administering the property that is the subject of the qualified disposition:

6.1.4.2.1 Such trustee shall have a first and paramount lien against the property that is the subject of the qualified disposition in an amount equal to the entire cost, including attorneys' fees, properly incurred by such trustee in the defense of the action or proceedings to avoid the qualified disposition. 12 Del. C. § 3574(b)(1)a;

6.1.4.2.2 The qualified disposition shall be avoided subject to the proper fees, costs, pre-existing rights, claims and interest of the trustee. 12 Del. C. § 3574(b)(1)b; and

6.1.4.2.3 There is a presumption that the trustee did not act in bad faith merely by accepting the trust assets. 12 Del. C. § 3574(b)(1)c.

6.1.4.2.4 The Act further provides that a creditor must prove, by clear and convincing evidence that the trustee acted in bad faith in accepting or administering the self-settled asset protection trust. 12 Del. C. § 3574(c).

6.1.5 Combatting Fraudulent Transfer Argument

6.1.5.1 Trustees that administer self-settled spendthrift trusts want to make efforts to ensure that the client is not engaging in a fraudulent transfer by transferring the assets to the trust.

6.1.5.2 There are three primary methods trustees use to help combat the fraudulent transfer argument:

6.1.5.2.1 Have the client execute an Affidavit of Solvency;

6.1.5.2.2 Conduct a background search on the client; and

6.1.5.2.3 Limit the amount of the client's net worth that is funding the trust.

6.1.5.3 An Affidavit of Solvency is an affidavit executed by the grantor of a self-settled spendthrift trust who is transferring assets to the trust which states that the client is not rendering himself or herself insolvent by virtue of the asset transfer. The affidavit should contain the following information:

6.1.5.3.1 That by virtue of the transfer of assets into the trust the grantor will remain solvent and able to pay his or her reasonably foreseeable obligations;

6.1.5.3.2 That there are no pending or threatened claims that the grantor reasonably anticipates may result in a judgment against the grantor;

6.1.5.3.3 That the grantor is not transferring assets to the trust with the intent to defraud his or her creditors; and

6.1.5.3.4 If the grantor is creating a self-settled spendthrift trust in one of the several jurisdictions that allow for certain creditor carve outs the affidavit should specify that those creditors do not exist and that the grantor does not expect the trust to defend a lawsuit against one of those potential creditors. For example, if a grantor who is married creates and funds a self-settled spendthrift trust in the State of Delaware the grantor should not expect that the assets in the trust will not be subject to claims of a divorcing spouse in the event of a dissolution of the marriage.

6.1.5.4 Sample Affidavit of Solvency Language.

6.1.5.4.1 I am engaged in the process of estate planning and as part of that process I intend to create The ________ Family Delaware Trust Agreement (the "Trust") that will be governed by the provisions of Delaware law, specifically by the provisions of the Delaware Qualified Dispositions in Trust Act, 12 Del. C. § 3570 et seq.

6.1.5.4.2 I further intend to transfer certain assets to the Trust.

6.1.5.4.3 There are no pending or threatened claims or proceedings that I reasonably anticipate may result in a judgment against me, and I am not named as a defendant in any lawsuit or involved in any administrative proceeding under the jurisdiction of a federal, state or municipal government as of this date.

6.1.5.4.4 I do not anticipate filing for relief under the provisions of any applicable bankruptcy or insolvency laws, nor am I involved in any matter that I reasonably believe will cause me to file for relief under any applicable bankruptcy or insolvency laws in the future.

6.1.5.4.5 I am not about to incur substantial debt, nor have I already incurred a substantial debt, in relation to the value of my assets. Based on a fair market valuation of my assets and my liabilities, the fair market value of my assets exceeds my liabilities.

6.1.5.4.6 The transfer of assets to the Trust is not being done by me to hinder, delay or defraud my creditors, whether such creditors have existing claims or may have future claims against me, nor do I intend to remove or conceal assets from my creditors by executing the Trust and transferring assets to the Trust.

6.1.5.4.7 The transfer of assets by me to the Trust will not consist of substantially all of my assets. Following the transfer of my assets to the Trust, I will remain solvent and be able to pay my reasonably anticipated debts as they come due from the balance of the assets retained by me and not transferred to the Trust.

6.1.5.4.8 I have the full right, title and authority to transfer assets to the Trust. I am not engaged in or about to become engaged in a business or other financial transaction for which my remaining assets will be unreasonable in relation to the business or financial transaction.

6.1.5.4.9 I do not intend to incur debts beyond my ability to pay such debts as they become due.

6.1.5.4.10 To the best of my knowledge, I am not liable for, or indebted to, any person who suffered death, personal injury or property damage on or before the date upon which I create and fund the Trust, whose death, personal injury or property damage may be determined at any time to have been caused in whole or in part either by my act or omission or by the act or omission of another person for whom I am vicariously liable.

6.1.5.4.11 I have made the foregoing statements with full knowledge that they will be relied upon by those who assist me in the creation and funding of the Trust through counseling, drafting, preparation of documents and the execution or funding of the Trust.

6.1.5.5 Background Check

6.1.5.5.1 Typically trustees will conduct a background check on the client.

6.1.5.5.2 Oftentimes this begins with a simple Google search of the client and his or her business if applicable.

6.1.5.6 Limitation on Asset Transfer

6.1.5.6.1 It is common practice for trustees administering self-settled spendthrift trusts to limit the total amount of the client's net worth funding the trust.

6.1.5.6.2 A loose rule of thumb is that a client should not transfer more than 40% of his or her unencumbered net worth into the trust.

6.1.5.6.3 Many times a trustee will require that the client provide the trustee with a balance sheet listing all of the client's assets in order to ensure that no more than 40% of the client's unencumbered net worth funds the trust.

