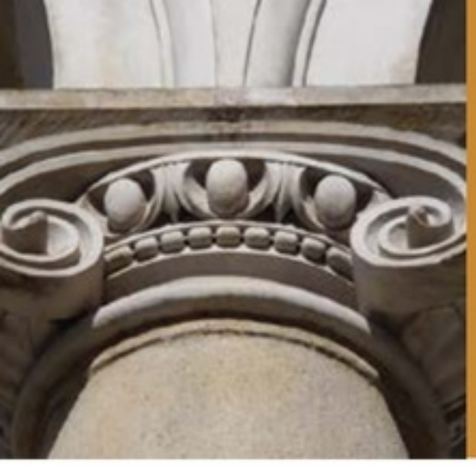

By **Mark Merric** & **Daniel G. Worthington**

Best DAPT Jurisdictions Based on Three Types of Statutes

Analysis of where to set up a domestic asset protection trust

Sixteen states, or over 30 percent of the states in the United States, now have domestic asset protection trust (DAPT) statutes. Some commentators thought that DAPT statutes would be limited to less populous states, but Ohio, for example, which is a populous state and one with a major banking center, adopted DAPT legislation. Also, at the time of this writing, both of Michigan's legislatures passed a DAPT statute, which is waiting for the governor's signature.[1] This adoption would create the 17th DAPT state. While the history of asset protection trusts (APTs) is fairly recent in the United States beginning with Alaska in 1996,[2] we anticipate that many more jurisdictions will adopt DAPT statutes.

DAPTs are a powerful tool to help clients legally shield assets from third-party liability, while at the same time permit clients to be discretionary beneficiaries of their own trusts.

In past articles, we gave one ranking of all the DAPT jurisdictions using the factors from the following two major types of statutes: (1) a discretionary support trust statute; and (2) the DAPT statute, which in many states is known as a "qualified disposition statute." We've now deviated from this approach. We've added an anti-alter ego statute, and we're now separately ranking: (1) the discretionary support trust statute; (2) the anti-alter ego statute; and (3) the DAPT statute.

A Brief History

To understand how the three statutes function, we'll give a brief history regarding the formation of these trust statutes. Common law discretionary trust protection originated under English common law and isn't related to spendthrift protection. Rather, discretionary trust protection is based on whether a beneficiary does or doesn't have an enforceable right to a distribution,[3] and therefore, whether a potential creditor may stand in the shoes of a beneficiary. In this respect, if the beneficiary has no enforceable right, the beneficiary's interest isn't a property interest[4] and is nothing more than an expectancy that can't be attached by any creditor.[5]

It's the beneficiary's lack of an enforceable right to force a distribution that provides the key concept to protecting against claims of creditors, including the following types of marital claim issues:

1. Will the beneficiary's trust interest be considered marital property subject to division in a divorce?
2. Will an estranged spouse be able to force a distribution through a minor child beneficiary? and
3. Will undistributed income be imputed by a court in the computation of a beneficiary's child support or alimony?

A discretionary support statute is designed to codify the common law of the *Restatement (Second) of Trusts (Restatement Second)*. It was created in response to the *Restatement (Third) of Trusts*' fairly unsupported position that would drastically weaken common law discretionary trust protection.

At the same time that South Dakota was the first state to codify discretionary support trust law, it also was concerned with the rise of alter ego arguments (sometimes referred to as "dominion and control" arguments) that

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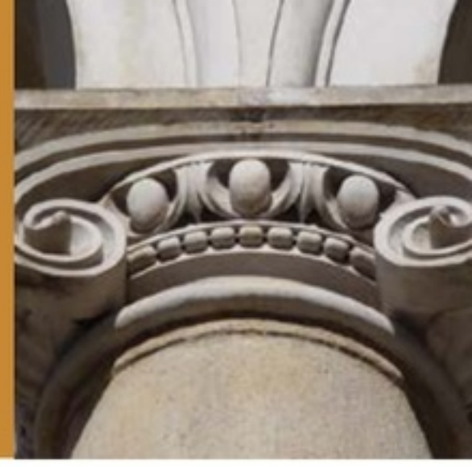


were being used to pierce a beneficiary's interest in a trust. Therefore, South Dakota, Nevada, Tennessee, as well as some other states, adopted statutes that protect against factors such as the settlor holding a removal/replacement power over the trustee, a trustee being a beneficiary, the settlor's relationship to the trustee and many others as constituting the trust being the alter ego of either the trustee or a beneficiary.

As U.S. trust law developed from English trust law, it continued to respect discretionary trust protection. Conversely, English courts throughout the world generally have rejected spendthrift protection developed under U.S. trust law. In general, a spendthrift clause is one that prohibits a creditor from attaching a beneficiary's interest and, in most states, also prohibits the beneficiary from selling the interest. The first offshore DAPT statute was designed based on the settlor/beneficiary's interest through spendthrift protection. This concept was instituted by almost all of the offshore APT statutes and DAPT statutes. However, the DAPT statutes incorporated the U.S. concept of exception creditors for items such as child support and maintenance—with one key difference. While exception creditors applied only to support trusts, a trust in which a beneficiary had an enforceable right to a distribution, DAPT exception creditors generally apply to both discretionary and support trusts. As discussed later in this article, the ability of an exception creditor to attach a discretionary trust interest in a DAPT is actually inconsistent with the common law definition of a discretionary trust. This leads to a major weakness in a third-party trust should the drafter decide to include both the benefits and burdens of certain DAPT statutes as part of the protection of the third-party trust. It also highlights the need for many states to adopt an anti-alter ego statute.

The Rankings

When ranking the DAPT statutes in the three categories of (1) discretionary support statutes, (2) anti-alter ego statutes, and (3) DAPT statutes, we report the following results.

The top tier states for the discretionary support statutes are Alaska, Michigan, Oklahoma, South Dakota and Tennessee. The second tier states are Delaware, Nevada, New Hampshire, Ohio and Wyoming. (See "Discretionary Support Statute Rankings," p. 66.)

The top tier states for anti-alter ego statutes are Mississippi, Nevada, Oklahoma, South Dakota and Tennessee. There's no second tier, as the other DAPT states haven't yet adopted an anti-alter ego statute. (See "Anti-Alter Ego Statute Rankings," p. 68.)

The top tier DAPT statutes are Nevada, Ohio and South Dakota. The second tier includes Alaska, Delaware, New Hampshire, Tennessee and Wyoming. While Nevada and South Dakota are very close, we note that Ohio most likely has drafted the leading edge DAPT statute at this point in time.[6] (See "DAPT Statute Rankings," p. 76.)

Kloiber involves the transfer of marital assets to a third-party irrevocable trust.

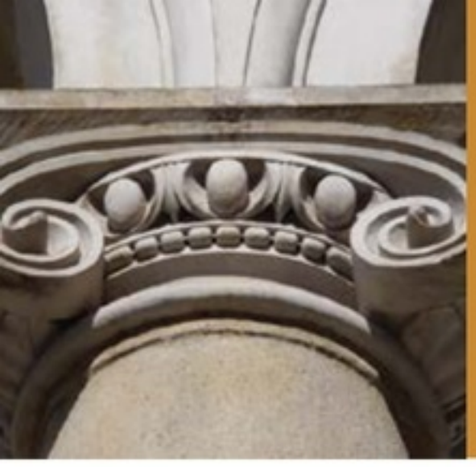
Finally, while no DAPT state has adopted the Uniform Voidable Transactions Act (UVTA), its adoption by a DAPT state would be fairly fatal to any such state trying to get business from settlors outside the state.

