Domestic Asset Protection Trusts

A Practice and Resource Manual

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CHAPTER 21

Two Sides of a Coin: How to Defend, or Challenge, a DAPT

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This chapter begins with the assumption that you, the reader, have a domestic asset protection trust in front of you, and it is in peril. Perhaps the DAPT is being challenged by a creditor, or the IRS, and you are the attorney who formed the trust or you are a litigator who has been asked to defend it. Alternatively, you may be on the other side, and have been retained by a creditor to challenge the DAPT, either as litigator or as estate planning expert.

We are also assuming that we are dealing with a typical DAPT. That is, an irrevocable trust that has an independent trustee who has absolute discretion to distribute income and principal to a class of beneficiaries that includes the settlor. Technically, a DAPT is a "self-settled discretionary spendthrift trust." Just what is "self-settled" in many situations can become an important issue. From a planner's standpoint, avoiding a "self-settled" trust may be an important defense. This will be discussed further later in the chapter.

An exploration of the rules for successfully forming and implementing a DAPT, by its very nature, provides a roadmap for analysis of its possible weaknesses. This article should be equally helpful for analyzing how to defend or, conversely, how to challenge a DAPT.

The assumption is that we are beyond the planning stage. The facts have been determined. We need to work with them and develop a defense or a challenge with respect to the DAPT. However, a planner may find this chapter very helpful with respect to whether to proceed with a DAPT and, if so, how to design and implement it.

I. How Can a Creditor Attack a DAPT?

There are three general avenues of attack that a creditor may use in an effort to reach assets that a settlor/debtor has transferred to a DAPT.

1. Choice of Law. The creditor may argue that the court should apply the spendthrift trust law of the state of residence of the settlor, rather than the law of the DAPT state.

2. Fraudulent Transfer. The facts may support an argument that the settlor's transfer to the DAPT was fraudulent and therefore should be set aside. Again, choice

of law issues may exist. The fraudulent transfer law of the settlor's state of residence may be more creditor friendly than that of the DAPT state.

3. Improper Implementation. The facts may support an argument that the settlor has failed to comply with the statutory requirements for forming a DAPT, or that an implied agreement between the settlor and fiduciaries exist, or that the trust has been implemented in a manner that establishes it is merely the "alter-ego" of the settlor, or the trust is a "sham."

The first general attack, choice of law, applies only when the settlor is a nonresident of the state where the DAPT is formed. The two other general attacks apply to both resident and nonresident settlors. The previously described general attacks may be made in a state court, federal district court, or bankruptcy court, located in either the settlor's state of residence or the DAPT state.

Before examining each type of attack, it is important to discuss three foundational subjects that are interwoven into these attacks: first, the jurisdictional principles that apply when a creditor is seeking to reach the assets in a DAPT; second, the choice of a bankruptcy court as a forum, rather than state or federal district court; third, the issue of the Full Faith and Credit Clause. These three subjects are often misunderstood and misapplied when DAPTs are discussed. Once we have a solid foundation for each of these subjects, we can return to how a creditor can attack a DAPT.

II. Jurisdiction

It is very important to understand the difference between obtaining a valid judgment against the settlor as compared to a judgment against the DAPT trustee or over DAPT assets. A judgment against the settlor will only entitle the creditor to reach the settlor's assets. The DAPT assets are no longer owned by the settlor. Therefore, even though a creditor is able to obtain jurisdiction over the settlor in the settlor's state of residence, and then subsequently obtain a judgment against the settlor, this does not allow the creditor to reach the DAPT assets.

To reach the DAPT assets, a creditor of the settlor will first have to bring an action in a state or federal court that can obtain jurisdiction over the trustee of the DAPT or the DAPT's assets. If such jurisdiction is obtained, then the creditor can assert one or more of the types of attacks discussed previously.

It is generally assumed that if a creditor challenges a DAPT it will be to the settlor/debtor's advantage to have the challenge occur in a court located in the DAPT state. The theory is that a court located in the DAPT state (whether state, federal, or bankruptcy) will more likely apply DAPT law than a court located in another state. Therefore, jurisdiction planning for a DAPT is important. Choices of trustees, lack of DAPT trustee contacts with the settlor's state of residence, the situs of DAPT assets in a DAPT-friendly jurisdiction, and implementation planning can avoid or minimize the risk that a court located outside the DAPT state will have jurisdiction over the trustee or the trust assets.

Assume that a nonresident of a DAPT state forms a DAPT that has a trustee located only in the DAPT state. Assume that the DAPT is funded by transferring assets, such as security accounts and other intangibles, to the trustee in the DAPT state. Assume further that the trustee has no contacts with the settlor's state of residence. If a creditor of the settlor brings an action in the settlor's state of residence, that state court will not have the ability to obtain personal jurisdiction over the DAPT

trustee or in rem jurisdiction over the trust assets.[1] If, instead, the creditor had sued in a federal court located in the settlor's state of residence, again, the court would not be able to obtain personal jurisdiction over the DAPT trustee or the trust assets.[2]

However, a state or federal court located in the settlor's state of residence may be able to obtain personal jurisdiction over the DAPT trustee based upon the forum state's long-arm statute and various contacts that the trustee may have with that state. These contacts must be more than typical trustee communications with a settlor or beneficiary. The ultimate long-arm question will be whether the DAPT trustee purposely availed itself of the benefits of doing business in the settlor's state of residence. The court will analyze how numerous and deliberate the contacts were, and how close the relationship is between the contacts and the litigation.[3]

Assume the same facts except that some of the assets transferred to the trust include real estate located in the settlor's state of residence. This will give a court located in the settlor's state of residence in rem jurisdiction over the asset. Several approaches have been suggested to avoid such in rem jurisdiction. The real estate could be contributed to a limited partnership or limited liability company formed under DAPT state law. Such

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1. For example, in *Rose v. FirStar Bank*, 819 A.2d 1247 (R.I. 2003), the Supreme Court of Rhode Island held that the lower court did not have personal jurisdiction over an Ohio corporate trustee that had periodically sent statements, checks, and other documents to a Rhode Island beneficiary and had communicated occasionally with the beneficiary by telephone. The court concluded that the trustee never purposely availed itself of the benefits of doing business in Rhode Island, and the beneficiary's trust mismanagement claims did not arise out of the trustee's Rhode Island contacts.

Another example is *In the Matter of the Estate of Ducey*, 241 Mont. 419, 787 P.2d 749 (1990). The Supreme Court of Montana held that the state court did not have personal jurisdiction over a Nevada corporate trustee. The court held that the case was nearly identical to *Hanson v. Denckla*, 357 U.S. 235 (1958), where the United States Supreme Court reversed a Florida Supreme Court decision which had tried to use a Florida probate proceeding to establish *in rem* jurisdiction over trust assets in Pennsylvania. The Montana estate, arguing for long-arm jurisdiction based upon the transaction of business within Montana, stated that the Nevada bank had transacted business in Montana based upon: (1) the decedent was a resident of Montana, (2) periodic trust payments were made to her, (3) the Nevada trustee amended the trust document while the decedent was a Montana resident, (4) at the decedent's request the trustee negotiated changes in the trust telephonically, (5) the trustee instructed the decedent to draft a will and send a copy to the trustee, and (6) the trustee received permission from the decedent to act as successor trustee. The Supreme Court of Montana concluded that the Nevada trustee did not conduct any business in Montana in a manner so as to purposely avail itself of the benefits and protections of Montana's laws. Further, the court distinguished *McGee v. International Life Insurance Co.*, 355 U.S. 220 (1957), finding that there was no solicitation of business in Montana to the degree which existed in *McGee*.

2. Rule 4(k) of the Federal Rules of Civil Procedure provides that the federal court will have the same personal jurisdiction as a state court in the state where the federal court sits.

3. *See* Karen E. Boxx, *Gray's Ghost—A Conversation about the Onshore Trust*, 85 Iowa L. Rev. 1195, 1211–12 (2000).

General media advertising, attendance at professional conferences, articles in national press and journals, and provision of promotional materials and website material may not be enough to satisfy the due process requirements for jurisdiction. A contemporary illustration of such general advertising contacts is provided by the Internet. Is the fact that a trustee maintains a website on the Internet enough to provide a due process basis for jurisdiction in states that can access the Internet material? The developing law in this new area of personal jurisdiction distinguishes between passive Internet sites that only provide information and interactive sites that conduct business transactions. (Zippo Mfg. Co. v. Zippo Dot Com, 952 F. Supp. 1119 (W.D. Pa. 1997).) Commentators suggest that the test should seek to determine if the defendant engaged in intentional conduct expressly aimed at the plaintiff in the forum state. (Amanda Reid, *Operationalizing the Law of Jurisdiction: Where in the World Can I Be Sued for Operating a Worldwide Web Page?*, 8 Comm. L. & Pol'y 227 (2003); Louis U. Gasparini, *The Internet and Personal Jurisdiction: Traditional Jurisprudence for the Twenty-First Century Under the New York CPLR*, 12 Alb. L.J. Sci. & Tech. 191, 228–29 (2001).)

a contributed interest should be considered intangible personal property with a situs in the DAPT state. However, if the real property is involved in any income-producing activity, then the DAPT limited partnership or limited liability company may be required to register to do business in the settlor's state of residence and submit to its jurisdiction. An alternative approach involves the settlor selling the real estate to another grantor trust in exchange for an installment note. The note would be secured by the real property. The note would then be contributed to the DAPT. Again, the promissory note should be considered intangible personal property that has its situs in the DAPT state. While a court located in the settlor's state of residence may be able to obtain jurisdiction over the real property, it will have reduced value due to the fact that it is subject to a lien securing the promissory note. To avoid any argument that the note and lien are a sham, their terms must be made in good faith at arm's length, must be respected by the parties, and must reflect economic reality.

Often, DAPTs will have more than one trustee. For example, there may be a family trustee who is responsible for management matters, a distribution trustee, and an administrative or qualified trustee in the DAPT state. A cotrustee located in the settlor's state of residence is another avenue for a creditor obtaining jurisdiction in that state.

With these jurisdictional principles in mind, let us turn to the bankruptcy court.

III. Bankruptcy Court

Bankruptcy court is an important forum to consider, and has unique aspects relating to jurisdiction, choice of law, and fraudulent transfers. Bankruptcy court solves the jurisdiction problem, as we will discuss. Whether bankruptcy court is a desirable forum depends upon the debtor's liability situation. If the debtor has more than one liability, then the proceeds of the bankruptcy proceeding will have to be shared with the other creditors. This may influence a creditor to proceed alone in a state court. If the DAPT is well planned, then the creditor may be limited to courts in the DAPT state.

The following discussion assumes that there is only one large creditor, and the creditor is interested in solving the jurisdiction problem by pursuing the claim in bankruptcy court in the settlor's state of residence. These situations may be few because when a debtor fails to pay a creditor the debtor may well have failed to pay others. Alternatively, a debtor may decide to declare bankruptcy, and may try to have that proceeding in a bankruptcy court located in the DAPT state.

A bankruptcy proceeding may be initiated voluntarily by the settlor in the state where the settlor resides. Such residence needs to have been for a period of at least 91 days.[4] Therefore, if a settlor desires to declare bankruptcy, the settlor may change residence to the DAPT state in order to try to have the bankruptcy proceeding located in that state. However, a creditor may move for a change of venue to the settlor's former state of residence because that is where the creditors are concentrated and where the debts were incurred.[5]

Alternatively, the settlor may be forced into involuntary bankruptcy by the settlor's creditors. If there are more than twelve creditors, then three or more must file for involuntary bankruptcy.[6] If there is only one large judgment outstanding, plus a number of small creditors who are being timely paid, there may not be three creditors

4. 28 U.S.C. § 1408.
5. 28 U.S.C. § 1412.
6. 11 U.S.C. § 303(b)(1).

who want to see a bankruptcy filed and their debts discharged. If there are fewer than twelve creditors, then only one is required to file for involuntary bankruptcy.[7]

A. Jurisdiction

If a proceeding is successfully filed in a federal bankruptcy court, then the creditor's jurisdiction problem is solved. The bankruptcy court has national jurisdiction and therefore will have jurisdiction over the DAPT trustee and the trust assets for the purpose of determining whether such assets should be included in the bankruptcy estate.[8]

B. Spendthrift Trust Exception

Section 54l(c)(2) of the Bankruptcy Code provides: "A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."[9]

A settlor will rely upon this express exemption from the bankruptcy estate for spendthrift trusts based upon the application of the DAPT state spendthrift trust law. Therefore, merely filing bankruptcy or being forced into bankruptcy does not bring the DAPT assets within the bankruptcy estate that will be shared by creditors. Rather, in order to include the trust assets in the bankruptcy estate, the creditor must persuade the bankruptcy court that the DAPT fails based upon one or more of the grounds stated in the following section C.

