

# Asset Protection Under the New Missouri Uniform Trust Code

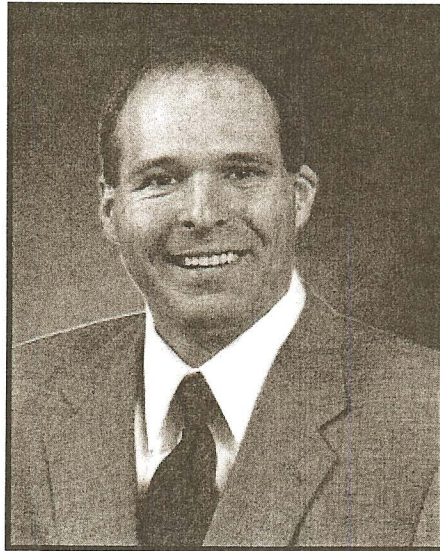
Recent trust legislation has codified most issues surrounding asset protection planning with trusts. This article addresses the nuances of this legislation and the planning opportunities now available.

## I. INTRODUCTION

Over the last decade asset protection has become a crucial aspect of estate planning. Irrevocable trusts are one of the most useful asset protection tools. Asset protection planning is not only for the super rich or those in high risk industries. All clients can benefit from basic asset protection education and planning. When drafting wills and trusts for the average client, it is important to discuss the asset protection benefits of lifetime trusts for their intended beneficiaries, as opposed to outright distributions or trusts with rights of withdrawal. Doctors, lawyers, real estate investors, and other small business owners may need more sophisticated asset protection planning due to the potential creditor claims inherent in their professions.

## II. MISSOURI TRUST CODE

The Missouri Uniform Trust Code (MUTC) became effective on January 1, 2005 and applies to pre-existing trusts.<sup>2</sup> The Missouri Bar Probate & Trust Law Committee prepared MUTC technical amendments that were enacted during the 2006 legislative session.<sup>3</sup> The MUTC provides a detailed statutory framework



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covering most of the asset protection issues surrounding trusts. This law is a welcome addition and clarifies many issues that were unclear under prior law. Several articles take the position that the Uniform Trust Code reduces the asset protection benefits of trusts.<sup>4</sup> The authors' arguments are based on misinterpretations of the Uniform Trust Code and case law, and can safely be ignored. Two recent articles analyzed and dismissed these attacks on the Uniform Trust Code.<sup>5</sup>

## III. ASSET PROTECTION FOR THE CLIENT'S BENEFICIARIES (THIRD PARTY TRUSTS)

This section discusses the asset protection benefits of trusts in which the grantor is not a beneficiary ("third-party trusts"). Section IV discusses "self-settled trusts" in which the grantor is a beneficiary.

### A. Spendthrift Provision

The ability of creditors to reach an interest in a trust depends on the terms of the trust and, most importantly, whether the trust contains a spendthrift provision. A spendthrift provision is language in the trust instrument "providing that the interest of a beneficiary is held subject to a 'spendthrift trust', or words of similar import."<sup>6</sup> A trust with a spendthrift provision is referred to herein as a "spendthrift trust."

#### 1. Voluntary vs. Involuntary Restraints

In Missouri, "[a] spendthrift provision is valid if it restrains either the voluntary or involuntary transfer or both" of the beneficiary's interest.<sup>7</sup> In most states the spendthrift provision must restrain the "voluntary and involuntary transfer of a beneficiary's interest."<sup>8</sup> Therefore, in

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<sup>2</sup> See §§ 456.11-1104 and 456.11-1106, RSMo Supp. 2005.

<sup>3</sup> MO. UNIF. TRUST CODE, Technical Amendments (Draft 5-03-05) available at <http://oldsite.mobar.org/member/tech0505.doc> (last visited June 19, 2006). The technical amendments take into account the 2004/2005 amendments to the Uniform Trust Code, as well as other issues that have arisen since enactment of the MUTC. DAVID M. ENGLISH, ST. LOUIS ESTATE PLANNING COUNCIL, MISSOURI UNIFORM TRUST CODE (2005).

<sup>4</sup> See Mark Merric & Steve J. Oshins, *How Will Asset Protection of Spendthrift Trusts Be Affected by the UTC?*, 31 ESTATE PLANNING 478, 2004; (3-part article) Mark Merric & Steve J. Oshins, *The Effect of the UTC on the Asset Protection of Spendthrift Trusts*, 31 ESTATE PLANNING MAGAZINE, (3-part article) Aug., Sept. and Oct. 2004; Mark Merric & Steve J. Oshins, *UTC May Reduce the Asset Protection of Non-Self-Settled Trusts?*, 31 ESTATE PLANNING 411, 2004; Mark Merric, Carl Stevens & Jane Freeman, *The Uniform Trust Code: A Divorce Attorney's Dream*, J. OF PRACTICAL ESTATE PLANNING, Oct.-Nov. 2004, at 41; Mark Merric & Douglas W. Stein, *A Threat to All SNTs*, TRUSTS & ESTATES, Nov. 2004, at 38.

<sup>5</sup> Suzanne Brown Walsh, et al., *What Is the Status of Creditors Under the Uniform Trust Code*, 32 ESTATE PLANNING 29 (2005); Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 REAL PROPERTY, PROBATE AND TRUST JOURNAL (Fall 2005).

<sup>6</sup> Section 456.5-502.2, RSMo Supp. 2005.

<sup>7</sup> Section 456.5-502.1, RSMo Supp. 2005.

Missouri a grantor may provide that a beneficiary may assign, gift, sell, commute, encumber, or transfer the beneficiary's interest in the trust without limiting the asset protection benefits of the trust, as long as the involuntary transfer of the beneficiary's interest is prohibited. Consider the following spendthrift provision:

No beneficiary shall have the power to assign, transfer, encumber or otherwise anticipate or dispose of any interest he or she may have in assets held in any trust estate governed by this Trust Agreement, either principal or income, and any such assignment, transfer, encumbrance, or other attempted anticipation or disposition thereof shall be void and of no effect.

