

**ASSET PROTECTION PLANNING –
THE NEW ESTATE PLANNING**

BY

JEROME L. WOLF, P.L.

DUANE MORRIS LLP

2700 NORTH MILITARY TRAIL, SUITE 300
BOCA RATON, FLORIDA 33431
TELEPHONE: 561/962-2100

200 SOUTH BISCAYNE BLVD., SUITE 3400
MIAMI, FLORIDA 33131
TELEPHONE: 305/960-2200

With the enactment of the “Tax Relief, Unemployment Reauthorization, and Job Creation Act of 2010” on December 17, 2010, and the resulting increase in the Federal Estate, Generation-Skipping Transfer, and, most surprisingly, Gift tax exemption to \$5,000,000 per person and \$10,000,000 to spouses jointly (until the provisions of the Act “sunset” on December 31, 2012), it has been estimated that only 5,000 to 6,000 Form 706 Federal Estate Tax Returns will be required to be filed for decedents dying in 2011 and 2012. In fact, many professionals in the estate planning community believe the need for traditional estate planning, including “A and B Trusts” (Marital and Credit Shelter Trusts), Irrevocable Life Insurance Trusts, and other value shifting strategies are no longer required for families having net worths of less than \$5 Million, and marginal for those having net worths in excess of \$5 Million, but less than \$10 Million. Hence the fear that estate planning lawyers may have now gone the way of the buggy whip maker.

In fact, however, traditional estate planning has focused on protecting assets at death from one particular creditor – the Internal Revenue Service. In recent years, “Asset Protection Planning” has become an ever increasingly important component of the family financial planning process.

Asset Protection Planning involves the organization and reorganization of a client's business and personal affairs, *in advance*, in order to reduce, minimize or even eliminate liability exposure. There is nothing shameful in this exercise. In fact, "the law recognizes the right of individuals to arrange their affairs so as to limit their liability to creditors." *In Re Heller*, 613 N.Y.S. 2d 809 (NY Sur.Ct., 1994). Similarly, Florida recognizes the value of the homestead exemption, among others, for asset protection purposes so that families shall not be reduced to absolute destitution and become charges of the state. *Public Health Trust of Dade County v. Lopes*, 531 So.2d 946 (Fla. 1988); *Orange Brevard Plumbing & Heating Co. v. La Croix*, 137 So.2d 201 (Fla. 1962); *Hospital Affiliates of Florida, Inc. v. McElvoy*, 393 So.2d 25 (Fla. 3d DCA 1981).

The concept of Asset Protection Planning is not new to the business and estate planning community. Business attorneys for decades have been forming corporations and other business entities to protect the assets of the principals from the liabilities of the business. And insurance of all kinds, life, casualty, key-man, disability, has been a product designed by a multi-billion dollar international industry to provide protection for every type of potential liability, exposure or short fall we can contemplate.

Fortunately (for certain of our brothers and sisters at the Bar) or unfortunately, we now live and conduct our businesses in an environment where we are no longer required to accept responsibility for our actions. Somewhere a "deep pocket" will be found upon whom liability will be imposed to make us whole from our misfortune – and oftentimes that deep pocket is the client whom we represent. Therefore, I submit that our professional responsibility has been expanded to require the incorporation of asset protection strategies into our traditional role as "estate" or "financial" planners.

I. FRAUDULENT TRANSFERS – ACTUAL INTENT TO HINDER, DELAY OR DEFRAUD

A. Overview of the Florida Uniform Fraudulent Transfer Act (UFTA)

1. Statute of Elizabeth. Statutes prohibiting transfers in fraud of creditors date back to the English Statute of Elizabeth. At common law in Florida, conveyances and transfers with the intent to hinder, delay or defraud creditors were void. *See Bayview Estates Corp. v. Southerland*, 154 So. 894, 900 (Fla. 1934). At the heart of the common law doctrine were the so-called “badges of fraud” utilized to circumstantially prove the transferor’s fraudulent intent.

2. Fraudulent Conveyance Act. In 1987, Florida passed the Uniform Fraudulent Transfer Act (UFTA). The act was substantially amended in 1997. The common law badges of fraud were codified in both versions of the statute. Significantly, the changes to the Act have expanded the Act to make constructively fraudulent transfers void in addition to those transfers made with actual intent to delay, hinder or defraud. *See, eg.*, F.S. 726.106.

3. Fraudulent Conversion Act. Likewise, in 1993, the Florida Legislature passed F.S. 222.30, which expressly declared that a conversion of a non-exempt asset into an exempt asset is void if made with the intent to hinder, delay or defraud creditors. F.S. 726.105 and F.S. 222.30 are to be read in tandem.

4. Intent.

(a) The common thread running from the common law through the modern statutes is the avoidance of transfers made with intent to hinder, delay or defraud creditors, most commonly involving transfers where the debtor / transferor receives less than equivalent value in exchange, and the remaining assets are insufficient to pay his or her just debts. A thorough estate plan may leave very little in the way of assets that are “owned” by the

putative debtor. Therefore, such transfers are particularly vulnerable to attack as a fraudulent conveyance or fraudulent conversion notwithstanding a bona fide estate planning or tax motive.

(b) The right to devise, alienate or gift one's property is a constitutional right. Art. I, §2, Florida Constitution. *See Shriners Hospital v. Zrillic*, 563 So. 2d 64, 67 (Fla. 1990). This right extends to completed inter vivos transfers, including transfers to trusts, even when those transfers are performed for the purpose of diminishing the transferor's probate estate, and even when the transfer was done with the specific intent to diminish a spouse's elective share rights. *See Freidberg v. Sunbank / Miami*, 648 So. 2d 204 (Fla. 3d DCA 1995); citing, *Traub v. Zlatkiss*, 559 So. 2d 443, 446 (Fla. 5th DCA 1990).

(c) The transfer of property inter vivos, whether it is by sale, gift, transfers to a trust, charitable gifts, contributions to a partnership or other transfer, are valid transfers and absolutely binding as between the parties themselves. *Bayview Estates Corp. V. Southerland*, 114 Fla. 635, 154 So. 894 (1934). The common law and the UFTA simply allow a "defrauded" creditor to avoid certain types of transfers under specific circumstances. *Id.*

5. Effective Date. The Uniform Fraudulent Transfer Act, F.S. 726.105, became effective October 1, 1988.

6. Transfers void as to both present and future creditors. F.S. 726.105, provides:

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

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

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

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

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

Most if not all cases decided under the UFTA and its counterparts, involve a finding of fraudulent intent or an inference of fraudulent intent from the circumstances surrounding the transaction. In proving intent, the statute sets forth the so-called “badges for fraud”.

