

Domestic Asset Protection Trusts: More Might than First Appears

By RICHARD W. HOMPESCH II

Domestic asset protection trusts offer viable planning opportunities for those clients who do not want to go offshore. The degree of creditor protection depends on whether the settlor is named beneficiary, which state has jurisdiction, and which law applies.

There are a number of reasons why our clients may prefer not to go offshore and create trusts in one of the foreign jurisdictions that have repealed the Statute of Elizabeth¹ and offer debtor-friendly fraudulent conveyance statutes.

Some clients may be concerned about the political uncertainty of these offshore "asset-protection" havens or the possibility that the particular foreign jurisdiction could retroactively increase the registration fees or taxation of trusts. If the client does not have any present creditors and foresees none on the horizon, she may be unimpressed by how much easier it is to defraud a creditor in a foreign jurisdiction that has a much shorter statute of limitations on fraudulent conveyances or no statute at all. If the client will also be a beneficiary of the trust, she may be concerned about the adverse application of Internal Revenue Code (Code) Section 684. If the plan is to repatriate the trust to the United States before death, the client may ask, why not initially settle the trust in Alaska or Delaware? After all, death may be a more likely risk than a creditor attack.²

Furthermore, some clients may decide that they do not have to be a beneficiary of the trust; they may decide to create a

trust for the benefit of their spouse and other members of their family. If the settlor will not be a beneficiary of the trust, the benefits of going offshore are less significant. There may be other considerations as well, such as cost and the selection of a trustee. For these clients, domestic trusts may achieve their desired level of asset protection.

SPENDTHRIFT AND DISCRETIONARY TRUSTS IN GENERAL

All testamentary or lifetime irrevocable domestic trusts usually include a spendthrift clause that prevents a beneficiary from selling or otherwise assigning his interest in the trust and that prevents the creditors of a beneficiary from attaching the beneficiary's interest. In this sense, every domestic trust is an asset protection trust to some extent. All states except New Hampshire³ recognize the validity of spendthrift trusts, although some states have enacted other specific statutory exceptions that limit the protection.⁴

The main drawback of spendthrift trusts is that they do not offer complete protection from all claims against a beneficiary. If the settlor is a beneficiary of the trust, the general rule in most states, other than

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Alaska, Delaware, Colorado, and perhaps Missouri,⁵ is that the settlor's creditors can reach "the maximum amount which the trustee under the terms of the trust could pay to the settlor or apply for his benefit."⁶ Even if the settlor is not a beneficiary of the trust, her creditors still can reach the trust's assets to satisfy several types of claims. These include a claim against the beneficiary for child support or alimony, for necessary services rendered to the beneficiary, for services that preserve or benefit the interest of the beneficiary, or for claims by the United States or a state.⁷

Discretionary trusts offer greater protection than spendthrift trusts so long as the settlor is not a beneficiary.⁸ The trustee of a discretionary trust typically has the sole and absolute discretion to pay some, all, or none of the income and principal to one or more beneficiaries of the trust (other than the settlor). The beneficiaries of such a trust have no enforceable right to any portion of it. At best, the beneficiary's interest is only a mere expectancy that someday the trustee will distribute trust assets to her. If a discretionary trust does not include a spendthrift clause, a beneficiary could assign her interest, such as it is. Creditor protection is derived from the fact that the creditor who tries to attach the beneficiary's interest in the trust stands in no better position than a beneficiary who herself could not force the trustee to make a distribution. For this reason, discretionary trusts generally offer protection even from tax claims, child support, and alimony for beneficiaries other than the settlor.

In most states, spendthrift and discretionary trusts can be effective asset protection vehicles, so long as the settlor is not a beneficiary. For example, a person could establish an inter vivos irrevocable trust with a spendthrift clause for the benefit of a class consisting of her spouse and children and give the trustee the absolute discretion to pay income or principal in its discretion to the exclusion of one or members of the class. The settlor could retain a special power of appointment over the trust in or-

der to prevent her transfer to the trust from being a completed gift.⁹ Absent fraud or any prearranged understanding between the settlor and the beneficiaries, the trust assets would be protected from the claims of the settlor's creditors.¹⁰ In the alternative, if the settlor's spouse were the only beneficiary of the trust during the spouse's lifetime and all income had to be paid to the spouse, the trust would qualify for the gift tax marital deduction under Code Section 2523(f). The spouse also could be given a general power of appointment that could be exercised during the spouse's lifetime to appoint all trust assets back to the settlor.