6.1.5.6.4 Other trustees will dispense with the 40% requirement as long as the trustee is ensured that the client is retaining sufficient assets outside of the trust to pay the client's reasonably foreseeable obligations.

6.1.5.6.5 For example, assume a client with an unencumbered net worth of $100 Million would like to transfer $60 Million into a self-settled asset protection trust. Although this compromises 60% of the client's unencumbered net worth, the client is still retaining $40 Million outside of the trust to pay the client's reasonably foreseeable future obligations.

6.2 Defending a Self-Settled Spendthrift Trust.

6.2.1 Practical Issues in Funding Cost of Defense.

6.2.1.1 The trustees and other fiduciaries of self-settled asset protection trusts owe a fiduciary duty to the beneficiaries of the trust which includes defending the trust in the face of an attack from a potential creditor.

6.2.1.2 There is no limitation on the type of assets a client can transfer to a self-settled asset protection trust and it is common practice for a client to transfer illiquid assets, such as an ownership interest in a closely-held business (i.e., an LLC), to the trust.

6.2.1.3 In many situations the only asset held in the trust will be an ownership interest in a closely-held business which creates the practical issue of how the trustee pays the legal fees and other expenses associated with defending the trust from a creditor claim.

6.2.1.4 For example, the operating agreement for the LLC owned by the trust may provide that all substantial decisions are made by the manager of the LLC and that the member has no ability to compel a distribution from the LLC. As such, even if the LLC has a substantial amount of cash or other liquid assets which could be used by the trustee to defend the claim, the trustee, as the member of the LLC, may not be in a position to compel a distribution out of the LLC.

6.2.1.5 When the trust is only funded with illiquid assets the trustee may be placed in the uncomfortable position of having to choose to use its own corporate funds to defend the trust or to not defend the trust and face a potential breach of fiduciary duty action from the beneficiaries.

6.2.1.6 There are steps that trustees can take to ensure that they are not forced to make this difficult decision:

6.2.1.6.1 The trustee could require that in addition to the illiquid assets funding the trust the client also fund the trust with cash or marketable securities under the control of the trustee. This would allow the trustee to use the liquid or marketable assets to fund the defense of the trust.

6.2.1.6.2 The trustee can require that the operating agreement for the entity funding the trust permit the trustee, as the member of the entity, to compel a distribution out of the entity to the trust which could then be used to fund the cost of litigation.

6.2.1.6.3 The trustee could require that express language be included in the trust agreement providing that the trustee has no duty to defend the trust from the attack of a creditor in the event there is not liquid assets in the trust to defend the cost of litigation, or if the grantor refuses to provide liquid assets to defend the cost of litigation. Sample language could read, as follows: "To the extent that any of the creditors of the grantor, or any other beneficiary of a trust created by or pursuant to this Agreement, asserts a claim that it is entitled, through the exercise of the judicial process or otherwise, to reach the assets of the trust in satisfaction of its claim, the trustee shall have no obligation to defend the trust or its assets against any such claim or to initiate or intervene in any litigation, arbitration, proceeding or mediation proceeding for the purpose of resisting any such claim, unless the trustee is reasonably satisfied that it will be held harmless and fully indemnified from the assets of the trust for all of its liabilities and expenses (including professional fees and expenses of counsel, accountants and expert witnesses) arising from or attributable to the trustee's participation therein. If the trustee reasonably determines that the readily marketable assets of the trust are, or have become, insufficient for such purposes, the trustee may request that the grantor provide the trustee with comparable indemnity, supported with such security as may be satisfactory to the trustee in its sole discretion, and in the absence of such additional indemnity or security, the trustee may refuse to participate in any such proceeding or may withdraw from an ongoing proceeding, even if such refusal or withdrawal may result in the granting or awarding of relief against the trust (including a distribution of trust assets in satisfaction of the claim). The trustee shall incur no liability to anyone whomsoever in connection with any such refusal or withdrawal pursuant to this Article ______."

6.2.1.7 The trustee may require the grantor to enter into an indemnity agreement with the trustee prior to the execution and funding of the trust pursuant to which the grantor agrees to indemnify the trustee for all costs and expenses associated with defending the litigation. Provided below is sample language:

6.2.1.7.1 Prior to accepting our role as trustee of your irrevocable trust (the "Trust"), we request that, as grantor, you read and signify your full understanding of the following acknowledgments and undertakings, by signing and dating this Agreement where indicated. Please keep a copy for your records and return a signed copy to the trustee (referred to herein as "we", "us" or "our").

6.2.1.7.2 You have asked us to serve as the Delaware trustee of the trust, to which you are transferring certain property in reliance on the provisions of the Delaware Qualified Dispositions in Trust Act, 12 <u>Del</u>. <u>C</u>. § 3570 et seq. (the "Act"). In our role as trustee, we will adhere to the provisions of the governing instrument to determine whether, when and to whom to distribute income or principal of the Trust. You understand that the Trust is irrevocable and we will not entertain any request or direction to terminate the Trust other than in accordance with the provisions of the governing instrument.

6.2.1.7.3 Due to the nature of the rights and powers that you retain under the Trust and the nature of the property interests that may be distributed to you from the Trust during your lifetime under the terms of the governing instrument, we make no representation as to whether under the Internal Revenue Code of 1986, as amended (the "Code"), and accompanying Treasury Regulations, or applicable state law, (a) any transfer of property to the Trust will be treated as a completed gift or an incomplete gift, (b) the assets held in the Trust upon your death will be subject to inclusion within, or exclusion from, your gross estate for federal (and any relevant state) transfer tax purposes, or (c) any income of the Trust will be taxable to you or the Trust. We further disclaim any warranty or representation to you or any of your heirs, beneficiaries, successors or assigns that the Trust will achieve any particular tax treatment that you intended for a portion of the income or the principal of the Trust.