7. Badges of Fraud. F.S. 726.105(2) sets forth the factors to be considered in determining fraudulent intent. These factors, along with commentary where appropriate, are:

(a) the transfer or obligation was to an insider (defined by F.S. 726.102(7));

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

“Retention of possession of property after transfer creates a prima facie presumption of fraud, and close relationship of transferee to transferor tends to establish prima facie case of fraudulent conveyance which must be met by the defendant. *U.S. v. Ressler*, 433 F. Supp. 459 (S.D. Fla. 1977) affirmed, 576 F. 2d 650, cert denied 440 U.S. 929. If settlor exercises day to day control over trust property by use of power to control trustee, then he has divested himself of nothing, and trust is merely an agency agreement. *Lane v. Palmer First National Bank and Trust Co. Of Sarasota*, 213 So. 2d 301 (Fla. 5th DCA 1968). Under Florida law, the purpose of spendthrift trusts is to protect beneficiary from himself as well as his creditors; thus spendthrift trusts cannot exist if beneficiary is able to control assets of the trust before its maturation. *See In re Smith* 129 B.R. 262 (M.D. Fla. 1991). *See also In re Cattafi, supra* [If a settlor creates a trust for his or her own benefit and inserts a spendthrift clause, then the trust is void as far as the then existing or future creditors are concerned and such creditors can reach the beneficiaries interests under the trust.] Transfers to a corporation dominated by another corporation or individual as a device to mislead creditors is fraudulent and corporate form will be disregarded. *See In re Gherman, supra.*”

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

“While failure to record a conveyance is merely a circumstance to be considered in connection with others in determining whether instrument is fraudulent as to creditors, *Baker & Holmes Company v. Gibson*, 102 Fla. 891, 136 So. 544 (1931), the transfer of real property is

made, for purposes of UFTA when the transfer is perfected by recordation of a deed. *In re Mizrahi* 179 B.R. 322 (M.D. Fla. 1995). Accordingly, the limitations period on fraudulent conveyance actions does not begin to run until the deed is recorded. *Sasha & Shasha, Inc. v. Stardust Marine, S.A.*, 741 So. 2d 558 (Fla. 4th DCA 1999).”

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

(e) the transfer was of substantially all the debtor’s assets;

(f) the debtor absconded;

(g) the debtor removed or concealed assets;

(h) the value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

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

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

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

Any one of these badges of fraud considered alone may not be sufficient to prove actual intent. *Meyers v. Brook*, 708 So. 2d 607 (Fla. 2d DCA 1998). Because actual fraud is difficult to prove, courts look to these badges of fraud as circumstantial evidence of fraudulent intent. A single badge of fraud may create suspicion, but does not prove the requisite fraud to set aside a conveyance, *In re Young*, 235 B.R. 666 (M.D. Fla. 1999). Several badges of fraud, when considered together, may raise an inference of fraud. *In re Goldberg*, 229 B.R. 877 (S.D. Fla.

1998). *General Trading, Inc. v. Yale Materials Handling Corp.*, 119 F. 3d 1485, 1498 (11th Cir. 1997) (citing *Johnson v. Dowell*, 592 So. 2d 1194, 1197 (Fla. 2d DCA 1992)).

It must be remembered that badges of fraud are evidentiary aids and not irrebuttable presumptions. *Jacksonville Bulls Football, Ltd. v. Blatt*, 535 So. 2d 626 (Fla. 1stD.CA 1988).

Of course, no intent is required for constructive fraud; that is, if the transfer was made for less than equivalent value in exchange, and the debtor was about to engage in a business transaction for which his or her remaining assets were unreasonably small, given the transaction, or about to incur debts which the debtor knew or reasonably should have known were beyond his or her ability to pay. F.S. 726.105(l)(b).

The constructive fraud provisions of §726.105 apply to both present and future creditors, whose identity and whose claims may be unknown at the time of the transfer. Thus, every transfer that is not a sale for equivalent value within the four year limitations period is potentially subject to challenge.

8. Fraudulent Conversions. F.S. 222.29 provides that an exemption provided in Chapter 222 is not effective if it results from a fraudulent transfer as provided in Chapter 726.

The avoidance of conversions of non-exempt assets to exempt assets is governed by F.S. 222.30, which provides:

“(1) As used in this section, “conversion” means every mode, direct or indirect, absolute or conditional, of changing or disposing of an asset, such that the products or proceeds of the asset become immune or exempt by law from claims of creditors of the debtor and the products or proceeds of the asset remain property of the debtor. The definitions of chapter 726 apply to this section unless the application of a definition would be unreasonable.

(2) Any conversion by a debtor of an asset that results in the proceeds of the asset becoming exempt by law from the claims of a creditor of the debtor is a fraudulent asset conversion as to the creditor, whether the creditor’s claim to the asset arose before or after the conversion of the

asset, if the debtor made the conversion with the intent to hinder, delay, or defraud the creditor.”

9. Elements of a Fraudulent Transfer Case. To establish a fraudulent conveyance under Florida law, a creditor must demonstrate that there was:

- (a) a creditor to be defrauded;
- (b) a debtor intending to defraud; and,
- (c) transfer of property that could have been applicable to payment of the debt due.

No intent to defraud is required to prove a constructive fraud under either F.S. 726.105(1)(b) or F.S. 726.106. The elements of a constructively fraudulent conveyance are:

- (a) a voluntary gift or transfer;
- (b) an existing or contemplated indebtedness against the debtor; and
- (c) the debtor has failed to retain sufficient property to pay the indebtedness.

B. Complimentary To U.S. Bankruptcy Code

The Uniform Fraudulent Transfer Act is to be read along with the fraudulent transfer language of the Bankruptcy Code. *Venice-Oxford Associates Ltd. Partnership v. Multifamily Mortgage Trust*, 236 B.R. 820 (M.D. Fla. 1999). “Section 544(b) of the Bankruptcy Code authorizes the avoidance of any transfer of ... the debtor in property that is voidable under applicable laws, including state laws to avoid fraudulent transfers, by a creditor holding an allowable unsecured claim.” *Id.*, at 833.

Moreover, the *Venice-Oxford* court noted that §548 of the Bankruptcy Code also has been considered simultaneously with state fraudulent transfer statutes based on the strong resemblance between the UFTA and the provisions of the Bankruptcy Code avoiding preferential and certain pre-petition transfers. Under the pre-BAPCPA Bankruptcy Code, fraudulent transfers were avoidable if made within one year of bankruptcy with actual intent and debtor received less than

equivalent value; BAPCPA extends the time to two years before the date of filing the petition. *In re Gherman*, 103 B.R. 326 (S.D. Fla. 1989).

II. HOMESTEAD

A. Under Art. X, Sec. 4 of the Constitution of the State of Florida, a Florida resident's homestead is protected from any forced sale and liens resulting from judgments, decrees or executions if:

1. the homestead is *owned by a natural person*;
2. the homestead is the permanent residence of the owner or a legal or natural dependent of the owner;
3. if the homestead is located within a municipality, the homestead is limited to one-half acre of contiguous land; and
4. if the homestead is located outside of a municipality, the homestead is up to one hundred sixty acres of contiguous land.

B. F.S. 732.405(1), directs that *the homestead shall not be subject to DEVISE if the OWNER is survived by a spouse or minor child*, except that the homestead may be devised to the owner's spouse if there is no minor child.