C. Resolve Choice of Law, Fraudulent Transfer, and/or Improper Implementation Claims

Since the bankruptcy court will have jurisdiction over the trustee and the trust assets, it may consider and resolve choice of law, fraudulent transfer, and improper implementation claims. Several unique rules apply when these matters are being considered in bankruptcy court. These will be discussed further in upcoming sections E, F, and G, which analyze these attacks.

D. Impact of the 2005 Bankruptcy Provision on Domestic Asset Protection Trusts

On April 20, 2005, President Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. During the debate of the Act in the Senate, the *New York Times* published an article describing the "millionaire's loophole" created by DAPTs.[10] The legislative history describes how an attempt was made to limit DAPTs to $125,000 of assets and omit the requirement of "actual intent to prove fraudulent transfers."[11]

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7. 11 U.S.C. § 303(b)(2). Attorney fees and damages may be awarded against a creditor who improperly files an involuntary bankruptcy proceeding. Therefore, this tactic needs to be carefully evaluated by a single large creditor.

8. 28 U.S.C. § 1334(e); Bankr. R. 7004(d).

9. Most DAPT states have enacted a state statute which attempts to "bootstrap" the state's spendthrift provision so it will come under § 541(c)(2) of the Bankruptcy Code. *See* Twelfth ACTEC Comparison of the Domestic Asset Protection Trust Statutes, updated through Aug. 2019, subject 21. This American College of Trust and Estate Counsel study is available at http://shaftellaw.com/docs/article-41.pdf.

Prior to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, commentators argued about whether § 541(c)(2) even applied to DAPT state statutes. However, the legislative history of the 2005 Bankruptcy Act appears to have resolved this issue in favor of DAPTs.

10. Morgenson, *Proposed Law on Bankruptcy Has Loophole*, N.Y. Times, Mar. 2, 2005.

11. The legislative history of the 2005 Bankruptcy Act as it relates to DAPTs is thoroughly described in the article David G. Shaftel & David H. Bundy, *Impact of New Bankruptcy Provision on Domestic Asset Protection Trusts*, 32 Est. Plan. 7 (July 2005).

However, these attempts failed and Congress affirmed the validity of DAPTs with respect to the Bankruptcy Code. The Bankruptcy Act debate placed squarely before Congress the question of whether DAPTs, formed without fraudulent transfers, should be allowed. Congress decided affirmatively, by a wide voting margin.

The key language of the 2005 Bankruptcy Act amendments relates to fraudulent transfers and the limitations period that applies. This language is discussed in upcoming section F, relating to fraudulent transfers.

IV. Full Faith and Credit

Often, a discussion of pursuing a settlor/debtor's assets that have been transferred to a DAPT brings up the Full Faith and Credit Clause.[12] It is common to hear an oversimplified argument that a creditor merely needs to take the judgment that the creditor has obtained in the settlor/debtor's state of residence to the DAPT state and demand full faith and credit for that judgment. It is not that simple. Again, jurisdiction is important, as the following analysis illustrates.

Assume that a nonresident of a DAPT state establishes a DAPT. Assume that a creditor sues the settlor in a court located in the settlor's state of residence and obtains a judgment. Next, assume that as part of that suit, or in a separate action in the settlor's state of residence, the creditor proceeds against the trustee of the DAPT in order to enforce the judgment against the trust assets. Assume that the court in the state of residence chooses that state's spendthrift trust rules and/or fraudulent transfer rules and enters a judgment against the trustee. The creditor then proceeds to the DAPT state and asks a court located there to enforce the judgment against the trustee based upon the Full Faith and Credit Clause.

A basic requirement for full faith and credit is that the judgment be valid.[13] One requisite for validity is that the forum court possessed jurisdiction.[14] Assume that the DAPT trustee did not participate in the court action in the settlor's state of residence and had few, if any, contacts with that state. Then, that state's jurisdiction over the DAPT trustee and the assets such trustee holds will be highly questionable.[15] Consequently, full faith and credit may well be denied.

Professor Karen Boxx describes this type of situation as follows:

> The Alaska court might rule that the judgment was void for lack of jurisdiction, since the personal jurisdiction issue was not "fully litigated," and could refuse to give full faith and credit to the Washington ruling. Such a ruling may comply with *Baker v. General Motors* because the Supreme Court merely held that a "final judgment in one State, if rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment, qualifies for recognition throughout the land." [*Baker v. General Motors*, 522 U.S. 222, 233.] Without jurisdiction over the trustee, the judgment would not be entitled to full faith and credit under that formulation.[16]

Even if the court in the settlor's state of residence had obtained jurisdiction over the trustee of the DAPT, Professor Austin Scott points out that the judgment may still not be entitled to full faith and credit in the DAPT state. If the court of the DAPT state

12. U.S. Const. art. IV, § 1.
13. 18 James W. Moore et al., Moore's Federal Practice § 130.04[3] (Matthew Bender 3d ed. 2016).
14. *Id.*; Restatement (Second) of Conflict of Laws § 92, cmt. e (Am. L. Inst. 1969).
15. *See* Boxx, *supra* note 3, at 1227.
16. *Id.* at 1214–15.

has primary supervision over the administration of the trust, either because the trustee has qualified as trustee in that state or because the administration of the trust is fixed in that state, then the decision of a court of another state may not be entitled to full faith and credit.[17]

In conclusion, Full Faith and Credit, as an issue, has been often superficially discussed as a creditor remedy. As explained, it is highly dependent upon jurisdiction over the DAPT trustee.

V. The First Type of Creditor Attack: Choice of Spendthrift Trust Law

With the previously described background relating to jurisdiction and full faith and credit in mind, the focus now turns to the first of the three general attacks that a creditor can bring against a DAPT. If the settlor is a nonresident of the DAPT state, the creditor first needs to analyze the law of the settlor's state of residence with respect to domestic asset protection trusts. A DAPT is a self-settled discretionary spendthrift trust. Prior to 1997, 48 of the 50 states had statutes or case law that allowed a creditor to reach all of the assets of a self-settled trust that were eligible for distribution to the settlor. Over the last 23 years, 19 states have enacted DAPT statutes that protect the assets of a properly formed DAPT from claims brought by a creditor of the settlor.

Assume that a nonresident of a DAPT state establishes a DAPT. Subsequently, the settlor is sued in either state or federal court by a creditor. The court may be located in the settlor's state of residence or in the DAPT state. Assume further that the court obtains jurisdiction over the trustee of the DAPT. The creditor will argue that the court should choose the spendthrift trust law of the settlor's state of residence, rather than the law of the DAPT state. If the court chooses to apply the law of the state of residence, which does not allow DAPTs, then the creditor will be allowed to reach the assets of the trust. Therefore, the issue is which state's spendthrift trust rules apply—those of the DAPT state or the rules of the settlor's state of residence?

We will analyze this issue by reference to the principles stated in the *Second Restatement of Conflict of Laws*. It is assumed here that such principles would be applied by a court sitting in the DAPT state or in the settlor's state of residence. However, each state's conflict of laws rules should be researched to determine if they differ from those of the Restatement. Further, a state may not have a developed conflict of laws rule with respect to creditor claims. Ultimately, that state's legislature or supreme court may develop a conflict of laws rule in the creditor area that is different from the principles provided by the Restatement.

A. Administration

If the question is one of administration of the trust, the settlor's choice of DAPT law in the trust instrument controls. Section 273(b) of the *Second Restatement of Conflict of Laws* provides that whether the interest of a beneficiary of a trust of movables is assignable by him and can be reached by his creditors is determined (in the case of an inter vivos trust), "by the local law of the state, if any, in which the settlor has manifested an intention that the trust is to be administered . . . ."[18]

17. Austin Wakeman Scott & Mark L. Ascher, Scott and Ascher on Trusts § 45.2.2.6 (5th ed. 2010).
18. Restatement (Second) of Conflict of Laws § 273(b).

B. Validity

If the question is one of validity of the trust, section 270(a) of the Restatement again provides that the settlor's choice of DAPT law in the trust instrument will prevail if the DAPT state "has a substantial relation to the trust and that the application of its law does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6 . . . ."[19]

Generally, the DAPT state will satisfy the requirement of having a substantial relation to the trust. However, a factual determination will need to be made as to which state has the most significant relationship to the trust.

The central issue is which of these Restatement sections provides the choice of law rule for DAPTs. A persuasive argument can be made that section 273(b) should apply. After all, this provision expressly addresses the subject of a creditor's ability to reach trust assets.[20]

As of yet, there are no DAPT cases that have directly considered whether section 273(b) of the Restatement should be applied to resolve the choice of law issue. However, there is one DAPT case[21] that applied the "strong public policy" rule of section 270(a) of the Restatement to resolve the choice of law issue. The bankruptcy court sitting in the state of Washington did not mention section 273(b). Also, several foreign trust cases have chosen to apply section 270(a) and its "strong public policy" test.[22]

It is unclear why the few courts that have considered this choice of law question have not discussed the principle provided in section 273(b), which defers to the settlor's selection of law in the trust instrument. Perhaps this reflects how the issue was litigated before the court. Alternatively, maybe the "strong public policy" principle is chosen because it supported the result that seemed the most equitable. Regardless, in future litigation, a settlor/debtor may aggressively argue that section 273(b) applies and the choice between these two Restatement sections may be expressly considered and resolved by one or more courts.

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19. Restatement (Second) of Conflict of Laws § 270(a) (Am. L. Inst. 1969). Section 6 provides:

> § 6. Choice-of-Law Principles
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> A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.
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> When there is no such directive, the factors relevant to the choice of the applicable rule of law include
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> the needs of the interstate and international systems,
>
> the relevant policies of the forum,
>
> the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,
>
> the protection of justified expectations,
>
> the basic policies underlying the particular field of law,
>
> certainty, predictability and uniformity of result, and
>
> ease in the determination and application of the law to be applied.

20. *See* Gideon Rothschild, Daniel S. Rubin & Jonathan G. Blattmachr, *Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch?*, 9 J. Bankr. Law & Prac. 59 (Nov./Dec. 1999).

21. Waldron v. Huber (*In re* Huber), 493 B.R. 798 (W.D. Wash. 2013); *see also* Dahl v. Dahl, 215 Utah 79 (2015), which used a "strong policy" ground for choice of law but did not mention the Restatement provisions.

22. *In re* Portnoy, 201 B.R. 685 (Bankr. S.D.N.Y. 1996); *In re* Brooks, 217 B.R. 98, 32 Bankr. Ct. Dec. (CRR) 23 (Bankr. D. Conn. 1998).

However, since the few cases involving one DAPT and several foreign trusts have adopted the "strong public policy" test, this stricter requirement for choice of DAPT law deserves a thorough analysis.

C. Strong Public Policy: Momentum and Other Self-Settled Statutory Provisions

Initially, the fact that now 19 states have DAPT statutes should influence this "strong public policy" subject. In 1997 after Alaska and Delaware enacted DAPT statutes, this law appeared exotic and subject to the argument that the vast majority of states disapprove of this policy. However, many other states have followed suit. As more states enact DAPT statutes, it becomes more difficult to argue that the DAPT policy is extraordinary and therefore violates the strong public policy of non-DAPT states.

The law of the settlor's state of residence should be analyzed to determine if other self-settled techniques are allowed in that state. The existence of such self-settled techniques will detract from the argument that the state has "a strong public policy" against such techniques and therefore a strong public policy against DAPTs. Consider the following techniques.

A new type of partial DAPT statute has emerged. These "Inter Vivos Qualified Terminable Interest Property (QTIP) Trust" statutes specifically abrogate the rule against self-settled spendthrift trusts for lifetime QTIP trusts. The non-DAPT states that have enacted these statutes are Arizona, Arkansas, Florida, Georgia, Kentucky, Maryland, North Carolina, Oregon, South Carolina, and Texas.[23] In essence, these statutes provide that the assets of an inter vivos QTIP trust are not to be considered assets contributed by the settlor. As a result, the assets cannot be reached by creditors of the donor spouse after the death of the donee spouse.[24]

Another way in which some states have "placed their toe in the water" with respect to self-settled trust asset protection is by enacting statutes that protect the assets in an irrevocable grantor trust from a creditor claim even though an independent trustee, in such trustee's discretion, may reimburse the settlor for income tax resulting from assets in the trust. The non-DAPT states with these statutes are Arizona, Florida, Georgia, Idaho, Kentucky, Maryland, New Jersey, New York, North Carolina, Oregon, Texas, and Virginia.[25] These statutes were enacted so that these states could take advantage of Revenue Ruling 2004-64.[26]

A section 529 plan is a statutory technique that allows a donor to place funds in a tax-free accumulation account for the educational purposes of the beneficiary. This is

23. Ariz. Rev. Stat. Ann. § 14 10505(E); Ark. Code Ann. § 28 73 505; Fla. Stat. § 736.0505(3); Ga. Ann. § 53-12-82(b); Ky. Rev. Stat. Ann. § 386B.5 020(8)(a); Md. Code Ann., Est. & Trusts § 14.5- 1003; N.C. Gen. Stat. § 36C-5-505(c); Or. Rev. Stat. § 130.315(4); S.C. Code Ann. § 62-7-505(b)(2); Tex. Prop. Code Ann. § 112.035(g).