Another possibility is to create a trust for the benefit of the settlor and other members of her family but to limit the settlor's interest in the trust. For example, the settlor could create a trust and direct the trustee to pay her all of the income for her lifetime and retain a testamentary special power of appointment over the principal. If the power were not exercised, the principal could pass to her children. Although the settlor's creditors could attach her income interest in such a trust, the principal would be protected under the laws of most states.

THE "STRONG" POLICY PROHIBITING SELF-SETTLED SPENDTHRIFT TRUSTS

If the settlor can make a gift in trust and protect it from the improvidence of her beneficiaries, then why shouldn't the settlor be able to name herself as a beneficiary and protect herself against her own improvidence as well?¹¹ Within the last two years Alaska and Delaware have challenged the public policy against self-settled spendthrift trusts and have passed specific statutory exceptions that allow such trusts.

The legislation has elicited a varied response. Very few Alaskans that this author contacted prior to passage of the Alaska Trust Act had heard about the "strong" public policy against such trusts. Most favored tort reform and did not believe that individuals could not put assets in a trust for the benefit of their families and themselves and protect the assets from their unknown fu-

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ture creditors. They felt that self-settled spendthrift trusts were not all that much different from individual retirement accounts (IRAs) or pension plans that were already protected from creditors under Alaska and federal law. Some commentators applauded Alaska and Delaware's new legislation.¹² Others were quick to point out the problems with the legislation and why foreign trusts offered superior creditor protection.¹³ One Attorney General stated publicly that he found Alaska's laws offensive and proposed legislation to counteract it.¹⁴ In this author's view, the public policy against self-settled spendthrift trusts is really not all that strong. Other states may follow Alaska and Delaware and erode, if not eradicate, this old English rule.¹⁵

It is interesting to note that the laws of some states other than Alaska and Delaware do not necessarily prohibit self-settled spendthrift trusts. Missouri Revised Statutes Section 456.080 appears to allow the creation of a "creditor proof" trust for the benefit of a class on a discretionary basis that includes the settlor of the trust in certain circumstances.¹⁶ Judges Learned and Augustus Hand and Judge Chase concluded in *Herzog v. Commissioner* [115 F.2d 591, 594 (2d Cir. 1941)] that under New York law the creditors of the settlor could *not* reach the assets of a trust where the settlor was merely one of several discretionary beneficiaries of the trust.¹⁷ The Seventh Circuit held that under Indiana law, settlor's creditors had no right to reach trust assets in *Estate of Uhl v. United States* [241 F.2d 867 (7th Cir. 1957)]. In this case, the settlor retained the right to be paid \$100 per month from the trust and gave the trustee discretion to pay him a greater sum than \$100 "if it shall deem advisable." The court of claims reached a similar result under Maryland law in *In Estate of German* [7 Cl. Ct. 641 (1985)]. The trust permitted the trustees to pay the settlor all or part of the trust income or principal in their uncontrolled discretion so long as they received written consent from the residual beneficiary and a trust committee of persons who were not

beneficiaries of the trust. The court of claims held that the creditors of the settlor could not attach the trust assets.

Another illustrative case is *In re Baum* [22 F.3d 1014 (10th Cir. 1994)]. Here the question was whether a trust that the debtor created six years before filing bankruptcy should be included in his bankruptcy estate under Title 11 of the United States Code (U.S.C.), Section 541(a)(1). The debtor established and filed of record a trust instrument creating two Colorado irrevocable trusts with an individual third-party trustee and transferred his residence, some furniture and fixtures, and a collection of antique clocks to the trust. He reserved the right to live in the residence so long as he timely serviced all encumbrances on the residence and paid all taxes, insurance, and utilities. When the trusts were settled, he had a net worth over \$1 million and total debts of only \$115,000. Six years later when he filed for Chapter 7 bankruptcy, the trustee sought to include the trust assets in the bankruptcy estate. The trustee argued that the trusts were void or at least voidable for the benefit of the creditors. The court stated that "the nature of a debtor's interest in property generally is determined by state law"¹⁸ and found that under Colorado law the rule that prohibits self-settled spendthrift trusts only applies to creditors who exist at the time the trust is settled.¹⁹ Because the trustee was not a creditor at the time the trusts were created, the court ruled that the trusts were not included in the debtor's bankruptcy estate.

