Integrating Asset Protection into your Estate Planning Practice: Be Not Afraid

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Michael J. Stegman has thirty years' experience in estate planning. Representing individual private clients, he focuses on the preservation and succession of wealth and the legal reduction of wealth transfer taxes. His services include:

- Family legacy planning over multiple generations, with an emphasis on flexible trust arrangements, asset protection, charitable giving, and the use of private family foundations;
- The international aspects of planning for U.S. expatriates and for U.S. citizens with foreign property holdings;
- Cross-border property and inheritance tax issues affecting foreign nationals holding U.S. assets or living in the U.S., either as a permanent resident (Green Card holder) or temporarily;
- The legitimate avoidance or reduction of the U.S. Expatriation Tax (Exit Tax) affecting long-term Green Card holders and U.S. nationals who renounce citizenship; and
- The establishment of private charitable foundations for both domestic and foreign grantmaking.

Michael is a fellow of the American College of Trust and Estate Counsel (ACTEC) and serves on its International Estate Planning Committee and Asset Protection Committee. He is also a member of The International Academy of Estate and Trust Law and of STEP. He is a Certified Specialist in Estate Planning, Trust and Probate Law, as certified by the Ohio State Bar Association. As a lawyer, he carries the highest designation of "AV Preeminent" by Martindale-Hubbell.

Michael co-authored the Ohio Legacy Trust Act and other asset protection reforms enacted by the 129th Ohio General Assembly as House Bill 479, which became effective 27 March 2013. With this Act and other changes to the Ohio Trust Code, the state is a major asset protection and tax-friendly dynasty trust jurisdiction.

Since 2008, Michael has served on the Council of the Estate Planning, Trust and Probate Law Section of the Ohio State Bar Association. The Council is charged with monitoring trust and estate law and drafting new legislation for consideration by the Ohio General Assembly. He serves as co-chair of the Asset Protection and Legacy Trust Committee, chair of the Community Property Law Committee, and as a member of the committees for Trust Decanting, Powers of Appointment and Dynasty Trusts.

Michael has authored numerous articles, including “Advising the Expatriating American: Beware the Exit Tax” (Trusts & Trustees, Oxford University Press, June 2015, doi:10.1093/tandt/ttv090); “The Ohio Legacy Trust as a Vehicle for Advanced Estate Planning” (Probate Law Journal of Ohio, Vol. 23, Is. 6, July/August 2013, co-authored with Brian C. Layman); “Elective Community Property in Ohio: Has its Time Come?” (Probate Law Journal of Ohio, Vol. 24, Is. 6, July/August 2014); “Welcome to Ohio: a Premier Trust Jurisdiction” (Journal of the Society of Trust & Estate Practitioners, June 2013); “Ohio Leaps Forward: The Ohio Legacy Trust Act and Other Reforms” (CCH Financial and Estate Planning, CCH, 12-2013, Vol. 3, Report No. 308 at ¶ 33,811, co-authored with D. Bowen Loeffler and John E. Sullivan III); “The New U.S. Exit Tax Scheme: Breaking Off a Long-Term Relationship with Uncle Sam” (Trusts & Trustees, Oxford University Press, Vol. 18, No. 3, March 2012); "Confronting the New Expatriation Tax: Advice for the U.S. Green Card Holder" (Journal of the American College of Trust & Estate Counsel, Vol. 35, No. 3, Winter 2009, co-authored with John L. Campbell); “Breaking Up is Harder to Do: The New Alternative Tax Regime on U.S. Expatriates” (Probate Law Journal of Ohio, Vol. 20, Is. 1, Sept./Oct. 2009); “The Noncitizen Spouse: Implications for Estate Planning and Administration” (Probate Law Journal of Ohio, Vol. 19, Is. 3, Jan./Feb. 2009); and "Should I Stay or Should I Go: Tax and Immigration Considerations for U.S. Permanent Residents and Citizens" (Bloomberg Law Reports - Immigration, Vol. 4, No. 11, February 2011, co-authored with Douglas J. Halpert).

Michael’s many professional presentations include “The European Union Succession: A U.S. Perspective” (STEP Germany Conference, Stuttgart, February 2015); “Domestic Asset Protection Trusts: Who’s on First? And How You Know When You’re Even in the Ball Park” (University of Kentucky College of Law 41st Annual Midwest/Midsouth Estate Planning Institute, Lexington, Kentucky, July 2014); “Choice of Law in Asset Protection Trusts: Will it be Respected?” (Second Annual Ohio Asset Protection & Legacy Trust Institute, Columbus, Ohio, April 2014); “Ohio’s Revised Dynasty Trust Statute” and “The Ohio Legacy Trust as a Vehicle for Advanced Estate Planning” (First Annual Ohio Asset Protection & Legacy Trust Institute, Columbus, Ohio, April 2013); “What Clients Want: Asset Protection for Themselves and Their Heirs; Advising on Asset Protection Trusts” (Notre Dame Tax and Estate Planning Institute, South Bend, Indiana, September 2012); “Money Laundering and the Unsuspecting Professional: Wising up to the FATF” (International Estate Planning Institute, New York State Bar Association/STEP, New York, March 2013); “Community Property for Separate Property Lawyers: the Problem of the Itinerant Couple” (Estate Planning Conference on Wealth Transfer, Columbus, Ohio, June 2012); “Matrimonial Property Regimes and Cross-Border Recognition” (ACTEC International Estate Planning Committee, October 2011); “Marital Property and Conflict-of-Laws” (Ohio Chapter of ACTEC, April 2011); “The Expatriation Trust”(Delaware Trust Conference, Wilmington, Delaware, December 2010); "The New Alternative Tax Regime on U.S. Expatriates" (Estate Planning Conference on Wealth Transfer, Columbus, Ohio, June 2009); "The Decanting - Friendly Trust : A Second Look after the Second Death" (Cincinnati Estate Planning Council, Cincinnati, Ohio, May 2010); "The International Executive As A Client" (National Association of Personal Financial Advisors, Chicago, Illinois, May 2010); and “Estate Planning and Administration Involving the Resident Non-Citizen” (Estate Planning & Probate Committee of the Northern Kentucky Bar Association, February 2010).

The University of Notre Dame awarded a Bachelor of Arts Degree *magna cum laude* to Michael in 1980, and he received his Juris Doctor degree from New York University School of Law in 1983. He is a member of *Phi Beta Kappa.*

Michael is listed in Sutton Who's Who in American Law and Best Lawyers in America (in practice area of Trusts & Estates) and is recognized as an Ohio SuperLawyer by *Law and Politics*.

Michael's professional memberships include the American College of Trust and Estate Counsel, The International Academy of Estate and Trust Law, STEP, the Ohio State Bar Association, the Cincinnati Bar Association, the Cincinnati Estate Planning Council, and the Kentucky Bar Association.

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A. Think Asset Protection

1. For the clients themselves

2. For descendants under irrevocable trusts established by the clients

B. Two-Step Analysis

1. What are the potential liabilities and claims?

   a. Clients

      Gaps in liability insurance coverage
      Claims in excess of liability coverage
      Fiduciary roles: trustee, executor, guardian, attorney-in-fact
      Board membership: private companies and nonprofits
      Guaranties: leases, loans
      Indemnities: business transactions
      Sanctions/fines: highly-regulated industries
      Environmental liability
      Premises liability

   b. Descendants

      All of the above
      Child support and alimony claims
      Marital property claims at divorce

2. What's available to protect the assets?

II. Clients

A. Asset Protection Devices Available Outside of Trusts

1. *Homestead Exemptions*

The state of the client's residence will provide an exemption from execution on a certain amount of the equity in the client's homestead (the land and abode constituting the person's primary residence). The exemption amount varies greatly by state. Furthermore, state exemption amounts and coverage can vary with respect to urban versus farm or rural land, single versus married or head-of-household status of owner, and the existence of dependents residing on the homestead.

State	Basic Exemption Amount [1]	Cite
Illinois	$15,000	735 ILCS §§ 5/12-901, 5/12-906
Indiana	$15,000	Ind. Code § 34-55-10-2(c)(1)[2]
Michigan	$30,000	Mich. Comp. Laws § 600.5451(n)
Ohio	$132,900	Ohio Rev. Code § 2329.66(A)(1) [3]
Wisconsin	$75,000 per spouse	Wisc. Stat. § 815.20

In the context of bankruptcy, the U.S. Bankruptcy Code provides a homestead exemption of $15,000. 11 U.S.C. § 522(d)(1). The person (the debtor in bankruptcy) can elect to apply the federal exemptions under the Bankruptcy Code or the exemption laws of the state of his or her residence. 11 U.S.C. § 522(b)(1). A state's legislature, however, may "opt out" of the federal bankruptcy exemptions and substitute the state's own exemptions, so that there is no choice in the matter by the debtor. 11 U.S.C. § 522(b)(2). In any case, the state exemption laws will not be available unless the debtor has been domiciled in that state for 730 days (two years) prior to filing a bankruptcy petition. 11 U.S.C. § 522(b)(3). In the special case of a state homestead exemption, if the debtor acquired the property within 1,215 days (about forty months) of the filing date, the Bankruptcy Code substitutes a maximum $125,000 exemption. 11 U.S.C. § 522(p). If the debtor satisfies both the 1,215 day acquisition rule and the 730 day residency rule, then the maximum homestead exemption is the maximum available under state law (assuming the debtor is using the state law exemption rather than the federal law exemption). Federal exemptions are indexed for inflation. 11 U.S.C. §104.