6.2.1.7.4 A principal purpose of a trust established under, and in reliance upon, the Act is to protect the property transferred to the trust from claims asserted by creditors against any of the trust's beneficiaries, including the grantor, particularly those future claims that did not exist when the grantor transferred property to the trust. We disclaim any warranty or representation to you or any of your heirs, beneficiaries, successors or assigns that the Trust will achieve any significant degree of protection against claims asserted against you or any other beneficiary of the Trust, or that the Trust will be successful in resisting a particular claim against the assets of the Trust, irrespective of whether such claim is ultimately reduced to a final judgment in a state or federal court of the United States, or in a court of foreign jurisdiction. We therefore make no representations regarding (i) the application of the Act to the Trust or the assets held therein, (ii) the extent to which the Trust or the assets held therein will be immune from claims asserted by a creditor of you, a beneficiary of the Trust or the Trust itself, or (iii) the degree to which we may be obligated to recognize a judgment obtained against you, against a beneficiary of the Trust or against the assets of the Trust.

6.2.1.7.5 Your trust agreement provides that if any of your creditors or a beneficiary's creditors asserts a claim that it is entitled, through the exercise of the judicial process or otherwise, to reach the assets of the Trust in satisfaction of its claim, we will have no obligation to defend the Trust or its assets against any such claim or to initiate or intervene in any litigation, arbitration proceeding or mediation proceeding for the purpose of resisting any such claim, unless we are reasonably satisfied that we will be fully indemnified from the assets of the Trust for all of our liabilities and expenses (including professional fees and expenses of our counsel, accountants and expert witnesses) arising from or attributable to our participation therein. If we reasonably determine that the readily marketable assets of the Trust are, or have become, insufficient for such purposes, we may request that you, as grantor, provide us with comparable indemnity, supported with such security as may be satisfactory to us in our sole discretion, and in the absence of such additional indemnity or security, we may refuse to participate in any such proceeding or may withdraw from an ongoing proceeding, even if such refusal or withdrawal may result in the granting or awarding of relief against the Trust (including a distribution of Trust assets in satisfaction of a claim). As provided in your trust agreement, we shall incur no liability to anyone whomsoever in connection with any such refusal or withdrawal pursuant to this Paragraph (d).

6.2.1.7.6 Prior to its execution, you have carefully reviewed the attached copy of the "Affidavit of Solvency". You have made a determination in good faith, with the assistance of your professional advisors that the Affidavit of Solvency will be accurate and complete in all material respects at the time of its execution. You understand that we are agreeing to accept your Trust and act as a trustee thereof in full reliance upon the Affidavit of Solvency and this Agreement.

6.2.1.7.7 In addition to any indemnity the Trust or you provide to us under Paragraph (d) hereof, you individually agree to indemnify us from any and all claims, liabilities, damages, costs and expenses (including professional fees and expenses of our counsel, accountants and expert witnesses) arising out of or attributable to (a) our acceptance or administration of the property transferred to the Trust, unless our administration of such property fails to adhere to the terms of the Trust, (b) any materially false or misleading information contained in your Affidavit of Solvency, (c) a finding of any court or other tribunal that the transfer of assets to the Trust constituted a fraudulent transfer under applicable law, or (d) a finding of any court or other tribunal that your receipt, as a beneficiary of the Trust, of income or principal of the Trust constituted bad faith.

6.2.1.7.8 The rights and duties of the parties under this Agreement shall survive the termination of the Trust or our resignation or removal as trustee, whichever first occurs.

6.2.1.7.9 The validity of this Agreement and the interpretation of any provision thereof shall be governed by the laws of the State of Delaware. Any action or proceeding relating to this Agreement shall be brought and enforced in the Delaware Court of Chancery. In reliance on the provisions of 6 Del. C. § 2708, you and we irrevocably consent to the exclusive jurisdiction of the courts of the State of Delaware for the resolution of all disputes, claims, actions or proceedings between us or arising hereunder and consent to service of process by certified mail, return receipt requested in, in connection therewith.

6.2.1.7.10 Whenever it is required that you notify us with respect to any matter contained herein (or otherwise), notification shall be in writing, and addressed as follows: ______________________.

6.3 Jurisdictional Concerns

6.3.1 One of the issues that often arises in defending a self-settled spendthrift trust is which jurisdiction's courts can entertain the dispute.

6.3.2 It is very important for clients creating self-settled spendthrift trusts, and for trustees defending self-settled spendthrift trusts, that any dispute relating to the trust be brought in the particular state where the trust is created. The clients and trustees want a court in the jurisdiction where the trust is created (as opposed to a court in another jurisdiction) to interpret the provisions of the trust.

6.3.2.1 For example, Delaware trust administration and trust interpretation cases are exclusively within the jurisdiction of the Delaware Court of Chancery, and, upon appeal, the Delaware Supreme Court. It is very important to trustees administering

Delaware self-settled spendthrift trusts to ensure that any dispute brought with respect to a Delaware trust is brought in the Delaware Court of Chancery.

6.3.2.2 The Act specifically provides that the Delaware Court of Chancery shall have exclusive jurisdiction over any action brought with respect to a Delaware self-settled spendthrift trust. 12 Del. C. § 3572(a).

6.3.2.3 There are two reasons why it is important for trustees administering self-settled spendthrift trusts that any dispute relating to the trust be brought in the jurisdiction where the trust is created:

6.3.2.3.1 Presumably a court in the jurisdiction where the trust is created will have a better understanding of the particular state's self-settled spendthrift trust legislation and therefore will be in a better position to interpret and apply the law; and

6.3.2.3.2 Certain jurisdictions have strong public policies against self-settled spendthrift trusts and there is concern that if a dispute relating to the trust is brought in such a jurisdiction a court may not apply the law of the jurisdiction where the trust is created but instead apply their own laws under the theory it was against public policy for the grantor to have created such a trust. Having the lawsuit brought in a court in the jurisdiction where the trust is created helps ensure the laws of the particular jurisdiction will be applied in determining a creditor's rights under the terms of the trust.