ENFORCEMENT OF JUDGMENTS AGAINST DOMESTIC SELF-SETTLED SPENDTHRIFT TRUSTS

Critics have argued that Alaska (and Delaware) trusts will not hold up because the creditors will get a judgment in the state where the settlor resides and will transfer the judgment to Alaska (or Delaware). Then the Alaska courts would have to give full faith and credit²⁰ to the judgment and allow the creditor to attach

the assets of the trust.²¹ This analysis can be found wanting in a number of respects.

The first problem is that there is a big difference between a judgment against the settlor of the trust and a judgment against the trust. If the creditor obtains a judgment against the settlor, then this judgment could be transferred to Alaska and enforced. Alaska is one of the few states that has adopted the Uniform Foreign Money-Judgments Act²² and would give full faith and credit to the judgment. The creditor could serve a writ of execution upon the trustee and thereafter the trustee would have to pay the creditor all distributions from the trust that would have otherwise been made to the settlor. However, if the settlor was merely a discretionary beneficiary of the trust, the trustee could not be compelled to make a distribution to the settlor.²³ Probably the trustee would make distributions to the settlor's spouse or children instead. A judgment against the settlor could not be enforced against the trust, because under Alaska law the settlor does not own the trust assets.

The next possibility is that the creditor would sue the trustee in the state where the settlor resides and obtain a judgment against the trustee, forcing it to pay over the trust assets. The creditor could argue that the trust was a sham or that the laws of the state where the settlor resides (which does not permit self-settled spendthrift trusts) should govern the trust rather than the laws of Alaska (or Delaware). The creditor could argue that the trust violates a strong public policy in the state where the settlor resides and therefore the court should not recognize the trust. The argument is that after the creditor obtains a judgment against the trustee and transfers the judgment to Alaska (or Delaware), the Alaska courts would enforce the judgment.

This argument is also too simplistic. The first problem for the creditor is that under the Uniform Foreign Money-Judgments Act "[a] foreign judgment need not be recognized if . . . the cause of action on which the judgment is based is repugnant to the

public policy of [Alaska]."²⁴ The trustee could argue that Alaska should not recognize the foreign judgment because the judgment was based on the policy of another state that is contrary to Alaska's strong public policy that allows self-settled spendthrift trusts. Alaska is experiencing an influx of trust business to the state at a time when Alaska's oil industry appears to be facing a recession and Alaska is realizing the lowest historic prices ever for crude oil from Prudhoe Bay. It is doubtful that an Alaska court would ignore the strong public policy allowing self-settled spendthrift trusts that is found in the Alaska Trust Act.

The other problem is that the courts of the state where the settlor resides may not be able to get personal jurisdiction over the Alaska (or Delaware) trustee. This would not be a problem if the trustee was a corporate fiduciary with offices and trust powers in the state where the settlor resided. However, if the trustee did not have an office in the state where the settlor resided or trust powers in that state and did not regularly conduct business there, it is unclear whether the courts would have personal jurisdiction over the trustee. Perhaps the Alaska trustee would enter a limited appearance in the other state for the sole purpose of arguing that the court had no personal jurisdiction over the trustee. On the other hand, the trustee could ignore the litigation in the state where the settlor resided and then argue to the Alaska courts that the foreign judgment was not conclusive because "the foreign court did not have personal jurisdiction over the [trustee]."²⁵

This full faith and credit analysis would be incomplete without a discussion of the leading U.S. Supreme Court case *Hanson v. Denckla* [357 U.S. 235 (1958)]. In this case Mrs. Donner, a woman from Pennsylvania, created a Delaware trust and named the Wilmington Trust Company as trustee. The corpus of the trust was composed of securities. Mrs. Donner reserved the income of the trust for her lifetime and directed that

the remainder be paid to such persons or trusts as she may appoint by an inter vivos or testamentary instrument. About nine years later, Mrs. Donner changed her domicile and moved to Florida. There she executed a new will and exercised her power of appointment by appointing \$400,000 to two trusts that her daughter created for her children that named the Delaware Trust Company as trustee.