1. However, subsection (2) includes as an "OWNER" the grantor of a revocable living trust; and includes a disposition of the homestead from such trust as a "DEVISE".

2. The homestead rights of a surviving spouse may be waived by a written contract signed by the surviving spouse in the presence of two subscribing witnesses; and each spouse must make a fair disclosure to the other of the spouse's estate if the waiver is executed after marriage. (F.S. 732.702).

3. On February 9, 2011, the Third District Court of Appeals issued a ruling in *Habeeb v. Linder*, 36 Fl. L. Weekly D300, holding that a husband's signature on a warranty

deed and joinder in the conveyance of homestead property to his wife's name constituted a waiver of his post death homestead rights. The decision addressed the issue of whether the transfer of the husband's homestead interests was effectual because the warranty deed failed to satisfy the requirements of F.S. 732.702(1). However, on May 17, 2011, in a *sua sponte* Order, the Third District Court of Appeals withdrew its decision in *Habeeb*. Consequently, the current law of Florida still requires compliance with F.S. 732.702, including (i) a written contract, (ii) waiving "all rights", (iii) with each spouse making "fair disclosure to the other of his or her estate", in order to waive a spouse's homestead rights.

4. In the interesting case of *Chames v. Demayo*, 972 So.2nd 850 (FlaSupCt 2007), a client engaged a lawyer and as part of the retainer agreement, agreed to "*..voluntarily and intelligently waive his rights to assert his homestead exemption in the event of a charging lien is obtained to secure the balance of attorney's fees and costs.*" The Third District Court of Appeals certified the issue of whether the Florida Constitution's exemption from forced sale of a homestead can be waived to the Florida Supreme Court. The Supreme Court, in denying the validity of the waiver, cited the dissent in the Third Circuit "*The waiver of the homestead exemption will become an everyday part of contract language for everything from the hiring of counsel to purchasing cellular telephone services...This inevitably will result in whittling away this century old constitutional exemption until it becomes little more than a distant memory.*"

5. A 99 year land lease in property used as a residence was held to be homestead. *In re McAtee* 154 B.R. 346, 349 (Bankr. N.D. Fla. 1993). For tax purposes, see *Higgs v. Warrick*, 994 So. 2d 492 (Fla. 3d DCA 2008), where the taxpayer created a trust that was funded entirely with his homestead property. He then transferred the trust property to his heirs who in turn gave him a 99 year lease. The property appraiser denied the taxpayer

homestead status on the property. F.S. 196.031 states that every person with legal or beneficial and equitable title to real property who resides on that property and in good faith makes that property his permanent residence shall receive homestead treatment. In addition F.S. 196.041 states that lessee owning the leasehold interest in a bona fide lease having an original term of 98 years or more in a residential parcel shall be deemed to have legal or beneficial and equitable title to said property. Following a clear reading of these statutes, the court stated that a 99 year lease constitutes a legal or beneficial and equitable title to the property and, therefore, the taxpayer is entitled to homestead status.

C. Even non-exempt funds intentionally converted into homestead acquire homestead protection. *In Havoco of America, Ltd. v. Elmer C. Hill, 197 F.3d 1135 (11th Cir 1999)* the court considered whether purposeful conversion of non-exempt funds into a Florida homestead eliminates the homestead exemption. In other words, can you take funds that would otherwise be available to a creditor, invest those funds in a homestead, even though the reason you are investing the funds in the homestead is merely to keep them out of the reach of creditors and still have the homestead exemption provide protection? The Florida Supreme Court says: “Yes, still exempt”. This action does not meet one of the three exceptions to homestead exemption and the court is not willing to extend such exception using equitable principles. The three exceptions to homestead provided in Florida’s Constitution where a forced sale can take place are: (1) payment of taxes and assessments thereon; (2) obligations contracted for the purchase, improvement or repair thereon; or (3) obligations contracted for house, field or other labor performed on the property.

D. In the *Estate of Moss, 777 So.2d 1110 (Fla. 4thDCA, January 31, 2001)*, decedent died leaving no surviving spouse or minor children. The personal representative filed a petition

to determine homestead status of real property. A creditor of the estate objected, stating the petitioner failed to establish that the devisees of the real estate were qualified heirs of the decedent. The Court ruled that in determining entitlement to homestead protection against creditors, “heirs” is not only limited to individuals that would actually take the homestead by law in intestacy but also to individuals categorized in the intestacy statute (F.S. 732.103). See *Snyder v. Davis*, 699 So.2d 999 (Fla. 1997).

E. 1. Because a trust is not a natural person, a person may not claim Florida property owned by the trust as covered by the homestead exemption. *In re Bosonetto*, (M.D. Florida 2001), 271 B.R. 403 (December 12, 2001).

2. If the debtor is the sole Trustee and sole primary beneficiary of the Revocable Trust, she is deemed to retain the equivalent of absolute ownership and is thus afforded the protection under Article X, Section 4(a) of the Florida Constitution. *Callava v. Feinberg*, 864 So. 2d 429 (Fla. 3d DCA, 2004).

3. The protection afforded to homestead property by Article X, Section 4(a) of the Florida Constitution applies even when homestead property is held in a Revocable Trust, and rejects *Bosonetto* because it neither cited to any Florida law in support of the ruling made in that case nor has it been followed in subsequent Florida cases. *In Re Alexander*, 2006 WL 2055881 (Bankr. M.D. Fla, July 25, 2006).

F. 1. Section 322 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 adds §522 (p) to the Federal Bankruptcy Code, which provides that except for certain family farmers, a debtor may not exempt as homestead any “interest” in the property that was acquired by the debtor during the 1,215-day (or three years and four months)

period preceding the date of the filing of the bankruptcy petition to the extent the value of that interest exceeds \$125,000.

2. Section 322 of the Bankruptcy Code states that, for purposes of computing the cap on the value of an interest in homestead property acquired within the 1215-day period, any interest in the property transferred from the debtor's previous principal residence (which was acquired prior to the beginning of the 1,215-day period) into the debtor's current principal residence is excluded, *but only if the debtor's previous and current residences are located in the same state.*

III. LIFE INSURANCE

A. F.S. 222.13 provides that the life insurance proceeds payable upon the death of a Florida resident shall be exempt from the claims of creditors of the insured and shall inure for the exclusive benefit of the beneficiary of the policy unless the insurance policy or valid assignment thereof provides otherwise.

B. Exceptions: No asset protection is provided from the claims of the insured if the life insurance proceeds are payable to the insured or his estate or to his executors, administrators or assigns. F.S. 222.13(1). [However, see discussion in paragraph C of Section IX, *infra*.]

IV. CASH SURRENDER VALUES AND ANNUITIES

A. The cash surrender value of a life insurance policy issued upon the life of a Florida resident and the proceeds of an annuity issued to a Florida resident shall not be subject to attachment, garnishment or legal process in favor of any creditor of the person whose life was insured or who was the beneficiary of the annuity unless the life insurance policy or annuity was purchased for the benefit of the creditor. F.S. 222.14.