24. Richard S. Franklin, *Lifetime QTIPs—Why They Should Be Ubiquitous in Estate Planning*, Fiftieth Annual Philip E. Heckerling Institute on Est. Plan., at 14-1 (U. Miami Sch. L., Jan. 2016); Barry A. Nelson, *Seeking and Finding New Silver Patterns in a Changed Estate Planning Environment: Create Inter Vivos QTIP Planning*, ABA RPTE Section Spring Symposium (Chicago May 2014).

25. Ariz. Rev. Stat. Ann. § 14-10505(A)(2); Fla. Stat. § 736.0505(1)(c); Ga. Code Ann. § 53-12-82(a)(2)(B); Idaho Code § 15-7-502(4); Ky. Rev. Stat. Ann. § 386B.5-020(7)(c); Md. Code Ann., Est. & Trusts § 14.5-1003(a)(1); N.J. Stat. Ann. § NJSA 3B:11-1(b); N.Y. Estates, Powers & Trusts Law § 7-3.1(d); N.C. Gen. Stat. § 36C-5-505(a)(2a); Or. Rev. Stat. § 130.315(1)(d); 20 Pa. C.S. § 7745; Tex. Prop. Code Ann. § 112.035(d)(1); Va. Code Ann. § 64.2-747(A)(2). Some DAPT states also have stand-alone statutes of this kind (*see, e.g.*, Alaska Stat. § 34.40.110(m); 12 Del. C. § 3536(c)(2); N.H. Rev. Stat. § 564-B:5-505A(6)).

26. 2004-2 C.B. 7.

a self-settled technique because the donor may withdraw the funds (subject to a penalty).

The following non-DAPT states provide asset protection for these accounts from the claims of a creditor of the donor: Colorado, Florida, Illinois, Louisiana, and New Jersey.[27]

Other types of self-settled techniques that provide protection against creditors of the donor exist in non-DAPT states. These include the well-known homestead exemption in Florida, life insurance policies, annuity policies, and IRA accounts.

Analysis of the law of the settlor/debtor's state of residence may establish that several of the previously described self-settled techniques are authorized under that state's law. If so, it may be difficult for a creditor to argue that the settlor/debtor's state of residence has a "strong public policy" against self-settled discretionary spendthrift trusts (DAPTs).[28]

D. Strong Public Policy: Academic Commentary

Professor Scott in his treatise "The Law of Trusts" states that differences in spendthrift trust law are not enough to establish a "strong public policy" that would justify disregarding the law of the state of administration chosen by the settlor.[29]

Professor Patrick Borchers, generally analyzing the public policy exception in the conflict of laws area, states the following:

> The latter possibility makes the "public policy" issue germane here, but on the American scene, where the federal constitution imposes minimum standards of fairness on all of the states, uncommon is the appearance of a law so offensive to a forum's "public policy" that the forum will refuse to apply it.
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> . . .
>
> Before a foreign claim or law is rejected on the ground that it violates forum "public policy", the forum feeling about the matter must be shown to be a deep one, to touch on something the forum deems to involve moral values rather than just a different way of doing things.
>
> . . .
>
> One may ask how much room there is today for an American court to refuse a sister-state claim on the ground that it offends forum public policy. The answer is: little.[30]

In addition to the principles involved in sections 270(a) and 273(b) of the Restatement, a rule of validation with respect to trusts needs to be considered. Professor Borchers describes this rule, as follows:

> Courts favor a rule of validation, meaning that if of two related states the trust is valid under the law of one but invalid under the law of the other, the one that validates is chosen. One finds this rule applied to both inter-vivos trusts (Hutchinson, NY

27. C.R.S. 23 3.1 307.4; Fla. Stat. § 222.22; 15 ILCS 505/16.5, 735 ILCS 5/12 1001(j); La. R.S. 17:3096G; and N.J. Stat. § 18A:71B 41.1.

28. *See* Robert T. Danforth, *Rethinking the Law of Creditors' Rights*, Hastings L.J. 287, 325, 333–43 (2002).

29. Scott & Ascher, *supra* note 17, § 45.7.1.1, at 3344. However, compare the discussion in § 45.7.1.2.

30. Patrick J. Borchers, Conflicts in a Nutshell § 57 (4th ed., West Academic 2015). In *Intercontinental Hotels Corp. v. Golden*, 254 N.Y.S.2d 527, 203 N.E.2d 210 (N.Y. 1964), the New York courts enforced a foreign gambling claim as not against public policy even though that type of gambling was not legal in New York state. Also, see the bankruptcy court cases discussed later in section V.F.

> 1933) and testamentary trusts (Chappell, Wash. 1923), and the rule is invoked even when internal forum law would invalidate the trust and the rule of validation points to the law of the other state, as occurred in Shannon v. Irving Trust Co., 275 N.Y. 294, 305, 9 N.E.2d 792 (N.Y. 1937), where, additionally, the instrument specifically chose the validating law. Implied in the rule of validation is that even a settlor who has made no choice of law in the instrument would choose the validating law if he thought about it.[31]

The *Second Restatement of Conflict of Laws* in section 6, comment g, reaffirms that "the courts seek to apply a law that will sustain the validity of a trust of moveables (see §§ 269–270)."[32]

E. Uniform Voidable Transactions Act; Its Comments Provide a New Choice of Law Rule

In 2014, the Uniform Law Commission passed amendments to the Uniform Fraudulent Transfer Act (UFTA), which not only renamed that act the Uniform Voidable Transactions Act (UVTA), but also included Comments that state an unusual choice of law rule relating to DAPTs. This new choice of law rule applies in states that have enacted these new amendments and Comments.

The UVTA contains a new Section 10 that addresses the question of which state's law determines whether a voidable transfer has occurred when contacts with multiple states are involved. Section 10(b) provides, in part:

> A claim for relief in the nature of a claim for relief under this [Act] is governed by the local law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred.

Section 10(a) provides:

> A debtor who is an individual is located at the individual's principal residence.

The final paragraph of Comment 8 under Section 4 of the UVTA (which section states which transfers shall be deemed voidable), says:

> Because the laws of different jurisdictions differ in their tolerance of particular creditor-thwarting devices, choice of law considerations may be important in interpreting § 4(a)(1) as in force in a given jurisdiction. For example . . . the language of § 4(a)(l) historically has been interpreted to render voidable a transfer to a self-settled spendthrift trust. Suppose that jurisdiction X, in which this Act is in force, also has in force a statute permitting an individual to establish a self-settled spendthrift trust and transfer assets thereto, subject to stated conditions. If an individual Debtor whose principal residence is in X establishes such a trust and transfers assets thereto, then under § 10 of this Act the voidable transfer law of X applies to that transfer. That transfer cannot be considered voidable in itself under§ 4(a)(l) as in force in X, for the legislature of X, having authorized the establishment of such trusts, must have expected them to be used . . . By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has no legislation validating such trusts, and if Debtor establishes such a trust under the law of X and transfers assets to it,

31. Borchers, *supra* note 30, § 96.
32. Also see Restatement (Second) of Conflict of Laws § 270, cmt. d.

> then the result would be different. Under § 10 of this Act, the voidable transfer law of Y would apply to the transfer. If Y follows the historical interpretation referred to in Comment 2, the transfer would be voidable under § 4(a)(1) as in force in Y.

Comment 2 under Section 4 of the UVTA provides in pertinent part:

> Section 4, unlike § 5, protects creditors of a debtor whose claims arise after as well as before the debtor made or incurred the challenged transfer or obligation. Similarly, there is no requirement in § 4(a)(l) that the intent referred to be directed at a creditor existing or identified at the time of transfer or incurrence. For example, promptly after the invention in Pennsylvania of the spendthrift trust, the assets and beneficial interest of which are immune from attachment by the beneficiary's creditors, courts held that a debtor's establishment of a spendthrift trust for the debtor's own benefit is a voidable transfer under the Statute of 13 Elizabeth, without regard to whether the transaction is directed at an existing or identified creditor . . . .

The effect of the previously described new Section 10 and the quoted Comments is to void transfers to DAPTs by nonresidents of a DAPT state who reside in a state that has adopted the 2014 amendments and Comments of the UVTA. The theory appears to be that fraudulent intent is not required. Rather, the mere creation of a DAPT by a resident of a UVTA state is voidable per se if the state has a statute or case law that allows creditors to reach the assets of a self-settled trust. The Comments have created considerable controversy. Critics assert that the Comments go well beyond existing fraudulent transfer law and are a "back door" approach to enacting a new choice of law rule. Critics argue that choice of law rules for trusts should be determined under existing trust law, as provided in the *Second Restatement of Conflict of Laws*. Critics of the Comments are concerned that courts will give them significant, and undeserved, weight in applying the UVTA. Critics are concerned that state legislatures that enacted the UVTA and the Comments have not been adequately informed of the breadth and consequences of these Comments as they affect DAPTs.[33]

Twenty states have enacted the UVTA.[34] Five of these states are also DAPT states.[35] Comment 8 of Section 4 makes it clear that if the state also has a DAPT statute, then a transfer cannot be considered voidable in itself because the legislature of the DAPT state has authorized the establishment of such trust. Four of the states that enacted the UVTA have rejected the Comments.[36]

Therefore, attorneys who represent clients in non-DAPT states who desire to form a DAPT will need to research whether their client's state of residence is one of the

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33. For example, see the discussion in George Karibjanian, Gerard J.J. Wehle & Robert L. Lancaster, *History Has Its Eyes on UVTA—A Response*, LISI Asset Prot. Plan. Newsl. (Leimberg Info. Servs.) No. 320 (Apr. 18, 2016); Richard Nenno & Dan Rubin, *Uniform Voidable Transactions Act: Are Transfers to Self-Settled Spendthrift Trusts by Settlors in Non APT States Voidable Transfers Per Se?* LISI Asset Prot. Plan. Newsl. (Leimberg Info. Servs.) No. 327 (Aug. 15, 2016); Ken Kettering & Ed Smith, *Comments to Uniform Voidable Transactions Act Should Not Be Changed*, LISI Asset Prot. Plan. Newsl. (Leimberg Info. Servs.) No. 329 (Aug. 25, 2016); George D. Karibjanian, *The Uniform Voidable Transactions Act Will Affect Your Practice*, 155 (5) Trs. & Ests. 17 (May 2016); George D. Karibjanian, Richard W. Nenno & Daniel S. Rubin, *The Uniform Voidable Transactions Act: Why Transfers to Self-Settled Spendthrift Trusts by Settlors in Non APT States Are Not Voidable Transfers Per Se*, 42 Bloomberg BNA Tax Mgmt. Ests., Gifts, & Trs. J. 173 (July/Aug. 2017).

34. *See* Twelfth ACTEC Comparison, *supra* note 9, at 1–3 (State Law Status of the Uniform Voidable Transactions Act, as of Aug. 1, 2019).

35. Indiana, Michigan, Rhode Island, Utah, and West Virginia. *Id.*

36. Alabama, Arkansas, Indiana, and New York. *Id.*

presently 12 non-DAPT states that has adopted both Section 10 and the Comments to the UVTA. If so, the issue is how significant is such an adoption?

F. Choice of Law in Bankruptcy Court

Assume that a creditor has decided that it is advantageous to commence an involuntary bankruptcy action in the debtor's state of residence. Assume it is a well-planned DAPT and therefore not vulnerable to a challenge based upon fraudulent transfers or improper implementation. This leaves the creditor with arguing that the bankruptcy court should choose the law of the debtor's state of residence, which in this example is not a DAPT state. The bankruptcy court will consider all of the matters discussed earlier in Section V relating to choice of spendthrift trust law.

Numerous bankruptcy courts have considered the choice of spendthrift law with respect to third-party settled trusts. These courts have recognized the choice of law issue and have applied the law where the spendthrift trust was administered rather than the law of the state where the bankruptcy court was located.[37] However, it is important to recognize that in all of these bankruptcy cases (except one, *Togut v. Hecht*) apparently the choice of law did not affect the result of the case. Therefore, the bankruptcy court was not forced to consider the Restatement's principles, including the "strong public policy" concept, discussed earlier in sections C and D. However, it may fairly be said that these existing bankruptcy cases do indicate that bankruptcy courts have "started down the road" that a DAPT settlor desires. That is, at least in uncontested cases, the bankruptcy courts have chosen the law of the state where the DAPT is administered, and presumably was also directed in the trust instrument.