Case Study

A recent case in Delaware, *In re Daniel Kloiber Dynasty Trust (Kloiber)*,[7] highlights many of the reasons a settlor would choose to seek a trust jurisdiction that has strong statutes in all three of the above types of asset protection statutes. Further, such trust jurisdiction should have resolved the legal inconsistencies among the different types of statutes, such as an exception creditor as applied to a discretionary trust. We'll use this case as a study to highlight some key asset protection features in the above APT statutes. Other factors of each statute are listed in our ranking charts comparing the various jurisdictions.

Kloiber involves the transfer of marital assets to a third-party irrevocable trust. However, the trust specifically invoked the asset protection benefits and detriments of Delaware's qualified disposition statute.

Case summary. The trust was designed as a beneficiary defective irrevocable trust (BDIT). On



Discretionary Support Statute Rankings

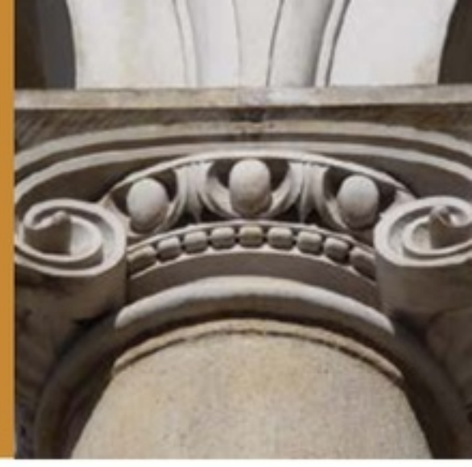
Five jurisdictions made the top tier

	Jurisdictions listed alphabetically within tier	No enforceable right to distribution	Detailed definition of discretionary trust	No creditor may attach discretionary interest	Elevated judicial review standard discretionary trust
First tier	Alaska	Yes	No[1]	Yes	Yes
	Michigan	Yes	No[1]	Yes	No
	Oklahoma	Yes	Yes	Yes	Yes
	South Dakota	Yes	Yes	Yes	Yes
	Tennessee	Yes	Yes	Uncertain[2]	Yes
Second tier	Delaware	No	No	Yes	Probably[3]
	Nevada	No	No[4]	Yes	Yes
	New Hampshire	Case law[5]	No	No	Case law[5]
	Ohio	Case law	Restrictive[6]	Yes	Probably
	Wyoming	No	No[1]	Yes	Uncertain[7]
Third tier	Arizona	No	No	No	No
	Hawaii	No	No	No	No
	Mississippi	No	No	No	No
	Missouri	Yes	Yes	No	No
	Rhode Island	No	No	Case law	Case law
	Utah	No	No	No	No
	Virginia	No	No	Yes	No
	West Virginia	No	No	No	No

Endnotes

1. Alaska, Michigan and Wyoming use a broad and possibly oversimplistic definition of "trust" whenever a trustee has discretion to make a distribution. Query whether the trust in *In re Daniel Kloiber Dynasty Trust*, 2014 WL 3924309 (Del. Chancery unpublished, Aug. 6, 2014), can be a discretionary trust under these states' laws.
2. Tennessee Uniform Trust Code (UTC) Section 501 appears to possibly allow an exception creditor to attach a discretionary trust.
3. Title 12, Delaware Code Section 3315(a) states, "Where discretion is conferred upon the fiduciary with respect to the exercise of a power, its exercise by the fiduciary shall be considered to be proper unless the court determines that the discretion has been abused within the meaning of Section 187 of the *Restatement (Second) of Trusts* not Sections 50 and 60 of the *Restatement (Third) of Trusts*." While this is a step in the right direction, Delaware's approach is a far cry from certainty when compared with a statute that specifically lists that judicial review is limited to (1) improper motive; (2) dishonesty; and (3) failure to use judgment.
4. Nevada doesn't have a detailed definition. For example, Nevada Revised Statute Section 163.017(b) classifies a distribution interest as a support interest, "If it contains a standard for distribution for the support of a person which may be interpreted by the trustee as necessary." This statement adds further concern, as leaving it up to a court to decide when the distribution language will create an enforceable right gives little guidance on how to draft a support trust or discretionary trust.
5. *In re Goodlander*, 20 A.3d 199 (N.H. 2011) favorably interpreted New Hampshire UTC Section 814(a) so that discretionary current distribution interest wasn't found to be either an enforceable right or a property interest in the context of marital property.
6. Richard Covey, in *Practical Drafting* (April 2007), at p. 8,918, criticized the Ohio UTC due to its very limited definition of "discretionary trust." An Ohio "wholly discretionary trust" (one that isn't a special needs trust), can't have any standards or guidelines. For many planners, this issue alone may be determinative in deciding not to situs a trust in Ohio.
7. Realizing the problems with a single judicial review standard of "good faith," Douglas McLaughlin, the primary drafter of the Wyoming UTC, was instrumental in deleting UTC Section 814(a). Unfortunately, it's still uncertain whether a Wyoming judge will apply a *Restatement (Second)* or *Restatement (Third)* judicial review standard.

— Mark Merric & Daniel G. Worthington



Dec. 20, 2002, the client's father settled a Delaware irrevocable discretionary dynasty trust (dynasty trust) with $15,000. The beneficiaries of the dynasty trust are Dan, Dan's spouse (defined in general as the person he's currently married to) and Dan's descendants.

In early 2003, Dan sold 99.45 percent of his shares in Exstream Software, Inc. (Exstream) to the dynasty trust for an unsecured promissory note with a face amount of $6 million. So, instead of an intentionally defective irrevocable trust installment sale, we have a BDIT installment sale. Naturally, most courts would question how a minority discount could be obtained on the sale of a 99.45 percent interest, as well as how beneficiary guarantees work with this type of structure. Further, in June 2007, the dynasty trust sold 80 percent of Exstream for $250 million. Nine months later, it sold the other 20 percent of Exstream for $60 million. This $60 million sale raised questions regarding the original valuation on the transfer and how something worth $340 million was sold five years later to the trust for a $6 million unsecured promissory note guaranteed by the beneficiary.

The dynasty trust was most likely drafted as a support trust with the following confusing language: The trustee "shall pay to or apply for [Dan's] benefit" such amounts as "shall be necessary or advisable from time to time for [Dan's] health, education, support, and maintenance." Under some states' laws, it might be uncertain whether the "or" gives any discretion to the trustee in denying Dan a request for a distribution pursuant to the standard of health, education, maintenance and support (HEMS). This is because the first part of the sentence is a common law support interest based on mandatory distribution language combined with an ascertainable standard. The "or advisable" language in the second clause implies discretion. This need for clarity is the exact reason why it's so important for a discretionary support statute to define the line between a discretionary trust and a support trust. In this respect, South Dakota and Tennessee have the best statutes that provide detailed examples.

The dynasty trust was drafted under Delaware's directed trust statute, with a Delaware trustee and a special trustee. The trust agreement delegated almost all the trustee powers, including investment and distributions, to the special trustee, Dan, who's a Kentucky resident. The Delaware Chancery Court correctly points out the only duties the Delaware trustee has is: "(i) to maintain or arrange for custody, in the jurisdiction serving as situs of the trust, of some or all of the trust property, (ii) to maintain records for the trust on an exclusive or nonexclusive basis; and (iii) to prepare or arrange for the preparation of fiduciary income tax returns for the trust."