The issue was whether Mrs. Donner's appointment of the \$400,000 was effectively exercised. If the appointment was ineffective, then the \$400,000 would pass under the residue clause of Mrs. Donner's Florida will and not to the Delaware Trust Company as trustee of the two Delaware trusts. The Florida Chancellor ruled that Florida had no jurisdiction over the Delaware trustees and dismissed the case as to them. As to the other parties before the court, the Chancellor ruled that the power of appointment was void under Florida law and that the \$400,000 passed under the residuary clause of the will. The Florida Supreme Court affirmed the Chancellor's conclusion that Florida law applied to determine the validity of the trust and the power of appointment, but reversed the Chancellor's ruling that Florida had no jurisdiction over the Delaware trustees. The Florida Supreme Court ruled that jurisdiction to construe the will carried with it substantive jurisdiction over the persons of the absent Delaware trustee, even though no trust assets were physically present in Florida. When the litigants sought to enforce the Florida judgment in Delaware, the Delaware Courts refused to give it full faith and credit on the grounds that under Delaware law the trusts and the power of appointment were valid.

The U.S. Supreme Court found that the Florida courts lacked jurisdiction over the Delaware trusts and the Delaware trustees. The Florida courts did not have in rem jurisdiction because "the trust assets that form the subject matter of this action were located in Delaware and not in Florida" [*Id.*

at 247]. The Florida courts lacked personal jurisdiction over the Delaware trustees because the "minimal contacts" necessary for Florida to have in personam jurisdiction over the Delaware trustee were not present, citing *International Shoe v. State of Washington* [326 U.S. 310]. "The defendant trust company has no office in Florida, and transacts no business there. None of the trust assets has ever been held or administered in Florida, and the record discloses no solicitation of business in that State either in person or by mail" [*Hanson* at 251]. The Supreme Court held that Delaware did *not* have to give full faith and credit to the Florida judgment when to do so would be offensive to the due process clause of the Fourteenth Amendment.

CHOICE OF LAW

The U.S. Supreme Court in *Hanson* did not decide what law should apply to determine the validity of the trust and the exercise of the power of appointment. The Florida courts held that Florida law applied because Mrs. Donner was domiciled there when she died. The Delaware courts held that Delaware law applied most likely because the trustees and the trust were located there.

The general rule that determines what law applies to determine whether the interest of a beneficiary can be reached by his creditors is determined

in the case of an inter vivos trust, by the local law of the state . . . in which the settlor has manifested an intention that the trust is to be administered, and otherwise by the local law of the state to which the administration of the trust is most substantially related.²⁶

For this reason both Alaska and Delaware law require a substantial nexus with the particular state. For example, in Alaska one of the trustees must be an individual domiciled in Alaska or a bank or trust company with its principal place of business in

Alaska, some or all of the assets must be physically present in Alaska, the Alaska's trustee's powers must include maintaining trust records in Alaska and preparing for arranging for the preparation of tax returns, and all or part of the trust administration must occur in Alaska.²⁷

National Shawmut Bank of Boston v. Cumming [91 N.E. 337 (Mass. 1950)] demonstrates the application of the general rule. In this case the settlor was domiciled in Vermont and settled a trust in Massachusetts, naming National Shawmut Bank of Boston as trustee. Upon his death, the income of the trust was paid equally to his widow, mother, two brothers, and three sisters. Upon the death of all income beneficiaries the trust was to be distributed to his nieces and nephews. After his death, his widow sued the bank and made two arguments. She alleged that the trust was created in bad faith with intent to defraud her of her widow's rights under Vermont law and that the validity of the trust should be determined by Vermont law (the state of the settlor's domicile). The Massachusetts court quoted the governing law provision of the trust that stated that "[t]his instrument shall be construed and the provisions thereof interpreted under and in accordance with the laws of . . . Massachusetts."²⁸ The court held that Massachusetts law governed the trust and affirmed the dismissal of the widow's claim.

The U.S. Bankruptcy Court in *In re Remington* [14 B.R. 496 (D.N.J. 1981)] also applied the general rule that the law governing the trust controls. The debtor in this case resided in New Jersey and was the beneficiary of a discretionary trust created by his grandfather that was governed by Pennsylvania law. The court found that Pennsylvania law, not New Jersey law, governed the debtor's interest in the trust.