No interest or right of any beneficiary in and to any assets held in any such trust estate hereunder, either principal or income, shall be subject to garnishment, attachment or any other legal or equitable process based on or otherwise relating to any debt or liability of such beneficiary.

The first paragraph prohibits the beneficiary from transferring his interest in the trust or encumbering the beneficiary's interest by use of the trust as collateral for a debt. The second paragraph prohibits a creditor from attaching (i.e., an involuntary transfer) the beneficiary's interest in the trust. Under most circumstances the grantor will want to prohibit both the voluntary and involuntary transfer of the beneficiary's interest. If the voluntary transfer is not prohibited, then the terms of the trust are jeopardized in that the beneficiary may sell his right to future distributions, and

the trustee may commute the beneficiary's interest.<sup>9</sup> This may be contrary to the grantor's intent in limiting the beneficiary's access to the trust assets under the distribution standards of the trust. However, there are a few estate planning techniques that can only be implemented if the beneficiary can assign his interest in the trust.<sup>10</sup> If you are drafting a grantor retained annuity trust, charitable lead trust, or charitable remainder trust in which you would like to preserve the beneficiary's ability to use one of these techniques, while protecting the trust from creditor attacks and limiting the beneficiary's ability to voluntarily transfer his or her interest, then you may wish to consider the following language:

No beneficiary of any trust may transfer, assign, anticipate, pledge or otherwise alienate or encumber his or her interest in the income or principal of such trust. Despite the preceding sentence, if there is any Trustee of such trust who is not such beneficiary, such beneficiary may transfer or assign his or her interest in the income or principal of such trust to or for the benefit of such one or more persons other than such individual, such individual's estate, such individual's creditors or the creditors of such individual's estate but only with the written consent of each such Trustee. Neither the income nor the principal of any trust shall be subject to any alimony or maintenance claims or to any legal or equitable claims of any creditor of any beneficiary.<sup>11</sup>

## 2. Powers of Appointment and Disclaimers

Draft spendthrift provisions to exclude from their scope any exercise of a power of appointment or disclaimer. Consider adding the following language after a spendthrift provision:

Notwithstanding the foregoing, nothing contained in this paragraph shall affect the validity of any powers of appointment granted by this Trust Agreement and exercised in accordance with the terms of this Trust Agreement, nor shall the provisions of this paragraph be construed to preclude any person from disclaiming all or any part of any interest in assets such person may receive pursuant to this Trust Agreement.

## B. Creditor Remedies if No Spendthrift Provision

### 1. Current Rule

If a trust has no spendthrift provision, then "an assignee or a judgment creditor of the beneficiary may, without court order, reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means."<sup>12</sup> However, "[t]he court may limit [a creditor's] award to such relief as is appropriate under the circumstances."<sup>13</sup> A creditor may not reach the underlying assets of the trust, as the beneficiary has no right to these assets. Similar to the charging order remedy in regard to a limited partnership or limited liability company, a creditor of a beneficiary may attach the right to future distributions from the trust, but may not attach the underlying assets of the trust. After the interest of the beneficiary has been attached, if the trustee decides to make a distribution to, or for the benefit of, the beneficiary, then the distribution

8 See UNI. TRUST CODE § 502(a) (amended 2003) available at <http://www.uniformtrustcode.com> (last visited June 19, 2006).

9 See Peter J. Wiedenbeck, *Missouri's Repeal of the Clafin Doctrine—New View of the Policy Against Perpetuities*, 50 MO. L. REV. 805, 811 (1985) ("Absent spendthrift restraint, a beneficiary can always accelerate or anticipate his interest by sale, notwithstanding the settlor's purpose to postpone enjoyment or withhold management.")

10 See David A. Handler & Steven J. Oshins, *The GRAT Remainder Sale*, TRUSTS & ESTATES 33, Dec. 2002; Richard A. Oshins & Arthur D. Sederbaum, *Generation-Skipping and the GRAT: Sale or Gift of the Remainder*, ESTATE PLANNING, June 2003; Roger D. Silk & James W. Lintott, *Selling CRT Lead Interests*, TRUSTS & ESTATES, Aug. 2005, at 37; David R. Hodgman, et al., *IRS Rulings Provide Guidance on Early Termination of CRUTs*, 30 ESTATE PLANNING 3 (2003).

11 ROY M. ADAMS & CHARLES A. REDD, PROTECTING BENEFICIARIES FROM THEMSELVES, CANNON FINANCIAL INSTITUTE 2004 ESTATE PLANNING TELECONFERENCE SERIES at 18, September 8, 2004.

12 Section 456.5-501, RSMo Supp. 2005.

13 *Id.*

must be made directly to the creditor, rather than to the beneficiary. The creditor cannot force "a distribution that is subject to the trustee's discretion."<sup>13</sup> However, a creditor "may reach a mandatory distribution of income or principal, . . . [if not made] within a reasonable time after the required distribution date."<sup>14</sup> Distributions described in terms of the beneficiary's best interests, happiness, health, support, maintenance, education, or welfare are subject to a trustee's discretion. Annuity (stated dollar amount) and unitrust (percentage of trust assets) interests are mandatory distributions. An all income requirement and an outright distribution upon termination of a trust (whether upon another beneficiary's death or any other triggering event) are also mandatory distributions. Note that the term "mandatory distribution" is not currently defined in the MUTC.<sup>15</sup> If the beneficiary is not a current permissible distributee, then the beneficiary's interest may be too remote or contingent for the creditor to reach. A creditor may also reach the beneficiary's interest "by other means."<sup>16</sup> This may mean that the creditor can force a judicial sale of the beneficiary's interest in the trust.<sup>17</sup> If a buyer can be found, a sale of the beneficiary's interest may allow the creditor to reduce the judgment to cash much faster than waiting for distributions to be made. Typically no discretionary distributions will be made after the beneficiary's interest is attached.