The rules relating to involuntary bankruptcy make it difficult for a creditor to put a person in bankruptcy and thus, under the appropriate circumstances as discussed above,

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[1] This chart does not reflect many of the "bonus" exemption amounts due to age, disability, the presence of minor or dependent children, or other similar factors, nor does it list many of the nuances or exceptions to the relevant state exemption amounts, such as whether or not debtors and their spouses may "stack" exemptions.

[2] Indiana's exemption amount is subject to an inflation adjustment every six years, as calculated by the Indiana Department of Financial Institutions.

[3] Ohio's exemption amount is subject to triennial inflation adjustments based on the Consumer Price Index for all urban consumers (sometimes referred to as the "CPI-U"). See ORC § 2329.66(B). These changes are posted at the Ohio Judicial Conference's website. The next triennial adjustment will occur in April 2016.

force down the homestead exemption to a limit that is less than under state law. 11 U.S.C. § 303.

2. *Tenancy by the Entireties*

Many states recognize the tenancy by the entireties (TBE) for married couples. In some jurisdictions, this tenancy is recognized for only real property (and, in some instances, is limited to the marital homestead), while in others it applies to personalty as well.

In these jurisdictions, regardless of the homestead exemption limitations, a married couple enjoys a *de facto* unlimited homestead exemption when their residence property is held in TBE, except where the debt is joint.

State	TBE?	Cite
Illinois	Yes	735 ILCS § 5/12-112 and *Premier Prop. Mgmt., Inc. v. Chavez,* 191 Ill.2d 101, 728 N.E.2d 476 (2000)
Indiana	Yes	Ind. Code § 34-55-10-2(c)(1)
Michigan	Yes	See, e.g., *Tkachik v Mandeville,* 487 Mich 38, 46 – 47, 790 NW2d 260 (2010); *Canjar v Cole,* 283 Mich App 723, 730 – 731; 770 NW2d 449 (2009); *Estes v Titus,* 481 Mich 573, 580 – 582, 751 NW2d 493 (2008)
Ohio	No longer	From February 9, 1972 – April 4, 1985, Ohio allowed the creation of TBE. The protection is still afforded to real estate so titled during that period. Ohio Rev. Code § 5302.21.
Wisconsin	No	

Planning point: TBE in some states provides creditor protection for non-homestead property. If your client has a second home in a TBE jurisdiction that extends the protection to non-homestead property, such as Florida and Michigan, consider advising them to hold the property as tenants by the entireties. Be aware, however, that upon the death of one of them, the property will be exposed to the creditors of the surviving spouse.

For examples of applying TBE rules based on the situs of the property or the law governing the creation of the TBE estate (rather than applying TBE based on the debtor's residence), see the following cases: *In re McNeilly,* 249 B.R. 576, 580 - 581 (B.A.P. 1st Cir. 2000) (Vermont TBE applies to bank accounts owned by out-of-state spouses; court expressed no opinion on whether creation of TBE in that case constituted a fraudulent transfer); *In re Gillette,* 248 B.R. 845, 849 - 850 (Bankr. M.D. Fla. 1999); *Lurie v. Blackwell*, 2002 WY 110, 51 P.3d 846 (2002); *Blackwell v. Lurie*, 134 N.M. 1, 71 P.3d 509 (App. 2003).

In bankruptcy cases where state exemptions apply, the Bankruptcy Code respects the creditor protection availed by holding property in tenancy by the entireties under applicable state law. 11 U.S.C. § 522(b)(3)(B). Also, in the case of TBE property, the 730 day domiciliary requirement and the 1215 day holding period do not apply. The seemingly special treatment of TBE property is probably owing to the fact that the debtor is not relying on a state exemption; instead, a tenancy by the entireties by its property law nature cannot be severed by one spouse, and thus not by a creditor of one spouse. *But see In re Giffune,* 343 B.R. 883 (Bankr. N.D. III. 2006) (denying an Illinois debtor the right to claim TBE in Michigan real estate; this case erroneously treated TBE as an exemption as opposed to a rule of property law that creates an estate in land and that defines the nature of an ownership interest).

3. *Life Insurance*

The protection for life insurance policies varies widely by state. The degree of protection also depends on whether the client (as debtor) is the owner or the beneficiary.

If the debtor is the owner of the policy, then he or she has a bundle of rights and interests, and the question is which rights and interests are protected and to what extent each is favored. The rights to terminate the policy, draw out cash, receive a dividend or take out a loan ("monetary interests") are typically treated differently from the right to rename the beneficiary. State exemptions usually protect some part of the monetary interests of the owner and generally keep creditors away from taking over complete ownership of the policy, whereby the creditors could change the beneficiary to the creditor. The protection of the monetary interest also typically depends on the identity of the policy's insured. In these cases, the states extend protection to the owner's monetary interests if the insured is the spouse or a dependent of the owner.

In general, the debtor as beneficiary fairs far better. Many states exempt the entire proceeds and avails of a policy if the beneficiary is not the owner. A limited number of states restrict the beneficiary's protection to an amount that is necessary for the support of the beneficiary or his or her own dependents.

<u>Planning point</u>: Because the exempt nature of an owner's interest in a life insurance policy can depend in some states on a spouse or a dependent being named as the beneficiary, refrain from naming a trust as the beneficiary in such cases. If the beneficiaries of the trust are in turn the spouse and dependents, there might be precedent in your jurisdiction that preserves the exemption. But if the non-spouse beneficiaries (the children, etc.) are adults, the precedent will likely not exist.

Under the federal bankruptcy exemptions, the debtor -policy owner is fully protected as to his rights under the insurance contract itself (e.g. the right to name the beneficiary and to terminate the policy). 11 U.S.C. § 522(d)(7). The debtor's monetary interest, however, is protected up to a mere $12,250 (as adjusted for inflation), and only if the insured is the debtor or a dependent. 11 U.S.C. § 522(d)(8).

4. *Annuities*

Nonqualified commercial annuity contracts are also a generally favored asset in terms of protection against creditors, but the degree of protection varies by state. As a matter of background on the nature of annuities, each contract has an owner (the person who takes out the contract and pays the premiums), an annuitant (the person who receives the payment stream from the annuity during his or her life), and a death beneficiary (the person who receives benefits, if any, payable at the death of the annuitant). The owner is typically the annuitant, but such is not a required feature of annuity contracts.

State exemption laws focus on the payment streams to the annuitant. Some states exempt all proceeds or benefits, while most limit the exempt amount to a dollar figure or an amount necessary for the support of the annuitant and his or her spouse and dependents. Some states restrict the available exemption to contracts that benefit the spouse and dependents of the debtor and not the debtor himself.

State	Life Insurance	Annuities	Cite
Illinois	100% of life insurance proceeds and the net cash value of a life policy payable to, a spouse, child, parent, or dependent of the insured are exempt from the debts and liabilities of the insured.	Same (as to net cash value of the annuity contract)	215 Ill. Comp. Stat. § 5/238, 735 Ill. Comp. Stat. § 5/12-1001(h)(3)
Indiana	If life insurance contract so provides, benefits of the policy payable to one other than the person effecting such contract are exempt from the debts, contracts, or engagements of the beneficiary.	Same	Ind. Code § 27-2-5-1; 27-1-12-14(e)
Michigan	100% of proceeds of life insurance are exempt from claims of creditors and representatives of insured so long as beneficiary is not insured.	Same	Mich. Comp. Laws § 500.2207
Ohio	100% of proceeds of life insurance policy for beneficiary who is spouse, child, or dependent of inured are exempt from claims of creditors of insured	Same, substituting “annuitant” for “insured”.	Ohio Rev. Code § 3911.10
Wisconsin	Up to $150,000 in value in any accrued dividends, interest, or loan value of any unmatured life insurance contract; only $4,000 in value for contracts issued less than 24 months.	Same	Wis. Stat. § 815.18

In the bankruptcy context, the Bankruptcy Code’s federal exemption for annuities applies to benefits receivable by the annuitant-debtor, but only if the cause of the pay-outs is the illness, disability, death or age of the annuitant, and the exemption is further limited to an amount necessary for support of the debtor and his or her dependents. 11 U.S.C. § 522(d)(10)(E).

5. *ERISA Plans*

Plans established under the federal Employee Retirement Income Security Act of 1974, 29 U.S.C. § 1001 *et seq*. (ERISA) provide sweeping protection for the plan participants against the claims of their creditors. Under ERISA, a pension vehicle (which is by definition a trust) must have a spendthrift provision, as required by 29 U.S.C. § 1056(d)(1) This section states, "Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated." On this basis, the U.S. Supreme Court found that this anti-alienation provision is central to the ERISA protection scheme and held that creditors in bankruptcy cannot reach plan assets. *Patterson v. Schumate*, 504 U.S. 753 (1992). Furthermore, as a matter of federal supremacy, ERISA trumps state law and provides the same protection outside of bankruptcy. 29 U.S.C. § 1144(a).

<u>Planning point</u>: Be aware that the attacks on assets held in ERISA plans focus on whether the plan is compliant with the many requirements of ERISA. *See e.g. In re Youngblood*, 29 F.3d 225 (5th Cir. 1994). Do not put yourself in a position of passing on the airtight exemption of an ERISA plan.

6. *Individual Retirement Accounts*

Most states provide generous exemptions for both Individual Retirement Accounts (IRAs) and Roth IRAs.