6.3.3 Trustees in jurisdictions authorizing self-settled spendthrift trusts often structure their particular trust company as a state chartered trust company, as opposed to a National Association, so that the trust company is not subject to the jurisdiction of other courts.

6.3.3.1 For example, it is very common for Delaware trust companies, even those that are part of a national bank, to structure the Delaware trust company as a separate Delaware limited purpose trust company, which is regulated by the Delaware State Bank Commissioner. This helps ensure that the Delaware trustee is not subject to the jurisdiction of other courts. The Delaware limited purpose trust company only does business in the State of Delaware.

6.3.4 An issue can arise when a trust instrument bifurcates traditional trustee responsibilities by appointing one or more trustees or advisers to hold key fiduciary powers.

6.3.4.1 Most of the jurisdictions which authorize the use of self-settled spendthrift trusts require that the trust have a trustee in the particular jurisdiction (whether it be an individual or a corporation), and that the trustee carry out certain duties and responsibilities in the particular jurisdiction.

6.3.4.1.1 For example, in order for a client to create a valid Delaware self-settled spendthrift trust the client must appoint a qualified trustee within the meaning of the Act. 12 Del. C. § 3570(8). Delaware law defines the term qualified trustee as an individual that resides in the State of Delaware or a bank or trust company authorized to conduct trust business in the State of Delaware. 12 Del. C. § 3570(8)a.

6.3.4.1.2 Delaware law also provides that a qualified trustee must maintain or arrange for the custody in the State of Delaware of some or all of the trust property, maintain records for the trust on an exclusive or nonexclusive basis, prepare or arrange for the preparation of fiduciary income tax returns for the trust, or otherwise materially participate in the administration of the trust. 12 Del. C. § 3570(8)b.

6.3.4.2 However, many of the states which authorize the use of self-settled spendthrift trusts also permit the use of directed trusts where typical trustee responsibilities are divided amongst one or more trustees or advisers.

6.3.4.2.1 For example, under Delaware law one or more persons may be given the authority by the terms of the trust instrument to direct a trustee's actual or proposed investment decision, distribution decision or other decision of the trustee. 12 Del. C. § 3313.

6.3.4.2.2 Delaware law also permits a trust instrument to bifurcate trustee responsibilities among the trustees themselves so that a particular co-trustee may be vested with all investment authority or distribution authority. 12 Del. C. § 3313A.

6.3.4.2.3 The National Conference of Commissioners of Uniform State Laws also recently promulgated the Uniform Directed Trust Act authorizing the division of fiduciary responsibilities among advisers and co-trustees.

6.3.5 Fiduciary Capacity of Advisers

6.3.5.1 Most state statutes authorizing the appointment of advisers to direct the trustee as to a particular function provide that the adviser is deemed to serve in a fiduciary capacity.

6.3.5.1.1 For example, Delaware's directed trust statute provides that where one or more persons are given authority by the terms of a governing instrument to direct, consent to or disapprove a fiduciary's actual or proposed investment decisions, distribution decisions or other decision of the fiduciary, such person shall be considered to be a fiduciary when exercising such authority unless the governing instrument provides otherwise. 12 Del. C. § 3313(a).

6.3.5.1.2 Section 8(a)(1) of the Uniform Directed Trust Act also provides that a person given the authority to direct the trustee with respect to certain trustee duties is a fiduciary.

6.3.5.2 The question becomes whether appointing trust advisers that are serving in a fiduciary capacity, or co-trustees, outside of the jurisdiction where the trust is created could result in the courts of another state obtaining jurisdiction over the trust.

6.3.5.2.1 This could be problematic in two respects: First, if there is sufficient contact with the particular state so that the state could obtain jurisdiction over the trust, then it would be the courts of that particular state interpreting the laws of the jurisdiction where the trust was created. Second, if the court can obtain jurisdiction over a particular power holder (i.e., the fiduciary responsible for distribution decisions) it is possible that the court could order the power holder to exercise the power in such a way that would be adverse to the grantor, such as directing the trustee to distribute all of the funds of the trust to the grantor so that the grantor can satisfy his or her creditor claims.

6.3.6 How to Prevent Other Courts of Obtaining Jurisdiction Over Trust

6.3.6.1 It is possible to structure the trust so as to limit the likelihood of another court having jurisdiction over the trust.

6.3.6.1.1 Some clients will structure the trust so that any fiduciary serving for the trust must reside in the jurisdiction where the trust is being created. However, this is not always practical for a client as the client may not have anyone who resides in the jurisdiction where the trust is created to serve in the particular role.

6.3.6.1.2 The trust agreement could be drafted to limit where any fiduciary resides so as to reduce the likelihood of courts of another jurisdiction being able to entertain a dispute regarding the trust.

6.3.7 Typically if a client has a creditor issue it will first begin in the jurisdiction where the client resides.

6.3.7.1 For example, assume a doctor who lives in the State of Texas creates a South Dakota self-settled asset protection trust.

6.3.7.2 Furthermore, assume that a patient of the doctor is alleging medical malpractice against the doctor.

6.3.7.3 Typically the patient alleging medical malpractice would first bring a suit in the State of Texas being that the doctor resides and practices in the State of Texas.

6.3.7.4 If the creditor is successful in obtaining a judgment against the doctor the next step would be for the creditor to collect on the judgment at which time the creditor may pursue the assets in the South Dakota self-settled spendthrift trust.