B. Exceptions:

1. The asset protection afforded to annuities has not been extended to an annuity payable in connection with lottery winnings. *In re Thomas Bertram Dixon*, 153 B.R. 594 (1993); and *In re Pizzi*, 153 B.R. 357 (1993).

2. In *In re Brown*, 303 F.3d 1261 (11th Cir. 2002), with her \$250,000 inheritance, the debtor funded a charitable remainder trust in which she reserved a lifetime interest. The court noted that Florida law does not recognize self-settled spendthrift trusts. A self-settled spendthrift trust is one in which the settlor and beneficiary are the same person. Although the debtor was solvent when she created the trust, and there was no intent to defraud creditors, the spendthrift nature of the trust was void as against public policy. Since the debtor reserved a unitrust interest based upon a percentage of the value of the trust, that was the portion of the trust her creditor could reach.

V. QUALIFIED PLANS

A. Any money or assets payable to a participant or beneficiary from or in a retirement or profit-sharing plan that is qualified under IRC Sections 401(a), 403(b), 408 or 409 is exempt from all claims of creditors of the beneficiary or participant. F.S. 222.21(2)(a).

B. Further, *Patterson v. Shumate*, 112 S.Ct. 2242 (1992), provides that property with anti-alienation requirements are exempt from being included in a debtor's bankrupt estate. See also *In re Schlein*, 114 B.R. 780 (Bkrcty M.D. Fla. 1990) (a SEP/IRA is also exempt from inclusion in the bankruptcy estate due to F.S. 222.21).

C. This past legislative session produced an amendment to F.S. 222.21, which clarifies that any interest in a fund or account that is otherwise exempt from claims of the creditors of the owner of the account do not cease to be exempt upon the owner's death,

including direct transfers of the account or rollovers to an inherited IRA. As a consequence, an inherited IRA of a Florida resident, such as the amount the surviving spouse “rolls-over” to her own IRA should be protected from creditors’ claims.

D. Exception:

1. The ERISA anti-alienation protection under *Patterson* does not prevent the Internal Revenue Service from proceeding against a participant’s plan benefits. *U.S. v. Sawaf*, 74 F.3d 119 (6th Cir. 1996).

2. Another exception to this general rule is plans established for the owners of a business or for self-employed individuals (e.g. Keogh plan). These plans do not satisfy the “ERISA qualified plan” under *Patterson* because an owner is not deemed to be an employee. *In re Witwer*, 148 B.R. 930 (Bankr. C.D. Cal. 1992); *In re Hall*, 151 B.R. 412 (Bankr. W.D. Mich. 1993); *In re Lane*, 149 B.R. 760 (Bankr. E.D.N.Y. 1993); and *In re Harris*, 188 B.R. 444 (Bankr. M.D. Fla. 1995).

VI. TENANCY BY THE ENTIRETY

Many Florida residents rely on ownership of property as tenants by the entirety because a creditor of only one individual spouse cannot reach such property to satisfy its claim without the consent of the other spouse. Reliance solely upon holding property as tenants by the entirety may be risky. Also, if one of the spouses dies, any asset protection is terminated. Finally, this alternative provides no protection for any unmarried clients.

A. Any type of property, real, personal or bank accounts, may be held by the entireties.

B. In *First Nat'l Bank of Leesburg v. Hector Supply Co.*, 254 So.2d 777 (Fla.1971), the Supreme Court of Florida confirmed that a presumption exists that when *real property* is acquired in the name of a husband and wife, a tenancy by the entireties is created.

C. In *Beal Bank v. Almand and Associates*, 780 So.2d 45 (Fla. 2001) (March 1, 2001), the Florida Supreme Court created a presumption that *bank accounts* held by husband and wife are held as tenants by the entirety. If the accounts are held as tenants by the entirety they can only be reached if both spouses are debtors.

VII. WAGE PLANS

A. F.S. 222.11 provides that all of the disposable earnings of a head of family whose disposable earnings are less than or equal to \$500 a week are exempt from attachment or garnishment.

B. Disposable earnings of a head of a family which are greater than \$500 a week may not be attached or garnished unless such person has agreed to otherwise in writing.

C. This statute also provides that wages of the head of the family are exempt, regardless of the amount, and remain exempt for six months after being deposited into an account at a financial institution. Where other funds are deposited into the bank account, if the funds can be traced and properly identified as earnings, the account will not lose its exempt status.

1. The statute does not state what type of account is exempt, therefore, it appears that a money market account, checking account, or savings account at a financial institution would qualify for this exemption.

2. However, a brokerage account would not qualify. *In Re Rutenberg*, 164 B.R. 683 (M.D. Fla. 1994).

D. 1. Based on these provisions, could a wage earner avoid the six month limitation by endorsing the wage check to his spouse, and/or transferring the funds into an account held by the wage earner and his spouse as tenants by the entirety?

2. Also, could the six month limitation be avoided if the wage earner receives the funds in cash and never deposits them into a bank account?

VIII. ENTITY PROTECTION

A. FLP's: An FLP is a *family limited partnership* which is a limited liability entity organized under Chapter 620 of the Florida Statutes.

1. The concept of the FLP arose from tax planning strategy involving members of a family, and was designed to shift the income tax burden from parents to children or other family members.

2. Over time, a more valuable planning purpose involved the transfer of assets to children without the parents having to part with control over the assets.

B. LLC's: An LLC is a *limited liability company* organized under Chapter 608 of the Florida Statutes.

1. An LLC is a hybrid entity which combines the limited liability of a corporation and the flow-through taxation of a partnership.

2. In order to form a limited liability company, the Articles of Organization must be filed with the office of the Secretary of State of Florida.

3. The LLC is composed of Members, all, some, or none of whom will serve as the governing body, or the "Managers", in accordance with the terms of an Operating Agreement.

4. A primary distinction between an LLC and an FLP, or any other form of partnership for that matter, is that a partnership requires at least two owners, whereas an LLC can be organized as a single member entity.

C. LLP's: An LLP is a general partnership that has registered as a *limited liability partnership* under Chapter 620 of the Florida Statutes.

1. An LLP has the same qualities as a general partnership except that the liability of its general partners may be limited in certain circumstances.

2. The LLP is not itself a form of enterprise; rather, it supplements existing partnership and limited partnership law.

3. General and limited partnerships, domestic and foreign, are eligible to register as an LLP.

4. In 1995, Florida enacted the Florida Revised Uniform Partnership Act ("FRUPA") and repealed Florida's existing Uniform Partnership Act. Effective January 1, 1996, FRUPA provisions relating to the formation and effect of LLP's are:

(a) Sec. 620.8306(3) setting forth the basic immunity of partners in an LLP from personal liability for partnership obligations;

(b) Sec. 620.9001 setting forth the process for a partnership becoming an LLP;

(c) Sec. 620.9002 creating the name requirements for an LLP; and

(d) Sec. 620.9003 requiring an annual report

5. In 1999, the Florida legislature repealed the Registered Limited Liability Partnership provisions which were part of FRUPA and replaced them in several significant respects, including:

(a) Florida is now a “full shield” state, meaning that the LLP provisions protect partners from personal liability for partnership obligations arising in both contract and tort. The former provisions afforded the partners protection only from tort actions.