State	Traditional IRAs	Roth IRAs	Cite
Illinois	100% of proceeds exempt	Same	735 Ill. Comp. Stat. § 5/12-1006
Indiana	100% of proceeds exempt	Same	Ind. Code § 34-55-10-2(c)(6)(A)
Michigan	100% of proceeds exempt; contributions within 120 days of filing of bankruptcy and contributions in excess of the maximum contribution allowed by IRC not exempt	Same	Mich. Comp. Laws § 600.6023
Ohio	100% of interest in, and right to receive payments from, is exempt, unless contribution limits were exceeded.	Same	Ohio Rev. Code § 2329.66(A)(10)(c)
Wisconsin	100% exempt to the extent reasonably necessary for the support of the debtor and dependents	Same	Wis. Stat. § 815.18

In bankruptcy, assets in traditional IRAs and Roth IRAs are exempt from creditors in an aggregate amount not to exceed $1,000,000 (unless the interests of justice require a greater amount). 11 U.S.C. § 522(n). The exemption limit does not apply to amounts rolled over from certain plans, such as 401(k)s. *Id*.

7. *Section 529 Plans*

College savings plans established under Section 529 of the Internal Revenue Code are a popular savings vehicle. States are increasingly moving to protect them. A majority of states provide a degree of protection to the account owner or the beneficiary, or both. Most of these states restrict the protection to investors and beneficiaries of that state's own plan. Some states, however, extend the protection to all plans. In a few states, the protection is afforded to only the beneficiary of the plan (the student or student-to-be) and not to the owner (*e.g.* the parent or grandparent).

State	Cite	Comments
Illinois	15 Ill. Comp. Stat. 505/16.5 735 Ill. Comp. Stat. § 5/12-1001(j)	Limited to state's own program. Protects against creditors of donor, account owner and beneficiary. Exemption limited to amount of gift tax annual exclusion for contributions during the 730-day period prior to filing bankruptcy.
Indiana	Ind. Code § 34-55-10-2(c)(9)	Not limited to state's own program. Protects "the interest of the debtor" in the program. Exemption limited to contributions made within federal limits. No protection for contributions made within one year of bankruptcy; lesser protection for contributions made within one to two years.
Michigan	No protection	
Ohio	Ohio Rev. Code § 2329.66(A)(10)(c)	Not limited to state's own program. Protects against creditors of anyone having any right or interest in the assets or of beneficiaries. Exemption limited to contributions made within federal limits.
Wisconsin	Wis. Stat. § 16.641	Limited to state's own program. Statute mentions protection against creditors of beneficiary only.

In bankruptcy, 529 Plans do not enjoy the level of protection that a debtor would like. The debtor's bankruptcy estate will not include funds contributed to a 529 Plan during the one year period prior to filing and, to a lesser extent, between one and two years before filing. 11 U.S.C § 541(b)(6). During the 365 days immediately prior to filing, the exclusion is limited to the maximum amount that can be contributed to the 529 Plan under the Internal Revenue Code. Under the Proposed Regulations for Section 529, a state program would be required to limit contributions to an account for any one beneficiary to the amount which would cover undergraduate tuition, room and board, and fees over a period of five years at the highest cost institution included within the plan. *Id.*; IRC § 529(b)(6); Prop. Reg. § 1.529-2(i)(2) (providing a safe harbor). This amount is indexed for inflation. The exclusion of contributions during the period between 365 and 720 days prior to filing is limited to $5,000. In either case, the beneficiary of the plan must be a child or grandchild (or a step-child or step-grandchild). 11 U.S.C § 541(b)(6).

B. Fraudulent Transfers: the Great Overlay

Regardless of the asset protection technique that the practitioner considers, he or she must be aware that no transfer in fraud of creditors is valid. Furthermore, the attorney is well-advised to thoroughly vet a potential client who seeks asset protection planning. Caution is warranted even in the situation of a known client.

A discussion of fraudulent transfer law is contained in **Appendix A**. The following states of interest have adopted the Uniform Fraudulent Transfers Act (UFTA).

State	Citation
Illinois	740 Ill. Comp. Stat. § 160/1 to 160/12
Indiana	Ind. Code §§ 32-18-2-1 to 32-18-2-21
Michigan	Mich. Comp. Laws §§ 566.31 to 566.43
Ohio	Ohio Rev. Code §§ 1336.01 to 1336.11
Wisconsin	Wis. Stat. §§ 242.01 to 242.11

C. *Irrevocable Trusts*

1. *Power-of-Appointment Trusts*

The typical POA Trust for asset protection works like this: the settlor transfers assets into an irrevocable trust for the benefit of others. Settlor grants a power of appointment to a donee, and the objects of the power include settlor. Thus, as the argument goes, the creditors of settlor cannot reach the assets of the trust, unless settlor's transfer to it was a fraudulent transfer. The donee of the power can appoint assets back to the settlor at a later time.

There are three problems with the argument:

a. Under the law of most states, it is not clear whether a creditor of the donor of the power may reach the assets that are subject to appointment. The Restatement (Third) of Property – Wills and Other Donative Transfers and the Uniform Trust Code are silent on the issue. To the author's knowledge, only two states have statutes that expressly forbid access, Ohio (Ohio Rev. Code § 5805.06(B)(3)(a)) and Arizona (Ari. Rev. Stat. § 14-10505(A)(2)). Ohio's legislation specifically states that it is a codification of common law (2012 Am. Sub. H. B. 479, § 4 eff. 3-27-2013).

b. A power of appointment is personal to the donee. There are no fiduciary duties such as prudence or impartiality. If the settlor's relationship with the donee sours, the donee has no duties to the settlor.

c. A claimant could invoke the sham trust doctrine, under which a creditor might prove a preexisting understanding between the settlor and donee based, in part, on previous partial appointments to the donor/object exclusively.

Unless the practitioner can be certain that Ohio or Arizona law will apply, or the common law of another state that has decided in favor of protection, the use of a power-of-appointment trust in this context should be avoided.

2. *Asset Protection Trusts*

i. Traditional Rule Against Self-Settled Spendthrift Trusts.

American law until recent times has uniformly allowed the creditors of a trust's settlor to reach the assets of the trust, even if the trust contains a spendthrift clause. Restatement (Third) Trusts, § 58(2); Uniform Trust Code, § 505(a)(2). The assets can be reached to the full extent that the settlor could, under any circumstances, receive back the assets. UTC § 505(a)(2). This posture is known as the rule against self-settled spendthrift trusts.

ii. Modern Trend to Reverse the Traditional Rule

The Domestic Asset Protection Trust (DAPT) is a creation of statute in sixteen states, the first of which was Alaska in 1997. The term “domestic” is meant to distinguish the asset protection trust from its foreign counterparts. Foreign APTs have long been available in numerous common and civil law jurisdictions. The law of these sixteen American states, with some exceptions and with variations among them, reverses the rule against self-settled spendthrift trusts. In alphabetical order, the states are:

Alaska	Mississippi	Ohio	Tennessee
Colorado	Missouri	Oklahoma	Utah
Delaware	Nevada	Rhode Island	Virginia
Hawaii	New Hampshire	South Dakota	Wyoming

iii. Comparison of the Leading DAPT Statutes

Appendix B contains a detailed chart of the characteristics of the sixteen current DAPT states. It was compiled by David G. Shaftel of Shaftel Law Offices, Anchorage, Alaska with the assistance of members of the American College of Trust and Estate Counsel (ACTEC) in the local jurisdictions.

The chart uses numerous criteria in comparing the statutes:

1. What requirements must the trust meet to come within protection of statute?
2. May a revocable trust be used for asset protection?
3. Has the state legislature consistently supported DAPTs and related estate planning by continued amendments?
4. What contacts with the state are suggested or required to establish situs?
5. What interests in principal and income may the settlor retain?
6. What is the trustee's distribution authority?
7. What powers may the settlor retain?
8. Who must serve as trustee to come within protection of statute?
9. May non-qualified trustees serve?
10. May the trust have a distribution advisor, investment advisor, or trust protector?
11. Are fraudulent transfers excepted from coverage?
12. Fraudulent transfer action: burden of proof and statute of limitations.

13. Does statute provide an exception (no asset protection) for a child support claim?
14. Does the statute provide an exception (no asset protection) for alimony?
15. Does statute provide an exception (no asset protection) for property division upon divorce?
16. Does statute provide an exception (no asset protection) for tort claims?
17. Does statute provide other express exceptions (no asset protection)?
18. Does statute prohibit any claim for forced heirship, legitime or elective share?
19. Are there provisions for moving an existing trust to the state and making it subject to the statute?
20. Does the statute provide that the spendthrift clause is a transfer restriction described in Section 541(c)(2) of the Bankruptcy Code?
21. Does statute provide that the trustee automatically ceases to act if a court has jurisdiction and determines that the governing law stated in the trust does not apply?
22. Does the statute provide that express/implied understandings regarding distributions to the settlor are invalid?
23. Does the statute provide protection for attorneys, trustees, and others involved in creation and administration of the trust?
24. Does the statute authorize a beneficiary to use or occupy real property or tangible personal property owned by trust, if in accordance with trustee's discretion?
25. May a trustee pay income or principal directly to a third party, for the benefit of a beneficiary, even if the beneficiary has an outstanding creditor?
26. Is a non-settlor beneficiary's interest protected from property division at divorce?
27. Are due diligence procedures required by statute?
28. Is the trustee given a lien against trust assets for costs and fees incurred to defend the trust?
29. Is there statutory authority supporting a trust's non-contestability clause even if probable cause exists for the contest?
30. Is the trustee given "decanting" authority to modify the trust?
31. What is the allowable duration of trusts?