If a bankruptcy court chose to ignore the above-referenced authority with respect to spendthrift trusts created by third parties, and determined the issue was one of validity of the trust and, further, made all of the factual determinations necessary to choose the spendthrift law of the settlor's state of residence, then it could apply that law and include some or all of the trust assets in the bankruptcy estate.

G. Avoid "Self-Settled": A Definitional Defense

For both the choice of law attack and the bankruptcy court's statute of limitations extension (see section VI.C), the definition of "self-settled" is key. If a trust is not self-settled (that is, the settlor is not a beneficiary), then the principle that a creditor can reach the trust assets that are distributable to the settlor—in non-DAPT states—can be avoided. Similarly, if a trust is not self-settled or a similar device, the extended fraudulent transfer limitations period under the Bankruptcy Code can be avoided.

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37. *See* Richard W. Nenno, *The Domestic Asset Protection Trust Comes of Age*, Thirty-Eighth Annual Philip E. Heckerling Institute on Est. Plan., ¶ 210.3, C (Matthew Bender & Co., June 2004), where the following cases are discussed: *Spindle v. Shreve*, 111 U.S. 542, 547–48, 28 L. Ed. 512, 514, 4 S. Ct. 522, 524–25 (1884); *Newman v. Magill*, 99 B.R. 881, 882 (C.D. Ill. 1989); *In re Hecht*, 54 B.R. 379, 382–83 (Bankr. S.D.N.Y. 1985), *aff'd sub nom. Togut v. Hecht*, 69 B.R. 290, 291 (S.D.N.Y. 1987); *Heidkamp v. Galliher (In re Hunger)*, 272 B.R. 792, 795 (Bankr. M.D. Fla. 2002); *In re Hunter*, 261 B.R. 789, 791 (Bankr. M.D. Fla. 2001); *Schwen v. Ramette (In re Schwen)*, 240 B.R. 754, 757 (Bankr. D. Minn. 1999); *Dzikowski v. Edmonds (In re Cameron)*, 223 B.R. 20, 24 (Bankr. S.D. Fla. 1998); *In re Gower*, 184 B.R. 163, 165 (Bankr. M.D. Fla. 1995); *McCauley v. Hersloff*, 147 B.R. 262, 264 (Bankr. M.D. Fla. 1992); *In re Portner*, 109 B.R. 977, 987 (Bankr. D. Colo. 1989); *In re Graham*, 1989 Bankr. Lexis 1283 (Bankr. D. Vt. 1989); *In re Sanders*, 89 B.R. 266, 269 (Bankr. S.D. Ga. 1988); *In re Kragness*, 58 B.R. 939 (Bankr. D. Or. 1986); *In re Hall*, 22 B.R. 942, 943 (Bankr. M.D. Fla. 1982); and *In re Remington*, 14 B.R. 496, 502 (Bankr. D.N.J. 1981).

A planner may be able to defensively avoid an attack based on choice of law, or the extended Bankruptcy Code limitations period, by designing a trust so that it is not self-settled. For example, a trust may be formed for a class of beneficiaries that includes the settlor's spouse and descendants. The settlor only becomes a beneficiary if the settlor's spouse is incapacitated or deceased, or if the marriage is terminated. Another approach does not include the settlor as a member of the class of beneficiaries, but an independent trustee or trust protector can add the settlor to the class in the future.[38] Alternatively, a trust can be designed so that it is only "partially self-settled." For example, a settlor's interest could be limited to only discretionary distributions of annual income, or other beneficiaries may be given ascertainable interests that would limit a trustee's power to make distributions to the settlor. This would prevent a portion of the trust assets from being vulnerable to a creditor's claim or becoming part of a bankruptcy estate.[39] These types of planning arguably either totally or partially change the trust so that it is no longer "self-settled." This would eliminate the choice of law issue and the applicability of the Bankruptcy Code's extended limitations period for fraudulent transfers.

H. Summary

The choice of law question of whether a non-resident of a DAPT state can successfully form a DAPT depends upon a number of factors. What are the facts connecting the settlor and the trust to the DAPT state? What is the forum court, and where is it located? What is the law of the settlor's state of residence with respect to other self-settled techniques? Has the settlor's state of residence adopted the UVTA and its comments?

These questions need to be answered, and then the rules and policies discussed in this section need to be applied. If the DAPT is well planned so that fraudulent transfers have been avoided, and has been properly implemented, then the choice of law attack will be all that is left for the challenger.

VI. The Second Type of Creditor Attack: Fraudulent Transfers

If a creditor cannot avoid the application of the DAPT spendthrift trust law, then an alternative may be to attack the transfer to the DAPT as fraudulent. Most fraudulent transfer situations can be avoided by good planning. Estate planners should carefully follow due diligence procedures in order to determine whether existing liabilities and foreseeable future liabilities are present. If so, then the settlor's contemplated transfer to the DAPT may result in fraudulent transfers. Therefore, either the DAPT should not be formed, or its formation should be postponed until a time when the liabilities have been satisfied or secured.

However, even when no known liabilities exist, the possibility that a future creditor will challenge a transfer to a DAPT as fraudulent cannot be completely eliminated. Fraudulent transfer rules of the 50 states vary significantly, as will be discussed later in the chapter. The planner needs to analyze the fraudulent transfer law of the DAPT state and of the state of residence of the settlor. Careful planning may influence which

38. Abigail O'Connor, Mitchell Gans & Jonathan Blattmachr, *SPATs: A Flexible Asset Protection Alternative to DAPTs*, 46 Est. Plan. 3 (Feb. 2019).

39. A bankruptcy court will only have jurisdiction over "all legal and equitable interests of the debtor." 11 U.S.C. § 541(a)(1).

state's fraudulent transfer law applies. A settlor will generally desire that the DAPT state's fraudulent transfer rules apply.

The intricacies of the law relating to fraudulent transfers is beyond the scope of this chapter. Here, we focus upon the limited subject of how fraudulent transfer rules apply to DAPTs.

A. Substantive Law

All of the DAPT states have an express exception that excludes fraudulent transfers from their spendthrift trust protection.[40]

All of the DAPT states, except Alaska are among 44 states that have adopted the UFTA.[41] That Act provides, in part:

> A transfer made . . . by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made . . . , if the debtor made the transfer . . . :
>
> with actual intent to hinder, delay or defraud any creditor of the debtor; or
>
> without receiving a reasonably equivalent value in exchange for the transfer . . . , and the debtor:
>
> was engaged or was about to engage in a business or transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
>
> intended to incur, or believed or reasonably should have believed that he [or she] would incur, debts beyond his [or her] ability to pay as they became due.[42]

Five states have not adopted the UFTA (1984) but, rather, have prior versions or their own particular rules that set aside fraudulent transfers.[43]

All of the DAPT states have varied some of the fraudulent transfer rules with respect to self-settled discretionary spendthrift trusts created under their law. These changes include limits on the intent necessary for a fraudulent transfer, the burden of proof, and the limitations periods for challenging a fraudulent transfer.[44]

B. Statute of Limitations under State Law

One subject area that many DAPT states have varied is the limitations period within which a creditor may challenge a transfer to a DAPT. Many clients who form DAPTs do so pursuant to what has been called the "nest egg" concept. That is, they want to set aside a certain portion of their net worth in a trust that will be protected from future events. They generally will have no known existing liabilities but are involved in activities, either work- or recreation-related, or investments, that create risks. These

40. *See* Twelfth ACTEC Comparison, *supra* note 9, subject 11.

41. Now, by amendment, named the Uniform Voidable Transactions Act.

42. U.F.T.A. §§ 5(a) and 4(a) (1984).

43. The five states are Alaska, Louisiana, Maryland, South Carolina, and Virginia.

44. *See* Twelfth ACTEC Comparison, *supra* note 9, subject 11. For example, prior to 2003, Alaska law allowed a creditor to successfully challenge a transfer to a trust if the "transfer was intended in whole or in part to hinder, delay, or defraud creditors or other persons . . . ." In 2003, this provision was amended to restrict a creditor's challenge to situations where "[t]he settlor's transfer of property in trust was made with the intent to defraud that creditor." The terms "in part," "hinder," "delay," and "creditors or other persons" were considered too ambiguous to allow for consistent application. (Alaska Stat. § 34.40.110(b)(1).)

clients want assurance that after a certain period of time a creditor cannot attack the DAPT and reach its assets.

The initial DAPT statutes followed the limitations period used by UFTA, which provides a four-year limitation period and a one-year discovery period. Some DAPT states have reduced this period to two years, or in one case, 18 months, and in another case 120 days after notice.[45]

However, each DAPT statute, except West Virginia, has a "discovery exception" that allows an existing creditor to assert a fraudulent transfer challenge later than the general limitations period.[46] This discovery exception allows challenges within the discovery period after the transfer was or could reasonably have been discovered by the claimant.

The creditors who can attempt to take advantage of the discovery exception are generally existing creditors who are asserting that the debtor made the transfer with the statutory required actual intent to defraud any creditor of the debtor. The discovery exception creates uncertainty concerning whether the statute of limitations has run with respect to a transfer to a DAPT.

In 2003, the Alaska legislature limited the discovery period by enacting amendments that required the creditor to have asserted the claim within four years after the transfer.[47]

Other states followed suit in limiting the discovery period. Nevada and Ohio deemed "discovery" when the transfer is reflected in a public recording, and Utah provides that the limitations period runs 120 days after notice of transfer is provided to known or unknown creditors of the settlor.[48]

Commentators in West Virginia conclude that there is no discovery exception to the four-year limitations period that applies to West Virginia DAPTs.[49]

C. Statute of Limitations under the Bankruptcy Act

If the state statute of limitations has expired, a creditor will want to consider proceeding in bankruptcy court where a ten-year limitations period is provided. While bankruptcy requires "sharing" with other creditors, something is better than nothing. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 enacted 11 U.S.C. § 548(e)(1) to provide:

> (e)(1) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if—
>
> such transfer was made to a self-settled trust or similar device;

45. *Id.*

46. *Id.*

47. The 2003 amendment limits the definition of an existing creditor to a creditor who:

> (1) can demonstrate, by a preponderance of the evidence, that the creditor asserted a specific claim against the settlor before the transfer; or (2) files another action, other than [a fraudulent conveyance action], against the settlor that asserts a claim based on an act or omission of the settlor that occurred before the transfer, and the action described in this sub-subparagraph is filed within four years after the transfer.

Thus, under this Alaska provision a settlor should know with certainty within four years of a transfer whether a creditor can attempt to challenge a transfer as fraudulent. Alaska Stat. § 34.40.110(d)(1)(B).

48. *See* Twelfth ACTEC Comparison, *supra* note 9, subject 12.

49. *Id.*

such transfer was by the debtor;

the debtor is a beneficiary of such trust or similar device; and

the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.[50]

The key operative language of the DAPT amendment (i.e., 11 U.S.C. § 548(e)) to the 2005 Bankruptcy Act is identical to the existing fraudulent transfer language of Bankruptcy Code § 548(a)(1)(A), with the one-year limitations period extended to ten years. Similarly, the operative language "actual intent to hinder, delay or defraud" is identical to the language used in UFTA,[51] which has been enacted in 44 states including 18 of the 19 DAPT states.[52] Further, all of the DAPT state statutes provide that fraudulent transfers to a DAPT will not be given spendthrift protection.[53] As a result, if the new amendment is construed and applied similarly to Bankruptcy Code § 548 and UFTA, then the enactment of this provision will have added little to the substantive law in this area.

The operative language that the debtor made such transfer with "actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted," which was taken verbatim from Bankruptcy Code § 548, needs clarification.[54] The terms "hinder, delay, or defraud," which have their roots in UFTA, can be traced back to the English Statute of Elizabeth.[55] Was it Congress's intent that this language be construed to be consistent with these existing statutes? This phrase also clearly includes future creditors. Which future creditors? With the extension of the limitations period from one year to ten years, the identification of qualifying future creditors becomes an important issue. Would these be just reasonably foreseeable future creditors, or any future creditor whose claim accrues during the ten-year period?

The Senate and House discussions are entirely centered on a debtor taking advantage of the bankruptcy laws by filing a voluntary bankruptcy action. Did Congress intend to include involuntary bankruptcy filings within the scope of this enacted amendment? One view is that fraudulent transfers should be avoided regardless of whether the bankruptcy action was initiated by the debtor or by the creditors. The alternative argument is that Congress's concern was that wealthy individuals would voluntarily take advantage of the Bankruptcy Code to discharge their debts, while still retaining the benefits of the DAPT. The intent was not to apply to cases where the debtor was involuntarily forced into bankruptcy.