BANKRUPTCY COURTS APPLY THEIR OWN LAW

The most daunting criticism about Alaska and Delaware self-settled spendthrift trusts

is the threat that the creditors will force the settlor into bankruptcy. The bankruptcy courts have exclusive jurisdiction over the property of the bankruptcy estate.²⁹ Although Title 11 of the United States Code, Section 541(c)(2) provides that "[a] restriction on the transfer of a beneficial interest in a trust that is enforceable under bankruptcy law is enforceable" in a bankruptcy case,³⁰ the bankruptcy courts have found reasons to ignore the law governing the trust. There are three cases on point, and each has its own set of egregious facts.

The first case, *In re Portnoy* [201 B.R. 685 (S.D.N.Y. 1996)], involved a debtor who resided in New Jersey, a New York creditor, and a Jersey Channel Island Trust. The court applied New York law after citing Restatement (Second) of Conflicts of Laws, Section 270 (1971):

An inter vivos trust of interests in movables is valid if valid (a) under the local law of the state designated by the settlor to govern the validity of the trust, provided that this state has a substantial relation to the trust and 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 the most significant relationship. . . .³¹

and concluding that Portnoy and his creditors (and therefore, his trust) had a more significant relationship to New York.

The second case, *In re Brooks* [1998 Bankr. LEXIS 69 (Jan. 26, 1998)], involved a debtor who resided in Connecticut and had Connecticut creditors and trusts located in the isle of Jersey and Bermuda. The court applied Connecticut law and held that the trust assets were part of the bankruptcy estate.

The third case is *In re Brown* [4 Ark. B.R. 279 (D.Alaska 1995)], which was decided before Alaska changed its law regarding self-settled spendthrift trusts. The case involved two Belize trusts created by another individual for an Alaska accountant and his spouse. Here the court applied old Alaska law, not Belize law, on the basis that the trusts were shams.

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These cases demonstrate what a bankruptcy judge will do when the debtor engages in disreputable conduct or when the formalities of a trust are not observed. For example, in *Portnoy*, Marine Midland Bank loaned Portnoy's (the debtor's) corporation over \$1 million in March of 1998. The debtor personally guaranteed the debt. In August 1989, the debtor established his offshore trust and began transferring assets to the trust. The reader can sense how the judge was going to rule from her opening comments about the case:

At the heart of this debtor's summary judgment motion lies an irrevocable offshore trust into which he placed virtually all of his assets at a time when he knew that his personal guarantee of his corporation's indebtedness was about to be called.³²

An inference can be drawn that the timing was purposeful, for in June, two months before the trust's creation, Portnoy knew that [his corporation] was in trouble and in December of that same year, [the corporation] had defaulted on its obligation.³³

The timing of the debtor in *Brooks* was only slightly better. In the spring and summer of 1990 he transferred the stock from his Connecticut corporations to his wife, who quickly thereafter transferred them to the offshore trusts. Shortly thereafter, on November 7, 1991, the creditors filed an involuntary Chapter 7 petition.

In *Brown* the facts were different. Neither trust conducted any business activity in Belize, none of the trust assets were placed in the hands of the trustee, nor did the trustee control any of the trust assets. In addition, the creator and trustee of the trust had not signed a single trust document since the trust was formed in 1989 and, in fact, the debtors had the ability to withdraw assets from the trust without any interference from the trustee. Under these facts it was easy for the court to conclude that the Belize trust with the most significant assets was "simply a sham."

Although this author will not dispute that the court reached the correct result in each case, the analysis in *Portnoy* and *Brooks* bears examination. In *Portnoy* the court applied the most significant relationship test and found that the debtor and his creditors had a more significant relationship to New York. However, the significant relationship test rule provides that the law governing the trust will apply

provided that this state has a substantial relation to the trust and 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 the most significant relationship [emphasis added].

The court never explained how the debtor's Channel Islands trust had a more significant relationship to New York law (or New Jersey law where the debtor resided) rather than Channel Islands law. In *Brooks* the court stated that "Connecticut courts have held that the legality of the trust of personalty [is determined] by the law of the settlor's domicile not the law chosen by the settlor in the trust instrument [citing *Stetson v. Morgan Guaranty Trust Co. of New York*, 164 A.2d 110 (1974)]."³⁴ However, in *Stetson* the trust instruments were silent regarding the law to be applied to them³⁵ and the court relied on following rule:

The determination of the question whether the trusts are Connecticut trusts or New York trusts will be resolved by the weighing of the following factors: (1) the implied intention of the settlors; (2) the domicile of the settlors; (3) the domicile of the trustee; (4) the domicile of the beneficiaries; (5) the place where the trust instruments were executed; and (6) the location of the trust property.³⁶

It would seem that the application of this rule would uphold the spendthrift protection of Alaska and Delaware trusts.