6.3.7.5 In structuring the trust, it is the doctor's hope that the Texas court will not have jurisdiction over the South Dakota trust being that the court does not have jurisdiction over the South Dakota trustee.

6.3.7.6 However, in the event that other fiduciaries reside in the State of Texas (such as a co-trustee, Distribution Adviser or Trust Protector) it is possible that a Texas court could determine that there is a sufficient nexus to the State of Texas for the Texas court to entertain the creditor's action to pursue the assets of the South Dakota self-settled spendthrift trust.

6.3.7.7 The trust agreement could be drafted so that at no time may a fiduciary reside in the same jurisdiction where the grantor resides decreasing the likelihood that a court in the jurisdiction where the grantor lives could entertain jurisdiction over the trust for purposes of determining whether the creditor could reach the assets of the trust.

6.4 Understanding the Nature of the Creditor Claim.

6.4.1 It is important for a trustee defending a self-settled spendthrift trust to understand the nature of the creditor's claim.

6.4.2 There are typically two main categories of creditors that attempt to reach the assets of a self-settled spendthrift trust:

6.4.2.1 An ordinary statute of limitations creditor alleging that the grantor made a fraudulent transfer. This will be addressed in the following section of this outline.

6.4.2.2 An exception creditor.

6.4.2.2.1 All jurisdictions that permit the use of self-settled asset protection trusts, other than Alaska and Nevada, provide for certain exception creditors.

6.4.2.2.2 For example, Delaware law permits for certain family law claimants and tort claimants to reach the assets of a Delaware self-settled spendthrift trust regardless of whether the client made a fraudulent transfer to the trust or whether the applicable statute of limitations has run.

6.4.2.2.3 Delaware law permits the following creditors to reach the assets of a Delaware self-settled spendthrift trust: (i) A person whose claim results on account of an agreement or court order for the payment of support or alimony for the grantor's spouse, former spouse or children, or for the division or distribution of property in favor of the grantor's spouse or former spouse (but only a person to whom the grantor was married at the time of the transfer). 12 Del. C. § 3573(1), and (ii) A person who suffered death, personal injury or property damage on or before the date the trust was created for which the grantor is liable. 12 Del. C. § 3573(2).

6.4.2.3 A trustee administering a self-settled spendthrift trust would not want to attempt to defend the trust against an exception creditor.

6.4.2.3.1 For example, assuming a grantor who is married creates and funds a Delaware self-settled spendthrift trust during the course of the marriage. The grantor later divorces her spouse and asks the trustee to take the position that the spouse is unable to reach the assets of the trust for purposes of alimony or property division.

6.4.2.3.2 The trustee could not validly defend the trust against an action by the divorcing spouse to reach the assets of the trust.

6.5 Statute of Limitations Defense.

6.5.1 The most common defense a trustee can make against a creditor attempting to reach the assets of a self-settled spendthrift trust is that the creditor's claim is time barred by the statute of limitation applicable to the trust.

6.5.2 It is important for a trustee defending a self-settled spendthrift trust to be aware of the statute of limitations applicable to the trust.

6.5.3 The various jurisdictions that have enacted self-settled spendthrift trust legislation have different statute of limitations periods. Provided below are some examples:

6.5.3.1 Nevada

6.5.3.1.1 Nevada law provides that a creditor whose claim arose before the creation of the trust must be brought within 2 years after the creation of the trust or, if later, within 6 months after the creditor discovered or reasonably should have discovered the trust. Nev. Rev. Stat. § 166.170 1(a).

6.5.3.1.2 Nevada law further provides that a creditor whose claim arose after the creation of the trust must be brought within 2 years after the creation of the trust. Nev. Rev. Stat. § 166.170 1(b).

6.5.3.2 Alaska

6.5.3.2.1 Alaska law provides that a creditor whose claim arose before the creation of the trust must be brought within 4 years after the creation of the trust or, if later, within 1 year after the creditor discovered or should have discovered the trust. Alaska Stat. § 34.40.110.(d)(1).

6.5.3.2.2 Alaska law further provides that a creditor whose claim arose after the creation of the trust must be brought within 4 years after the creation of the trust. Alaska Stat. § 34.40.110.(d)(2).

6.5.3.3 South Dakota

6.5.3.3.1 South Dakota law provides that a creditor whose claim arose before the creation of the trust must be brought within 2 years after the creation of the trust or, if later, within 6 months after the creditor discovered (or should have discovered) the trust. S.D. Cod. Laws § 55-1-45(1).

6.5.3.3.2 South Dakota law further provides that a creditor whose claim arose after the creation of the trust must be brought within 2 years after the creation of the trust. S.D. Cod. Laws § 55-1-45(2).

6.5.3.4 Delaware

6.5.3.4.1 Delaware law provides that a creditor whose claim arose before the creation of the trust must be brought within 4 years after the creation of the trust or, if later, within 1 year after the creditor discovered (or should have discovered) the trust. 12 Del. C. § 3572(b)1.

6.5.3.4.2 Delaware law further provides that a creditor whose claim arose after the creation of the trust must be brought within 4 years after the creation of the trust. 12 Del. C. § 3572(b)(2).

6.5.3.5 Ohio

6.5.3.5.1 Ohio law provides that a creditor whose claim arose before the creation of the trust must be brought within 18 months after the creation of the trust or, if later, 6 months after the trust is or reasonably could have been discovered by the creditor. Ohio Legacy Trust Act, Chapter 5816 of the Ohio Revised Code § 5816.07(B)(1).

6.5.3.5.2 Ohio law further provides that a creditor whose claim arose after the creation of the trust must be brought within 18 months after the creation of the trust. Ohio Legacy Trust Act, Chapter 5816 of the Ohio Revised Code § 5816.07(B)(2).