## 2. Discretionary Interests

The technical amendments make a significant change to the asset protection of discretionary trusts with no spendthrift provision. The rule prohibiting a creditor

from forcing a distribution that is subject to the trustee's discretion is removed in favor of a much more powerful anti-creditor rule. The following new technical amendment rule applies whether or not the trust contains a spendthrift provision:

A beneficiary's interest in a trust that is subject to the trustee's discretion does not constitute an interest in property even if the discretion is expressed in the form of a standard of distribution or the beneficiary is then serving as a trustee or co-trustee. A creditor or other claimant may not attach present or future distributions from such an interest, obtain an order from a court ordering the judicial sale of the interest or order compelling the trustee to make distributions, or reach the interest by any other means, even if the trustee has abused the discretion.<sup>18</sup>

The Missouri Comment explaining this change states that "[t]his section was also altered to clearly state present Missouri law that discretionary interests in trusts are not property for any purposes, including bankruptcy, dissolution of marriage, Medicaid claims, or any other claims of creditors or others."<sup>19</sup> This section would be subject to the same exceptions (explained below) that apply to spendthrift trusts, and presumably would be subject to the more specific rule for self-settled trusts (also explained below). Under this section the only difference between trusts with and without spendthrift protection would be that mandatory distributions from a spendthrift trust cannot be attached (overdue mandatory distributions may be compelled

by a creditor irrespective of whether the trust contains a spendthrift provision).

## C. Creditor Remedies Against a Spendthrift Trust

### 1. General Rule

If a trust contains a valid spendthrift restraint on involuntary transfers, then a creditor "may not reach the interest or a distribution by the trustee before its receipt by the beneficiary."<sup>20</sup> This means that a creditor cannot force a trustee to make distributions directly to the creditor, and the creditor cannot force a judicial sale of the beneficiary's interest in the trust. A creditor may only attempt to collect directly from the beneficiary after payment is made. To avoid the reach of a creditor, a trustee may purchase assets in the name of the trust and allow the beneficiary the use of the assets, or spend the trust assets for the benefit of the beneficiary, as opposed to making the distribution directly to the beneficiary. A creditor cannot force "a distribution that is subject to the trustee's discretion."<sup>21</sup> However, a creditor "may reach a mandatory distribution of income or principal, . . . if . . . not made . . . within a reasonable time after the required distribution date."<sup>22</sup>

### 2. Exceptions to Spendthrift Protection

*Support or Maintenance Obligations.* "[A] beneficiary's child, spouse, or former spouse who has a judgment against the beneficiary for support or maintenance" may attach the beneficiary's rights to "present or future trust income."<sup>23</sup> However, this section does not grant a spouse or child any rights to attach a beneficiary's interest in distributions of

14 Section 456.5-504.1, RSMo Supp. 2005.

14 Section 456.5-506, RSMo Supp. 2005.

15 Under § 456.5-506.1 of the technical amendments, the term "'mandatory distribution' means a distribution of income or principal which the trustee is required to make to a beneficiary under the terms of the trust, including a distribution upon termination of the trust. The term does not include a distribution subject to the exercise of the trustee's discretion even if (1) the discretion is expressed in the form of a standard of distribution, or (2) the terms of the trust authorizing a distribution couple language of discretion with language of direction."

16 Section 456.5-501, RSMo Supp. 2005.

17 See UNIF. TRUST CODE § 501, COMMENT (2003).

18 Section 456.5-504.1, Mo. UNIFORM TRUST CODE TECHNICAL AMENDMENTS (Draft 5-03-05).

19 Mo. Comment, Mo. UNIFORM TRUST CODE TECHNICAL AMENDMENTS (Draft 5-03-05).

20 Section 456.5-502.3, RSMo Supp. 2005.

21 Section 456.5-504.1, RSMo Supp. 2005. But see the explanation above, in the *Discretionary Interests* section, as to the change made to this section by the technical amendments.

22 Section 456.5-506, RSMo Supp. 2005.

23 Section 456.5-503.2, RSMo Supp. 2005.

principal. The child or spouse may not compel a distribution that is subject to the trustee's discretion.<sup>24</sup>

*Services For Protection of Beneficiary.* "[A] judgment creditor who has provided services for the protection of a beneficiary's interest in the trust" may also attach the beneficiary's rights to "present or future trust income."<sup>25</sup> An attorney's services for a beneficiary may fall within this exception.

*Other State and Federal Laws.* "A spendthrift provision is unenforceable against a claim of [the] state [of Missouri] or the United States to the extent a statute of [Missouri] or federal law so provides."<sup>26</sup> There is a separate body of case law that describes when a trust is subject to a federal tax lien (or a lien related to a federal crime). Generally, a spendthrift provision is not enough to prevent the attachment of a federal lien. A trust must provide for completely discretionary distributions to avoid attachment of a federal lien.<sup>27</sup> In other words, the beneficiary must have no rights to force a distribution. Distribution standards based on an ascertainable standard related to health, support, maintenance or education are not completely discretionary distributions. The following is an example of a completely discretionary distribution standard.

The trustee, in the trustee's sole and absolute discretion, may distribute so much, none or all of the income and principal of the

trust as the trustee determines is appropriate.

One should avoid planning against attachment of a federal lien, as the attorney and client may violate federal criminal statutes to do so. Note that notwithstanding the amount of discretion conferred upon a trustee, discretionary distributions must always be made in good faith.<sup>28</sup>

### 3. Powers of Withdrawal

To the extent a beneficiary has a power of withdrawal, the beneficiary "is treated in the same manner as the [grantor] of a revocable trust" and the assets of the trust will be subject to creditor claims.<sup>29</sup> A "power of withdrawal" [is] a presently exercisable general power of appointment other than a power exercisable only upon consent of the trustee or a person holding an adverse interest."<sup>30</sup> According to the comments to § 456.01-103 of the Uniform Trust Code, "[a] general power of appointment is a power [that may be exercised] in favor of the [power] holder, . . . the power holder's creditors, the power holder's estate or the creditors of the power holder's estate."<sup>31</sup> This definition is consistent with the definition under federal tax law.<sup>32</sup> "[U]pon the lapse, release, or waiver of [a right of withdrawal, the beneficiary] is treated as the [grantor] of the trust only to the extent the value of the property affected by [the right of withdrawal] exceeds the greater of the amount specified in Sections 2041(b)(2) [estate tax lapse of five and five power],