Proposals were made in both the Senate (Sen. Schumer) and the House (Rep. Delahunt) that would have severely limited DAPTs. Congress rejected these proposals. Instead, Congress extended the § 548 fraudulent transfer remedy, which duplicates a remedy that already exists in the 44 states that have adopted UFTA. The major apparent difference is a fixed ten-year limitations period instead of UFTA's four years plus a one-year discovery period, or the modified limitations periods enacted by various DAPT states. The main consequence of this amendment is that it now provides a

50. 11 U.S.C. § 548(e)(1).

51. UFTA § 4(a)(1).

52. Legislative Fact Sheet, http://www.uniformlaws.org; *see* Twelfth ACTEC Comparison, *supra* note 9, subjects 11 through 13.

53. *See* Twelfth ACTEC Comparison, *supra* note 9, subject 11.

54. The term "entity" is defined in the Bankruptcy Code broadly and includes a person. 11 U.S.C. § 101(15).

55. 13 Eliz. Ch. 5.

uniform fraudulent transfer remedy and limitations period in all 50 states. However, because every DAPT state statute provides that fraudulent transfers to a DAPT will not be protected, the new Bankruptcy Act provision does not significantly change the effectiveness of DAPT asset protection.

D. Which State's Fraudulent Transfer Law Applies?

As discussed, the fraudulent transfer laws of the DAPT state and the settlor's state of residence may be significantly different. Therefore, if a creditor attacks a transfer to a DAPT on the grounds that the transfer was fraudulent or voidable, it will be necessary to determine which state's fraudulent transfer law will apply.

The *Second Restatement of Conflict of Laws* does not directly address this subject. See section 235, comment c, which indicates that a transfer of land in fraud of the transferor's creditors may be determined by the law governing the tort (rather than the law of the situs); section 244, which provides that a claim for fraud between the transferor and the transferee is determined by the law of the state which has the most significant relationship to the parties, the chattel, and the conveyance; and section 245, which provides that questions as to the effect of a conveyance upon a third party who has an existing interest in the chattel will be determined by the law of the state where the chattel was located at the time of the conveyance.

Professor Borchers, discussing gratuitous transfers, states:

> In the case of an ordinary gift by a living donor, it is made by the donor merely giving the thing to the donee. The validity of the transfer will be governed by the law of the place where the transfer is made. The Restatement couches this in terms of the "most significant relationship" test, but points to the law of "the location of the chattel" as having the "greater weight" (Rest.2d § 244). It is also permissible to accompany the gift with a writing selecting the law to be applied, and the general rule here as in contract cases (§ 68) is that if the law selected is that of a reasonably related jurisdiction, the choice will be honored.
>
> . . .
>
> If the interest is embodied in a more formal instrument, such as a check, note, bill, certificate of title or stock or the like, the instrument, as indicated, is likely to be deemed the property and a gift of it will be adjudged by the law of the place of its delivery.
>
> . . .
>
> If the transfer is made by a donor in State R sending the chattel to a donee in State E, and the donor is a competent adult and the transfer is clearly voluntary, the law of State E will usually govern if the laws of the two states differ, or—more than likely today in view of the apparent wishes of the donor to make a gift of the property—it will be sustained if valid by the laws of either place. This is known as the "rule of validation". It was previously met in discussing usury (§ 74). The principal cases manifesting circumstances like these involve trusts, but gifts in trust are gifts nevertheless, and, invoking essentially the same rules, supply answers applicable generally.[56]

These rules indicate that the choice of law may depend upon where the transfer occurred. Therefore, good planning will make sure that all transfers funding the DAPT occur in the DAPT state.

56. Borchers, *supra* note 30, § 90.

An alternative analysis is provided by Professor Ehrenzweig, discussing the controversial New York Court of Appeals case of *James v. Powell*.[57] Professor Ehrenzweig concluded that the conflict of laws rules for the law of torts control fraudulent conveyances.[58]

Section 145 of the *Second Restatement of Conflict of Laws* provides that the rights and liabilities of the parties with respect to an issue in tort are determined by the local law of the state that, with respect to that issue, has the most significant relationship to the occurrence and the parties under the principles stated in Section 6.[59] Certainly, the decision will be highly fact dependent and will be decided by the forum court.

Regardless of which state's substantive law is applied, it appears that the limitations period of the forum state will control. Assume that a court in the settlor's state of residence is not able to obtain personal jurisdiction over the trustee of the DAPT. Therefore, a creditor who desires to attack the settlor's transfer to the DAPT as fraudulent decides to bring an action in the DAPT state. The question is whether the DAPT state limitations period applies to such a cause of action or whether the limitations period of the settlor's state of residence controls.

The *Second Restatement of Conflict of Laws* section 142 provides in part:

> Statute of Limitations of Forum.
>
> An action will not be maintained if it is barred by the statute of limitations of the forum, including a provision borrowing the statute of limitations of another state.

Comment d to section 143 of the same restatement provides:

> d. It is consistent with full faith and credit for a State of the United States to apply its statute of limitations to preclude the maintenance of an action arising under the local law of a sister State even though the applicable statute of limitations of the sister State has not yet run and was of the sort that barred the right. *Wells v. Simonds Abrasive Co.*, 345 U.S. 514 (1953).[60]

In conclusion, analysis of asserting a fraudulent transfer claim against a DAPT requires determining what body of law will be applied and has the claim been barred. Assuming the claim is still viable, then the challenger must evaluate the relevant facts and applicable case law to determine if the claim will be successful.

VII. The Third Type of Creditor Attack: Improper Implementation, Alter-Ego, or Sham

The third type of creditor attack upon a DAPT can be generally described as improper implementation. This is a catchall category that commentators have also labeled as

57. 225 N.E.2d 741 (1967).

58. Albert A. Ehrenzweig & Peter K. Westen, *Fraudulent Conveyances in Conflicts Law*, 66 Mich. L. Rev. 1679, 1689–96 (1968).

59. Section 6 of the Restatement (Second) of Conflict of Laws is quoted in note 19.

60. Some commentators have speculated that adoption of the Uniform Enforcement of Foreign Judgments Act might provide a creditor with an argument that would prevent a court from denying Full Faith and Credit based upon expiration of its statute of limitations. (Nenno, *supra* note 37, ¶ 212.3.) However, the Uniform Act expressly defines a "foreign judgment" as "any judgment, decree, or order of a court of the United States or of any other court which is entitled to full faith and credit in this state." *See* Alaska Stat. § 09.30.260. Therefore, it appears that the Uniform Act does not change the preceding conclusion with respect to the applicable statute of limitations.

alter-ego theory or sham theory.[61] This is the same type of general concept that can be used to attack the validity of any entity, whether a trust, limited partnership, limited liability company, or corporation. In essence, the theory is that the key parties have failed to respect the separate existence of the entity and the basic requirements for proper implementation of the entity.

A. Trustee Independence

Perhaps the most vulnerable implementation area for a DAPT involves the independence of the trustee who has authority to make distributions to the beneficiaries, including the settlor.[62] This is an area where a settlor, who is reluctant to give up control, may make decisions that render the trust vulnerable. A typical DAPT will provide that the independent trustee has absolute discretion to make distributions to a class of beneficiaries that includes the settlor, the settlor's spouse, and the settlor's descendants. The settlor must not have any control over distributions to the settlor. If the settlor did have such distribution powers, then a court in the settlor's state of residence that rendered a judgment against the settlor could force the settlor to make distributions to himself or herself. Then the creditor would have access to the distributions. This prohibition against the settlor having discretion to make distributions to the settlor is so important that it is stated some DAPT statutes.[63]

In order to preserve the independence of the trustee, there must not be any agreement between the independent trustee and the settlor regarding distributions to the settlor. The existence of such an agreement would impute the distribution powers to the settlor. An additional result would be inclusion of the assets in the settlor's gross estate.[64] Such an agreement could be written, oral, or implied. Facts which may create an implied agreement can be a pattern of distributions, a close relationship with the trustee, and/or a dependence upon the trust assets for the payment of reoccurring personal expenses.[65] If such a collusive relationship exists, then the trust is a "sham," and is the settlor's "alter-ego."[66]

It would be more likely that a court might imply an agreement between the trustee and settlor if the independent trustee had a relationship with the settlor. Such relationships would include being a close relative, close friend, or employee. A

61. For example, see Richard W. Nenno & John E. Sullivan III, *Domestic Asset Protection Trusts*, Tax Management Portfolio series, 868 T.M. (BNA), at 54–63 (2010); *e.g.*, *see* Duncan E. Osborne, *Asset Protection and Jurisdiction Selection: Clearing Up Your Situs Headaches*, Thirty-Third Annual Philip E. Heckerling Institute on Est. Plan., at 13–20 (U. Miami Sch. L., Jan. 1999).

62. An exception would be the Oklahoma revocable trust DAPT. *See* Twelfth ACTEC Comparison, *supra* note 9, subject 2 at 37.

63. *E.g.*, Alaska Stat. § 34.40.110(b)(3).

64. *See* Treas. Reg. § 20.2036-1(a), which finds "retention" under § 2036 if such an agreement exists.

65. Numerous cases exist in the family limited partnership area where courts have found an implied understanding of grantor control and, as a result, have applied I.R.C. § 2036, for example: *Estate of Rosen*, T.C. Memo 2006-115; *Estate of Disbrow*, T.C. Memo 2006-34; *Strangi v. Comm'r*, 417 F.3d 468 (5th Cir. 2005), *aff'g* T.C. Memo 2003-145; *Estate of Abraham v. Comm'r*, 408 F.3d 26 (1st Cir. 2005), *aff'g* T.C. Memo 2004-39; *Estate of Austin Korby v. Comm'r*, T.C. Memo 2005-103; *Estate of Edna Korby v. Comm'r*, T.C. Memo 225-102 (May 10, 2005); *Estate of Bigelow v. Comm'r*, T.C. Memo 2005-65; *Estate of Bongard v. Comm'r*, 124 T.C. No. 8 (2005); *Estate of Hillgren*, T.C. Memo, 2004-46; *Estate of Thompson v. Comm'r*, T.C. Memo 2002-246, *aff'd* 382 F.3d 367 (3rd Cir. 2004); *Kimbell v. United States*, 2003-1 USTC ¶ 60,455 (N.D. Tex. 2002); *Estate of Harper v. Comm'r*, T.C. Memo 2002-121; *Estate of Reichardt v. Comm'r*, 114 T.C. 144 (2000); and *Estate of Schauerhamer v. Comm'r*, T.C. Memo 1997-242. *See also* Boxx, *supra* note 3, at 1244–51.

66. *See* Danforth, *supra* note 28, at 302.

planner should choose a trustee who will minimize the risk that an implied agreement will be found.[67]

Dependence upon distributions for personal living expenses is another fact that may support an implied agreement argument. A "rule of thumb" has developed concerning the portion of a client's assets that should be transferred to a DAPT. This "rule" limits such assets to no more than one-third (conservative) to one-half (aggressive) of the client's net worth. The rationale for this "rule" is that a settlor would not give away assets that the settlor knew with some certainty he or she would need in the future, unless the settlor also knew that he or she could get the assets back. Thus, the transfer of too large a proportion of the settlor's assets to a DAPT invites a court to find that an agreement exists between the settlor and the trustee. This "rule of thumb" may be too conservative if the settlor can establish that adequate assets existed outside of the DAPT to provide for the settlor's normal living expenses.

A pattern of distributions, such as monthly or quarterly distributions of very similar amounts, could be used to support an implied agreement. The creditor's argument would be that such a pattern indicates that the settlor and the independent trustee had reached an agreement concerning future distributions.[68]

B. Risks Created by Distributions Pursuant to a Standard

A trustee's power to distribute assets pursuant to an ascertainable standard opens the argument that a creditor can force a trustee to make distributions to the settlor pursuant to the required standard (for example, health, education, maintenance, and support).[69] For instance, a creditor could argue that maintenance or support includes the payment of a settlor's creditors. Alternatively, a creditor could argue that a trustee is required, pursuant to an ascertainable standard, to distribute assets to an insolvent beneficiary. Then, the creditor could attempt to attach the distributions.

C. Statutory Requirements

Another type of improper implementation is the failure to comply with the requirements of DAPT state law. An example is that almost all DAPT states require that the DAPT trust have an administrative or qualified trustee, who is a resident individual or trust company or bank of the DAPT state. Most states require that this trustee maintain records and prepare or arrange for the preparation of income tax returns, on an exclusive or non-exclusive basis, and must participate in trust administration. Some trust assets need to be located in the DAPT state.[70] Another example is that some DAPT states require the settlor to sign an affidavit supporting the premise that

67. The previously described concerns about an implied agreement between the settlor and a trustee may also apply with respect to relationships between the settlor and trust protectors and trust advisors, depending upon the powers held by these persons.

68. Some DAPT statutes attempt to nullify the risk of an implied agreement by stating, "An agreement or understanding, express or implied," between the settlor and the trustee that attempts to grant or permit the retention of greater rights or authority than are stated in the trust instrument is void. *See* Twelfth ACTEC Comparison, *supra* note 9, subject 23.