Dan asserts that his estranged spouse, Beth, knew of the beneficiary installment sale to the trust in 2003. Beth asserts she didn't find out about the trust until after the divorce proceedings began. Finally, when the Kentucky Family Court issued an order over Dan, he resigned as special trustee and appointed Nick, who appears to be Dan's brother. Later, Nick filed for a temporary restraining order (TRO) asking the Delaware court to declare that the Kentucky court is engaging in undue interference with the Delaware court's primary supervision over the dynasty trust and disregarding due process in an attempt to arrogate to itself control over the administration of the trust.

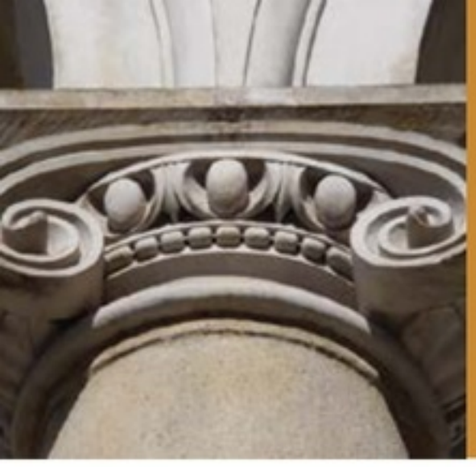
> The best codification of discretionary trust law is South Dakota's discretionary support trust act.

The Delaware court held:

> This court has an interest in having matters of trust administration that are governed by Delaware law decided here so that the Delaware Supreme Court can ensure they are decided correctly. Just as this court has no interest in interfering in the conduct of judicial proceedings before a court of a different state, this court also has no interest in having Delaware law deployed to defeat the marital property laws of another state.[8]

Further, the Delaware court concluded:

> Given that this court has not previously exercised supervisory jurisdiction over the Dynasty Trust, the terms of the Trust Agreement that minimize the opportunities for judicial supervision, the potentially ephemeral connection between the



Anti-Alter Ego Statute Rankings

Just five states have enacted these laws

Jurisdictions listed alphabetically	Settlor serves as trustee or co-trustee	Beneficiary serves as trustee or co-trustee	Settlor or beneficiary has a management duty in any entity owned by the trust	Person related by blood or adoption is appointed trustee	Agent, accountant, attorney, financial advisor or friend of settlor or beneficiary is appointed as trustee	Business associate of settlor or beneficiary is appointed as trustee	Beneficiary holds any power of appointment over the trust property
Mississippi	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Nevada	Yes	Yes	Yes	Yes	Yes	Yes	No
Oklahoma	Special trustee[1]	Yes	Yes	Yes	Yes	No	No
South Dakota	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Tennessee	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Endnote

1. The Oklahoma statute allows the settlor to serve as a trust protector, trust administrator and special trustee.

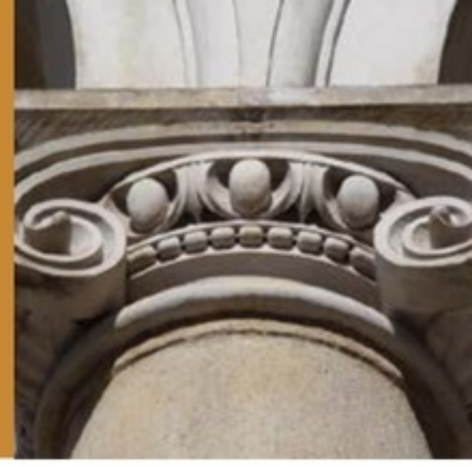
> Dynasty Trust and Delaware [referring to almost all of the Trustee powers being allocated to the Special Trustee, a Kentucky resident], and the lack of any supervisory jurisdiction in this court when the Kentucky Family Court issued its orders, the claim of interference is faintly tinged at best.[9]

Then, the court denied Nick's TRO request, noting that "when a Delaware state statute assigns exclusive jurisdiction to a particular Delaware court, the statute is allocating jurisdiction among the Delaware courts. The state is *not* making a claim against the world that no court outside of Delaware can exercise jurisdiction over that type of case."[10] Further, the court concluded, "this court's role does not include acting as a quasi-appellate court for interlocutory review of divorce proceedings in other jurisdictions."[11] Finally, the court held that whether a Delaware court accepts jurisdiction is permissive.

Many estate planners might find the Delaware court's decision not to exercise jurisdiction surprising based on the "exclusive jurisdiction" language of the Delaware DAPT statute. However, this decision, as well as the conclusion that acceptance of jurisdiction is permissive within the Delaware court's discretion, was based both on constitutional law and inconsistent Delaware law.[12]

Comments of possible legal theories to pierce the trust. While the Delaware court found Nick's motion as special trustee to invoke the jurisdiction of the Delaware courts to be "faintly tinged," it still decided to balance the interests of the parties before denying the special trustee's motion and deciding to dismiss the motion. During this balancing process, it alluded to the following possible legal theories that would potentially pierce the dynasty trust:

- The initial installment sale of Extream was a fraudulent conveyance;
- Dan may not have had proper legal title to transfer marital assets to the trust;
- A spouse isn't a creditor of the trust, meaning a spouse isn't subject to spendthrift provisions;
- A marital property settlement under Delaware's



Trustee may loan property to settlor or beneficiary for less than full and adequate consideration	Trust contains broad purposes or highly discretionary language	Trust has only one beneficiary who may receive distributions	Beneficiary serves as co-trustee, trust advisor or trust protector	Isolated occurrences of settlor acting as trustee when in fact settlor is a beneficiary	Settlor requesting distributions be made from trust to a beneficiary	Settlor requesting that trustee invest in certain property
Yes	Yes	Yes	Yes	Yes	Yes	Yes
No	No	No	No	Yes	Yes	Yes
No	No	No	No	Yes	Yes	Yes
Yes	Yes	Yes	No	Yes	Yes	Yes
Yes	Yes	Yes	No	Yes	Yes	Yes

— Mark Merric & Daniel G. Worthington

DAPT statute is an exception creditor; and
- Alter ego arguments.

The factors in this case study provide an excellent opportunity to discuss how the three asset protection statutes provide different levels of asset protection depending on the circumstances. However, we should add another factor to the list—the discretionary support statute. Exception creditors can't attach to a common law discretionary interest or force a distribution from the trust. As this may well be the most important aspect of any asset protection statute, we'll address this factor first.