2514(e) [gift tax lapse of five and five power] or 2503(b) [annual exclusion] of the Internal Revenue Code."<sup>33</sup>

No provision of the MUTC allows a creditor to attack a third party trust solely on the basis of the beneficiary serving as trustee unless the trustee has a power of withdrawal, which would cause the assets to be subject to creditor claims. A power of withdrawal does not include a general power of appointment exercisable only upon consent of the trustee. It is not entirely clear whether this provision will prevent a trustee/beneficiary's fiduciary authority from being treated as a power of withdrawal. The technical amendments alleviate this uncertainty by providing that "'power of withdrawal' means a presently exercisable power of a beneficiary to withdraw assets from the trust without the consent of the trustee or any other person."<sup>34</sup> Under the amendments, there are no adverse asset protection consequences to a beneficiary serving as trustee of a third party trust. (As explained below, the grantor/beneficiary of a domestic asset protection trust should never serve as trustee.)

### 4. Drafting Suggestions for Third Party Spendthrift Trusts

Consider the following when drafting third party spendthrift trusts:

*Multiple Current Beneficiaries.* Allow the trustee to make discretionary distributions to additional beneficiaries,

24 Section 456.5-504.1, RSMo Supp. 2005. Curiously, this section begins "[e]xcept as otherwise provided in section 456.5-503"; however, § 456.5-503 does not contain any direction as to whether an exception creditor may compel a distribution. The technical amendments completely rewrite this section and leave unclear whether an exception creditor can compel a discretionary distribution.

25 Section 456.5-503.2, RSMo Supp. 2005.

26 Section 456.5-503.3, RSMo Supp. 2005.

27 See *United States v. O'Shaughnessy*, 517 N.W.2d 574 (Minn. 1994). The United States may attach future distributions a trustee decides to make in the exercise of its discretion. *U.S. v. Cohn*, 855 F. Supp. 572 (D. Conn. 1994).

28 Section 456.8-814.1, RSMo Supp. 2005. Under the technical amendments, this good faith standard would only apply to an ascertainable standard. If there is no ascertainable standard, then the standard under common law would apply. *American Cancer Soc'y v. Hammerstein*, 631 S.W.2d 858, 863 (Mo. App. E.D. 1981) ("When a testator vests sole discretion in a matter in the trustee and supplies no objective standards by which to evaluate the reasonableness of his conduct, a court must not interfere unless the trustee, in exercising his power, wilfully abuses his discretion or acts arbitrarily, fraudulently, dishonestly or with an improper motive").

29 Section 456.5-505.5(1), RSMo Supp. 2005.

30 Section 456.1-103(15), RSMo Supp. 2005.

31 2004 MISSOURI TRUST AND LEGISLATION, THE MO. BAR PROB. & TR. COMM. 68. Although the comments to the Uniform Trust Code are not part of the statutory text, they have been published, along with other Missouri comments.

32 I.R.C. § 2041(b)(1) (2006) and I.R.C. § 2514(c) (2006).

33 Section 456.5-505.5(2), RSMo Supp. 2005. It is unclear whether an election to split gifts will apply under this section, but one commentator assumes that it does not. Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 REAL PROP., PROB. & TR. J. (2005). This statute should be amended to make clear that gift splitting is to be taken into account so there are no negative asset protection consequences to a Crummey withdrawal right that takes advantage of a donor and donor's spouse's annual exclusions.

34 Section 456.1-103(16), Mo. UNIF. TRUST CODE (Draft 5-03-05) available at <http://oldsite.mobar.org/member/tech0505doc> (last visited June 19, 2006).

such as the primary beneficiary's descendants.

*No Mandatory Distributions.* Many trusts provide that the beneficiary is to receive all of the trust income. For asset protection purposes, make distributions of income and principal subject to a discretionary standard. This will allow the trustee to withhold all distributions in the event of creditor attack, or make distributions for the benefit of the beneficiary.

*Allow Indirect Distributions.* Allow distributions not only to the beneficiary, but also for the benefit of the beneficiary. This will avoid the requirement of placing trust assets directly in the hands of the trustee, where they may be susceptible to attack.

*No Rights of Withdrawal.* Many trusts allow the beneficiary to withdraw assets at a certain age or ages. A right of withdrawal causes a loss of creditor protection, as the beneficiary will be treated in the same manner as the grantor of a revocable trust to the extent of the right of withdrawal. Other trusts provide that the trust will terminate at a certain age and distribute outright to the beneficiary. For asset protection planning, it is best to provide that the trust will last indefinitely, not only for the lifetime of the current beneficiary, but for the lifetimes of all of the future contingent beneficiaries.<sup>35</sup>

If the grantor wishes to give the beneficiary control over distributions and investment of the trust assets, the beneficiary may serve as trustee. This will give the beneficiary control over the trust property without causing a loss of creditor protection.

*Trust Protector.* A trust protector is an extremely valuable tool for providing flexibility. A trust protector is an

individual or entity appointed with the authority to take certain actions under special circumstances. A trust protector may have the ability to amend the terms of the trust in response to a change in circumstances (such as creditor problems) or a change in the law.