PRIVATE LETTER RULING ON AN ALASKA TRUST

All commentators seem to agree that the choice of law issue would not be a problem if the debtor resided in Alaska or Delaware.³⁷ A recent private letter ruling confirms this point. Private Letter Ruling 9837007 involved an Alaska resident who wanted to create a self-settled spendthrift trust in Alaska for the benefit of her family and herself. Other than the expectation that someday she could be a beneficiary of the trust, the settlor did not retain any other powers over the trust such as a veto power or a special testamentary power of appointment.³⁸ She asked the Internal Revenue Service (IRS) to rule that the transfer to her trust would be a completed gift and that the trust would not be included in her estate. After citing Treasury Regulation 25.2511-2(b) and Revenue Ruling 77-378 [1977-2 C.B. 348], the IRS ruled that the transfer to the trust would be a completed gift because under state law "a creditor of the settlor will be precluded from satisfying claims out of the settlor's interest in the trust." The service declined to rule, however, as to whether the trust assets would be part of the settlor's estate.

DO THEY WORK?

Whether a domestic asset protection trust will achieve the level of protection desired by a client depends on a myriad of factors. It is well accepted that if the settlor is not a beneficiary, domestic trusts can offer sub-

stantial protection. If the settlor will be a beneficiary, the outcome will be less predictable.³⁹ The most important fact will be the timing of the creation of the trust and the date the creditor claim arose. If the settlor settles a domestic trust, or a foreign trust for that matter, and a creditor is on her heels, the courts seem to be very willing to apply whatever law is necessary to achieve a just result. This does not mean that domestic asset protection trusts do not work.⁴⁰ Certainly any asset protection is better than none, and perhaps the time (and money) it will take a creditor to litigate over a domestic asset protection trust will be sufficient to forge a favorable settlement.

Although no one can claim that Alaska or Delaware law offers greater asset protection than the law of any number of offshore jurisdictions, domestic asset protection trusts may have one slight advantage. If the settlor settles a trust under domestic law and is willing to assume all the attendant risks, then perhaps the settlor really does not intend to defraud her creditors.⁴¹ One could argue that foreign trusts offer much better planning opportunities for the "dishonest" debtor, notwithstanding the results in *Portnoy* and *Brooks*; the last thing a dishonest debtor should do is to settle a domestic trust. On the other hand, bankruptcy judges seem to be very suspicious of debtors who try to move their assets outside of the reach of the American judicial system. For this reason, bankruptcy judges just may find the settlor of a domestic trust a little more believable.

ENDNOTES

1. This rule was codified in England in 1487 by a statute that provides "All deeds of gift of goods and chattels, made or to be made in trust to the use of that person or persons that made the same deed or gift, be void and of none effect" [Stat. 3 Hen. VII, c. 4]. A similar statute has been enacted in the following states:

Alabama: CODE 1975, § 8-9-7

Arkansas: STATS. 1947, § 68-1301

Colorado: REV. STAT. 1973 § 38-10-11

Idaho: CODE 1947, § 55-905

Indiana: CODE 1971, § 32-2-1-15

Kansas: GEN. STAT. 1949, § 33-101

Michigan: STAT. ANN. § 26.921

Nebraska: REV. STAT. 1943, § 36-201

New Jersey: REV. STAT. § 25-2-1

New York: ESTATE, POWERS AND TRUST LAW § 7-3.1

Ohio: REV. CODE § 1335.01 (real and personal property)

Oregon: REV. STAT. § 95.060

Utah: CODE ANN. § 25-1-11

Washington: REV. CODE § 19.36.020

Wisconsin: STATS. § 701.06

See, generally, SCOTT ON TRUSTS § 156, note 5, at 168 (4th ed. 1989).