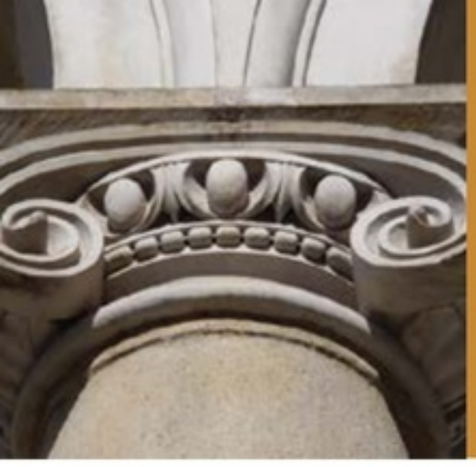
Discretionary Support Statute

For purposes of this article, the term "common law discretionary trust" refers to a trust in which a beneficiary has neither an enforceable right to compel a distribution nor a property interest, and no creditor may attach such interest.[13]

The best codification of discretionary trust law is South Dakota's discretionary support trust act (DSTA).[14] Oklahoma adopted Delaware's DSTA in whole, and Tennessee incorporated it into its Uniform Trust Code (UTC). Alaska has also passed a discretionary trust statute.[15] Other DAPT states that have codified many parts of the *Restatement Second* are Missouri, Nevada, New Hampshire, Ohio and Wyoming and have created a "wholly discretionary trust," but the distribution language is quite limited when compared to the other DAPT states that have addressed the issue.[16]

Listed in order of our opinion of what's most important, states should include the following four areas in a discretionary support statute:

1. The legal ramifications of a discretionary interest. That is, the statute states that the beneficiary who holds a discretionary interest doesn't hold a property interest or an enforceable right to a distribution.
2. The definition of a "discretionary trust" so planners will know the correct distribution language that should be used.



3. The concept that no creditor may attach a discretionary interest.
4. The *Restatement Second's* elevated judicial review standard for a discretionary interest in which a judge would only review the trustee's distribution decision if the trustee: (1) acted with an improper motive; (2) acted dishonestly; or (3) failed to use its judgment.[17]

These factors are discussed in detail in our article, "Find the Best Situs for Domestic Asset Protection Trusts," in the January 2015 issue of *Trusts & Estates* (January 2015 article). On a side note, Delaware originally had passed a statute that codified the first and most important element stating a discretionary interest was neither a property interest nor an enforceable right. Unfortunately, when some Delaware trial attorneys complained, Delaware repealed this part of the trust law one year later. This action resulted in many commentators expressing concerns that repeal of the discretionary support provision within a year creates the express legislative intent that a discretionary interest in a Delaware trust would be classified as an enforceable right and property interest. This issue is further complicated by Delaware's lack of trust case law.[18]

Mississippi, Nevada, Ohio, South Dakota and Utah allow for public notice recording the transfer to a trust.

So, the first question with any trust jurisdiction's law is whether it's possible to draft a common law discretionary trust—one in which no exception creditor may attach the interest. If not, it would be better to use the laws of a more favorable trust jurisdiction. Second, to the extent that an exception creditor is allowed to attach and/or force a distribution from a support trust, an exception creditor may not receive any greater benefits than the beneficiary holds. For example, if distributions are limited to HEMS, that's the maximum amount that an exception creditor would receive. With child support or maintenance as exception creditors to a support trust, this result is almost always the case, and therefore, no legal inconsistency is created. However, many DAPT statutes provide that the trust may be pierced for a marital settlement claim. As discussed later in this article, this creates an inconsistency between common discretionary trust law and a DAPT statute.

Spouse Isn't a Creditor

Some commentators have advocated that a spouse isn't a creditor under Delaware law based on Delaware's only discretionary support case—*Garretson v. Garretson*.[19] Others take the position that a spouse is an exception creditor under the statute. The difference may be one of semantics. The real question is under what circumstances a spouse is an exception creditor or not a creditor under Delaware law.

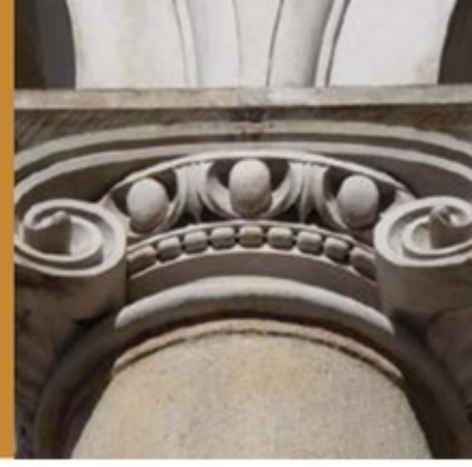
Garretson is a 1973 case. The trust would most likely have been classified as a support trust under common law. By 1973, many courts were adopting the concept of exception creditors for child support, as well as maintenance. Therefore, while the language used in *Garretson* states that a "spouse is not a creditor," most likely, it's limited to the facts of the case. A spouse isn't a creditor for the purpose of maintenance—meaning the spouse is an exception creditor for maintenance as applied to a support trust.

Conversely, if *Garretson* is ultimately interpreted to mean that a spouse isn't a creditor for any purpose in any Delaware trust, then such a holding would be drastically inconsistent with both a common law discretionary trust, as well as a common law support trust. This would give a spouse more rights than a beneficiary holds. The exception creditor for a marital property settlement allows a spouse to pierce all Delaware trusts for a marital property settlement in excess of the beneficiary's right to demand a distribution. For this reason, we don't agree with the "not a creditor for any purpose" theory.

In *Kloiber*, Dan's interest in the dynasty trust should be classified as a support interest, and to the extent of an exception creditor, the trustee could be forced to make a distribution to the extent of Dan's HEMS.

Fraudulent Conveyance

With the exceptions of Missouri, Oklahoma and



Virginia, the DAPT statutes provide that the only remedy a creditor may bring is a claim that there was a fraudulent transfer to the DAPT. In essence, this should eliminate all other legal and equitable claims such as constructive trust, resulting trust, alter ego, pierce the veil or dominion and control type of arguments. Equitable remedies, such as alter ego or pierce the veil arguments, require the client to dot all "i's" and cross all "t's" in the administration of the trust. Further, the dominion and control arguments allow any court (that is, DAPT state or non-DAPT state) to use its standards to determine whether the settlor retained too much control.[20] We find that the elimination of all remedies other than a fraudulent conveyance is a major asset protection that distinguishes 14 states with DAPT statutes from the other three.

In our January 2015 article, we discussed the following five key areas of a debtor-friendly fraudulent conveyance statute:

1. The statute limits claims to fraudulent intent;
2. The statute requires the specific creditor alleging a fraudulent transfer to prove intent as applied to that specific creditor;
3. The statute requires the creditor to prove the transfer was fraudulent by clear and convincing evidence;
4. A favorable statute of limitations (SOL) period for a present creditor; and
5. A favorable SOL period for a future creditor.

To this list, we add one more factor. Mississippi, Nevada, Ohio, South Dakota and Utah have added a new twist to the date-of-discovery rule that greatly improves their fraudulent conveyance statutes. These jurisdictions allow for public notice recording the transfer to the trust. That is, once public notice is given by recording the transfer to the DAPT, then the SOL period begins to run, regardless of the date-of-discovery rule as applied to a present creditor.

As applied to *Kloiber*, Dan asserts his estranged spouse knew of the transfer, therefore, under Delaware law, its 4-year SOL would have tolled. Conversely, his estranged spouse asserts the opposite, that she didn't learn of the transfer until 2011. Under the date-of-discovery rule, a present creditor would have one year from the date of discovery to file a claim. Had the trust been sitused in one of the five jurisdictions with notice statutes, most likely the SOL would have tolled.