32. Does the state assert income tax against DAPTs formed by non-resident settlors?

33. Have state limited partnership and LLC statutes been amended to provide maximum creditor protection?

34. What is the procedure and time period for a trustee to provide an accounting and be discharged from liability?

In practice, the leading jurisdictions are Alaska, Nevada, Ohio and South Dakota.

iv. The Main Criteria of Comparison

(a) The main criteria for evaluating DAPT statutes are as follows:

i. Exception Creditors (Criteria #13 - 17)

Certain creditors of the settlor are preferred in that they do not have to prove that the transfer to the trust was fraudulent. Instead, they can reach the trust estate in the same way as under the traditional rules. *See e.g.* Uniform Trust Code, Section 503; Restatement (Third) Trusts, Section 59.

Examples of exception creditors in DAPT statutes include:

(a) Person claiming child support.

(b) Spouse or former spouse claiming support or having a marital property claim.

(c) Claim of a secured creditor against collateral.

(d) Judgment creditor in tort.

(e) Claim of the state, the United States, or financial institutions.

Under the federal Bankruptcy Code, the trustee can reach assets in any self-settled trust to which the debtor has transferred assets within the past ten years if the transfer was fraudulent as defined in the Code. Section 548(e)(1) of the Code provides:

> In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if —
> (A) such transfer was made to a self-settled trust or similar device;
> (B) such transfer was by the debtor;
> (C) the debtor is a beneficiary of such trust or similar device; and
> (D) the debtor made the transfer with the actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.

(b) Fraudulent Transfers: Criteria for Proving Fraud (Criteria #11 & 12)

i. UFTA Standards

The Uniform Fraudulent Transfers Act provides standards for avoiding transfers where either actual or constructive fraud was present. See **Appendix A** of this outline for a discussion of the UFTA rules. In general, a creditor suing under the UFTA may avoid a transfer to a DAPT by proving that the debtor intended to hinder, delay or defraud creditors in making the transfer. There are various "badges of fraud" that serve as evidence of intent. If the creditor's claim arose before the transfer, then the creditor's task is easier, because the creditor may avoid the transfer if it rendered the debtor insolvent (known as constructive fraud).

In DAPT statutes, most states have simply adopted the same UFTA approach or UFTA-type approach as to proving fraud. Examples are Alaska, Colorado, Delaware, Mississippi, Missouri, Nevada, New Hampshire, Oklahoma, Rhode Island, Tennessee, Utah, Virginia and Wyoming.

States differ as to whether the creditor must prove fraud by a preponderance of the evidence or by clear and convincing evidence.

ii. Narrow Standards of Leading States

Only Ohio and South Dakota require the creditor to prove that the settlor had <u>the specific intent to defraud the specific creditor bringing the claim</u>, The intent must be to defraud, not to merely hinder or delay. The intent to defraud must be specific to the suing creditor, as opposed to creditors generally. This intent must be proved by clear and convincing evidence. There is no option of proving mere constructive fraud, as there is for pre-transfer claims as under the UFTA.

(c) Fraudulent Transfers: Statutes of Limitations (Criterion #12)

The typical limitations period on claims against a DAPT is four years after the transfer. Alaska and Delaware are examples of such. Some other states are as follows:

Two years: Mississippi, Nevada, Tennessee and South Dakota

Eighteen months: Ohio

Pre-transfer creditors also enjoy a potentially longer period measured by the time at which the transfer was discovered or could reasonable have been discovered. It is typically one year. For example, in Alaska, a pre-existing creditor must bring the claims within the longer of (i) four years after transfer or (ii) within one year after the transfer was or could reasonably have been discovered (but the creditor must "establish" the claim within four years under Alaska law).

In a few states, the post-discovery period for pre-transfer claims is only six months: Mississippi, Nevada, Ohio, South Dakota and Tennessee. In two of these states, the notice period is deemed to begin upon a public recording of the transfer: Nevada and Ohio.

(d) Reserved Rights, Powers and Interests of the Settlor (Criteria #5 & 7)

To the extent that the statute sanctions reserved rights, powers and interests of the settlor, the flexibility of the structure is enhanced. Examples are the settlor's retained right to veto a distribution, to retain an income interest, to personally use real and tangible personal property held in the trust, and to enjoy a limited power of appointment, whether *inter vivos* or testamentary. Some states have provisions that are designed to allow a CRAT or GRAT, for example, to be within a DAPT structure. The most flexible states are Nevada and Ohio.

In the context of estate planning uses of the DAPT, certain reserved rights, interests and powers will cause an incomplete gift and estate inclusion. Choices will also affect grantor versus nongrantor status for income tax purposes.

v. Will the Settlor's Choice of Law in a DAPT be Respected?

Under the conflict-of-law principles of both the Restatement (Second) Conflict-of-Laws and the Uniform Trust Code, a court in a non-DAPT jurisdiction may refuse to apply the chosen law of the DAPT state if the court finds that the law violates a strong public policy of the state with the closest connection to the matter. See MJ Stegman, "Choice of Law in Domestic Asset Protection Trusts: Will it be Respected?" Second Annual Ohio Asset Protection and Legacy Trust Institute, April 28, 2014, available at www.kplaw.com/attorneys/Michael_J._Stegman.

vi. The DAPT as a Vehicle for Advanced Estate Planning

When the DAPT is employed for purely asset protection purposes, the client will typically want a tax neutral trust. As such, the transfers to the trust will be incomplete for federal gift tax purposes (IRC § 2511) and includible in the settlor's taxable estate under the federal estate tax (IRC § 2031 et seq.). In order to achieve neutral income tax treatment, the client will desire a "grantor trust" for federal income tax purposes under the principles of Internal Revenue Code Sections 671-677.

For estate planning purposes, however, the client may desire to render the transfer "complete" for gift tax purposes and to enjoy non-inclusion in the client's estate for estate tax purposes. If this is the desired tax result, then the client can transfer property to an appropriately-drafted DAPT and achieve significant wealth transfer tax savings. A transfer to a DAPT might be much more palatable to the client than a gift to an irrevocable trust for the benefit of persons which do not include the settlor, because under a DAPT the settlor can remain as a beneficiary who will be eligible to receive income or principal, usually in the discretion of the trustee or a trust advisor. In advising on such transfers, however, it is paramount that you explain to the client the legal reality, namely, that he or she is truly parting with control over the money. Although a friend, a non-beneficiary relative or the attorney may be the distribution advisor, there can be no understanding between the settlor and the advisor as to distributions. Furthermore, it would be bad practice to have a pattern of distributions back to the settlor, which could be used to establish an understanding. The best advice is to tell the client that no assets should be placed into this trust that the client might expect to need under normal circumstances. Such a limited parting with assets will also help to establish the non-fraudulent nature of the transfer for asset protection purposes. The client should probably view the assets in the trust as the bastion of last wealth resort.

Appendix C is a discussion of federal wealth transfer taxation in relation to DAPTs.

III. Beneficiary Protection under Third-Party Settled Trusts (Traditional Trusts)

Clients are not only interested in protecting their assets from their own potential creditors but, even after their deaths, from creditors and predators that attempt to reach trust assets held for their descendants. As we shall see, a "predator" is a reference to a beneficiary's divorcing spouse.

The following discussion assumes that the beneficiary is not also a trustee or a distribution advisor to the trustee. For asset protection purposes, such designations would not be advisable, because creditors and predators will claim that the beneficiary has control over distributions. The fiduciary duties of the beneficiary-trustee or advisor may not be a winning defense.

A. Spendthrift & Discretionary Trusts

Most every trust contains a traditional spendthrift clause. These are widely-held to be enforceable to protect the interests of beneficiaries (other than the beneficiary-settlor) against creditors of the beneficiary. But there are exceptions to the protection for the claims of certain parties and for interests that mandate distributions. In the context of beneficial interests that are purely discretionary, the protection is significantly greater. Regardless of the level of protection, however, a "predator" such as a divorcing spouse of a beneficiary may be effective in counting all or part of the trust estate as either marital property or as part of equation in determining a division of pure marital property, resulting in one party being awarded more of the marital property than the other party.

The spendthrift and discretionary trust law of certain states of interest is cited here:

State	Citations
Illinois	735 Ill. Comp. Stat. § 5/2-1403
Indiana	Ind. Code §§ 30-4-3-2, 30-4-2.1-14
Michigan	Mich. Comp. Laws §§ 700.7501, 700.7502, 700.7503, 700.7504, 700.7505, 700.7815(1)
Ohio	Ohio Rev. Code §§ 5805.01, 5805.02, 5805.03, 5805.04, 5808.14(A)
Wisconsin	Wis. Stat. §§ 701.0501,04, 701.0502, 701.0503, 701.0504, 701.0814

The spendthrift and discretionary trust provisions of the Restatement and the Uniform Trust Code will be examined next.

1. *Restatement (Third) Trusts*

The Restatement (Third) Trusts provides the following on the general validity of spendthrift clauses:

§ 58. Spendthrift Trusts: Validity and General Effect

(1) Except as stated in Subsection (2)…, 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 creditor, the restraint on voluntary and involuntary alienation of the interest is valid.