69. Restatement (Second) of Trusts § 155, cmt. b (1957); Gideon Rothschild, *Protecting the Estate from In-Laws and Other Predators*, Thirty-Fifth Annual Philip E. Heckerling Institute on Est. Plan., at 17-21 through 17-23 (Matthew Bender & Co., June 2001).

70. *See* Twelfth ACTEC Comparison, *supra* note 9, subject 4.

the transfers to the trust are not being done with an intent to evade creditors.[71] Failure to comply with these requirements will support the argument that DAPT law should not be applied to the trust.

D. Management Formalities

Another area where a DAPT would be vulnerable to "alter-ego" theory is if the settlor or members of the settlor's family who are not trustees or authorized managers continued to manage trust assets that had been transferred to the DAPT—that is, a situation where the management roles relating to the trust assets have been ignored by the settlor, or members of the settlor's family.

If such management is desired, there are several acceptable approaches. The settlor, or a member of the settlor's family, can be an administrative trustee who has investment and management powers, but does not have distribution or other tax-sensitive powers.[72]

Alternatively, the assets could first be contributed to a family limited partnership (FLP) or family limited liability company (FLLC). The settlor or family member could be the general partner or manager. Then, the settlor transfers the FLP interest or the FLLC nonmanagerial interest to the DAPT. In this way, the settlor or family member may retain the ability to manage assets without violating the actual property ownership of the assets.[73] If the settlor is a general partner or manager and if transfer tax minimization planning is also a purpose of the trust, then conservative transfer tax planning would include another co–general partner or special manager who would have all distribution and liquidation powers.[74]

In conclusion, the best way to defend a DAPT against an improper implementation argument is to satisfy all formation requirements, carefully choose trustees, and maintain close communication and provide guidance to the client after formation. The client must understand that the project does not end when the client signs the DAPT instrument that transfers assets to the trust. The estate planner should maintain a continuing relationship and communications with the client, the client's assistants, and the accountant.

The other side of this coin is that a creditor challenging a DAPT should pursue aggressive and diligent discovery to determine if there are "cracks in the armor" with respect to formation, relationships, and proper implementation. If enough of these "cracks" exist, then this third mode of attack may be adequate to reach the assets that have been transferred to the DAPT.

VIII. The Contract Clause

In addition to the three general types of attacks previously discussed, some commentators have suggested that a DAPT may be challenged as violating the Contract Clause.[75] For such a violation to occur, a DAPT statute must substantially impair the

71. *See id.*, subject 28.

72. Jeffrey N. Pennell, 1 Estate Planning § 7.3.3 (CCH 7th ed. 2011).

73. T. Randall Grove, *Designing, Implementing and Operating the Family Limited Partnership to Avoid a Successful Section 2036 Attack*, Thirty-Eighth Annual Philip E. Heckerling Institute on Est. Plan., at 7-23, 7-24 (Matthew Bender & Co., June 2004).

74. *Id.*

75. U.S. Const. art. I, § 10, cl. 1.

obligations of parties to existing contracts or make them unreasonably difficult to enforce.[76] The violation of the Contract Clause occurs because of the retroactive effect of the DAPT statute upon contracts that exist on the date of enactment of the statute.[77] Creative arguments have been made in support of a Contract Clause violation by the new DAPT statutes.[78] The settlor's response would be that a contract creditor still has adequate remedies under the state's fraudulent transfer statute. The contract creditor would contend that if the transfer does not constitute a fraudulent transfer, then the settlor has successfully protected assets which the contract creditor could otherwise have reached.[79]

The Contract Clause contention applies only to contract creditors who existed on the date of enactment of the DAPT statute. As time passes after enactment of the DAPT statute, this argument will become factually irrelevant to settlors forming new DAPTs.[80]

IX. Special Types of Claims

A DAPT statute may provide express exceptions to the DAPT statute's spendthrift protection.[81] For example, some DAPT statutes have exceptions for child support, alimony, or property division claims. Some exceptions are only for claims that existed on or before the date of the transfer.[82] Nevada and Oklahoma do not provide any statutory exceptions.

A. Child Support

With respect to child support, federal statutes have been enacted to facilitate the collection of court-ordered child support. However, personal jurisdiction is still required for full faith and credit.[83] Therefore, even if a DAPT statutory exception exists, a state court in the settlor's state of residence will need to obtain personal jurisdiction over the DAPT trustee in order to reach the DAPT assets. Even if a DAPT express statutory exception does not exist, DAPT state case law may provide exceptions from spendthrift protection with respect to exigent child-support situations.

B. Alimony

As described, some states do not provide an exception for alimony. Others provide a limited exception, and one state provides an unlimited exception. An argument has been made that even if a DAPT state's law does not provide an express exception for alimony, the DAPT state courts may well construe the DAPT statutes to allow claims.[84] The legislative history of the relevant DAPT state statute may resolve this issue. Again, state case law may create an exception to spendthrift protection for alimony in

76. Osborne, *supra* note 61, at 13–26.
77. *Id.*
78. *See id.*; *see also* Boxx, *supra* note 3, at 1230.
79. Osborne, *supra* note 61, at 14–26; Boxx, *supra* note 3, at 1240.
80. Boxx, *supra* note 3, at 1240, n.295.
81. *See* Twelfth ACTEC Comparison, *supra* note 9, subjects 14 through 18.
82. *Id.*
83. The Full Faith and Credit for Child Support Orders Act, 28 U.S.C. § 1738B(c).
84. *See* Nenno, *supra* note 37, ¶ 212.2, B; *see also* Restatement (Second) of Trusts § 157 (1959).

emergency situations such as where a divorcing spouse is ill or incapacitated and has no other funds for support or health purposes.

C. Property Division

Similarly, some state DAPT statutes do not provide any exception for a property division during a divorce, some states provide a limited exception, and some states provide an unlimited exception.[85] The Utah case of *Dahl v. Dahl* is an example of a court applying a choice of law rule and a strained construction of a DAPT instrument to reach assets in the trust.[86]

Even if the DAPT statute does not provide an exception for property divisions, court decisions interpreting various state statutes and commentators' analyses have raised questions about whether a beneficiary's interest in a trust would be protected. This concern exists for beneficiaries of third-party created trusts as well as a settlor who is a beneficiary of a self-settled trust. One commentator describes certain cases and theories both in states that have equitable distribution statutes and in community property states. Pursuant to these cases and theories, a beneficiary's interest in a trust has been or may be invaded or considered when the divorce court divides up the couple's property.[87] Often the theories of the courts are based upon an interpretation of the applicable state statutes' concept of "property" that may be divided or considered upon divorce.

In addition, several other aspects of property division rights should be considered. First, a spouse may be able to reach some of the DAPT assets by claiming that the spouse owned an interest in such assets prior to their contribution to the DAPT. The success of such an argument will depend upon the time the trust was created and the source of assets that were contributed to the trust. If the trust was created prior to marriage, or with assets that the settlor inherited during marriage, then the spouse may have no rights to such assets. However, if the assets were contributed during marriage either from community property or from property in a separate property state which that state considers "marital property," then a portion or even one-half of such assets may be considered to belong to the spouse.[88]

Some DAPT state statutes prohibit the family court from reaching a nonsettlor beneficiary's interest in a DAPT or other irrevocable trust. Some statutes may prohibit invading the nonsettlor beneficiary's interest but will consider it when "balancing" the property interests of the divorcing spouses.[89]

In 2006, the Alaska Legislature decided to expressly protect beneficial interests in trusts from invasion or consideration in a beneficiary's divorce property division. This protection applies whether the trust is a third-party trust or a DAPT created prior to marriage.[90] Alaska may be the first state to directly address this subject, and to

85. *See* Twelfth ACTEC Comparison, *supra* note 9, subject 16.

86. *Dahl v. Dahl*, 215 Utah 79 (2015), discussed later in Appendix 1.

87. Marc A. Chorney, *Interests in Trusts in Divorce: What the Settlor Giveth the Divorce Court May Taketh Away*, Fortieth Annual Philip E. Heckerling Institute on Est. Plan., ch. 14 (U. Miami Sch. L., Jan. 2004).

88. *See Brooks v. Brooks*, 733 P.2d 1044, 1055 (Alaska 1987).

89. *See* Twelfth ACTEC Comparison, *supra* note 9, subject 27.

90. Subsection (*l*) of Alaska Statute 34.40.110.

expressly prohibit the divorce court's invasion or consideration of trust interests in divorce property divisions.[91]

D. Federal Tax Liability

The question here is whether the federal government may satisfy a tax liability of the settlor from the assets in a DAPT which the settlor had created prior to incurring such tax liability. This subject is discussed in Chapter 22.

X. Payments When an Outstanding Judgment Exists

Assume that there are no fraudulent transfers. However, subsequent to the funding of a DAPT, assume that a creditor obtains a judgment against the settlor, or one of the other beneficiaries of the trust. Can the creditor force the trustee to distribute assets to the beneficiary, which the creditor could then reach? May the trustee of the DAPT directly pay expenses of the beneficiary and therefore avoid the reach of the creditor? This is a practical issue that often will face a trustee.

Some DAPT state statutes directly address this issue. For example, in Alaska, as long as the trustee has discretion to make distributions to a beneficiary, then a creditor may not force a distribution nor can a creditor compel a trustee to exercise the trustee's discretion to make a distribution.[92] Even if a beneficiary has an outstanding creditor, a trustee with discretion may pay income or principal to a third party for the benefit of the beneficiary.[93] That is, the trustee may directly pay the beneficiary's expenses or bills. A trustee is not liable to a creditor for paying income or principal on behalf of the beneficiary.[94] A creditor of a beneficiary may not maintain an action or proceeding that interferes with the trustee's discretion to apply income or principal on behalf of the beneficiary.[95] A creditor of a beneficiary may not obtain an order of attachment or similar relief that would prevent a trustee from making a discretionary payment to a third party on behalf of the beneficiary.[96] The same is true in Nevada.[97] Approximately one-half of the other DAPT states provide a similar type of protection for the trustee's payments.[98]

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91. The Alaska Legislature must have been prescient when it enacted this amendment. At the same time the amendment was being considered, and apparently without knowledge of the amendment, the Alaska Supreme Court was deciding *Krize v. Krize*. In that case, the Alaska Supreme Court held that a trial court may consider a prospective inheritance when deciding how a couple's property should be divided upon divorce. The court stated, "[i]nterests that have already vested may be considered as an asset of the beneficiary when the superior court divides the property." The interest in the *Krize* case was not as definite as a vested interest of a beneficiary in a trust. Rather, it was the husband's prospective inheritance because he was named as a beneficiary in the wills of his parents, who apparently were still alive. The Alaska Supreme Court was apparently unaware of the new legislation. Thus, the Alaska Supreme Court and the Alaska Legislature "passed each other like ships in the night."

92. Alaska Stat. § 34.40.113(c).

93. Alaska Stat. § 34.40.113(d).

94. *Id.*

95. Alaska Stat. § 34.40.113(e).

96. Alaska Stat. § 34.40.113(f).

97. Nev. Rev. Stat. § 166.120(3) provides that a beneficiary's share is not subject to attachment or execution and the trust estate and its income may "be applied by the trustee solely for the benefit of the beneficiary, free, clear, and discharged of and from any and all obligations of the beneficiary whatsoever and of all responsibility therefor."

98. *See* Twelfth ACTEC Comparison, *supra* note 9, subject 26.

XI. DAPT Case Law

At present, DAPT cases are few. However, it is inevitable that the courts will be asked to resolve controversies involving the interpretation and application of DAPT statutes. So far, there are only six relevant DAPT cases. Three cases involve Alaska's statute and were decided by the Alaska Supreme Court,[99] an Alaska bankruptcy court,[100] and a Washington bankruptcy court.[101] One case involves Delaware's statute and was decided by the Delaware Court of Chancery.[102] One case involved the Nevada statute and was decided by the Nevada Supreme Court,[103] and another case involving the Nevada statute was decided by the Utah Supreme Court.[104] The Alaska bankruptcy cases were mixed with fraudulent transfers, and the creditors prevailed. In a recent Alaska case, the Alaska Supreme Court refused to enforce an Alaska statute that stated that Alaska courts have exclusive jurisdiction over fraudulent transfer issues involving Alaska law. The Delaware case involved the application of a statute of limitations to bar the creditors, and the debtor prevailed. A Nevada case held that DAPT assets could not be reached for satisfaction of future spousal-support claims and child-support claims. A Utah case applied Utah law to a Nevada DAPT, rather than Nevada's law, in a divorce action. As a result, the spouse was able to reach assets in a DAPT formed by her husband. A detailed analysis of each case is provided in Appendix 1.