Proper Legal Title

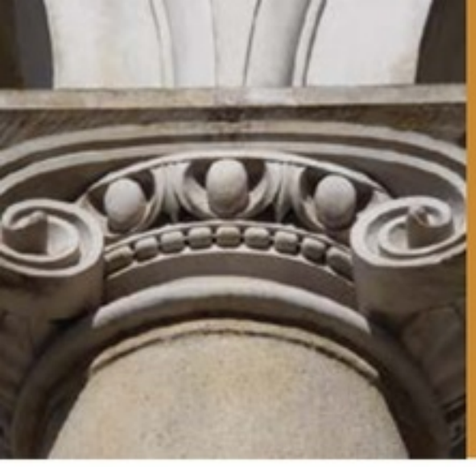
Before a settlor can transfer any property to a trust, the settlor must have legal title to the property transferred. In the legendary Bahamas APT case of *Grupo Torras v. Fahad*,[21] Sheikh Fahad couldn't use a Bahamian APT as a shield from creditor attack, because he didn't have legal title to the property he transferred into the Bluebird Trust. Sheikh Fahad was the oil minister to the Shah of Iran before it fell, and the claim was made that he'd illegally obtained the property transferred to the trust from the Iranian citizens. In holding against Sheikh Fahad, the court concluded that the provisions of an APT statute can't protect a beneficiary, unless the settlor had proper legal title to the assets transferred.

Many DAPT statutes provide that a spouse who's married to the settlor at the time of the transfer is an exception creditor for a marital property settlement.

As related to the *Kloiber* case, the Delaware court made what it called an "extreme and unrealistic hypothetical," when it stated that if Dan took a Kentucky neighbor's artwork without permission and delivered it to the dynasty trust, then Dan would have no power to transfer the artwork to the trust. The unrealistic hypothetical is very similar to the facts of *Fahad*. However, more relevant is that the Delaware court's analogy was being used to question whether Dan had the capacity to transfer marital property to the trust under Kentucky law. If he didn't, similar to Sheikh Fahad, none of the APT law needs to be consulted. The transfer would have been void from inception, and Beth could recover the transferred property.

Marital Property Exception Creditor

Many DAPT statutes provide that a spouse who's



married to the settlor at the time of the transfer is an exception creditor for a marital property settlement. Accordingly, the beneficiaries of the dynasty trust may have wished that the trust agreement didn't reference the Delaware Qualified Disposition Act. A beneficiary-controlled trust would generally be considered a third-party trust, not a self-settled trust. However, any irrevocable trust meeting the requirements of the qualified disposition statute may be governed by its benefits and burdens.[22] One key benefit is that the only remedy a creditor has against the trust is a fraudulent conveyance. Conversely, a key detriment is that many DAPT statutes expand the exception creditors from some traditional ones, such as child support and maintenance, to include a property settlement in a divorce.

> The UVTA's provisions and comments may impact the use of DAPTs by settlors who reside in states where the law has been adopted, by making transfers to DAPTs "voidable."

Here, most DAPT statutes take a drastically inconsistent position with common law by providing that a spouse who was married to the settlor at the time of the transfer may receive greater rights than a beneficiary of the trust. For example, a beneficiary of a common law discretionary trust would have no rights to force a distribution and no property interest. Conversely, a beneficiary of a support trust would only have rights within the distribution standard. Further, the rights to the trust property of other beneficiaries would need to be balanced. However, with these DAPT statutes, a spouse who was married at the time of the transfer would be able to reach whatever was needed to satisfy the property claim, regardless of common law trust law.

This inconsistent DAPT provision is found in many DAPT statutes, because most DAPT statutes were based on Delaware's. As related to *Kloiber*, the dynasty trust references Delaware's qualified disposition statute and most likely is bound by this large burden. Therefore, Beth can use this provision as a simple avenue to recover from the trust. All that's needed is an order from the Kentucky divorce proceedings or an agreement among the parties dividing the trust property. In fact, such agreement was reached with a Delaware court order dated Aug. 16, 2016.

Alter Ego Arguments

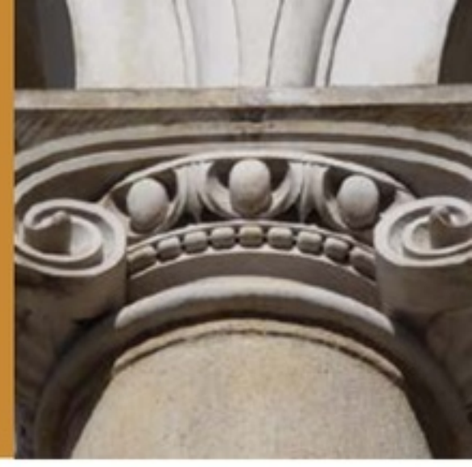
A qualified disposition statute has the advantage that it limits a creditor's remedies to a fraudulent conveyance. However, as noted in *Kloiber*, in many DAPT jurisdictions, it may be better not to invoke this benefit for a third-party trust, due to the creation of an exception creditor for a marital property settlement. Further, some commentators question whether courts won't seek to apply equitable remedies regardless of a DAPT statute limiting a creditor's remedy to only a fraudulent conveyance. Finally, the Delaware court detailed the incredible amount of dominion and control that Dan exercised over the dynasty trust. In this respect, the Delaware court may have been alluding to possible alter ego types of arguments to pierce the trust. The Delaware court performed a detailed analysis regarding Dan's extensive control over the trust in the following areas:

1. As special trustee, he controlled investments and distribution decisions;
2. He was the "primary beneficiary" of the trust;
3. He held a 5x5 power over the trust principal;
4. He had an inter vivos and testamentary special power of appointment to his wife or descendants;
5. He held a removal/replacement power over the trustee;
6. He was the manager or president over significant entities owned by the trust.

Mississippi, Nevada, Oklahoma, South Dakota and Tennessee have all adopted anti-alter ego statutes so that a court can't hold that any one of these factors, or all the listed factors combined, would mean that either the settlor or a beneficiary was the alter ego of the trust.

Not an Earth Shaking Decision

While some commentators refer to the holding of the motion in *Kloiber* and a subsequent distribution order in favor of the ex-spouse as a major flaw in the Delaware DAPT, we would conclude that in any DAPT



that's funded with marital assets that's used to thwart an estranged spouse from child support, maintenance or a division of marital property, almost any court will, to the extent possible, use any equitable remedy or theory to attempt to pierce the trust. For example, in *Reichers v. Reichers*,[23] the court found that the property transferred to an offshore APT was marital property. Once property is gifted to an irrevocable trust, it's no longer owned by the settlor. Therefore, the *Reichers* decision is perplexing. Further, there's always the Sheikh Fahad argument that the settlor didn't have valid title to transfer the gifted marital property in the first place. So, we don't find the *Kloiber* decision to be earth shaking as to Delaware's trust laws. Rather, we find that Delaware ranks in the second tier of DAPT statutes based on all the factors listed in "DAPT Statute Rankings," p. 76.

The South Dakota DAPT statute provides a novel approach to this issue of marital property being transferred into a DAPT. It says that a settlor may notify a spouse of the transfer of marital property to the trust, and if the spouse doesn't object to the transfer, he's deemed to have consented and isn't an exception creditor to the trust.[24] If notice is given, South Dakota has no exception creditors and most likely won't need to worry about a court attempting to find any method to pierce a DAPT for a marital property settlement.

Beware of the UVTA

In 2014, The National Conference of Commissioners on Uniform State Laws adopted the UVTA. The UVTA is intended to amend and replace the Uniform Fraudulent Transfer Act (UFTA), but buyer beware—it differs from the UFTA in some significant ways. While the promoters of the UVTA are praising it for removal of the word "fraudulent" in favor of the more innocent word "voidable," the UVTA takes some liberties that are intended to extend protections to creditors with respect to DAPTs. The UVTA's provisions and comments may impact the use of DAPTs by settlors who reside in states where the law has been adopted, by making transfers to DAPTs "voidable."[25] Gratuitous comments by the reporter of the Uniform Law Commission, in Section 4 of the UVTA, imply that such transfers to DAPTs are per se voidable. This position is contrary to most legal precedent on such questions.