## D. Other Specific Creditor Rules

### 1. Bankruptcy

"A restriction on the transfer of a beneficial interest . . . in a trust that is enforceable under applicable nonbankruptcy law" will be enforceable in bankruptcy.<sup>36</sup> The beneficiary's interest in a spendthrift trust will not become part of the bankruptcy estate. A discretionary interest in a trust without a spendthrift clause may also be excluded from the bankruptcy estate.<sup>37</sup>

### 2. Marital Property Division<sup>38</sup>

In a dissolution of marriage proceeding, the court is to divide all of the "marital property" "in such proportions as the court deems just after considering all relevant factors."<sup>39</sup> Marital property is

all property acquired by either spouse [after] the marriage except:

- (1) Property acquired by gift, bequest, devise, or descent;
- (2) Property acquired in exchange for property acquired prior to the marriage or in exchange for property acquired by gift, bequest, devise, or descent;
- (3) Property acquired by a spouse after a decree of legal separation;
- (4) Property excluded by valid written agreement of the parties; and
- (5) The increase in value of property acquired prior to the

marriage or pursuant to subdivisions (1) to (4) of this subsection, unless marital assets including labor, have contributed to such increases and then only to the extent of such contributions.<sup>40</sup>

Income earned during a marriage from non-marital property is marital property.<sup>41</sup>

If a trust is created before marriage, then the spouse's interest will not be marital property, unless an event occurs (such as termination of the trust or a right of withdrawal upon the beneficiary attaining a certain age) that causes the trust assets themselves to be deemed to have been acquired by the beneficiary after marriage. Absent such an occurrence, distributions from the trust to the beneficiary, whether of trust accounting income or principal, will not be marital property, as these distributions are the realization of the property interest the beneficiary held prior to marriage.

A trust created for a beneficiary *after* marriage will not be marital property, as the beneficiary's interest will be excluded as "property acquired by gift, bequest, devise, or descent." The same analysis above applies. Neither the accumulated nor the distributed trust income will be marital property, unless the beneficiary's right to withdraw the trust assets or terminate the trust is tantamount to owning the trust assets outright.

Only one Missouri case, *Moore v. Moore*, contains useful guidance as to whether a beneficiary's interest in a trust is marital property.<sup>42</sup> The facts of this case are unique, as the trust was self-settled and the grantor/beneficiary had the unilateral right to terminate the trust. Husband created an irrevocable trust in 1984 with himself as the beneficiary and his parents as the trustees. Husband funded

35 See § 456.025, RSMo Supp. 2005.

36 See 11 U.S.C. § 541(c)(2) (2006).

37 *In re Britton* (Bankr. D. Conn. 2003); *In re Knight*, 164 B.R. 372 (Bankr. S.D. Fla. 1994); *In re Pechanec*, 59 B.R. 899 Bankr. (D. Kan. 1986); but see *In re Katz*, 203 B.R. 227 (Bankr. E.D. Pa. 1996).

38. The technical amendment and Comment to § 456.5-504 make clear that "[a] beneficiary's interest in a trust that is subject to the trustee's discretion does not constitute an interest in property" for dissolution of marriage purposes. However, to the extent the beneficiary has a right of withdrawal or right to terminate the trust, § 456.5-504 may not provide help, as it is not the beneficiary's interest in the trust that would be at issue, but the beneficiary's ability to terminate or control the trust.

39 Section 452.330.1, RSMo Supp. 2005.

40 Section 452.330.2, RSMo Supp. 2005.

41 *Kauffman v. Kauffman*, 101 S.W.3d 35 (Mo. App. W.D. 2003).

42 *Moore v. Moore*, 111 S.W.3d 530 (Mo. App. S.D. 2003).

the trust with his own assets. Husband and wife were married in 1989. After husband was married, "husband's parents [transferred additional property] to the trust as a gift."<sup>43</sup> The trust "provide[d] that the trustees [could] terminate the trust after husband attained age 25."<sup>44</sup> In addition, husband could terminate the trust himself after age 35, and if not terminated sooner, the trust would terminate when husband attained the age of 50. Husband turned 35 in 1998 and their marriage was dissolved in 2001.

The trial court found that the husband's interest in the trust, as well as the underlying assets of the trust, were non-marital property. On appeal, the wife argued that the assets of the trust were marital property, because husband's right to terminate the trust was "tantamount to full ownership of the trust assets."<sup>45</sup> The appellate court found that the "husband constructively [acquired] the trust assets at [the] time" he turned 35, and that the income derived from the trust assets *after* that date was marital property.<sup>46</sup>

### 3. Special Needs Trusts

The MUTC makes no changes to special needs trusts.<sup>47</sup>

## IV. ASSET PROTECTION FOR THE CLIENT (SELF-SETTLED TRUSTS)

### A. Generally

"[T]he property of a revocable trust is subject to claims of the [grantor's] creditors," "[w]hether or not [the] trust contain[s] a spendthrift clause."<sup>48</sup> The general rule for irrevocable trusts in most states is that if a trust grantor (someone who has contributed assets to the trust) is a beneficiary, then a creditor can reach the maximum amount that can be distributed to or for the grantor's benefit.<sup>49</sup> However, nine states, including Missouri, have altered this rule.<sup>50</sup> A self-settled irrevocable spendthrift trust created to meet the statutory requirements of one of these nine states is often referred to as a domestic asset protection trust (DAPT). The relevant Missouri statute provides that if certain requirements are met, then the third party spendthrift trust rules, as explained above, will apply.<sup>51</sup> If the grantor is a beneficiary and these requirements are not met, then a creditor "may reach the maximum amount that can be distributed to or for the settlor's benefit."<sup>52</sup>

### B. Statutory Requirements

The requirements for a Missouri DAPT are as follows:<sup>53</sup>

(1) The funding of the trust was not a fraudulent transfer pursuant to the Missouri Uniform Fraudulent Transfer

Act,

(2) The grantor cannot have the ability to amend or revoke the trust,

(3) In addition to the grantor, there must be additional present or contingent beneficiaries of trust income and principal,

(4) The grantor/beneficiary's interest in the trust must be completely discretionary, and

(5) The trust must contain a spendthrift provision.

Although not specifically required by the statute, it seems likely that a court would not apply the statute unless someone other than the grantor/beneficiary was trustee.<sup>54</sup> The comments to the MUTC acknowledge that several cases brought into question whether self-settled trusts could actually be used for asset protection in Missouri. The comments clarify that the incorporation and reenactment of Missouri's DAPT law was intended to overrule any holding that would render the creditor protection aspects of the statute meaningless.

### C. Tax Consequences

In order to avoid a completed gift upon the funding of a Missouri DAPT, the grantor will often retain a testamentary limited power of appointment.<sup>55</sup> This also gives the grantor the added flexibility of rewriting the terms of the trust, and changing the beneficiaries, upon his death. If the grantor retains a limited power of

43 *Id.* at 532.