XII. Conclusion

Well planned and implemented DAPTs will minimize the avenues for attack. However, often the client's planning situation and subsequent implementation leaves the client open to arguments that the transfers were fraudulent and/or that faulty implementation justifies ignoring the validity of the trust.

A settlor who is a nonresident of a DAPT state faces the additional choice of law hurdle. Whether DAPT state law will be applied is not guaranteed. The settlor will argue that the Restatement principles, academic commentary, and the somewhat analogous case law all support application of the DAPT spendthrift trust law selected in the trust instrument. The creditor will counter by arguing that the DAPT rules violate a strong public policy of the settlor's state of residence, and will rely on the *Huber* case[105] and the existing foreign asset protection cases. As always, the particular facts of the case will significantly affect the outcome.

To counter the "strong public policy" argument, the nonresident settlor's chances of success will be improved by planning that establishes a substantial relation between the trust and the DAPT state, and by demonstrating that the settlor's home state does not have a strong policy against self-settled discretionary spendthrift trusts. Residents of "mini DAPT states"—those states that have enacted inter vivos QTIP trust statutes and/or tax reimbursement statutes—should have a significant argument that their state legislatures have signaled a lack of a strong public policy against self-settled trusts.

99. Toni I Trust v. Wacker, 413 P.3d 1199 (Alaska 2018).
100. Battley v. Mortensen, 2011 WL 5025288 (Bankr. D.C. Alaska 2011).
101. Waldron v. Huber (*In re* Huber), 493 B.R. 798 (Bankr. W.D. Wash. 2013).
102. Trust Co. Bank v. Matthews, 2015 WL 295373 (Del. Ch.).
103. Klabacka v. Nelson, 394 P.3d 940 (Nev. 2017).
104. Dahl v. Dahl, 215 Utah 79 (2015).
105. Waldron v. Huber (*In re* Huber), 493 B.R. 798 (Bankr. W.D. Wash. 2013).

A nonresident settlor who is a resident of a UVTA state that has also adopted the Comments will have another hurdle to overcome. Future case law may be necessary to indicate the weight that the courts will give to the amendments and comments.

After more than 20 years, DAPTs have become an established and important approach for the estate planner. Their popularity is illustrated by the 19 states that have enacted DAPT statutes and appears to be continually growing. Not only are they used for asset protection but equally important is their use for transfer tax minimization planning. They also can be valuable for prenuptial planning, pre-immigration transfer tax planning, and state income tax planning.

For a resident of a DAPT state, the use of a DAPT should be considered a default planning approach. The client may form a DAPT, be a discretionary beneficiary, gift assets to the DAPT during the client's lifetime, and use the DAPT as the client's residuary dispositive plan. The DAPT may contain a perpetual trust approach for the client's descendants. Even for clients with very large estates, the reassurance that DAPT assets can be distributed back to the client, if "the sky falls," may be the factor that convinces the client to go forward with sophisticated transfer tax minimization planning. During the settlor's lifetime, assets can be transferred to the DAPT through gift, GRAT (grantor retained annuity trust), sales to this grantor trust, and other planning techniques.

As with any sophisticated estate planning approach, problems can occur. As discussed at the beginning of this chapter, the client may have presented a fact situation or planning directives that are less than desirable. Nevertheless, the client and the planner may have decided to proceed knowing that some risks exist. Alternatively, or additionally, during the implementation period mistakes can be made. Often these mistakes are those of the client rather than of the estate planning attorney. Nevertheless, the fact situations, problems, and mistakes create the potential for a challenge. You may end up being at one or other end of that defense or attack. Hopefully, this chapter will serve as a useful roadmap for you, whichever role you end up serving.

Appendix I
Analysis of Case Law

1. ***Battley v. Mortensen,***[106] decided May 26, 2011, by a bankruptcy court sitting in Alaska, was the first Alaska DAPT case. Also, this case is one of the initial bankruptcy court decisions to construe and apply the 2005 Bankruptcy Act provisions in subsection 548(e).

Mortensen was a self-employed project manager for the environmental aspects of construction projects. He and his wife had acquired a parcel of land on McDonald Spit, a very scenic and now trendy recreational area near Seldovia and across from Homer, Alaska. In 1998, Mortensen and his wife divorced, and Mortensen was awarded the Seldovia property.

Mortensen struggled financially and had heard about Alaska's DAPT law. He researched the topic and copied a trust form from the web. In 2005, Mortensen quitclaimed the Seldovia property to the trust. The trust language in several places clearly stated that the grantor's intention was that assets held in the trust shall not be subject to the claims of creditors. From 2005 through 2009, Mortensen's financial situation and health deteriorated. Four years and two months after transferring the Seldovia property to the trust, and after Alaska's four-year limitations period had run, Mortensen filed for bankruptcy. The bankruptcy trustee brought an adversarial proceeding to set aside as fraudulent the transfer of the Seldovia property.[107] The trustee argued that Mortensen was struggling financially from 2001 forward. He emphasized that Mortensen admitted this in his divorce action. The trustee pointed out that immediately after Mortensen formed the trust in 2005, he engaged in a frenzy of credit card activity and ran up credit card debt from $85,000 to $250,000.

The bankruptcy court first held that the ten-year limitations period of Bankruptcy Code § 548(e) applied. Therefore, the trustee's fraudulent transfer claim was not barred by Alaska's four-year limitations period. The court concluded that Mortensen was "well under water" when he sought to put the Seldovia property out of the reach of his creditors. The court pointed out that after the transfer of the property to the trust, Mortensen used the trust assets to make stock market investments and also made a car loan to one of Mortensen's friends. The court concluded that "the bottom line for Mr. Mortensen is that he attempted a clever but fundamentally flawed scheme to avoid exposure to his creditors." In summary, the court's decision establishes that the judge found ample evidence to support a finding of a transfer with actual intent to defraud existing creditors. Mortensen's tenuous financial situation, his existing credit card debt, the running up of credit card debt with the same and other credit card companies over the next four years, his use of the trust for purposes other than the protection of its assets, and the court's finding of a lack of credibility, were recited as support for the fraudulent transfer conclusion.

However, the bankruptcy judge's opinion contains a serious misunderstanding of the effect of the 2005 Bankruptcy Code amendments. The court uses this

106. 2011 WL 5025288 (Bankr. D.C. Alaska 2011).

107. Mortensen did not retain an attorney to accomplish his estate planning. He only hired an attorney after an adversarial proceeding was brought against him in bankruptcy court.

misunderstanding to justify the court's conclusion that language in a trust instrument, which states that a purpose of the trust is to protect assets from potential future creditors, is a "badge of fraud." Not only was this court conclusion unnecessary to its finding of a fraudulent transfer, it ignores the reality of modern financial, business, and estate planning.[108]

The troubling part of the bankruptcy court's reasoning in Mortensen is the judge's conclusion that Congress, in enacting § 548(e), has established the federal principle that justifies the court not only to ignore state law but also to conclude that the trust's express language established an intent to hinder, delay, and defraud present and future creditors. Reaching this conclusion, the court relied heavily on a commentator's conclusion that § 548(e) "closes the self-settled trust loophole" based on the legislative history. An examination of that legislative history establishes that it is directly counter to the court's interpretation of Bankruptcy Code § 548(e).[109] Unfortunately, the *Mortensen* case was settled rather than appealed. Therefore, we will not obtain review of the judge's legal reasoning.

A settlor's general intention, as stated in the settlor's trust document, to protect assets from potential future creditors should not be used as a badge of fraud. This is a primary intention of many people who form business entities and irrevocable trusts. Planning to safeguard assets is so common that its neglect may even be malpractice. Statements in a trust instrument or business entity document, discussions with professional advisors, and even direct statements in a deposition with respect to such an intent should not be considered a badge of fraud. Rather, such an intent should be encouraged as sound business, financial, and estate planning. This type of planning and these statements are so common as to have no significance to the analysis of whether a transfer is fraudulent.[110]

108. The bankruptcy trustee's argument that language in the trust instrument indicating an attempt to protect assets from future creditors was a badge of fraud probably found its basis in *USA v. Townley, et al.*, U.S. Dist. Ct. Case No. 2:02-cv-00384-RHW (E.D. Wash. 2004). In this Washington case, the facts again clearly established a fraudulent transfer. However, the court added that Mr. Townley's statements that he wanted to protect his assets from any potential lawsuits represents direct evidence of his intent to defraud one of his potential future creditors.

109. See the discussion of the legislative history in Shaftel & Bundy, *supra* note 11.

110. A full analysis of the *Battley v. Mortensen* can be found in David G. Shaftel, *Court Finds Fraudulent Transfer to Alaska Asset Protection Trust*, 39 Est. Plan. 15 (Apr. 2012).

Appendix I
Analysis of Case Law

2. *Waldron v. Huber (In re Huber).*[111] Huber was involved in real estate development and management in the Puget Sound area of Washington. On many of his projects he was required to sign as guarantor in favor of third-party lenders. In 2007, several of his joint projects were having financial problems. The real estate market began to deteriorate due to the collapse of the subprime mortgage market and implementation of more restrictive lending standards. In 2008, Huber's son, on behalf of his father, contacted an estate planning attorney stating that his father had some assets that he would like to protect and shield. An Alaska DAPT was established in 2008. Correspondence acknowledges that one of the debtor's principle goals for creating the trust was to "protect a portion of the debtor's assets from his creditors." In a number of emails between Huber and his estate planning attorney, Huber expressed urgency in setting up the trust. Huber transferred ownership interests in over 25 entities to an Alaska limited liability company. Ninety-nine percent of the limited liability company was owned by the DAPT and one percent by Huber's son, the manager of the limited liability company. In summary, the assets owned by the trust, directly or indirectly, consisted of interests in 13 development projects, Huber's residence, the residence of his daughter, interests in several shopping centers, a few corporations, and $3,000,000 in uncollectible receivables. Only one asset of the trust was held in Alaska, which was a certificate of deposit for $10,000. All other assets were located in Washington state.

> Monthly distributions were made from the trust to Huber in the amount of $14,500. Between October 2010 and July 2012, distributions of $571,000 were made. The Alaska trustee, Alaska USA Credit Union Trust Company, approved the disbursements without any inquiry. The Alaska trustee did nothing to become involved with the preservation and/or protection of the assets of the trust and was acting merely in the nature of a straw man.
>
> Huber filed for Chapter 11 bankruptcy protection in 2011. The Chapter 11 proceeding was converted to Chapter 7 at the request of the creditor.
>
> The bankruptcy trustee filed for summary judgment under § 548(e)(1) on the grounds that the transfers to the trust were made with actual intent to hinder, delay, or defraud. In support of his motion for summary judgment, the trustee submitted over 100 exhibits containing declarations, emails, documents, and pleadings to establish the debtor's intent to hinder, delay, or defraud his creditors.
>
> In its analysis, the court pointed out that at the time Huber transferred his assets into the trust there was threatened litigation against him. He was not making timely payments on his project's debts, which he had guaranteed. The court noted that substantially all of Huber's property was transferred into the trust. Further, Huber had significant indebtedness when he transferred his assets into the trust. The court pointed out that the debtor effectively retained the property transferred into his trust. Substantially all of Huber's requests for distributions were granted. The Alaska

111. 493 B.R. 798 (Bankr. W.D. Wash. 2013).

trustee (Alaska USA Trust Company) did absolutely nothing to become involved with the trust assets. The court stated the only reasonable conclusion is that Huber continued to use and enjoy the trust assets just as he did before the transfers. The court concluded that the trustee established that five badges of fraud exist in the case. The court held that the evidence presented by the trustee supports an inference of actual fraudulent intent by the debtor to hinder, delay, or defraud his current or future creditors in violation of § 548(e)(1)(D).

As an alternative theory, the trustee argued that Washington law, rather than Alaska law, should govern the DAPT. The bankruptcy court stated that the court should apply federal—not forum state—choice of law rules. The court stated that courts in the Ninth Circuit follow the approach of the *Second Restatement of Conflict of Laws* (1971). Then the court applied section 270(a) of the Restatement. This section provides that the validity of a trust is to be determined under the local law of the state designated by the settlor to govern the validity of the trust, provided that the 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 its most significant relationship. The court's analysis does not mention section 273(b) of the Restatement, which directly addresses whether an interest of a beneficiary of a trust can be reached by his creditors. That section provides that the applicable law is that which the settlor chose in the trust instrument.

Then the bankruptcy court pointed out that at the time the trust was created the settlor was not domiciled in Alaska, the assets were not located in Alaska, nor were the beneficiaries domiciled in Alaska. The only relation to Alaska was that it was the location where the trust was to be administered and the location of one of the trustees, Alaska USA Trust Company. Conversely, Huber resided in Washington, all of the property placed in the trust (except the $10,000 certificate of deposit) was transferred to the trust from Washington, the creditors were located in Washington, the trust beneficiaries were Washington residents, and the attorney who prepared the trust documents and transferred the assets into the trust was located in Washington. Therefore, Washington is the state with which the trust has its most significant relationship.