Currently, nine states have adopted the UVTA. They are: California, Georgia, Idaho, Iowa, Kentucky, Minnesota, New Mexico, North Carolina and North Dakota. Indiana, Massachusetts, Michigan, New York and South Carolina legislatures have introduced it.[26]

The general rule is that settlors are free to choose the trust law of other jurisdictions when establishing a trust. Exceptions are discussed below. One of the ways that the UVTA attempts to thwart transfers to DAPTs is the application of Section 10, the governing law provision. Section 10 of the UVTA provides: "a claim for relief… is governed by the law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred."[27]

Under the UFTA, there's a conflict-of-laws analysis that's applied to determine which law applies based on substantial contacts and public policy considerations. Changing the presumption that the law of the debtor's residence applies negatively affects the creation of DAPTs by UVTA settlors because it requires the application of the law of the state where the transfer occurred. The argument goes like this: If an individual in a UVTA jurisdiction makes a transfer to a DAPT, then the resident state law would apply to make the transfer voidable with respect to the creditor. The comments in Section 10 support this conclusion. It's important to note that comments don't have the force of law, and states are free to revise the uniform law to suit their own situations.[28]

As stated above, the comments in Section 4 imply that such transfers to DAPTs are per se voidable. But, the comments only cite several very old Pennsylvania case law, and the comments aren't founded in current

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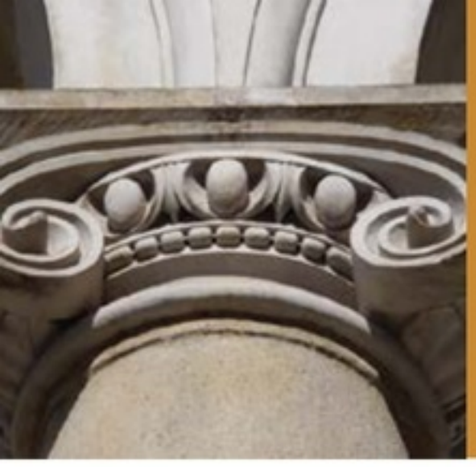


generally accepted legal principles or cases.[29] Note that the U.S. Supreme Court in *Schreyer v. Scott* stated that debtors are free to take steps to protect assets from creditors that were neither in existence prior to, nor reasonably anticipated at, the time of transfer.[30] Consequently, many advisors believe that unless specific case law or statutes[31] exist in the state, no strong public policy argument would exist.

Furthermore, a lack of DAPT legislation in a state, whether it's adopted the UVTA or not, doesn't necessarily create a presumption of a strong public policy against the laws of DAPT states. In a full faith and credit claim against a DAPT state trustee, the DAPT state shouldn't be required to afford deference to the domicile state's judgment. This should be the law unless the transfer falls within the fraudulent transfer window of the DAPT jurisdiction, or the transfer applies to an exception creditor. This may be the case even in states that adopt the comments of the UVTA, because the collection action would be taken against the trustee of the DAPT in the DAPT jurisdiction.[32]

Traditionally, in a conflict-of-laws analysis regarding a DAPT, a settlor of the trust can designate the laws that govern the trust so long as there are sufficient contacts with the state.[33] The "sufficient contacts" requirement was a major issue in *In re Huber*.[34] Additionally, the *Restatement (Second) of Conflicts of Laws* Section 270(a)[35] states that Section 273 applies so long as the law doesn't violate a strong public policy of the state that has the most significant relationship to the trust.

In our view, the UVTA shouldn't be allowed to change the general rule of law, which is that a settlor may designate laws that govern a trust, unless trust situs and trust administrative ties and situs rules aren't substantial enough[36] to the DAPT state pursuant to Section 273 (for example, substantial presence) and unless it can be shown that creating a DAPT in a DAPT state is a violation of a strong public policy of the settlor's domicile state (see discussion above). Thus, the DAPT and its supporting laws would generally be upheld provided there wasn't a fraudulent conveyance,[37] an exception creditor[38] or any other issue pursuant to the DAPT state's laws.

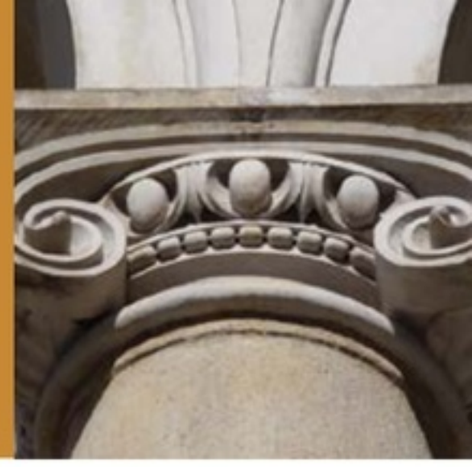
We believe that states that have adopted or are considering adopting the UVTA should beware of the difficulties that the UVTA potentially creates and should consider amending or removing Section 4, Comment 2 and Section 10 and its comments from the UVTA. Also, both Texas and Ohio have created model fraudulent conveyance laws that should be considered as an alternative to the UVTA.

Significant Factors

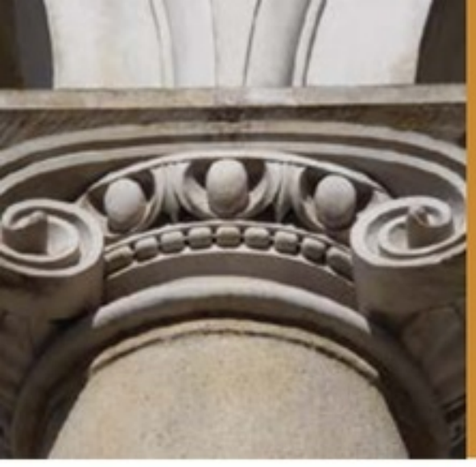
Like any comparison of jurisdiction articles, different authors will have different conclusions regarding what are the most important factors when evaluating a jurisdiction. Since 40 percent to 50 percent of the population will experience at least one divorce,[39] protection against marital claims is one of the most significant factors when evaluating the strength of a trust statute. The primary key to protecting against a marital claim may well be whether a beneficiary has an enforceable right to a distribution. This protection isn't found in the DAPT statute, but is in discretionary support legislation being enacted by many states. Some of the more important DAPT statute provisions include limiting a creditor's claim solely to a fraudulent conveyance, debtor-friendly fraudulent conveyance law and forcing the litigation to the DAPT state.