(b) The former provision establishing liability for an act committed by someone “under the partner’s direct supervision and control” (Sec. 620.782(2)(b)) was repealed. This eliminates the notion of pure vicarious liability, but the LLP statute does not relieve partners of personal liability for their own tortious misconduct, which might include assistance in the tortious activity of others.

(c) LLP registration must be renewed each year. Unlike the prior law, the new LLP provisions provide a notice from the state and a cure period before registration is cancelled for failure to file a renewal.

6. As a result of the 1999 amendments, general partners in registered LLPs enjoy the same immunity from personal liability as shareholders of a corporation. Inasmuch as creditors will only be able to recover from partnership assets, it is possible that equitable principles analogous to “piercing the corporate veil” will develop in partnership litigation.

7. Rule 4-8.6 of the Rules of Professional Conduct of the Florida Supreme Court’s Rules Regulating The Florida Bar authorizes the practice of law as an LLP. However, it must be emphasized that the Supreme Court’s approval was based upon the prior LLP statute. The Supreme Court has not indicated that Rule 4-8.6 also applies to LLPs formed under the 1999 amendments.

D. LLLP’s: An LLLP is a limited partnership that has registered as a *limited liability limited partnership* under Chapter 620 of the Florida Statutes.

1. An LLLP has the same qualities as a limited partnership except that the liability of its general partners (and its limited partners who may be deemed to be liable as general partners) may be limited in certain circumstances.

2. A totally new limited partnership statute, repealing and replacing the existing statute was enacted in 2005 (“RULPA”), effective January 1, 2006.

3. A pre-existing partnership can, if it so chooses, elect to be governed wholly by the new statute.

4. The new statute is not in the same format as the old statute and contains numerous changes, some small, some significant. Among the most significant changes are:

(a) The old statute requires that the certificate filed with the state include “the latest date upon which the partnership is to dissolve.” (Sec. 620.108). The new statute provides for perpetual existence unless the partnership agreement otherwise provides. (Sec. 620.1104).

(b) The requirement to file an affidavit showing the amount of actual and anticipated capital contributions from limited partners has been eliminated.

(c) Limited partners under the new statute will be analogous to shareholders of a corporation in that they will have no liability for entity obligations regardless of any acts of control or any third party beliefs. This is one of the most important changes in the new statute and eliminates the old notion in Sec. 620.129 of liability predicated upon limited partners engaging in acts that constitute some control of the entity. (Sec. 620.1703)

(d) The conversion and merger provisions were expanded with regard to the types of entities to which or into which limited partnerships may be converted or merged. (Sec. 620.2101-620.2124).

E. Comparison of Limited Liability.

1. FLP's: The partnership agreement of an FLP can act similar to a spendthrift trust by preventing the partners from pledging their interest in such entity to secure debt or by preventing their interest from being seized by a creditor or a divorced spouse.

Example:

“6.1. Involuntary Withdrawal” means, with respect to any Partner, the occurrence of any of the following events:

(i) the Partner makes an assignment for the benefit of creditors;

(ii) the Partner files a voluntary petition fo bankruptcy;

(iii) the Partner is adjudged bankrupt or insolvent, or there is entered against the Partner an order for relief in any bankruptcy or insolvency proceedings;

(iv) the Partner files a petition seeking for the Partner any reorganization, arrangement, composition, readjustment, liquidation, dissolution, or similar relief under any statute, law, or regulation;

(v) the Partner seeks, consents to, or acquiesces in the appointment of a trustee for, receiver for, or liquidation of the Partner or of all or any substantial part of the Partner's properties;

(vi) the Partner files an answer or other pleading admitting or failing to contest the material allegations of a petition filed against the partner in any proceeding described in items (i) through (v); and

(vii) any proceeding against the Partner seeking reorganization, arrangement, composition, readjustment, liquidation, dissolution, or similar relief under any statute, law, or regulation, continues for one hundred twenty (120) days after the commencement thereof, or the appointment of a trustee, receiver, or liquidator for the Partner or all or any substantial part of the Partner's properties without the Partner's agreement or acquiescence, which appointment is not vacated or stayed for one hundred twenty (120) days or, if the appointment is stayed, for one hundred twenty (120) days after the expiration of the stay during which period the appointment is not vacated.”

Example:

“6.2. Optional Buy-out In Event of Involuntary Withdrawal

6.2.1. After an Involuntary Withdrawal, the withdrawn Partner shall be deemed to offer for sale (the “Withdrawal Offer”) to the Partnership all of the Partnership Rights owned of record and beneficially by the withdrawn Partner (the “Withdrawal Interest”).

6.2.2. The Withdrawal Offer shall be and remain irrevocable for a period (the “Withdrawal Offer Period”) ending at 11:59 P.M., local time at the Partnership’s principal office on the sixtieth (60th) day following the date the Involuntary Withdrawal occurred. At anytime during the Withdrawal Offer Period, the Partnership may accept the Withdrawal Offer by notifying the withdrawn Partner (the “Withdrawal Notice”) of its acceptance. The withdrawn Partner shall not be deemed a Partner for the purpose of the vote on whether the Partnership shall accept the Withdrawal Offer.

6.2.3. If the Partnership accepts the Withdrawal Offer, the Withdrawal Notice shall fix a closing date (the “Withdrawal Closing Date”) for the purchase which shall be not earlier than ten (10) or later than ninety (90) days after the expiration of the Withdrawal Period.

6.2.4. If the Partnership accepts the Withdrawal Offer, the Partnership shall purchase the Withdrawal Interest for a price equal to the amount the withdrawn Partner would receive if the Partnership were liquidated and an amount equal to the [Book][Appraised][Agreed] Value were available for distribution to the Partners pursuant to Section 4.4 (the “Withdrawal Purchase Price”). The Withdrawal Purchase Price shall be paid in cash on the Withdrawal Closing Date.

6.2.5. If the Partnership fails to accept the Withdrawal Offer, then the withdrawn Partner or the withdrawn Partner’s successor, as the case may be, upon the expiration of the Withdrawal Offer Period, thereafter shall be treated as the unadmitted assignee of a Partner.”

2. LLLP’s – effective January 1, 2006

F.S. 620.1703 Rights of creditor of partner or transferee.

“(1) On application to a court of competent jurisdiction by any judgment creditor of a partner or transferee, the court may **charge the partnership interest of the partner** or transferable interest of a transferee with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of a transferee of the partnership interest.

(2) This act shall not deprive any partner or transferee of the benefit of an exemption law applicable to the partner's partnership or transferee's transferable interest.