2. It might be better to create a domestic trust with a flee clause allowing the trustee or trust protector to move the trust offshore than to create a foreign trust

- and plan to repatriate it in the future. If a creditor appeared on the horizon and the situs of the domestic trust was changed to a foreign jurisdiction, the transfer of assets offshore might not be a fraudulent conveyance. See A. Bove & J. Williams, *Does All That Glitter Really Protect the Gold?*, ASSET PROTECTION J., 1 (Winter 1999).
3. *Bradley v. State*, 100 N.H. 232, 123 A.2d 148 (1956).
 4. California allows creditors to reach up to 25 percent of the payment that would have otherwise been made to the beneficiary [Calif. Prob. Code §15306.5(b)]. Georgia and Louisiana allow tort creditors of a beneficiary of a spendthrift trust to satisfy their claims from the trust [GA. CODE ANN. §53-12-28; LA. REV. STAT. ANN. §9:2005].
 5. According to the interpretations of state law in *Herzog v. Commissioner* [115 F.2d 591, 594 (2d Cir. 1941)], *Estate of Uhl v. United States* [241 F.2d 867 (7th Cir. 1957)], and *In Estate of German* [7 Cl. Ct. 641 (1985)], New York, Indiana, and Maryland law should be added to the list.
 6. RESTATEMENT (SECOND) OF TRUSTS §156(2) (1957).
 7. RESTATEMENT (SECOND) OF TRUSTS §157 (1957).
 8. If the settlor is a beneficiary of a discretionary trust, the rule stated in Restatement (Second) of Trusts, Section 156(2) applies.
 9. Treas. Reg. §25.2511-2(b).
 10. It seems that the beneficiaries could make gifts back to the settlor so long as there was no prearranged understanding to this effect or no pattern of conduct upon which such an understanding could be inferred.
 11. For a summary of the policy arguments for and against self-settled spendthrift trusts, see R. MANLEY, ESTATE PLANNING AND ASSET PROTECTION USING SELF-SETTLED ALASKA TRUSTS (Heckerling Institute 1999), at 9-11.
 12. See, e.g., L. Asinof, *Protection of Offshore Trusts Comes Onshore in Two States*, THE WALL STREET JOURNAL, July 23, 1997, quoting Barry S. Engel: "Now you have a state legislature saying this thing is good. This is just the next step in the line of acceptance."
 13. See, e.g., L. Giordani & D. Osborne, *Will the Alaska Trust Work?*, 3 J. OF ASSET PROT. 1 (Sept./Oct. 1997).
 14. The Honorable Richard Blumenthal, Attorney General for the State of Connecticut, during his remarks at the Third Annual Bankruptcy Symposium on November 6, 1998, at the Quinnipiac College School of Law, sponsored by the Commercial Law and Bankruptcy Section of the Connecticut Bar Association.
 15. The rule against perpetuities also appears to be eroding. It has been repealed in eight states.
 16. *Cf. In re Enfield*, 133 B.R. 515 (Bankr. ED Mo. 1991). Here, the court stated that the new statute did not change the existing rule that prohibited self-settled spendthrift trusts.
 17. An intermediate court of the state of New York held, in effect, to the contrary of *Herzog*. See *Vanderbilt Credit Corp. v. Chase Manhattan Bank, NA*, 100 A.D.2d 544, 473 N.Y.S.2d 242 (1984).
 18. *Id.* at 1017.
 19. All deeds of gifts, all conveyances . . . of goods, chattels, or things in action, or real property, made in trust for the use of the person making the same shall be void as against the creditors existing of such person" ((emphasts added), COLO. REV. STAT. §38-10-111).
 20. Article IV, Section 1 of the U.S. Constitution states: "Full faith and credit shall be given in each State to the public Acts, Records, and judicial proceedings of every other state."
 21. See, e.g., B. McMenamin, *Filmsy Shelters*, FORBES, Sept. 8, 1997.
 22. ALASKA STAT. § 09.30.100 *et. seq.*
 23. Alaska Statutes Section 34.40.110, entitled "Restricting transfers or trust interests," provides:
 - (a) A person who in writing transfers property in trust may provide that the interest of a beneficiary of the trust may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee. In this subsection, (1) "property" includes real property, personal property, and interests in real or personal property; (2) "transfer" means any form of transfer, including deed, conveyance, or assignment.
 - (b) If a trust contains a transfer restriction allowed under (a) of this section, the transfer restriction prevents a creditor existing when the trust is created, a person who subsequently becomes a creditor, or another person from satisfying a claim out of the beneficiary's interest in the trust, unless the
 - (1) transfer was intended in whole or in part to hinder, delay, or defraud creditors or other persons under AS 34.40.010;
 - (2) trust provides that the settlor may revoke or terminate all or part of the trust without the consent of a person who has a substantial beneficial interest in the trust and the interest would be adversely affected by the exercise of the power held by the settlor to revoke or terminate all or part of the trust; in this paragraph, "revoke or terminate" does not include a power to veto a distribution from the trust, a testamentary special power of appointment or similar power, or the right to receive a distribution of income, corpus, or both in the discretion of a person, including a trustee, other than the settlor;
 - (3) trust requires that all or a part of the trust's income or principal, or both, must be distributed to the settlor; or
 - (4) at the time of the transfer, the settlor is in default by 30 or more days of making a payment due under a child support judgment or order.
 - (c) The satisfaction of a claim under (b)(1)-(4) of this section is limited to that part of the trust to which (b)(1)-(4) of this section applies.
 - (d) A cause of action or claim for relief with respect to a fraudulent transfer under (b)(1) of this section or under other law, is extinguished unless the action is brought as to a person who
 - (1) is a creditor when the trust is created within the later of
 - (A) four years after the transfer is made; or
 - (B) one year after the transfer is or reasonably could have been discovered by the person; or
 - (2) becomes a creditor subsequent to the transfer into trust within four years after the transfer is made.