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

Spendthrift clauses do not prevent attachment by a general creditor, however, where the beneficiary has the "equivalence of ownership" (such as a presently-exercisable general power of appointment) or an enforceable right to a distribution. Regarding enforceable rights to a distribution, comment d(2) to Section 58 provides:

> In addition, property that has become distributable to the beneficiary but is retained by the trustee beyond a time reasonably necessary to make distribution to the beneficiary, and thus to which the beneficiary has a right to demand immediate distribution, is then subject to attachment by creditors of the beneficiary.

Examples of such enforceable rights are powers of withdrawal (*cf.* comment b to Section 58) and distributions upon the occurrence of an event (the attainment of a certain age or the death of a life income beneficiary). In the event of an attempt to attach an enforceable interest, however, a trust instrument may validly provide that the interest may be forfeited or become discretionary. The relevant section is as follows:

§ 57. Forfeiture for Voluntary or Involuntary Alienation

Except with respect to an interest retained by the settlor, the terms of a trust may validly provide that an interest shall terminate or become discretionary upon an attempt by the beneficiary to transfer it or by the beneficiary's creditors to reach it, or upon the bankruptcy of the beneficiary.

The Restatement further provides for certain exception creditors who can reach the trust estate despite a spendthrift provision:

§ 59. Spendthrift Trusts: Exceptions for Particular Types of Claims

The interest of a beneficiary in a valid spendthrift trust can be reached in satisfaction of an enforceable claim against the beneficiary for

(a) support of a child, spouse, or former spouse; or

(b) services or supplies provided for necessities or for the protection of the beneficiary's interest in the trust.

2. *Uniform Trust Code*

The Uniform Trust Code (2000) (as amended in 2001, 2003, 2004 and 2005) provides for the general validity of spendthrift clauses:

SECTION 502. SPENDTHRIFT PROVISION

(a) A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest.

(b) 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.

(c) 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.

The UTC allows any creditor to compel or attach a mandatory distribution. This provision parallels the Restatement concept of a creditor coming through an enforceable right of a beneficiary to a distribution. The relevant UTC section is as follows:

SECTION 506. OVERDUE DISTRIBUTION

(a) In this section, "mandatory distribution" means a distribution of income or principal which the trustee is required to make to a beneficiary under the terms of the trust, including a distribution upon termination of the trust. The term does not include a distribution subject to the exercise of the trustee's discretion even if (1) the discretion is expressed in the form of a standard of distribution, or (2) the terms of the trust authorizing a distribution couple language of discretion with language of direction.

(b) Whether or not a trust contains a spendthrift provision, a creditor or assignee of a beneficiary may reach a mandatory distribution of income or principal, including a distribution upon termination of the trust, if the trustee has not made the distribution to the beneficiary within a reasonable time after the designated distribution date.

Like the Restatement, however, the UTC provides for certain exception creditors:

SECTION 503. EXCEPTIONS TO SPENDTHRIFT PROVISION

(a) In this section, "child" includes any person for whom an order or judgment for child support has been entered in this or another State.

(b) A spendthrift provision is unenforceable against:

(1) a beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance;

(2) a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust; and

(3) a claim of this State or the United States to the extent a statute of this State or federal law so provides.

As is apparent from Section 503, the UTC expands on the Restatement's list of exception creditors by adding the state itself and the federal government. The UTC further defines the remedy available to the exception creditors in subsection (c):

(c) A claimant against which 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.

Such a remedy is limited to attachment of current and future distributions.

The UTC specifically frustrates a creditor's ability to *compel* a distribution from a discretionary trust that the trustee or distribution advisor does not otherwise contemplate, unless the creditor is seeking child or spousal support, and even then under limited circumstances. UTC § 504(b) and (c) provide:

(b) Except as otherwise provided in subsection (c) [relating to attaching present or future distributions in satisfaction of support claims], 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.

(c) To 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.

In the context of discretionary trusts, UTC Sections 503 and 504, taken together, mean that no creditor may *compel* a distribution from a discretionary trust, except that an exception creditor for support may compel a distribution to the extent that the trustee has abused its discretion or has failed to abide by a standard of distribution. Any exception creditor may attach a distribution that is to be made currently under the terms of the trust or that is to be made in the future under such terms but may not otherwise compel a distribution.

3. *Ohio's "Wholly Discretionary Trust"*

Ohio has put trust assets of a certain "wholly discretionary trust" outside the reach of not only the support claims of a child, spouse or former spouse, but from claims of the State of Ohio itself (such as Medicaid claims against a beneficiary of a third-party settled trust who has received benefits, provided the third-party settlor is not the spouse of the recipient) and any other creditor. Ohio Rev. Code § 5805.03. There are simply no exception creditors at all.

The key to a wholly discretionary trust is that "the terms of the trust do not provide any standards to guide the trustee in exercising its discretion to make distributions to or for the benefit of the beneficiary". Ohio Rev. Code § 5801.01(Y)(1)(e). Thus, the trustee cannot be bound by a standard such as the beneficiary's comfort, well-being, support, health, *etc*.

B. Beneficial Interests in the Context of the Divorcing Spouse

In the context of divorce, a so-called "predator" (the soon-to-be ex-spouse) may be successful in counting the partner's beneficial trust interest as property for purposes of determining either the amount of spousal support (maintenance or alimony) or the overall marital property award. In this context, the ex-spouse does not reach the trust estate (except in the limited case of delinquent support), but he or she nevertheless benefits by successfully counting assets of the trust into the overall pool for purposes of division of property.

1. *A General Review of Property Division and Spousal Support*

State law on property division at divorce is essentially a recharacterization of the property held separately or jointly by the couple using community property concepts. As such, regardless of how property is titled, property earned during the marriage is considered to be "marital property"; and property that a spouse held at the time of marriage or acquired during marriage by gift or inheritance is that spouse's "separate property". States differ on whether the income from or the appreciation of separate property during the marriage is marital property. Illinois, for example, does not gross-up marital property with the income from or the appreciation on separate property or otherwise compensate the non-owning spouse, unless the personal efforts of the non-owning spouse were involved. 750 Ill. Comp. Stat. § 5/503.

In general, absent special circumstances, marital property is subject to division and separate property is not. In a small minority of states, such as Indiana, all property of either spouse is subject to division. Ind. Code § 31-15-7-4. In the majority of states that respect the distinction between marital and separate property, however, the court is generally free to apply equitable principles in considering separate property when dividing up marital property or even awarding part of a spouse's separate property to the other spouse.

An award of support to one spouse (also known as maintenance or alimony) is a different issue than property division. The court will award support to a spouse, payable from the income or property of the other spouse, if justice so requires. In determining the need for and the amount of support, the court is typically instructed by statute to consider a variety of factors. These include the amount of the property division in favor of the spouse seeking support, the standard of living established during the marriage, the present and future earnings capacity of each party, and the duration of the marriage. *E.g.* 750 Ill. Comp. Stat. § 5/504.

States differ on the validity and effect of pre- and post-nuptial agreements as affecting property division and support. A discussion of such is beyond the scope of this presentation.

When a spouse has a beneficial interest in a trust settled by an ancestor or other third party, courts generally will consider that interest in making an overall marital property award or determining support. *See e.g., In re Marriage of Benz*, 116 Ill.Dec. 336, 518 N.E.2d 1316 (App. 4th Dist. 1988).

When analyzing beneficial interests in trusts, courts sometimes use property law concepts from the law of present and future interests as applied to trusts. Such leads to inconsistent and sometimes inaccurate characterizations. A brief review of such concepts is in order.

2. *A General Review of the Law of Present and Future Interests*

The Restatement (Third) Property – Wills and Other Donative Transfers (“Restatement of Property” or “Restatement Third”) introduces the classification of present and future interests as follows:

> The system of classification developed over the centuries in English land law to serve a variety of purposes, originating in feudal, military, and fiscal arraignments that have long since become archaic [citation omitted]. Today, present and future interests are predominantly created as equitable interests in trust, not as legal interests in land. For modern purposes, the system of classification based on English land law is unnecessarily complex.

Restatement Third, Division VII – Present and Future Interests, Scope of Division VII. For the benefit of judges and lawyers (and perhaps for the good of humanity) the Restatement Third adopts simplified terminology for classification that is descriptive of the interest itself. *Id.*

Present interests include interests that give a present benefit to the beneficiary, such as an income interest for life or a term of years. Restatement Third § 24.1, cmt. d. In contrast, future interests involve postponed enjoyment. Restatement Third § 25.1, cmt. c. A future interest may be contingent or vested.

i. Contingent Future Interests.

A future interest is contingent if, for any reason, it might not take effect in enjoyment. Restatement Third § 25.3 and cmt. f. Prior to the issuance of this Restatement in 2010, the terminology was overly complicated. What is now classified as "contingent" had been previously subdivided into three categories, namely, "vested subject to complete defeasance"; "vested subject to open" (or "vested subject to partial defeasance"); and "contingent". All are now simply contingent. Restatement Third § 25.3, cmt. a. The distinctions among the three categories were subtle and in some instances contrary to reason. It is no wonder that courts confused and misconstrued these classifications when consulting earlier versions of the Restatement or the jurisdiction's particular common law.