6.5.4 The UVTA also contains a statute of limitations period whereby a claim for relief with respect to a transfer or obligation is extinguished unless the action is brought within a certain period of time.

6.5.4.1 Section 9(a) of the UVTA provides that a claim under Section 4(a)(1) must be brought not later than four (4) years after the transfer was made or obligation was incurred, or, if later, not later than one (1) year after the transfer or obligation was or could reasonably have been discovered by the claimant.

6.5.4.2 Section 9(b) of the UVTA provides that a claim brought under Section 4(a)(2) or 5(a), must be brought, not later than four (4) years after the transfer was made or the obligation was incurred.

6.5.4.3 Section 9(c) of the UVTA provides that a claim brought under Section 5(b), must be brought, not later than one (1) year after the transfer was made.

6.5.5 The *TrustCo vs. Matthews* Case and the Importance of Statute of Limitations Analysis

6.5.5.1 In 2015 the Delaware Court of Chancery decided an important case involving a Delaware self-settled spendthrift trust. *TrustCo v. Susan M. Matthews*, C.A. No. 8374-VCP, V.C. Parsons (Del. Ch. Jan. 22, 2015).

6.5.5.2 Factual Background.

6.5.5.2.1 On December 21, 2006, Ms. Matthews created three self-settled spendthrifts trusts in Delaware with RBC Trust Company (Delaware) Limited, as trustee. At the time the trusts were created Ms. Matthews was a New York resident.

6.5.5.2.2 In two sets of transfers that took place in January of 2007, Ms. Matthews transferred stock in a company she had created to the trusts.

6.5.5.2.3 In July of 2006, TrustCo Bank ("TrustCo") had lent $9,300,000 to a Florida LLC of which Ms. Matthews was a member and manger. The purpose of the loan was for the LLC to construct a self-storage facility in Florida. Ms. Matthews executed a personal guaranty of the loan.

6.5.5.2.4 In April of 2011 the LLC defaulted on the loan and on April 25, 2011, TrustCo filed a foreclosure action against the LLC and Ms. Matthews in Florida State Court.

6.5.5.2.5 On July 12, 2011, the Florida Court entered a judgment in favor of TrustCo of roughly $8.2 Million.

6.5.5.2.6 TrustCo, the LLC and Ms. Matthews agreed to the entry of a deficiency judgment of $2.3 Million and submitted a stipulation to that effect to the Florida Court in February of 2013.

6.5.5.2.7 TrustCo filed a complaint on March 1, 2013 in the Delaware Court of Chancery alleging that Ms. Matthews' transfers to the trusts were fraudulent transfers. Ms. Matthews disputed that the transfers to the trusts were fraudulent transfers.

6.5.5.2.8 Ms. Matthews also argued that the claims being brought by TrustCo were time barred as they were beyond the applicable statute of limitations.

6.5.5.3 Court's Analysis and Opinion

6.5.5.3.1 The key issue addressed in the Court's opinion is which state's statute of limitations applies in determining whether Ms. Matthews made fraudulent transfers to the trusts.

6.5.5.3.2 TrustCo argued that New York's statute of limitations applied to their fraudulent transfer claims being that Ms. Matthews resided in New York at the time the trusts were created. Under New York law an action to avoid a fraudulent transfer must be brought within the greater of 6 years from the date the cause of action accrued or 2 years from the time the plaintiff discovered the transfer, or with reasonable diligence could have discovered the transfer.

6.5.5.3.3 Ms. Matthews argued that Delaware's statute of limitations governs. Under Delaware law an action to avoid a fraudulent transfer must be brought within 4 years after the transfer was made or the obligation was incurred or, if later, within 1 year after the transfer or obligation was or could reasonably have been discovered by the claimant.

6.5.5.3.4 The parties' contended that if Delaware's statute of limitations governed the claim would be time barred.

6.5.5.3.5 In determining which jurisdiction's laws should govern with respect to the statute of limitations period for the fraudulent transfer the Delaware Court of Chancery applied the "most significant relationship test". Under that test the Court concluded that Florida, followed by Delaware, had the most significant relationship to the case.

6.5.5.3.6 The Court further determined that because both Florida and Delaware have identical statute of limitations periods for fraudulent transfers it wasn't necessary to distinguish whether Florida or Delaware law had the most significant relationship to the trust and which jurisdiction's laws should govern the statute of limitations for the fraudulent transfer.

6.5.5.3.7 Applying the 4 year statute of limitations period the Court determined that the plaintiff's claims were time barred and therefore dismissed the case.

6.5.5.4 Analysis

6.5.5.4.1 It is important to note that the *Matthews* case did not specifically address whether the Court was required to look to the statute of limitations contained in the Act to determine whether the creditor's claims were time barred. The Court found that analysis unnecessary as the creditor's claims were time barred under the general fraudulent transfer laws of the States of Delaware and Florida.

6.5.5.4.2 It is also worth noting that the Delaware Court of Chancery would not entertain the fraudulent transfer argument being that the claims were time barred.

6.5.5.4.3 The case is of significance as the end result was that the creditors of the grantor were not successful in reaching the assets of a Delaware self-settled spendthrift trust.

6.5.5.4.4 The *Matthews* case provides clear guidance of how a trust may be defended using the statute of limitations argument.

6.5.5.4.5 Query whether the result would have been different if TrustCo filed its complaint to reach the assets of the trusts in a Florida State court and whether the Florida State court would have entertained such an action.