(e) In this section, "settlor" means a person who transfers real property, personal property, or an interest in real or personal property, in trust.

The creditor of a beneficiary of a discretionary trust can only attach whatever interest the beneficiary has (see, generally, P. SPERO, ASSET PROTECTION (Warren Gorham & Lamont, 1994 and 1997, Cum. Supps.), ¶ 6.02 and ¶ 6.03).

24. ALASKA STAT. §09.30.120(b)(3).
25. ALASKA STAT. §09.30.120(a)(2).
26. RESTATEMENT (SECOND) CONFLICTS OF LAWS §273(b) (1971).
27. ALASKA STAT. §§13.36.390(1), 13.36.035(c).
28. *Id.* at 339.
29. 28 U.S.C. §1334.
30. Some experts argue that Congress did not contemplate domestic self-settled spendthrift trusts before it enacted section 541(c)(2) [see, e.g., L. Giordani & D. Osborne, *supra* note 13, at 12]. Other experts maintain that Congress intended to protect all spendthrift trusts. See, e.g., R. NENNO & W. SPARKS, THE USE OF DELAWARE TRUSTS IN ESTATE PLANNING (Heckerling Institute, 1999), at III-A-27: "Because the legislative history indicates that this exception was intended to cover spendthrift trusts, and because the Act requires a spendthrift clause, it is unlikely that a bankruptcy court would include a qualified disposition (under Delaware law) in the bankruptcy estate of a debtor."
31. *Portnoy* at 698.
32. *Id.* at 688.
33. *Id.* at 689.
34. *Brooks* at 15.
35. *Stetson*, 164 A.2d at 240.
36. *Id.*
37. One expert even suggested that a debtor could avoid the public policy issues by moving to Alaska or Delaware (P. Spero, *The Effectiveness of the New Alaska and Delaware Asset Protection Trust Laws*, J. OF ASSET PROT. (Mar./Apr. 1998), at 45.
38. The settlor may retain a veto power or a special testamentary power of appointment over an Alaska trust and still enjoy the spendthrift protection (ALASKA STAT. §4.40.110(b)(2)). If the settlor retains a special testamentary power over the trust, her transfers to the trust will be incomplete gifts [Treas. Reg. §25.2511-2(b)].
39. Another planning option is to combine both options. Consider having a spouse settle a trust for the benefit of her spouse and children and provide that if the spouse predeceases the settlor, then the settlor will become a discretionary beneficiary of the trust. The settlor could be given the power to renounce her potential interest in the trust in the event her spouse predeceases her, but she really does not need to be a beneficiary of the trust at that time.
40. See B. Engel, *Does Asset Protection Planning Really Work?*, J. OF ASSET PROT. (Sept./Oct. 1998).