In the context of beneficial interests in trusts, contingent future interests include interests that take effect in enjoyment depending on surviving another person or living until a certain age. Such is true even if premature expiry would vest the enjoyment in that person's descendants pursuant to the terms of the trust. *See* Restatement Third § 25.3, cmt. g, illustrations 12 and 16. Under prior classification, such would have been "vested subject to complete defeasance". *Id*.

ii. Vested Future Interests.

A future interest is vested if it is certain to take effect in enjoyment. Under prior classifications, this interest was known as "indefeasibly vested". Restatement Third § 25.3 and cmt. a. In the context of trusts, there is no future interest that is vested, save in the case of a corporate taker such as a charitable organization or a trustee of a charitable trust. In such cases, there is a successor in interest to the named taker, specifically the charitable corporation or trust. See Restatement Third § 25.3, cmt. f, cmt. g, illustration 8. For example, the interest of a charitable organization of a charitable remainder trust is a vested future interest. In contrast, the interests of individuals at the back end of a charitable lead trust are contingent future interests.

With these classifications in mind, we may now turn to the diverse case law on property division and support where a beneficial interest in a trust is or is not considered to be "property".

3. *Case Law on either Including or Considering a Beneficiary's Interest when Determining Property Division or Spousal Support.*

In divorce cases, a spendthrift clause is often meaningless, because the court is not typically ordering a third-party trustee to distribute property; instead, the court is considering that property in making an overall property division or determining support.[4]

i. Present Interests.

A mandatory income interest is an example of a present interest because the beneficiary has current enjoyment. Because the trust is generating current income and this income stream is capable of valuation, a mandatory income interest makes for any easy target when a court makes an award of property. *E.g. Fox v. Fox*, 592 N.W.2d 541 (N.D. 1999). Some courts have reached a different

[4] A trial judge indeed issued such an order in one case, but was overturned on appeal for other reasons. In that case, the spouse was also a co-trustee, so it is presumed that personal jurisdiction was attained based on the co-trusteeship. *Tannen v. Tannen*, 3 A.3d 1229 (N.J. Sup. Ct. 2010).

conclusion. *E.g. Sayer v. Sayer*, 492 A.2d 238 (De. 1985); *In re Marriage of Guinn*, 93 P.2d 568 (Colo. Ct. App. 2004).

In a Massachusetts case, the husband was a beneficiary of a trust of real estate established by his father. It appears that the real estate was personal use property, as opposed to investment property. The court noted that the son had an enforceable right to use the trust property and had a "vested right" to take his share of the real estate upon termination of the trust according to its terms. It did not seem to matter that the trust could be amended by the father to eliminate the son as a beneficiary. The court held that the son's interest was divisible marital property. *Lauricella v. Lauricella*, 565 N.E.2d 436 (Mass. 1991).

ii. Contingent Future Interests.

Remainders are an example of contingent future interests, but courts have been fairly liberal in counting them as marital property. E.g. *Buxbaum v. Buxbaum*, 692 P.2d 411 (Mont. 1984); *Zuger v. Zuger*, 563 N.W.2d 804 (N.D. 1997); *In re Balanson*, 25 P.3d 28 (Colo. 2001); *In re Marriage of Dale*, 87 P.3d 219 (Colo. Ct. App. 2003); *Trowbridge v. Trowbridge*, 114 N.W.2d 129 (Wis. 1962).

The most extreme example of such jurisprudence occurred in a Massachusetts case. In *Davidson v. Davidson*, the husband held a contingent future interest in his father's testamentary trust. If he survived his mother and lived to age 35, he would receive his share of the trust outright. The trustees had "uncontrolled discretion" to invade principal for his mother. Although the husband's remainder interest was "at the outer limits" of a property interest and was inalienable, the court classified it as marital property to be considered in making an overall division. 474 N.E.2d 1137 (Mass. Ct. App. 1985).

Other courts have not allowed a remainder interest to be considered. *Loeb v. Loeb*, 301 N.E.2d 349 (Ind. 1973); *Solomon v. Solomon,* 611 A.2d 686 (Pa. 1992).

iii. Effect of a Power of Appointment Held by Another.

Despite the nature of a spouse's beneficial interest, if the spouse's interest is subject to complete divestment by the possible exercise of a power of appointment held by another, then the interest is not to be included as marital property (even in Massachusetts). *S.L. v. R.L.*, 774 N.E.2d 1179 (Mass. App. Ct. 2002); *D.L. v. G.L.*, 811 N.E.2d 1013 (Mass. App. Ct. 2004).

iv. Discretionary Interests in Income or Principal.

If the spouse is one of several beneficiaries and the trustee has complete discretion in distributing principal and income among them, courts have generally not considered such beneficial interests to be marital property.

In the Illinois case of *In re Marriage of Eddy*, the wife was a beneficiary of a trust for the primary benefit of her mother, who was still alive, but also for the benefit of the wife and her descendants (the children of her marriage to husband). Other than the mandate to consider the wife's mother first, the trustee had complete discretion as to distributions. It also appears that her father had a testamentary power of appointment over the trust assets that could have left her with no remainder upon her mother's death. The appellate court held that although the trial court could consider wife's "present interest" in making a property division, the trial court had erred in determining that a fixed percentage of the trust estate was marital property. "Potential inheritances … are not property which can be valued and awarded to a spouse, although they can be given some consideration in determining property distribution." 210 Ill.App.3d 450, 569 N.E.2d 174, 181 (1991).[5]

A still better result was reached in the Colorado case of *In re Marriage of Jones*. The trust in this case was for the benefit of wife, wife's father, and wife's descendants. The trustee had complete discretion to distribute income and principal to any one or more of the beneficiaries. Upon the death of wife's father, wife did not take; instead, the trust would continue for the remainder of her life for the benefit of her descendants and her. At her death (or the later of the death of her father and her), her descendants took outright. The court concluded that the wife's interest was a "mere expectancy"[6] and its appreciation in value during the marriage could not be considered as part of a marital property division, as would otherwise be the case under Colorado law for the appreciation in value of separate property. The court said that the wife had no "vested 'property' right to receive payment from the trust". 812 P.2d 1152 (Colo. 1991).

C. Drafting Recommendations

1. *Use Multi-Generational Discretionary Pot Trusts for Beneficial Interests of Children and Further Descendants.*

The *Jones* case in particular suggests that a purely discretionary, multi-generational pot trust provides the best protection against predators. They also serve to protect beneficiaries from their own destructive habits or tendencies, because a beneficiary will never have a mandatory right to income or principal. To best protect against predators and imprudent beneficiaries, omit any standards that the trustee must take into consideration in making discretionary distribution decisions, as these may give a toehold to the beneficiary, for example, in seeking to show abuse of discretion for not making distributions.

Such trusts, with the proper allocation of GST exemption, also make for an outstanding vehicle for the succession of family wealth without wealth transfer taxation.

The following are some clauses to consider in drafting such trusts:

<u>Language of discretion in dispositive provisions of the trust or each sub-trust</u>: "The Trustee may distribute, at any time and from time to time, all or as much of the net income and principal of the trust estate to any or all of [class of

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[5] There was also a parallel trust set up for the primary benefit of wife's father on similar terms.
[6] The court quoted G .Bogert, Trusts & Trustees, § 228, at 512-13 (2d ed. 1979): "Until the trustee elects to make a payment, the beneficiary has a mere expectancy".

> beneficiaries**]** as may be living from time to time as the Trustee [or other fiduciary] determines in its discretion to be advisable."
>
> **Discretion**. A Trustee, Distribution Advisor, Protector or other fiduciary's "discretion" means in all cases the person's sole, absolute and unfettered discretion. The Settlor has not provided any standards to guide any such person in exercising its discretion. This definition, like the other definitions contained in this Agreement, is a substantive part of it.
>
> **Interests of Beneficiaries**. It is Settlor's intent that no beneficiary under any trust created under this Agreement shall enjoy any vested right or entitlement to a distribution of income or principal. Any distribution that may be made shall be in the discretion of the fiduciary making the determination pursuant to the terms of this trust.
>
> **Discretionary Distributions**. Whenever a fiduciary shall be authorized to distribute all or any part of either the net income or the principal, or both, of a trust created under this Agreement, such authority may be exercised in the discretion of the fiduciary, by distributions to or applications directly for a beneficiary in cash or in kind, at any time and from time to time, but the existence of such authority shall not require the fiduciary to make any distribution to or for any person. Furthermore, such authority shall permit the fiduciary to terminate such trust by such distributions. If there shall be more than one beneficiary of such trust, any such distribution may be made to or for all or any one or more of such beneficiaries in such equal or unequal proportions and amounts as the fiduciary in its discretion may determine, and no adjustment among said beneficiaries by reason of any such distribution is required to be made. Any net income of a trust which shall not be distributed by reason of the fiduciary's exercise of discretion shall be accumulated and added to the principal of such trust. The decision of the fiduciary in the exercise of the discretion conferred in this Agreement upon the fiduciary shall be final, binding and conclusive upon all persons whomsoever.

In Ohio, use the "wholly discretionary trust" vehicle so as to further isolate the trust from exception creditors. (Or import Ohio law, but with the understanding that a court may not ultimately respect the choice of law.) Bolster the intent with a statement such as this:

> Settlor intends that this trust (or any trust created under it), for so long as the administration and construction of any such trust is governed by the laws of the State of Ohio, be administered and construed as a "wholly discretionary trust" pursuant to Section 5805.03 of the Ohio Revised Code.