44 *Id.*

45 *Id.* at 533.

46 *Id.* at 535.

47 See Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 REAL PROP. PROB. & TR. J. (2005). Several cases give guidance on Missouri Special Needs Trusts. *Tidrow v. Dir. Mo. State Div. of Family Servs.*, 688 S.W.2d 9 (Mo. App. E.D. 1985); *Couch v. Dir. Mo. State Div. of Family Servs.*, 795 S.W.2d 91 (Mo. App. W.D. 1990); *Mo. Div. of Family Servs. v. Wilson*, 849 S.W.2d 104 (Mo. App. W.D. 1993); *Masterson v. Dep't of Soc. Servs.*, 969 S.W.2d 746 (Mo. banc 1998).

48 Section 456.5-505.1, RSMo Supp. 2005.

49 UNIFORM TRUST CODE § 505(a)(2) (amended 2005).

50 The primary eight states in the order they adopted such legislation are as follows: Missouri, § 456.5-505.3, RSMo 1986 (reenacted with minor modifications in 2005), ALASKA STAT. § 34.40.110 (Michie 1997), DEL. CODE ANN. titl. 12, § 3571 (1997), NEV. REV. STAT. 166.040 (1999), R.I. GEN. LAWS § 18-9.2-2 (1999), UTAH CODE ANN. § 25-6-14 (2004), OKLA. STAT. titl. 31, § 31-10 (2004), and S.D. CODIFIED LAWS § 55-16-12 (Michie 2005). The 1861 Colorado law (COLO. REV. STAT. § 38-10-111 (2006)) has been questioned by the Colorado Supreme Court. See *In re Cohen*, 8 P.3d 429 (Colo. 1999); but see *Connolly v. Baum*, 22 F.3d 1014 (10th Cir. 1994) (holding that assets of a self-settled trust were immune from future creditor claims).

51 Section 456.5-505.3, RSMo Supp. 2005.

52 Section 456.5-505.2, RSMo Supp. 2005. The rights of a creditor under this provision are greater than those of a creditor of a non-spendthrift third party trust that may only reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means. The creditor of a self-settled trust may reach as much of the underlying assets of the trust that could have been distributed to the beneficiary, which will be the entire trust under most discretionary standards. See UNIFORM TRUST CODE § 505 cmt at 87 (amended 2005).

53 Section 456.5-505.3, RSMo Supp. 2005.

54 For an alternative view, see James G. Blase, *The Missouri Asset Protection Trust*, 61 J. MO. BAR 72 (2005). No state's DAPT law allows the grantor/beneficiary to serve as sole trustee, although some, such as Alaska, allow the grantor to serve as a co-trustee with limited authority.

55 See Treas. Reg. § 25.2511-2(b) (2005). However, distributions made to beneficiaries other than the grantor will be completed gifts.

appointment, the assets of the trust will be subject to estate tax upon the grantor's death.<sup>56</sup> If the grantor does not retain a power of appointment, it is unclear whether the grantor's retained right to receive discretionary distributions, and the possibility of a creditor reaching the trust assets due to a conflict of laws (as explained below), will cause an incomplete gift and the trust assets to be subject to estate tax at the grantor's death.<sup>57</sup> The tax apportionment clauses in revocable trusts and DAPTs should be coordinated, and in many cases the DAPT should provide that upon the grantor's death the trustee will reimburse the personal representative for the portion of the grantor's estate tax bill that is attributable to the DAPT assets.

A DAPT will be a grantor trust for income tax purposes, meaning that the grantor will continue to report the income, deductions and credits of the trust as if the grantor owned the assets outright.<sup>58</sup> Before creating a DAPT, the grantor should be advised that he will have no guarantee that the trustee will make a distribution to cover his tax bill and may have to pay such taxes out of his other assets. If the grantor does not want to be taxed on the trust income, the trust may be drafted to provide that all distributions are subject to the consent of an adverse party (another current beneficiary or a vested remainder beneficiary).<sup>59</sup>

#### D. Multi-State Conflicts of Law

Several state acts provide more detailed statutes for self-settled trusts than Missouri. Some commentators feel that

Missouri's self-settled trust statute is not up to par with other states, such as Delaware and Alaska.<sup>60</sup> However, for Missouri residents, there are advantages to using Missouri's DAPT statute. For example, an out-of-state trustee is not required for a Missouri trust. Invoking another state's DAPT law may require a Missouri resident to transfer trust assets to an out-of-state trustee.<sup>61</sup>

It is unclear whether a state that does not allow DAPTs will apply the DAPT law of the state designated in the trust. Two bankruptcy cases, *In re Portnoy* and *In re Brooks*, have applied the law of the forum state, as opposed to the law selected by the grantor in the trust instrument, in order to avoid finding that "applicable non-bankruptcy law" exempted off-shore, self-settled trusts from the bankruptcy estate.<sup>62</sup> However, it would be difficult for a court to find another state's law applicable to a Missouri resident who creates a Missouri DAPT consisting of assets located in Missouri with a Missouri trustee.<sup>63</sup> Other than in a bankruptcy proceeding (as bankruptcy courts have national jurisdiction), it would be difficult for a non-Missouri court to obtain in rem jurisdiction over trust assets or personal jurisdiction over the trustee if the trustee and all trust assets are located in Missouri. One should avoid naming an individual trustee who resides in a state that does not recognize the validity of DAPTs, or a corporate trustee who does business in such a state.