The court stated that Washington has a "strong public policy" against self-settled asset protection trusts. The court based this conclusion upon a Washington statute that provided that transfers to self-settled trusts are void as against existing or future creditors and cited a Washington state case. The court relied on the foreign asset protection trust case of *Marine Midland Bank v. Portnoy*[112] in support of its analysis. The court concluded, "[T]hus, in accordance with § 270 of the Restatement this Court will disregard the settlor's choice of Alaska law, which is obviously more favorable to him, and will apply Washington law in determining the Trustee's claim regarding validity of the Trust."

The facts of *In re Huber* are almost classic with respect to a fraudulent transfer. The court needed to go no further. As such, *In re Huber* is of little consequence to planners, other than to stand for the obvious conclusion that clear fraudulent transfers will be set aside under § 548(a)(1) of the Bankruptcy Code.

The court's alternative holding, choosing Washington rather than Alaska law, is similarly of only modest guidance. There is a total absence of consideration of section

112. 201 B.R. 685 (Bankr. S.D.N.Y. 1996).

273(b) of the Restatement. Similarly, there is no sophisticated analysis of what constitutes a "strong public policy" under section 270(a). Rather, the court only states the conclusion that Washington has a public policy against self-settled trusts, based upon a statutory provision. Does this really constitute a "strong public policy?" It appears that a sophisticated analysis of this choice of law issue was not presented to, or considered by, the bankruptcy court. Only with such a sophisticated analysis will a court's decision on this issue be helpful to planners.

Appendix I
Analysis of Case Law

3. *Trust Company Bank v. Matthews*.[113] This is a statute of limitations case involving three Delaware DAPTs. Matthews was a member of StoreSmart, LLC, which did business in Florida, where Matthews also resided. In 2006, StoreSmart borrowed $9,300,000 from a bank in New York. Matthews guaranteed the loan. Matthews then transferred stock and other assets into three separate Delaware DAPTs.

In 2011, StoreSmart defaulted on the loan and a judgment was entered against the limited liability company and Matthews for $8,200,000. In 2013, in an effort to try and collect on its judgment, the bank went to Delaware and sued Matthews and the three DAPTs on the grounds that Matthew's transfers to the trusts were fraudulent.

In its analysis, the Delaware Court of Chancery assumed that the transfers were fraudulent. Rather, the key issue was whether the action brought by the bank in the Delaware court was barred by the applicable statute of limitations. The key question was which state's statute of limitations should apply? The bank argued that New York's six-year statute should apply. Matthews argued that either Delaware's or Florida's four-year limitations period should apply.

The court first stated the general rule that a forum state's statute of limitations will apply. Delaware has modified this general rule to enable its courts to use procedural or substantive rules of other states through its "borrowing statute." Therefore, the court proceeded to determine where the cause of action arose. Delaware's conflict of laws rules require that the court apply the "most significant relationship" test of the *Second Restatement of Conflict of Laws* § 145. The court held that Florida had the most significant relationship, Delaware a close second, and New York had only minimal contacts due to the loan being made from there. The court emphasized that the most important events with respect to such a relationship were: first, the failure of the Florida StoreSmart business; next, the various transfers made by Matthews to the three Delaware trusts in Delaware. Since the statute of limitations had run in both Delaware and Florida, the court concluded that the transaction was barred.

The court also pointed out that even if New York's law were to be considered, the bank's action would be barred there as well. This is because in order for action to be within New York's limitations period, the discovery exception would have to apply. Here, the bank was given actual and inquiry notice of the transfers to the DAPT in 2010 so that the discovery period had run as well.

It is interesting that the bank chose to proceed in state courts (Florida and Delaware). If the bank had instead forced Matthews into involuntary bankruptcy, then the 2005 bankruptcy act's ten-year limitation period would have applied. Perhaps there were other creditors with substantial claims and the bank did not want to "share" the bankruptcy estate.

113. 2015 WL 295373 (Del. Ch.).

Appendix I
Analysis of Case Law

4. *Dahl v. Dahl*.[114] During marriage, Dr. Dahl, a Utah cardiologist, formed a Nevada trust which evidently was intended to be a DAPT. Substantial assets were transferred to the trust, including significant marital property. Subsequently, the Dahls divorced and Mrs. Dahl argued that the assets in the trust should be considered as part of the equitable distribution of marital property. The Utah trial court and an intermediate court held that the trust was irrevocable and that Mrs. Dahl had no enforceable interest in the trust assets.

On appeal, Mrs. Dahl argued that the trust was in fact revocable (and therefore not a DAPT) based upon Utah law. Apparently the parties stipulated that under Nevada law the trust would be irrevocable. The Utah Supreme Court had to choose whether Nevada or Utah law would apply. The court stated that since Utah is the forum state that Utah choice of law rules apply. Further, under Utah choice of law rules, the courts will generally enforce a provision contained in the trust document unless doing so would undermine a strong public policy of the state of Utah. The Utah Supreme Court held that Utah has a strong public policy of equitable distribution of marital assets and, therefore, declined to enforce the trust's choice of law provision on the grounds that doing so would deny the trial court the ability to achieve an equitable division of the marital estate. Therefore, the court construed the trust according to Utah law.

The court then analyzed what appears to be contradictory and careless language in the trust instrument. While the trust stated that it is irrevocable, it also stated "settlor reserves any power whatsoever to alter or amend any of the terms or provisions hereof." Focusing on this language, the Utah Supreme Court concluded that the trust was revocable. As a result, the court concluded that Mrs. Dahl was a settlor of the trust by virtue of the fact that her interests in the marital property were contributed to the trust. Because she was a settlor of the trust, she can revoke that portion of the trust funded with either her separate or marital property.

The court stated in footnote 13, "Were we to construe the Trust as irrevocable, it would create a serious conflict between trust law and divorce law in Utah. The question of whether a spouse could create an irrevocable trust in which he or she placed marital property, thereby frustrating the equitable distribution of property in the event of a divorce, is not before us in this case. Accordingly, we take no position on a likely outcome of such conflict. Rather, we bring the potential pitfalls to the Legislature's attention."

The *Dahl* case may well be an illustration of a result-oriented opinion. The court strained to interpret the trust instrument as revocable and thereby avoid Nevada's, and possibly Utah's, DAPT statutory provisions. The case is also interesting in the court's finding of a strong public policy in favor of the law of the state of residence. This is not surprising in the area of family law as this is one of several areas that conflict of laws rules favor the state of residence or the state of location of the property. An alternative approach for the court, instead of straining to find the trust revocable, would have been to create a case law policy exception for property division in divorce matters. The court was reluctant to do so.

114. 215 Utah 79 (2015).

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Analysis of Case Law

5. *Klabacka v. Nelson.*[115] This is a Nevada divorce case which involves the wife's attempt to reach assets in the husband's DAPT for child-support and alimony payments. In 1993, ten years into their marriage, the couple signed a separate property agreement that transmuted their community property in to separate property. In 2001, for creditor protection purposes, the spouses transferred their separate property into separate DAPTS: one for the husband one for the wife. The transfers to the DAPTs were incomplete gifts. In 2009, the husband filed for divorce. The trial court found that the DAPTs were validly established and funded with separate property. The trial court ordered an equalization of $8,700,000 total trust assets between the two DAPTs and that funds from the husband's DAPT be used to pay alimony and child support.

> Upon appeal, the Nevada Supreme Court held that the trial court erred in equalizing the trust assets and invading the husband's trust for alimony and child support payments. The supreme court stated that both DAPTs were valid Nevada self-settled spendthrift trusts in plain, unambiguous language indicating a clear intent to create spendthrift trusts. As a result, the trial court may not consider the parties' testimony regarding their purported intent when fashioning remedies related to the SSSTs. The Nevada Supreme Court then carefully analyzed the statutory foundation for DAPTs under Nevada law. The supreme court stated:
>
> We conclude the district court's order runs contrary to Nevada law. Despite the public policy rationale used in the other jurisdictions, Nevada statutes explicitly protect spendthrift trust assets from the personal obligations of beneficiaries.
>
> * * *
>
> The legislative history of SSSTs in Nevada supports this conclusion. It appears that the Legislature enacted the statutory framework allowing SSSTs to make Nevada an attractive place for wealthy individuals to invest their assets, which, in turn, provides Nevada increased estate and inheritance tax revenues. . . . When crafting the language to allow SSSTs, the Legislature contemplated a statutory framework that protected trust assets from unknown, future creditors, as opposed to debts known to the settlor at the time the trust is created. . . . The legislative history explicitly mentions child support as an example of a debt that would not be free from attachment *if known at the time the trust was created*. . . . However, the trust assets would be protected from attachment as to debts unknown at the time the trust was created—presumably, this protection extended to child- and spousal-support obligations unknown at the time the trust was created. Additionally, in 2013, the Legislature proposed changes to NRS Chapter 166 that would have allowed a spouse or child to collect spousal support or child support from otherwise-protected spendthrift trust assets. However, the proposed changes to NRS Chapter 166 did not pass, ...
>
> This rigid scheme makes Nevada's self-settled spendthrift framework unique; indeed, the "key difference" among Nevada's self-settled spendthrift statutes and statutes of other states with SSSTs, including Florida, South Dakota, and Wyoming, "is that Nevada abandoned the interests of child- and spousal-support creditors, as

115. 394 P.3d 940 (Nev. 2017).

well as involuntary tort creditors," seemingly in an effort to "attract the trust business of those individuals seeking maximum asset protection."

* * *

We conclude Nevada SSSTs are protected against the court-ordered child-support or spousal-support obligations of the settlor/beneficiary that are not known at the time the trust is created.

* * *

We further conclude the child- and spousal-support exception articulated in section 59 of the Third Restatement of Trusts is inconsistent with Nevada's statutory framework and the legislative history of NRS Chapter 166, and we expressly reject that exception here.

While this case involves a spouse as creditor, rather than a third-party creditor, it does provide important support for proponents of DAPTs by confirming that Nevada has no exception creditors and that extrinsic evidence is not allowed to refute the plain, unambiguous language of the trust instrument. This is the first DAPT case where a state supreme court analyzes and upholds the creditor protection provided by DAPT statutes.

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Analysis of Case Law

6. *Toni I Trust v. Wacker*.[116] This fascinating case involves the issue of whether a state legislature can limit jurisdiction to its state courts with respect to certain causes of action. A Montana state court issued a series of judgments against Tangwall. His family members then transferred two pieces of property to the "Toni 1 Trust," created under Alaska law. Bertran, a family member and defendant, filed for bankruptcy in Alaska. The bankruptcy trustee filed a fraudulent transfer claim against Tangwall under the federal bankruptcy code fraudulent transfer provision.

Tangwall filed a complaint in Alaska state court seeking a declaratory judgment that Alaska Statute 34.40.110 grants Alaska courts exclusive jurisdiction over any fraudulent transfer actions against the trust.

The Alaska Supreme Court recognized that "Tangwall's argument is not frivolous." The court then analyzed several United States Supreme Court decisions, including *Tennessee Coal Iron & R.R. Co. v. George*, 233 U.S. 354, 360 (1914), which stands for the proposition that "jurisdiction is to be determined by the law of the court's creation, and cannot be defeated by the extra-territorial operation of a statute of another state, even though it created the right of action." The Alaska Supreme Court determined that Alaska Statute 34.40.110(k) crossed the limit recognized by *Tennessee Coal* by purporting to grant Alaska courts exclusive jurisdiction over a type of *transitory action* against Alaska trusts. The court determined that a fraudulent transfer cause of action could have taken place anywhere and therefore is regarded as transitory. The court held that *Tennessee Coal* established that "a state cannot create a transitory cause of action and at the same time destroy the right to sue on that transitory cause of action in any court having jurisdiction." The court noted that the Delaware Court of Chancery had reached a similar result.

The Alaska Supreme Court pointed out that a recent United States Supreme Court case confirmed that the *Tennessee Coal* rule also applies to claims of exclusive jurisdiction asserted against federal courts. The court concluded that if Alaska Statute 34.40.110(k) were interpreted to deny parties access to the federal courts without those courts' consent, the statute might well run afoul of the Supremacy Clause of the Constitution of the United States of America. The Alaska Supreme Court stated, "[b]ecause AS 34.40.110(k) purports to grant Alaska courts exclusive jurisdiction over all fraudulent transfer claims against Alaska trusts, and because 28 U.S.C. § 1334(a) grants federal courts jurisdiction over some of these claims, the Alaska law 'conflicts with . . . federal law to the extent that . . . it is impossible to comply simultaneously with both.' Therefore, the Supremacy Clause prevails."

116. Toni I Trust v. Wacker, 413 P.3d 1199 (Alaska 2018).