Endnotes

1. Senate Bill 597 on Qualified Dispositions and House Bill 5504.
2. Prior to 1996, 18 nations had provided offshore asset protection trust (APT) statutes. While Missouri had amended its spendthrift trust statute in 1986 in a way that may have permitted the creation of APTs, the law lacked information about the intent of the statute and caused many concerns that the Missouri law wouldn't prove to be an effective APT statute. Richard G. Bacon, "The Domestic Asset Protection Trust at Five Years–Has its Time Arrived?" ALI-ABA course materials, *Asset Protection Planning* (Nov. 5, 2002), at p. 84. Also, note that Colorado hasn't been listed on the chart as an APT legislation state due to case interpretation that severely questions whether Colorado's 1800's statute, C.R.S. Section 38-10-111, was ever intended for such a purpose. *See In re Cohen*, 8 P.3d 429 (Colo. 1999) and *In re Bryan*, 415 B.R. 454 (Bankr. D. Colo. 2009); contrast with *In re Baum*, 22 F.3d 1014 (10th Cir. 1994).
3. *Restatement (Second) of Trusts (Restatement Second)* Section 155(1) and Comment (1).
4. Mark Merric, "How to Draft Distribution Standards for Discretionary Dynasty Trusts—Part II," *Estate Planning Magazine* (three-part series) (March 2009). Endnote 41 lists cases from 16 states noting that a discretionary distribution interest isn't a property interest.
5. *Ibid.*, endnote 42 lists cases from 18 states noting discretionary interests couldn't be attached at common law. Please note that the *Restatement (Third) of Trusts (Restatement Third)* and the Uniform Trust Code (UTC) reverse common law in this area allowing a creditor to attach a discretionary interest. However, five UTC states have modified the national version of the UTC to retain common law in this area.



6. As all other domestic asset protection trust (DAPT) statutes, Ohio's DAPT statute was built on its predecessors such as the Cook Islands, Alaska, Delaware and South Dakota. However, the primary drafter, John Sullivan III, took into account that many DAPT state statutes most likely stepped over some constitutional limits, and this statute provides caveats that the provisions must be within such limits. Some attribute this mastery to the great inspiration that Irishman John Sullivan III received when writing the Ohio DAPT statute at the same time he was drinking the "nectar of the gods"—Guinness. One of these constitutional issues was the "exclusive jurisdiction issue" that the Delaware Court of Chancery addressed in *In Re Daniel Kloiber Dynasty Trust* u/a/d Dec. 20, 2002, 2014 WL 3924309 (Del. Chan., unpublished (Aug. 6, 2014)). On a side note, almost all state DAPT statutes would benefit by not having an exception creditor for a marital property settlement, as well as by applying exception creditors only to a support trust.
7. *Kloiber, ibid.*
8. *Ibid.*
9. *Ibid.*
10. *Ibid.*
11. *Ibid.*
12. We admire the court's frankness in stating when Delaware courts have issued inconsistent holdings when interpreting the term "exclusive jurisidiction."
13. For a further discussion in drafting discretionary dynasty trusts, *see* Merric, *supra* note 4. All three parts to that article may be downloaded at *InternationalCounselor.com*.
14. S.D.L. Section 55-1-24 through Section 55-1-43.
15. Ala. Stat. Section 34.40.113.
16. An Ohio "wholly discretionary trust" is restricted to distribution language when a beneficiary has no distribution standard and no guidelines for distributions. Richard Covey, in *Practical Drafting* (April 2007) at p. 8,918, criticized the Ohio's UTC due to its very limited definition of a discretionary trust.
17. *Restatement Second* Section 187, Comment j and Section 122. While this is the judicial standard of review adopted by all courts, it's by far the most common discretionary trust judicial review standard with courts from 14 states and two other countries using it. *See Merric, supra* note 4.
18. Remember that Delaware first emerged as a trust law jurisdiction in 1986 when it was the second state to adopt a DAPT statute.
19. *Garretson v. Garretson*, 306 A.2d 737 (Del. 1973).
20. *Merric, supra* note 4 (Part III, April 2009).
21. *Grupo Torras v. Fahad*, 1994 No.72/1 OFLR 443 (Bahamas Sup. Ct 1994).
22. Nick, when serving as special trustee to the dynasty trust, takes the position that the original transfer of $15,000 to the trust by Dan's father was subject to the qualified disposition statute, but not the beneficiary defective installment sale for $6 million.
23. *Reichers v. Reichers*, 679 N.Y.S.2d 233, 236 (N.Y. Sup. Ct. Westchester 1998).
24. S.D.L Section 55-16-15(2).
25. *See* Al W. King III, "Tips From the Pros: Be Aware of the Uniform Voidable Transactions Act," *Trusts & Estates* (October 2016) at p. 7; George D. Karibjanian, "The Uniform Voidable Transactions Act Will Affect Your Practice," *Trusts & Estates* (May 2016), at p. 17; George D. Karibjanian, Gerald Wehle, Robert Lancaster and Michael A. Sneeringer, "New Uniform Voidable Transactions Act: Good for the Creditors' Bar, But Bad for the Estate Planning Bar?" Part Two, *LISI Asset Protection Planning Newsletter* #317 (March 15, 2016); George D. Karibjanian, Gerald Wehle and Robert Lancaster, "History Has Its Eyes on UVTA—A Response to Asset Protection Newsletter #319," *LISI Asset Protection Planning Newsletter* #320 (April 18, 2016); Richard W. Nenno and Daniel S. Rubin, "Uniform Voidable Transfers Act: Are Transfers to Self-Settled Spendthrift Trusts by Settlors in Non-APT States Voidable Transfers Per Se?" *LISI Asset Protection Planning Newsletter* #327 (Aug. 15, 2016).
26. *See* Uniform Law Commission, Uniform Voidable Transactions Act (UVTA), Enactment Status Map & Legislative Tracking, *www.uniformlaws.org/Act.aspx?title=Electronic%20Transactions%20Act.*
27. *Ibid.*
28. *Ibid.*
29. *See supra* note 25; *see also* Section 4, Comment 2 of the UVTA, citing *MacKason's Appeal*, 42 Pa. 330, 338-39 (1862); *Ghormley v. Smith*, 139 Pa. 584, 591 (1891); *Patrick v. Smith*, 2 Pa. Super. 113, 119 (Super. Ct. 1896).
30. *Schreyer v. Scott*, 134 U.S. 405, 414-415 (1890). The U.S. Supreme Court held that individuals have a right to protect against future issues, stating, "Under such circumstances, the presumption of any fraudulent intent is rebutted, and it is manifest that he had done no more than any business man has a right to do, to provide against future misfortune when he is abundantly able to do so."
31. *Supra* note 25.
32. Note that if a DAPT jurisdiction adopts the UVTA and specifically includes Section 10 Governing Law, and Section 4, Comment 2, this could prove problematic and possibly prevent legitimate wealth preservation planning using DAPTs in that state; *see supra* note 25.
33. *See* King, *supra* note 25; *Restatement (Second) of Conflict of Laws* Sections 270 and 273 (1971); *See also Reichers, supra* note 23. In dictum, the court stated, "[a] cause of action would not lie to set aside the trust since the trust was established for the legitimate purpose of protecting family assets for the benefit of the Riechers family members." The defendant-husband established an irrevocable trust in the Cook Islands, holding 99 percent of a Colorado limited partnership owning over $4 million of marital assets. The court held that it didn't have jurisdiction over the corpus of the offshore trust, nevertheless the court ruled that the trust assets were part of the marital estate and were subject to inclusion in the calculation of the total marital assets. *See also TrustCo Bank v. Susan M. Mathews*, C.A. No. 8374-VCP, V.C. Parsons (Del. Ch. Jan. 22. 2015), in which a New York bank made a loan to a Florida limited liability company (LLC) with a personal guarantee by the defendant to construct self-storage facilities in Florida. The lender sued three Delaware DAPTs, contending that the defendant fraudulently transferred assets. The defendant claimed that the Delaware or Florida 4-year statute of limitations (SOL) should apply and not New York's 6-year SOL. The court applied the 4-year Florida SOL and held that the plaintiffs' fraudulent transfer claims were time-barred, finding that Florida and Delaware had more significant relationships than New York; Florida's contacts included foreclosed real estate and business; Delaware contacts included Delaware trusts and Delaware trustees. The court further held that if New York had been