Missouri's choice of law statute provides that "[t]he meaning and effect of the terms of a trust are determined by" (1)

the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue. . . ."<sup>64</sup> Presumably, whether the interest of a grantor/beneficiary can be reached by creditors is a question of the legal "effect" of the terms of the trust, which would be covered by Missouri's choice of law statute. Therefore, if a controversy is litigated in a Missouri court and the trust provides that the meaning and effect of its terms are to be governed by Missouri law, then this will be sufficient to take advantage of Missouri's self-settled trust statute (whether the grantor is a Missouri resident or otherwise) unless a court finds that to do so would be contrary to the strong public policy of the state with the most significant relationship to the trust. No cases have found, in this context, that taking advantage of a DAPT statute is contrary to the public policy of another state.<sup>65</sup>

However, if the question of whether the interest of a grantor/beneficiary can be reached by creditors arises in a non-Missouri court, then the forum state's choice of law rule will apply to this question. The general rule under the RESTATEMENT (SECOND) OF CONFLICT OF LAWS is that whether the interest of a beneficiary of a trust of movables (i.e., anything other than land<sup>66</sup>) can be reached by creditors is determined by the law of the state in which the grantor has specified that the trust is to be "administered."<sup>67</sup> Note that this section does not contain the public policy exception the RESTATEMENT

56 I.R.C. § 2036 (2006) and I.R.C. § 2038 (2006).

57 See Richard W. Nenko, *Planning with Domestic Asset-Protection Trusts: Part I*, 40 REAL PROP. PROB. & TR. J. (2005).

58 I.R.C. § 677 (2006).

59 *Id.*

60 See Richard W. Nenko, *Planning with Domestic Asset-Protection Trusts: Part I*, 40 REAL PROP. PROB. & TR. J. 263, 271 (2005) ("Although he or she also might be able to create this type of trust in Oklahoma, Missouri, or Colorado . . . the statutes in question are either flawed, not fully developed, or both.").

61 See 12 Del. C. § 3570(9) (2003).

62 *In re Portnoy*, 201 B.R. 685 (Bankr. S.D.N.Y. 1996); *In re Brooks*, 217 B.R. 98 (Bankr. D. Conn. 1998); Gideon Rothschild, et al., *Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch?*, 9 J. BANKR. L. & PRAC.

63 *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985) ("[F]or a State's substantive law to be selected in a constitutionally permissible manner, that state must have a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair.") *Id.* at 818.

64 Section 456.1-107, RSMo Supp. 2005.

65 See Richard W. Nenko, *Planning with Domestic Asset Protection Trusts: Part I*, 40 REAL PROP. PROB. & TR. J. 263 (2005).

66 RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 267 (1971) (Introductory Note to "Topic 1. Movables").

67 RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 273 (1971).

allows for questions concerning the validity of a trust.<sup>68</sup> Therefore, Missouri DAPT's should direct that the trust be administered in Missouri. In Missouri, a designation as to the trust's principal place of administration will be valid if "(1) a trustee's principal place of business is located in or a trustee is a resident of [Missouri]; or (2) all or part of the [trust's] administration [actually] occurs in [Missouri]." <sup>69</sup> Appointing a Missouri resident as trustee and/or actually administering the trust in Missouri will increase the chances of an out of state court applying Missouri law.

Under the RESTATEMENT, with regard to a trust of an interest in land, whether the beneficiary's interest can be reached by creditors is determined by the law that would be applied by the courts of the situs as long as the land remains subject to the trust (i.e., a court should apply the law of the state in which the land is located).<sup>70</sup> A Missouri DAPT should not be funded with real estate, or any other assets, located in another state over which a non-Missouri court may obtain in rem jurisdiction.

For example, assume a DAPT provides that the meaning and effect of the terms of the trust are to be governed by Missouri law, and that the trust is to be administered in Missouri. If a creditor obtains personal jurisdiction over the trustee in Illinois and sues claiming that the trust assets should not be protected, then the Illinois court must decide whether to apply Missouri or Illinois law.<sup>71</sup> As Illinois does not have any statute or caselaw that would apply to this specific choice of law question, the court may apply § 273 of the RESTATEMENT (SECOND) OF CONFLICT OF LAWS and find that the creditor protection issue is to be determined by Missouri law, the state in which the grantor has specified that the

trust is to be administered. Note that under this RESTATEMENT section, this analysis should apply whether the trust was created by a resident of Missouri, Illinois, or some other state. If such a controversy is being litigated in the court of a state that has adopted the Uniform Trust Code, then the court will apply Missouri law, unless the designation of Missouri law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue.<sup>72</sup> Presumably, if the trust is being administered in Missouri, then Missouri would have the most significant relationship to the trust, unless the trustee or a majority of the assets were located in another state.

#### E. Bankruptcy

The 2005 Bankruptcy Act added § 548(e), which allows a bankruptcy trustee to avoid a transfer to a "self-settled trust or similar device" "made on or within 10 years before the date of the filing of" a bankruptcy petition if the transfer was made "with actual intent to hinder, delay, or defraud any [creditor] to which the debtor was or became [indebted] on or after the date that such transfer was made."<sup>73</sup> The application of this section is unclear. If the creation of the DAPT does not fall within this section, the assets will not be brought into the bankruptcy estate unless, under choice of law principles (as explained above), the court finds a non-DAPT state's laws, as opposed to the state law selected in the trust, the "applicable nonbankruptcy law" under 11 U.S.C. § 541(c)(2).

#### F. Drafting and Administration Suggestions for Missouri DAPTs

When implementing or drafting a Missouri DAPT, in addition to ensuring

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that the trust meets the statutory requirements, the following items should be considered:

*Choose Trustee Carefully.* One should appoint a Missouri resident (or bank or trust company that only does business in Missouri) as trustee. The grantor/beneficiary should not serve as trustee, and a trustee that resides or does business in a state that does not recognize the validity of DAPTs should be avoided. The grantor should not retain the authority to remove and replace trustees.<sup>74</sup> One author suggests that spouses and adult children should not serve as trustee to avoid an argument that the grantor had an

68 RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 270 (1971); see Gideon Rothschild, et al., *Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch?*, 9 J. BANKR. L. & PRAC. at <http://www.mosessinger.com/articles/files/spenthrift.htm>.

69 Section 456.1-108.1, RSMo Supp. 2005. Under the Uniform Trust Code, fixing the principal place of administration is important to determine where the trustee and beneficiaries have consented to suit, and the rules for locating venue within a particular state. UNIF. TRUST CODE § 202, § 204 (amended 2005). However, the place of administration may also be considered by a court in another jurisdiction in determining whether it has jurisdiction, and if so, whether it is a convenient forum. UNIF. TRUST CODE § 108 cmt. (amended 2005).