(3) This section provides the exclusive remedy which a judgment creditor of a partner or transferee may use to satisfy a judgment out of the judgment debtor's interest in the limited partnership or transferable interest. ***Other remedies, including foreclosure on the partner's interest in the limited partnership or a transferee's transferable interest and a court order for directions, accounts, and inquires that the debtor general or limited partner might have made, are not available to the judgment creditor attempting to satisfy the judgment out of the judgment debtor's interest in the limited partnership and may not be ordered by a court.*** (emphasis added.)

3. LLC's:

(a) (1) Prior to May 31, 2011, in contrast to the charging lien provision with respect to limited partnerships, the charging lien provision applicable to membership interests in LLC's was found in F.S. 608.433(4), which provided:

“On application to a court of competent jurisdiction by a judgment creditor of a member, the court may charge the limited liability company membership interest of the member with payment of the unsatisfied amount of the judgment with interest.”

(2) There is no corresponding provision to F.S. 620.1703(3) which statutorily mandates that the charging lien is the exclusive remedy available to a judgment creditor.

(b) (1) In the June 24, 2010 case, *Shaun Olmstead, et al. v. Federal Trade Commission*, (44 So. 3rd 76, 35 Fla. L. Weekly S357), a 5-2 majority of the Florida Supreme Court held that a charging order is not the sole remedy available to a creditor seeking to seize a debtor's membership interest in a *single member* LLC organized in Florida.

(2) Unfortunately, the dissenting members of the Court expressed concern whether the majority's ruling applied to not only *single* member LLC's, but *multimember* LLC's as well. When the Florida Legislature updated the limited partnership

charging order rules in 2005, a corresponding change was not similarly made in the limited liability company statute. Accordingly, it was argued that the distinction between the treatment of partnerships and LLC's was intentional.

(3) On May 31, 2011, F.S. 608.433 was amended to provide that a charging order is the sole and exclusive remedy by which a judgment creditor of a member may satisfy a judgment, and, consistent with the partnership rules, expressly provides foreclosure of the debtor's LLC interest as an unavailable remedy to the judgment creditor. Although the new statute does not expressly state the charging order is the exclusive remedy for multimember LLC's, the application of the statute to single member LLC's could be difficult from a practical perspective (see F.S. 608.433(6)).

(4) 608.433 "Right of Assignee to become member.

(1) Unless otherwise provided in the articles of organization or operating agreement, an assignee of a limited liability company interest may become a member only if all members other than the member assigning the interest consent.

(2) An assignee who has become a member has, to the extent assigned, the rights and powers, and is subject to the restrictions and liabilities, of the assigning member under the articles of organization, the operating agreement, and this chapter. An assignee who becomes a member also is liable for the obligations of the assignee's assignor to make and return contributions as provided in s. 608.4211 and wrongful distributions as provided in s. 608.428. However, the assignee is not obligated for liabilities which are unknown to the assignee at the time the assignee became a member and which could not be ascertained from the articles of organization or the operating agreement.

(3) If an assignee of a limited liability company interest becomes a member, the assignor is not released from liability to the limited liability company under s. 608.4211, s. 608.4228, or s. 608.426.

(4) (a) *On application to a court of competent jurisdiction by any judgment creditor of a member or a member's assignee, the court may enter a charging order against the limited liability*

company interest of the judgment debtor or assignee rights for the unsatisfied amount of the judgment plus interest.

(b) *A charging order constitutes a lien on the judgment debtor 's limited liability company interest* or assignee rights. Under a charging order, the judgment creditor has only the rights of an assignee of a limited liability company interest to receive any distribution or distributions to which the judgment debtor would otherwise have been entitled from the limited liability company, to the extent of the judgment, including interest.

(c) This chapter does not deprive any member or member's assignee of the benefit of any exemption law applicable to the member's limited liability company interest or the assignee's rights to distributions from the limited liability company.

(5) *Except as provided in subsections (6) and (7), a charging order is the sole and exclusive remedy by which a judgment creditor of a member or member's assignee may satisfy a judgment from the judgment debtor's interest in a limited liability company or rights to distributions from the limited liability company.*

(6) *In the case of a limited liability company having only one member, if a judgment creditor of a member or member 's assignee establishes to the satisfaction of a court of competent jurisdiction that distributions under a charging order will not satisfy the judgment within a reasonable time, a charging order is not the sole and exclusive remedy by which the judgment creditor may satisfy the judgment against a judgment debtor who is the sole member of a limited liability company or the assignee of the sole member, and upon such showing, the court may order the sale of that interest in the limited liability company pursuant to, a foreclosure sale. A judgment creditor may make a showing to the court that distributions under a charging order will not satisfy the judgment within a reasonable time at any time after the entry of the judgment and may do so at the same time that the judgment creditor applies for the entry of a charging order.*

(7) In the case of a limited liability company having only one member, if the court orders foreclosure sale of a judgment debtor's interest in the limited liability company_or of a charging order lien against the sole member of the limited liability company pursuant to subsection (6):

(a) The purchaser at the court-ordered foreclosure sale obtains the member's entire limited liability company interest, not merely the rights of an assignee;

(b) The purchaser at the sale becomes the member of the limited liability company; and

(c) The person whose limited liability company interest is sold pursuant to the foreclosure sale or is the subject of the foreclosed charging order ceases to be a member of the limited liability company.

(8) *In the case of a limited liability company having more than one member, the remedy of foreclosure on a judgment debtor's interest in such limited liability company or against rights to distribution from such limited liability company is not available to a judgment creditor attempting to satisfy the judgment and may not be ordered by a court.*

(9) Nothing in this section shall limit:

(a) The rights of a creditor that has been granted a consensual security interest in a limited liability company interest to pursue the remedies available to such secured creditor under other law applicable to secured creditors;

(b) The principles of law and equity which affect fraudulent transfers;

(c) The availability of the equitable principles of alter ego, equitable lien, or constructive trust, or other equitable principles not inconsistent with this section; or

(d) The continuing jurisdiction of the court to enforce its charging order in a manner consistent with this section.”

(c) The rationale behind the distinct treatment of single member LLC’s is the charging order exists to protect **other** members of an LLC from having involuntarily to share governance responsibilities with someone they did not choose, or from having to accept a creditor of another member as a co-manager. A charging order protects the autonomy of the original members, and their ability to manage their own enterprise. In a single-member entity, there are no non-debtor members to protect. The charging order limitation serves no purpose in a single member limited liability company, because there are no other parties’ interests affected. *In re Ashley Albright, 291 B.R. 538, 541 (Bankr. D. Colorado April 4, 2003).*

4. However, the courts have held that utilizing a legitimate business structure for the sole purpose of shielding assets from creditors borders on a fraud on creditors. For example, in the bankruptcy case of *Movitz v. Fiesta Investments, LLC (in re Ehmann)*, 319 B.R. 200, 206 (Bankr. D. Ariz. 2005), the bankruptcy judge held that the debtor's non-managing membership interest in an LLC, including the debtor's non-economic rights, may be the property of the debtor's bankruptcy estate.