Furthermore, instead of setting forth in the trust instrument Settlor's non-binding wishes as to distributions over time, put these in a separate letter of wishes. An example of an omnibus letter of wishes (which may be applicable to more than one trust instrument) is attached as **Appendix D**.

2. *Include Liberal Decanting Clauses to Change Beneficial Interests in the Event of a Problem.*

The following is an example of a broad decanting power.

> **Trustee's Power to Distribute in Further Trust/Decanting**. Settlor specifically authorizes and empowers the Trustee or other applicable fiduciary to distribute any or all of the principal and accumulated but undistributed income of any trust created under this Agreement, at any time and from time to time, in further trust as may be permitted under the laws of the jurisdiction governing the administration of this trust at such time, and regardless of whether such laws existed at the time of execution of this trust. Such authorization includes, but is not limited to, the distribution of assets to a trust that benefits fewer than all of the beneficiaries of the trust over which the Trustee is exercising the power or that otherwise alters or terminates the beneficial interests of one or more such beneficiaries. The trustee of such further trust need not be within the jurisdiction of the courts of the State of ____; the validity, construction and administration of such trust need not be governed by the laws State of ____; and the principal place of administration of the trust need no longer be within the State of ___. The Trustee shall not be required to give notice to the beneficiaries of an exercise of such power. In exercising such power, the Trustee or other applicable fiduciary may liquidate all or any part of the trust estate in order to facilitate or expedite the transfer. Notwithstanding any other provisions of this Agreement, the Trustee and the Protector (if applicable) shall be indemnified against and held harmless from the tax or investment consequences to the trust or any beneficiaries of any such liquidation of the trust estate and for expenses associated with the carrying out of the exercise of such power.

If decanting may not be available under the statutory or common law of the jurisdiction of governing law, then consider giving the protector a fiduciary power of appointment to accomplish the same.

3. *What Not to Do.*

Do not provide automatic forfeiture clauses in the event that a divorcing spouse or other predator attempts to reach trust assets or include them in the determination of dividing overall property. Settlors rarely want forfeitures.

Do not require or specifically enable the trustee to fund a beneficiary's divorce litigation should the predator spouse make an attempt as provided above. Such would only draw the attention of the court in a detrimental way.

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Appendix A

Fraudulent Transfers

Fraudulent transfer laws vary by state, but there are three main groupings by type of statute or source of law.

A. Uniform Fraudulent Transfer Act (1984)

Thirty-seven jurisdictions have adopted a version of the Uniform Fraudulent Transfer Act (UFTA). A fraudulent transfer falls generally into one of two categories, so-called "actual fraud" and "constructive fraud".

1. *Actual Fraud*

Section 4 of the UFTA provides as follows:

SECTION 4. TRANSFERS FRAUDULENT AS TO PRESENT AND FUTURE CREDITORS.

(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:

(1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or

(2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:

(i) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

(ii) intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due.

(b) In determining actual intent under subsection (a)(1), consideration may be given, among other factors, to whether:

(1) the transfer or obligation was to an insider;

(2) the debtor retained possession or control of the property transferred after the transfer;

(3) the transfer or obligation was disclosed or concealed;

(4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

(5) the transfer was of substantially all the debtor's assets;

(6) the debtor absconded;

(7) the debtor removed or concealed assets;

(8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;[7]

(9) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(10) the transfer occurred shortly before or shortly after a substantial debt was incurred; and

(11) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

The type of fraud that falls under Section 4(a) is known as "actual fraud". A creditor can prove the requisite intent required of actual fraud under Section 4(a)(1) by presenting sufficient evidence of the so-called "badges of fraud" under Section 4(b). Absent the transferor's intent to defraud, there is room for the claimant to prove actual fraud under circumstances where either (i) the debtor undertook a transaction which left the value of his or her remaining assets unreasonably small in relation to the transferred assets, or (ii) the debtor intended to incur, or the debtor could have anticipated that he or she would incur, debts beyond the debtor's ability to pay. A present or future creditor has standing to bring a claim of actual fraud.

In the case of a future creditor attempting to void a transfer that occurred in the past, however, courts tend to inquire as to whether the transferor should have anticipated the claim, relying it seems on the language of Section 4(a)(2)(ii) (the transferor "reasonably should have believed that he [or she] would incur debts beyond his [or her] ability to pay"). See e.g. *Hurlbert v. Shackleton*, 560 So.2d 1276 (Fla. Ct. App. 1990); *First National Bank in Kearney v. Bunn*, 241 N.W.2d 127 (Neb. 1976); *Klein v. Klein*, 112 N.Y.S.2d 546 (1952).

The statute of limitations on an intentional fraud claim under Section 4(a)(1) is rather open-ended, such that the claim must be brought within four years after the transfer or, if later, one year after the claimant discovered or could reasonably have discovered the transfer. UFTA § 9(a). If the claim is under Section 4(a)(2), it must be brought within four years after the transfer. UFTA § 9(b).

2. *Constructive Fraud*

The UFTA also provides for what is known as "constructive fraud":

[7] This eighth point would be a factor tending to weigh against a finding of intent to defraud.

SECTION 5. TRANSFERS FRAUDULENT AS TO PRESENT CREDITORS

> (a) A transfer made or obligation incurred by a debtor is fraudulent 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 that time or the debtor became insolvent as a result of the transfer or obligation.
>
> (b) A transfer made by a debtor is fraudulent 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 that time, and the insider had reasonable cause to believe that the debtor was insolvent.

Constructive fraud occurs when a transfer renders the transferor insolvent or when the transferor was already insolvent, provided in either case that reasonably-equivalent consideration was not received in exchange. Insolvency occurs when the value of a transferor's debts exceed the value of his or her assets. UFTA § 2. In this regard, it is noteworthy that exempt assets do not figure into the solvency analysis, so the practitioner advising such a client on transfers should be cognizant of not counting items such as ERISA plans, IRAs and life insurance policies as assets. UFTA § 1(2). Furthermore, in the case of married transferors where the claim arises against only one of them, a transferor's interest in tenancy-by-the-entireties property is not considered an asset in the solvency analysis. *Id.*

For a fraudulent transfer to occur under the constructive fraud analysis, the claim must have arisen before the transfer occurred. UFTA § 5. The statute of limitations for constructive fraud claims is four years after the transfer. It is not open-ended as a claim of actual fraud can be.

The Bankruptcy Code has its own version of fraudulent transfers which is akin to the UFTA. 11 U.S.C. § 548.

B. *Uniform Fraudulent Conveyance Act (1918)*

The earlier Uniform Fraudulent Conveyance Act, a version of which is still the law in three states, was a compilation of the law of fraudulent transfers as it had developed under the law of the states until that time (1918). It sought to draw from what the Uniform Law Commissioners deemed to be the better decisional law. Until that time, the states either had a mere common law of fraudulent transfers or had adopted a statute based on England's sixteenth century Statute of Elizabeth.

C. *Statute of Elizabeth (1571)*

The English Statute of Elizabeth, 13 Eliz. 1, c. 5, is the basis for jurisprudence on the subject of fraudulent transfers. States which have not adopted a uniform act rely on a similar statute or on common law.

Appendix B

ACTEC Comparison of the Sixteen DAPT States

Appendix C

Discussion of Federal Wealth Transfer Taxation as it relates to APTs

If the client wishes to make a completed gift to the DAPT and avoid inclusion at death, the following discussion is relevant.

1. *Gift Tax*

The ability to obtain a completed gift for a transfer to a discretionary self-settled spendthrift trust is well established.

An understanding of the precedent for completed gift treatment begins with the case of *Herzog v. Commissioner*, 116 F.2d 591 (2d. Cir. 1941). In *Herzog*, the taxpayer made a transfer to an irrevocable trust for the benefit of his wife and himself. The trustee had full discretion as to whether to distribute the income of the trust to the taxpayer or his wife. The principal was not distributable until after his death. On his gift tax return, the taxpayer asserted that the gift was complete only to the extent of the value of the principal interest and not as to the income interest. The Commissioner countered that the entire gift was complete and assessed a deficiency.

In upholding the Board of Tax Appeals decision in favor of the Commissioner, the Second Circuit rejected the taxpayer's argument that "his creditors might reach the income through a suit in equity directing the trustee to exercise the power in their favor." The court dismissed this contention on the basis that there was no New York statute or case law to that effect. Thus, the argument failed, and the court found that the entire transfer to the trust was a completed gift.

Of course, New York law is now clear that a creditor of the settlor could indeed reach his interest in the trust, but we must analyze the case based on its own assumptions. The case stands firmly for the proposition that a transfer to a self-settled discretionary spendthrift trust is a completed gift.

In subsequent Revenue Rulings and Letter Rulings, the IRS has picked up on the Second Circuit's emphasis on whether or not a creditor of the settlor has the ability to reach the assets of the trust in satisfaction of a judgment against the settlor. If the creditor can reach them, the IRS denotes this as the ability of a transferor to not pay his or her debts and to "relegate" his or her creditors to the assets of the trust. Under such circumstances, the transfer is an incomplete gift, because the transferor has not in fact parted with dominion and control of the assets. But, if the transferor cannot relegate creditors to the trust, as in a valid self-settled spendthrift trust, the result is the opposite. Rev. Rul. 76-103, 1976-1 C.B. 293; Rev. Rul. 77-378, 1977-2 C.B. 347 (grantor was sole beneficiary during his life); Ltr. Rul. 9837007; Ltr. Rul. 9332006; Ltr. Rul. 200944002. Despite its earlier rulings, the IRS argued to the contrary and lost in *Outwin v. Commissioner*, 76 T.C. 153 (1981). The Service then acquiesced to the result. 1981-2 C.B. 2.