6.6 What are the Remedies of a Creditor When a Fraudulent Transfer is made?

6.6.1 Section 7(a) of the UVTA provides that in an action for relief against a transfer or obligation under the UVTA, a creditor may obtain:

6.6.1.1 Avoidance of the transfer or obligation to the extent necessary to satisfy the creditor's claim;

6.6.1.2 An attachment or other provisional remedy against the asset transferred or other property of the transferee if available under applicable law; and

6.6.1.3 Subject to the applicable principles of equity and in accordance with the applicable rules of civil procedure:

6.6.1.3.1 An injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or of other property;

6.6.1.3.2 Appointment of a receiver to take charge of the asset transferred or of other property of the transferee; or

6.6.1.3.3 Any other relief the circumstances may require.

6.6.2 The Delaware Act also provides remedies to creditors when it is determined that a fraudulent transfer is made.

6.6.2.1 The Act provides that if a qualified disposition is deemed to be void the creditor is able to reach the assets of the trust to the extent necessary to satisfy the transferor's debt to the creditor at whose instance the disposition had been avoided, together with such costs, including attorneys' fees, as the court deems appropriate. 12 Del. C. § 3574(a).

6.6.2.2 The Act also provides that the sole remedy available to a creditor of a transferor shall be an order directing the trustee to transfer to the transferor such amount as is necessary to satisfy the transferor's debt to the creditor at whose instance the disposition has been avoided. 12 Del. C. § 3574(g).

6.7 Is there a Duty to Decant to Protect Trust Assets? The *Ferri v. Powell-Ferri* case.

6.7.1 What is a Decanting?

6.7.1.1 The word "decant" means to pour a liquid from one vessel into another. In the trust context, the liquid is the trust assets and the vessels are the trust instruments.

6.7.1.2 Under the common law of certain jurisdictions, a trustee who has the ability to distribute principal outright from a trust to or for a beneficiary may instead exercise such authority by distributing the assets in further trust for the beneficiary. *Phipps v. Palm Beach Trust Company*, 142 Fla. 782 (1940); *Wiedenmayer v. Johnson*, 254 A.2d 534 (N.J. Super. Ct. App. Div. 1969); *In re: Estate of Spencer*, 232 N.W. 2d 491 (Iowa 1975).

6.7.1.3 In 1992, New York became the first state to enact a decanting statute specifically authorizing a trustee in certain situations to pour the principal of one irrevocable trust into another trust. NY Estates, Powers & Trust Law § 10-6.6(b). Since then, at least 20 other states have also enacted decanting legislation.

6.7.1.4 In addition, the Uniform State Laws Commission recently approved the Uniform Trust Decanting Act. The Uniform Trust Decanting Act contains several safeguards for fiduciaries exercising their discretion to decant and also contains innovations not seen in some of the other state decanting statutes.

6.7.1.5 The various state statutes that permit a trustee to exercise a decanting power vary in their details but all operate off of the same fundamental premise. If a trustee has the ability to invade principal for a beneficiary under the terms of the trust agreement, the trustee may, in the exercise of its principal invasion power, appoint the principal to a new trust for the benefit of some or all of the beneficiaries of the first trust.

6.7.2 Can a Decanting be used to Eliminate Certain Beneficiary Rights in a Trust?

6.7.2.1 Elimination of Income Interest.

6.7.2.1.1 New York, Alaska and Tennessee prohibit the decanting power from reducing any fixed income interest a beneficiary may have in the trust.

6.7.2.1.2 Under Delaware law, the decanting power may be used to eliminate a fixed income right with respect to a trust as long as the trust is not one which qualifies for the marital deduction. 12 Del. C. § 3528(a)(3).

6.7.2.2 Eliminating Right of Withdrawal or Mandatory Distribution.

6.7.2.2.1 Another issue that often arises in a decanting is whether the decanting can eliminate a beneficiary's right of withdrawal over the trust property or a mandatory distribution the beneficiary is to receive from the trust.

6.7.2.2.2 Some states, such as North Carolina, provide that if a beneficiary has a power of withdrawal over trust property in trust one, the terms of trust two must provide the beneficiary with an identical right of withdrawal or sufficient property must remain in trust one to satisfy the outstanding power of withdrawal. N.C. Gen. Stat. § 36C-8-816.1.

6.7.2.2.3 Other states, such as Delaware, permit a decanting to eliminate a beneficiary's right of withdrawal over the trust as long as the right of withdrawal is not presently exercisable. 12 Del. C. § 3528(a)(4).

6.7.2.2.4 For example, assume the terms of the first trust provide that the trustee may distribute income and principal of the trust to or for the benefit of A in its sole and absolute discretion and upon attaining the age of 35, A shall have the ability to withdrawal all of the trust assets. As long as A has not attained the age of 35 prior to the decanting, the decanting statute of certain states would permit trust two to eliminate A's right to withdraw the assets upon attaining the age of 35.

6.7.2.3 Who Holds the Power to Decant?

6.7.2.3.1 The decision to decant is typically in the sole and absolute discretion of the trustee.

6.7.2.3.2 If the trust instrument bifurcates trustee responsibilities by giving a different fiduciary the distribution authority (i.e. a Distribution Adviser), the decision to decant would be in the discretion of the Distribution Adviser.

6.7.3 *Ferri v. Powell-Ferri*, 476 Mass. 651 (2017)

6.7.3.1 In 2017 the Massachusetts Supreme Court decided an important case regarding a trustee's decanting which implicated the ability of a divorcing spouse to reach the assets of the decanted trust.

6.7.3.2 Factual Background

6.7.3.2.1 In 1983 the husband's father created an irrevocable trust for the benefit of husband. The 1983 trust was to be governed in accordance with Massachusetts law.

6.7.3.2.2 The terms of the 1983 trust gave husband the ability to withdraw the trust assets at specified ages.

6.7.3.2.3 Husband and wife lived in Connecticut and in 2011 wife filed an action in Connecticut court to dissolve the marriage.