(a) This holding was despite Arizona law restricting the involuntary transfer of a member's LLC interest, which was deemed inapplicable under the Bankruptcy Code.

(b) The central issue was whether federal bankruptcy law applied, or the restrictive Arizona LLC law applied. This turned on whether the articles of organization and operating agreement defining the membership interest was an "executory contract" requiring the application of Arizona law under section 365 of the Bankruptcy Code.

(c) The flip side was whether the membership interest was a "non-executory contract", and thus simply a property interest under section 541 of the bankruptcy code such that federal bankruptcy law would apply, rather than Arizona law.

(d) After a very detailed analysis, the court concluded that a membership interest which does not include any management rights or responsibilities and does not require the non-managing member to do anything of substance should not be considered an executory contract. Such a membership interest should be considered part of a non-executory contract, and the membership interest would be subject to section 541 of the Bankruptcy Code, rather than Arizona law.

(e) The Court noted that the membership interest might have been considered an executory contract if the member had substantial obligations to perform, and the non-performance of which would have amounted to breach of contract. But the debtor simply had no such obligations under the LLC's operating agreement.

(f) The effect of the court's ruling is that the restrictive language of an operating agreement does not control the creditors' rights in bankruptcy if the debtor's interest was non-executory. In other words, the bankruptcy trustee becomes a full member of the LLC even if the operating agreement provides otherwise.

IX. SPENDTHRIFT TRUSTS

A. In General.

1. The authority for acceptance of "spendthrift" trusts is found in the common-law concept that maximum effort should be given to the objectives and intentions of the settlor.

2. In Florida, the general rule is that the interest of a beneficiary under a trust, including the right to income from the corpus of the trust, is alienable by the beneficiary. *Goldman v. Mandell*, 403 So.2d 511 (Fla. 5th DCA 1981).

3. Additionally, the interest of a beneficiary is liable to be taken in satisfaction of his or her debts and obligations. *Bradshaw v. American Advent Christian Home & Orphanage*, 145 Fla. 270, 199 So. 329 (1941) (when trust provides income is to be applied for use of beneficiary, equity may direct application of that income to payment of beneficiary's debt); *Croom v. Ocala Plumbing & Electric Co.*, 62 Fla. 460, 57 So. 243 (1911) (when one has interest in property that he or she may alienate or assign, that interest, whether legal or equitable,

is liable for payment of his or her debts); *Preston v. City National Bank of Miami*, 294 So.2d 11 (Fla. 3d DCA 1974).

4. Trust assets may be protected against dissipation by a beneficiary or levy by creditors through creation of a “spendthrift” or similar protective trust. *Waterbury v. Munn*, 159 Fla. 754, 32 So.2d 603 (1947).

(a) Spendthrift trusts are enforced and upheld as valid in Florida. *Waterbury*, supra.

(b) Provisions vesting discretion in the trustee to determine the time, amount, or manner of payments to the beneficiary are likewise recognized as valid. *Philp v. Trainor*, 100 So.2d 181 (Fla. 2d DCA 1958).

(c) A spendthrift provision restricts a beneficiary from voluntarily or involuntarily alienating his or her interest in a trust, which includes access to or attachment through the claims of his or her creditors. 56 FLA.JUR.2d Trusts §36.

(d) A spendthrift trust is created to provide a fund for the maintenance of another while securing such fund against the beneficiary’s own improvidence or incapacity, i.e., a beneficiary’s inability to protect himself or herself. “A spendthrift trust operates through the mechanism of a direct restraint against voluntary or involuntary alienation of the beneficial interest in the trust.” 56 FLA.JUR.2d Trusts §36.

B. More importantly, the “Spendthrift Trust” has now been statutorily adopted under the Florida Trust Code which became effective on July 1, 2007.

1. F.S. 706.0502 Spendthrift provision.

“(1) A spendthrift provision is valid only if the provision restrains both voluntary and involuntary transfer of a beneficiary’s interest. This subsection does not apply to any trust in existence on the effective date of this code.

(2) A term of a trust providing that the interest of a beneficiary is held subject to a spendthrift trust, or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest.

(3) A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this part, a creditor or assignee of the beneficiary may not reach the interest or distribution by the trustee before receipt of the interest or distribution by the beneficiary.

(4) A valid spendthrift provision does not prevent the appointment of interests through the exercise of a power of appointment."

2. F.S. 736.0603 Exceptions to spendthrift provision.

"(1) As used in this section, the term "child" includes any person for whom an order or judgment for child support has been entered in this or any other state.

(2) To the extent provided in subsection (3), a spendthrift provision is unenforceable against:

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

(b) A judgment creditor who has provided services for the protection of a beneficiary's interest in the trust.

(c) A claim of this state or the United States to the extent a law of this state or a federal law so provides.

(3) Except as otherwise provided in this subsection, a claimant against which a spendthrift provision may not be enforced may obtain from a court, or pursuant to the Uniform Interstate Family Support Act, an order attaching present or future distributions to or for the benefit of the beneficiary. The court may limit the award to such relief as is appropriate under the circumstances. Notwithstanding this subsection, the remedies provided in this subsection apply to a claim by a beneficiary's child, spouse, former spouse, or a judgment creditor described in paragraph (2)(a) or paragraph (2)(b) only as a last resort upon an initial showing that traditional methods of enforcing the claim are insufficient."

3. F.S. 736.0504 Discretionary trusts; effect of standard.

“(1) Whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee’s discretion, even if:

(a) The discretion is expressed in the form of a standard of distribution; or

(b) The trustee has abused the discretion.

(2) If the trustee’s discretion to make distributions for the trustee’s own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor’s claim were the beneficiary not acting as trustee.

(3) This section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution.”

4. F.S. 736.0505 Creditors’ claims against settlor.

“(1) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

(a) The property of a revocable trust is subject to the claims of the settlor’s creditors during the settlor’s lifetime to the extent the property would not otherwise be exempt by law if owned directly by the settlor.

(b) *With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor’s benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor’s interest in the portion of the trust attributable to that settlor’s contribution. (emphasis added)*

(c) *Notwithstanding the provisions of paragraph (b), the assets of an irrevocable trust may not be subject to the claims of an existing or subsequent creditor or assignee of the settlor, or whole or in part, solely because of the existence of a discretionary power granted to the trustee by the terms of the trust, or any other provision of the law, to pay directly to the taxing authorities or to reimburse the settlor for any tax on trust income or principal which is payable by the settlor under the law imposing such tax. (emphasis added)*

(2) For purposes of this section:

(a) During the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power.

(b) Upon the lapse, release, or waiver of the power, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater amount specified in:

(1) Section 2041(b)(2) or s. 2414 (3); or

(2) Section 2503 (b).”

C. Self-Settled Spendthrift Trusts.

1. (a) When a settlor creates a spendthrift or discretionary trust for his or her own benefit, the settlor’s creditors may still be able to reach the assets of the trust. See RESTATEMENT (SECOND) OF TRUSTS §156(2), which provides: “Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.”