In reliance on Revenue Ruling 77-378, the Eighth Circuit in *Vak Estate v. Commissioner*, 973 F.2d 1409 (8th Cir. 1992), found a completed gift under a trust where the settlor and others were discretionary beneficiaries of income and principal. The Court stated:

> We note that even though the trustees could have given Joseph A. all of the trust corpus under the discretionary sprinkling power, that discretionary power is not sufficient under Revenue Ruling 77-378 to find that the transfer of the certificates [of beneficial interests in the trust] is an incomplete gift.

The completed nature of the gift, of course, would be defeated if the grantor retained a power or interest that would otherwise render the gift incomplete, such as a limited power of appointment. *See* Treas. Reg. § 25.2511-2(b); CCA 201208026 (2/24/12). Furthermore, it is conceivable that the Service could look to surrounding circumstances, such as impending creditor claims, to determine that the transfer to the trust was void under the relevant fraudulent transfers act and, as a result, the gift is incomplete, but no ruling indicates such an approach. And the IRS would be unlikely to raise the issue of whether a transfer by a resident of a non-DAPT state to a trust in a DAPT state does not with certainty render the assets beyond the reach the taxpayer's creditors. *See* Rev. Rul. 76-103, 1976-1 C.B. 293; *Estate of German v U.S.*, 7 Ct. Cl. 641 (1985).

2. *Estate Tax*

The flipside of planning for a completed gift is subsequent non-inclusion in the gross estate for estate tax purposes. The authority for non-inclusion is not as strong, but it is likely that the outcome will be favorable to the decedent's estate.

In Revenue Ruling 76-103, the IRS advised on the complete or incomplete nature of a gift to a self-settled spendthrift trust which was not settled in a DAPT state. Under these circumstances, the Service found that the gift was incomplete. The ruling went on, however, as follows:

> If and when the grantor's dominion and control of the trust assets ceases, such as by the trustee's decision to move the situs of the trust to a State where the grantor's creditors cannot reach the trust assets, then the gift is complete for Federal gift tax purposes under the rules set forth in section 25.2511-2 of the regulations (quoted above).
>
> Furthermore, if the grantor dies before the gift becomes complete, the date of death value of the trust corpus will be includible in the grantor's gross estate, for Federal estate tax purposes, under section 2038 of the Code because of the grantor's retained power to, in effect, terminate the trust by relegating the grantor's creditors to the entire property of the trust.

Rev. Rul. 76-103, 1976-1 C.B. 293. The logical extension to the last-quoted paragraph is that if the grantor dies after the gift becomes complete (as by transfer of the trust situs to a DAPT state), the date-of-death value of the corpus will not be includible in the grantor's estate under IRC section 2038, because the grantor, at the time of death, did not retain the power to terminate the trust by relegating the grantor's creditors to the entire property of the trust. A curious caveat to Revenue Ruling 76-103 is that it did not analyze inclusion of non-inclusion under section 2036.

A recent Private Letter Ruling (which cannot be cited as authority but which gives the practitioner a view to how the Service is analyzing a particular issue) is also helpful and, unlike Revenue Ruling 76-103, speaks to Code section 2036. Under the facts of PLR 200944002, grantor settled an irrevocable discretionary trust for the benefit of grantor and grantor's spouse and descendants in a state that does not allow creditors to reach assets of the trust to satisfy claims against the grantor, except under certain circumstances, such as a fraud on creditors and delinquent child support claims. The Service ruled that the transfer to the irrevocable discretionary trust would constitute a completed gift and, at death, the value of the trust would not be includible in grantor's gross estate. The ruling states, "the trustee's discretionary authority to distribute income and/or principal to Grantor, does not, by itself, cause the Trust corpus to be includible in Grantor's gross estate under § 2036." As a caution, the Service added, "We are specifically not ruling on whether Trustee's discretion to distribute income and principal of Trust to Grantor combined with other facts (such as, but not limited to, an understanding or pre-existing arrangement between Grantor and trustee regarding the exercise of this discretion) may cause inclusion of Trust's assets in Grantor's gross estate for federal estate tax purposes under § 2036." Ltr. Rul. 200944002 (10/30/2009).

Under the facts of a case from the Court of Claims, *Estate of German*, a Florida resident settled several discretionary trusts under Maryland law, each for the benefit of a Maryland resident (a son of the grantor) and with at least one Maryland trustee. The court described the terms of each trust as follows: "…during the grantor's life the trustees had the power at any time in their absolute and uncontrolled discretion to pay to or apply for the benefit of the grantor all or part of the net income and principal as the trustees should determine, in their absolute and uncontrolled discretion, for any reason whatsoever, including the termination of the trust, subject only to the condition that the trustees receive the written consent thereto of the respective beneficiary of the particular trust, …" This beneficiary was a son of the grantor, who benefitted after his mother's death.

Although during her life, Mrs. German did not report the gift, her estate sought to ultimately seek completed gift treatment and exclude the value of the trust from her taxable estate. At the time of the gift (1969) and her death (1970), the gift tax was in fact lower than the estate tax.

In ruling that the trust corpus was not includible in Mrs. German's estate, the Court of Claims based its conclusion on two "equally important" principles: (1) under Maryland law (at least as interpreted by the court), the settlor's creditors could not have reached the trust income or principal; and (2) any distribution had to be approved by an adverse party, i.e. the subsequent beneficiary. *Estate of German v U.S.*, 7 Ct. Cl. 641 (1985).

The fact that the *German* court's ruling did not rely solely on the inability of the settlor's creditors to reach the corpus renders the case as merely helpful in arguing for non-inclusion. If, however, an asset protection trust requires that an adverse party must consent to distributions, which may indeed be employed by the draftsperson to cause the trust to be non-grantor for income tax purposes under IRC section 677(a), then *German* is good authority.

Practice Point (courtesy of Jonathan Blattmachr, Esq.): As a practical matter, two steps in administration will help keep the assets out of the client's estate at death. The first is to appoint a new trustee before any distribution to the client is made. If that person was unaware of the trust when it was created, it would seem difficult for the IRS to argue successfully that there was an understanding with the trustee that distributions would be made. Second, someone (such as the trust advisor) should be authorized to eliminate the grantor as a beneficiary. The provisions of the Internal Revenue Code that are used to try to cause APTs into a client's estate apply only if the client has the interest at death.

Appendix D

Example of Omnibus Letter of Wishes

NAME
Address

Date

Letter of Wishes

To the Trustees, Distribution Advisors and Trust Protectors, and to their respective successors, under the following trusts established by us or either of us:

Dear ______:

Our purpose in creating these trusts is to provide a legacy of financial security to our descendants over multiple generations. It is our hope that our descendants will live responsibly and productively, but without the fear of financial hardship. We hope that our purpose will be respected at all times by our descendants and the fiduciaries acting under the trust.

This letter is to express our wishes to you when exercising discretion as to making or not making distributions to beneficiaries. We appreciate that our wishes do not bind you in any way and that you remain free to make distributions as you see fit in the exercise of your unfettered discretion. We have no understanding or agreement with any of you as to distributions, and this letter is not meant to establish any such understanding or agreement. The contents of this letter are not intended to constitute terms of any trust and are not intended to establish or imply any standard to guide any fiduciary in exercising discretion. These wishes are merely for your consideration to the extent that you deem advisable under the circumstances.

In administering these trusts, you would do well as fiduciaries if you would coordinate among yourselves when a distribution request is made by a beneficiary or when one of you perceives a need to act. Furthermore, when you determine to make distributions, we would suggest that you keep in mind the tax-sensitivity of these trusts. The _______ Trust is exempt from generation-skipping transfer tax. Therefore, it would be tax-advantageous if distributions were made first from non-exempt trusts.

Our wishes would be as follows:

If an adult beneficiary has sufficient maturity and has demonstrated prudence with financial affairs, to distribute each year up to _______ for his or her benefit.

To pay for any major health care costs that are not covered by insurance.

To pay for education at any level and related expenses such as books, supplies, room and board, whether at public or private institutions in the U.S. or abroad, and including graduate school and post-graduate studies.

To expend for educational [or leisure] travel.

To enable the beneficiary to purchase a home [or a second home], or to purchase the same as an asset of a trust and to allow the beneficiary cost-free use of the home.

To cover or contribute to the cost of [one] wedding.

To enable the beneficiary to go into business, if his or her business plan appears viable.

To expend for medical or psychological treatment which may be warranted by an addiction or other harmful condition.

To pay the costs of adequate health insurance, life insurance, disability insurance, long-term care insurance, and liability (umbrella) insurance for a beneficiary, and such other coverages as you may deem fit.

To pay the legal and other professional costs associated with the beneficiary's planning of his or her own legacy, with a view to appropriate structures for the succession of wealth and wise tax planning over multiple generations.

In general, it is our wish that our assets remain protected over time from the reach of any creditor or potential creditor of any descendant of ours, including, but not limited to, a spouse or former spouse. Please consider preconditioning any distribution on the beneficiary's undertaking to enter into a valid marital property agreement or valid choice of governing marital property law that, in your judgment, would serve to protect the distribution from the claims of a spouse or former spouse.

Sincerely yours,