6.7.3.2.4 The trustees of the 1983 trust were concerned that the divorcing wife would be able to reach the assets of the 1983 trust as part of dissolution of the marriage. As such, the trustees transferred the assets of the 1983 trust to a new trust (the 2011 trust) without the knowledge or consent of husband.

6.7.3.2.5 At the time of the creation of the 2011 trust, husband had a right to withdrawal 75% of the value of the 1983 trust and during the course of the legal proceedings his right matured to 100%.

6.7.3.2.6 The 2011 trust was valued between $69 and $98 Million.

6.7.3.2.7 Wife alleged that the trustees of the 1983 trust did not have the authority to transfer the assets from the 1983 trust into the 2011 trust.

6.7.3.2.8 The Connecticut Supreme Court asked the Massachusetts Supreme Court to determine whether the trustees validly exercised their power under the 1983 trust to distribute the trust property to the 2011 trust. It is worth noting that one of the trustees of the 1983 trust was husband's brother.

6.7.3.3 Massachusetts Supreme Court's Analysis

6.7.3.3.1 Massachusetts does not have a state decanting statute.

6.7.3.3.2 The Massachusetts Supreme Court, relying on a previously decided Massachusetts case, *Morse v. Kraft*, 466 Mass. 92 (2013), held that while there is no inherent decanting power under Massachusetts law, a trustee's decanting authority turns on the facts of each case and the terms of the trust.

6.7.3.3.3 The Massachusetts Supreme Court provided that the rationale behind a decanting is that if a trustee has a discretionary power to distribute property to or for the benefit of the beneficiaries, the trustee likewise has the authority to distribute the property to another trust for the benefit of one or more of those beneficiaries.

6.7.3.3.4 The Massachusetts Supreme Court looked at the broad discretionary distribution authority afforded the trustees by the 1983 trust along with other provisions of the 1983 trust in concluding that the terms of the 1983 trust, read as a whole, demonstrated the settlor's intent to permit a decanting.

6.7.3.3.5 The Massachusetts Supreme Court also found that the husband's withdrawal rights were not inconsistent with the decanting power.

6.7.3.3.6 As such, the Massachusetts Supreme Court found that the decanting was valid under Massachusetts law.

6.7.3.3.7 The Massachusetts Supreme Court did not rule on whether the trust assets must be considered in the divorce, including for alimony purposes.

6.7.3.3.8 In a concurring opinion of the Massachusetts Supreme Court, it was emphasized that "under Connecticut law, the public policy that would prevent one spouse during the divorce proceeding from transferring marital assets to deprive the other spouse of those assets did not apply here because it was undisputed that the beneficiary husband did not have a role in creating the new 2011 trust".

6.7.3.3.9 The Court also found that the trustees of the 1983 trust did not consult with husband regarding the decanting.

6.7.3.4 Are the Assets of the 2011 Trust Marital Assets?

6.7.3.4.1 The Connecticut Court ruled that because the decanting was determined to be appropriate under Massachusetts law the assets of the 1983 trust could not be considered for purposes of dissolution of the marriage.

6.7.3.4.2 The Connecticut Court also determined that because the 2011 trust was a spendthrift trust protected from creditor claims of husband, it could not be considered an asset of the marital estate that the Court could divide under Connecticut law.

6.7.3.4.3 The Connecticut Court concluded that they could have reached the assets for purposes of dividing the marital estate assets while they were in the 1983 trust, but they were precluded from doing so once they moved into the 2011 trust and therefore the decanting was successful to remove the assets from claims of wife for purposes of division of the marital assets.

6.7.3.4.4 The Connecticut Court did determine that while it could not consider the assets in the 2011 trust for purposes of equitable distribution, it could consider the assets in the 2011 trust for purposes of entering its alimony orders.

6.7.3.4.5 The Connecticut Court found that the assets in the 2011 trust had routinely supported husband's investments and therefore could be taken into consideration when providing the amount of alimony husband was required to pay wife.

6.7.3.5 Analysis

6.7.3.5.1 The *Ferri* case clearly shows how a decanting may be used to remove the assets from the reach of a creditor claim.

6.7.3.5.2 Had the trustees of the 1983 trust not taken the action to decant the assets into the 2011 trust the divorcing spouse would have been able to reach the assets in the 1983 trust for purposes of marital property division.

6.7.3.5.3 It is worth noting that most state decanting statutes which permit a decanting to eliminate a beneficiary's right of withdrawal only do so with respect to a future right of withdrawal. If a beneficiary holds a currently exercisable right of withdrawal typically it cannot be eliminated via a decanting under most state decanting statutes. As such, if the trust at issue in the *Ferri* case were being administered in a jurisdiction with a state decanting statute prohibiting the elimination of a presently exercisable right of withdrawal it would not have been permissible for the trustees to decant into a new trust which eliminated husband's right to withdraw 75% of the trust assets as such right was presently exercisable at the time the decanting occurred.

6.7.3.5.4 It is also worth noting that an important factor in the Massachusetts Supreme Court's decision was that husband played no role in the decanting and in fact was not aware of the decanting.

6.7.3.5.5 Many state decanting statutes require the trustee to provide notice to a beneficiary of the decanting power. Query whether the result would have been different had husband been aware that the decanting was occurring.

6.7.3.5.6 The *Ferri* case raises the question of whether a trustee has a duty to decant the assets into a new trust in a similar fact pattern.

6.7.3.5.7 As previously mentioned, the decision to decant is solely in the discretion of the fiduciary responsible for distribution decisions. Those fiduciaries clearly owe a fiduciary duty to the beneficiaries, most likely which would include the duty to protect the assets of the trust from creditor claims of the beneficiary.

6.7.3.5.8 A trustee who becomes aware that a beneficiary may have outstanding creditor claims may be under a duty to decant the assets of the existing trust into a new trust which better protects the assets from the reach of creditor claims.