DAPT Statute Rankings

Nevada, Ohio and South Dakota made the top tier

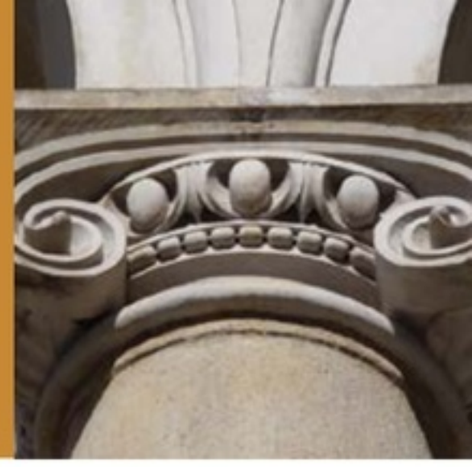
	Fraudulent Conveyance Law					
Jurisdictions listed alphabetically within tier	Type of exception creditor	Only remedy is a fraudulent conveyance	No hinder or delay	Only that specific creditor	Burden of proof	Present creditor length of time (years)
First tier						
Nevada	None	Yes	Yes	Yes	Clear and convincing	2/6 months
Ohio	1,2,4	Yes	Yes	Yes	Clear and convincing	18 months/6 months
South Dakota	None if notice[1]	Yes	Yes	Yes	Clear and convincing	2/6 months
Second tier						
Alaska	4	Yes	Yes	Yes	Clear and convincing	4/1
Delaware	1,2,4	Yes	Yes	Yes	Clear and convincing	4/1
New Hampshire	1,2,4	Yes	No	No	Preponderance	4/1
Tennessee	1,2,4	Yes	Yes	Yes	Clear and convincing	2/6 months
Wyoming	1	Yes	Yes	No	Preponderance	4/1
Third tier						
Hawaii	1,2,3,4	Yes	No	No	Clear and convincing	4/1
Michigan	1 always; 2,4 if no agreement[3]	Yes	No[4]	No[4]	Preponderance	2/1
Mississippi	1,2,3,4	Yes	No	No	Clear and convincing	2/?
Missouri	1,2,3	No	No	No	Clear and convincing	4/1
Oklahoma	1	No	No	No	Clear and convincing	4/1
Rhode Island	1,2,4	Yes	No	No	Clear and convincing	4/1
Utah	1	Yes	No	No	Preponderance[5]	2/1
Virginia	1,2,3	No	No	No	Clear and convincing	5/?
West Virginia	1,2,3,5?	Probably	No	No	Clear and convincing	4

Exception creditors

1. Child support
2. Maintenance
3. Governmental claims
4. Marital property
5. Attorneys' fees protecting a beneficial interest

Endnotes

1. S.D.L. Section 55-16-15 provides that if the settlor transfers marital property to a domestic asset protection trust (DAPT), notifies the settlor's spouse and the spouse doesn't object, then the settlor spouse won't be an exception creditor.
2. *In re Daniel Kloiber Dynasty Trust*, 2014 WL 3924309 (Del. Chan., unpublished, Aug. 6, 2014), held that "exclusive jurisdiction" allowed the Delaware courts to permissively decide whether to accept a case. The court noted that Delaware cases were inconsistent in defining the term "exclusive jurisdiction."
3. The Michigan DAPT allows spouses to agree the qualified disposition isn't subject to either maintenance or a marital property settlement. However, child support may never be waived.



Future creditor length of time (years)	Notice provision	Forcing litigation to the DAPT state	Automatic removal of trustees
2	Yes	Yes	Yes
18 months	Yes	Yes	Yes
2	Yes	Yes	Yes
4	No	Yes	No
4	No	Permissive[2]	Yes
4	No	No	No
2	No	No	Yes
4	No	No	Yes
2	No	No	Yes
2	No	No	No
2	Yes	No	No
4/1	No	No	No
4	No	No	No
4	No	No	No
2/1	Yes	No	No
5/?	No	No	No
4	No	No	No

4. An accompanying bill, HR 5504, specifically reverses the fraudulent conveyance provisions of Michigan's qualified disposition statute so that any creditor may recover under the hinder, delay or defraud criteria.
5. As to any transfer to a settlor/beneficiary, the creditor must prove by a preponderance of the evidence.

— Mark Merric & Daniel G. Worthington

deemed to have a more significant relationship, then Delaware's "borrowing statute" (which states if a cause of action arises outside of Delaware, then either the applicable Delaware limitations period applies or that of the state where the cause of action arose, whichever is shorter) would apply, and thus Delaware's SOL would apply.

34. *In re Huber*, 201 B.R. 685 (Bankr. W.D. Wash. May 17, 2013). The court held that Washington held the most significant relationship with the Alaska DAPT, not Alaska, and thus, Washington law applied. The settlor, a Washington resident, established an Alaska DAPT. The trust named an Alaskan corporate trustee in the DAPT state (Alaska) but named the settlor's son, based in Washington, as co-trustee. The settlor's son made frequent distributions to the settlor. This activity was one of the many factors that made the Alaska trustee look like a "straw man." The Alaska trustee did very little. Additionally, an Alaska LLC (99 percent owned by the DAPT and 1 percent owned by the settlor's son) held entities and real property located in Washington; the settlor's son, based in Washington, was also the manager of the LLC. The case also featured fraud and bankruptcy issues and provides a useful lesson on how not to structure a DAPT to receive maximum situs protection and how not to administer a DAPT considering the substantial presence test of *Restatement (Second) of Conflict of Laws* Section 273.
35. *See supra* note 30.
36. *Ibid.*
37. *See* Al W. King III, "Defend Against Attacks on DAPTs?" *Trusts & Estates* (October 2014), at p. 11. Creditors may argue that there was a fraudulent conveyance to the trust. For this claim to prevail, the creditor must prove that there was intent to hinder, delay or defraud a specific creditor. This argument, generally, is subject to a "clear and convincing" or "preponderance of the evidence" standard of proof, which varies depending on the DAPT state's statute. There's also an SOL for a fraudulent conveyance (usually two to four years), depending on state statute, after which time a cause of action or claim for relief with respect to a transfer of the settlor's assets to a DAPT is extinguished, and the creditor may not be able to reach the assets. If the creditor is an existing creditor at the time the DAPT is established, that creditor may also have the period of time starting from when the creditor discovers or reasonably could have discovered the transfer to bring its claim (usually six months to a year), depending on state statute. Note that Nevada and South Dakota fraudulent conveyance periods are two years, and Alaska, Delaware, New Hampshire and Wyoming are four years. South Dakota and Nevada now have notice by publication statutes that begins the time at publication of notice instead of reasonably discovered.
38. *See King, ibid.* A creditor may also claim to be an exception creditor, that is, the creditor fits within a defined type or class, so that it may be able to reach the DAPT assets. Exception creditors vary by state statute. Some of the more common are tort victims, divorcing spouses/marital property divisions and those receiving alimony or child support, and generally, any judgments in place at the time of the transfer regardless of state. It's important to compare jurisdictions regarding the class of exception creditors.
39. *See http://www.divorce.usu.edu/files/uploads/lesson3.pdf.*