70 RESTATEMENT (SECOND) OF CONFLICT OF LAWS, § 280 (1971).

71 Under Illinois law, if the grantor is a beneficiary of a trust, the trust is not protected from the grantor's creditors. 735 ILL. COMP. STAT. 5/2-1403; *Gordon v. Reynolds*, 28 N.E. 455 (1885).

72 UNIF. TRUST CODE § 107 (2005).

73 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub.L. 109-8, 119 Stat. 23.

74 No DAPT law authorizes a grantor to retain the right to remove and replace trustees. However, several states allow the grantor to appoint a trust protector with such discretion.



implied agreement with the trustee to make distributions.<sup>75</sup>

*Trust Assets.* To avoid the possibility that a court in an unfriendly state could obtain in rem jurisdiction over the trust assets, the trust should not be funded with real estate, or any other assets, located in a state that does not recognize the validity of DAPTs. Out-of-state real estate may be contributed to a Missouri LLC or FLP to attempt to avoid this problem. The trust should be funded with assets to which the grantor does not expect to need access. One commentator suggests that, to be conservative, the trust should be funded with less than one-third of the grantor's total assets.<sup>76</sup>

*Governing Law Clause.* The governing law clause should provide that Missouri law governs (i) the validity of the trust, (ii) the administration of the trust, (iii) the construction of the trust terms, and (iv) the legal effect of the trust terms, including the effect of the spendthrift provision.<sup>77</sup> For flexibility, the trust should also provide the trustee with the authority to change the designation of the state's governing law as to any one or more of these four issues.

*Administer Trust in Missouri.* The trust should direct the trustee to administer the trust in Missouri.

*Avoid Violating Other Laws.* Ensure that the transfer of assets to a self-settled trust does not violate the Missouri Uniform Fraudulent Transfer Act, and that the attorney's assistance with the creation of the trust does not violate any state or federal criminal statute or the Missouri Rules of Professional Conduct. In this regard, the client should complete a questionnaire listing all of the client's assets and liabilities (current and potential) to ensure the client is not insolvent.

*Multiple Current Beneficiaries.* To bolster the asset protection of the trust, the trust may provide that individuals other than the grantor are also current permissible distributees of income and principal.

*Limited Power of Appointment.* The grantor should retain a testamentary limited power of appointment to avoid a

completed gift upon the funding of the trust, and to maintain the ability to rewrite the trust upon the grantor's death.

*No Rights of Withdrawal.* If the beneficiary of a DAPT has a right of withdrawal, the trust assets will be subject to the claims of creditors.

*Income Taxes.* Coordinate the tax apportionment clauses in DAPTs with the client's other estate planning documents, and educate the client on the advantages and disadvantages of grantor trust status.

*Trust Protector.* For flexibility, a trust protector is also a wise choice for a DAPT. The client may wish to give the trust protector the broad discretion to amend the trust if it is in the best interests of the beneficiaries, or may limit the trust protector's authority to remove and replace trustees. The grantor may retain the ability to remove and replace trust protectors.

#### G. DAPT Alternative

Many clients are unwilling to make an irrevocable transfer to a trust in which the client retains no rights to compel a distribution. An alternative to a DAPT is a trust for a spouse. If a client is not willing to make an irrevocable transfer to a third party trustee, then the client should consider creating a spendthrift trust for the client's spouse. If the trust is drafted as a QTIP trust or incomplete gift, then there will be no gift tax consequences. The client may serve as the sole trustee. The assets transferred to the trust will not be subject to the client's creditors, as he no longer owns the assets. If the client needs access to the trust assets, he may make a distribution for the benefit of his spouse from which he also benefits. Or he may distribute assets directly to his spouse and ask his spouse to gift them back to him. Of course, the trust should be drafted to protect against an unexpected divorce,<sup>78</sup> and the trust instrument may be drafted to automatically take into account remarriage (by treating a future spouse as a beneficiary).

One may take this technique one step further by having a client's spouse create a trust for clients with similar terms. Although there is a judicially created

reciprocal trust doctrine in the context of estate/gift tax transfers that would unwind this type of technique, there does not appear to be a similar doctrine for creditor protection purposes.

#### H. Conclusion

A Missouri DAPT is a valuable planning tool (although, to date, no court has upheld the effectiveness of a DAPT). A client may protect his assets by a transfer to a trust in which he can retain the right to receive distributions in the discretion of a third party trustee. It is important to keep in mind that, due to conflicts of law, a Missouri DAPT may lose its effectiveness if a court in a state that prohibits DAPTs obtains jurisdiction over the trust. Nonetheless, a Missouri DAPT is a deterrent to litigation and may increase a client's bargaining position. A Missouri DAPT is best utilized when combined with other asset protection devices, such as LLCs and FLPs.

#### V. SUMMARY

Attorneys should consider asset protection issues when preparing a client's estate plan. A client with potential creditor problems should consider a DAPT or a spendthrift trust for a spouse. When drafting the dispositive provisions of a will or trust, consider the asset protection benefits of a lifetime trust for the beneficiary with the beneficiary as sole trustee. Lastly, attorneys should always be mindful of planning techniques that may violate the Missouri Uniform Fraudulent Transfer Act.<sup>79</sup>

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75 RICHARD W. NENNO, ET AL., EVERYTHING YOU ALWAYS WANTED TO KNOW ABOUT DOMESTIC ASSET PROTECTION TRUSTS BUT COULD NEVER FIND OUT (UNIVERSITY OF MIAMI 2004). (Heckerling Institute On Estate Planning, Special Session I-C.)

76 *Id.*

77 Under Missouri law, a designation of the state to govern the validity of the trust has no effect, but such a designation should be included as it may be useful in a non-Missouri court proceeding. See § 456.4-403, Supp. RSMo 2005.

78 See § 456.1-112.1, Supp. RSMo 2005.

79 See §§ 428.005, RSMo Supp. 2005, et seq.