(b) According to Comment d following that section of the Restatement, when a settlor creates a trust for his own support, he or she is able to assign his or her interest.

(c) Thus, under this rule the interest of a settlor can be reached by the settlor’s creditors.

(d) The creditors can compel the trustee to pay to them the maximum amount the trustee could pay to the settlor or apply for the settlor’s benefit.

(e) When the terms of a trust direct a trustee to pay the settlor or apply for his or her benefit as much of the income or principal as the trustee may in its discretion determine, the settlor’s transferee or creditors can reach the maximum amount the trustee could

pay to the settlor or apply for his or her benefit. See RESTATEMENT (SECOND) OF TRUSTS §156(2), Comment e.

2. Whether the rule stated in §156(2) of the Restatement is intended to apply when a trust instrument gives a trustee the discretion to distribute any amount of income or principal among a group of beneficiaries that includes the settlor and others has not been addressed by a Florida court or by statute. Nevertheless, based on public policy it has been held by courts in other jurisdictions that the rule stated in §156(2) should apply in such situations. See, e.g., *Greenwich Trust Co. v. Tyson*, 27 A.2d 166 (Conn. 1942).

3. (a) In holding the spendthrift provisions ineffective, the court cited RESTATEMENT OF TRUSTS §156 to support its conclusion:

“The trust before us is not a spendthrift trust but, by reason of the discretion reposed in the trustee as to the use of the income, it is a “discretionary” trust. If in such a trust the settlor is the sole person entitled to the income, that income can be reached by his creditors. . . . A provision in the trust instrument that the trustee might in his discretion withhold the income from the settlor and accumulate it would not in itself place the income beyond the reach of his creditors. . . . We are brought, then, to the question of the effect of the provision that the trustee in his “absolute discretion” might expend any part of the income for the support and maintenance of the wife of the settlor or the support, education and maintenance of a named son and of other children who might be born to him.”

(b) Thus, the court recognized that this case differed from the usual self-settled trust case because the settlor was not the sole current beneficiary. Nonetheless, the court recognized:

“The outstanding factor in the situation is that, under a trust where the trustee has absolute discretion to pay the income or expend it for the settlor’s benefit, the trustee could, even though he had a like discretion to expend it for others, still pay it all to the settlor. Such a trust opens the way to the evasion by the settlor of his just debts, although he may still have the full enjoyment of the income from his property. To subject it to the claims of the settlor’s creditors does not deprive others to whom the trustee might pay the income of anything to which they are entitled of right; they could not compel the trustee to use any of the income for them. The public policy which subjects to the demands of a settlor’s

creditors the income of a trust which the trustee in his discretion may pay to the settlor applies no less to a case where the trustee might in his discretion pay or use the income for others.”

4. Florida courts appear to adopt an identical definition of a spendthrift trust ascribing to these same policy considerations. For example, in *Waterbury (supra)*, the court stated that a “spendthrift trust is one that ***is created with the view of providing a fund for the maintenance of another***, and at the same time securing it against his own improvidence or incapacity for self protection.”

5. Similarly, the court in *Preston v. City National Bank of Miami (supra)*, recognized that a spendthrift trust is usually conceived by parent or relatives, or friends concerned over the irresponsible propensities of a loved one, or their inability to cope with the problems of earning a livelihood and to prevent them becoming public charges, these documents have been long recognized by the courts. After the benefits of such a trust pass to the possession of the beneficiary, the creator’s power to protect the beneficiary against himself or herself is gone.

6. Grimsley, in his treatise, FLORIDA LAW OF TRUSTS §15-5(b) (Harrison Co. 3d ed. 1993), has also examined the issue of self-settled trusts in Florida, and suggests that “a settlor cannot create for himself a spendthrift trust to avoid creditors.”

7. See F.S. 736.0505(1)(b).

D. Rights of Creditors To Retirement Plans.

1. (a) For retirement or pension plans to qualify as “qualified plans” for favorable tax purposes under ERISA, the plan must contain an anti-alienation provision. ERISA §206(d)(1).

(b) Section 541(c)(2) of the Bankruptcy Code excludes from a debtor's bankruptcy estate the debtor's beneficial interest in a trust that contains restrictions on the transfer of beneficial interests (i.e., spendthrift provisions).

2. The United States Supreme Court, in *Patterson v. Shumate*, 504 U.S. 753, 112 S.Ct. 2242, 119 L.Ed.2d 519 (1992), specifically held that "ERISA-qualified" retirement plans are not subject to claims of creditors under §541(c)(2) of the Bankruptcy Code.

3. The State of Florida has elected to "opt out" of the specifically enumerated exemptions under the Bankruptcy Code.

(a) Florida has enacted F.S. 222.21, which provides a statutory exemption of pension money and retirement and profit-sharing benefits from legal process.

(b) Issues have been raised as to whether ERISA preempts Florida statutes with respect to bankruptcy-related issues (*In re Schlein*, 8 F.3d 745 (11th Cir. 1993)).

(c) Because retirement plans that qualify as spendthrift trusts under state law are excluded from the bankruptcy estate under §541(c)(2) of the Bankruptcy Code, precedence would dictate inclusion of appropriate provisions in all trusts created to manage or administer ERISA-qualified plans.

E. Medicaid Trusts.

The Omnibus Budget Reconciliation Act of 1993 (commonly referred to as "OBRA '93") has addressed the issue of whether a public agency, having assumed the responsibility for the mounting costs of modern institutional care for an incapacitated person, may reach funds held in trust for the benefit of the incapacitated person in satisfaction of its claim for supporting and maintaining that person in an institution or nursing home. See 42 U.S.C. §1396.

1. For purposes of determining eligibility for Medicaid and access to nursing home care based on insufficient resources and income, OBRA '93 includes assets of an individual that are used to form all or a part of the corpus of any trust if either the individual or the individual's spouse established the trust other than by will and without regard to (a) the purposes for which the trust was established, (b) any restrictions on when or whether distribution may be made for the trust, (c) whether the trustees have exercised any discretion under the trust, or (d) any restriction on the use of distributions from the trust.

2. Furthermore, OBRA '93 now requires all states to institute programs to recover nursing home and long-term-care Medicaid expenses from the estate of deceased recipients.

(a) Until enactment of OBRA '93, estate recovery programs were optional with the states and limited to the probate estate of the beneficiary.

(b) The law now permits estate recovery against any real or personal property or other assets in which the beneficiary had any legal title or interest at the time of death (including, generally, the principal residence, which in Florida is nevertheless subject to the constitutionally imposed homestead protection. See Art. X, §4, Fla. Const.).

3. For purposes of this subsection, the term "estate", with respect to a deceased individual (A) shall include all real and personal property and other assets included within the individual's estate, as defined for purposes of State probate law; and (B) may include, at the option of the State (and shall include, in the case of an individual to whom paragraph (1)(C)(i) applies), any other real and personal property and other assets in which the individual had any legal title or interest at the time of death (to the extent of such interest), including assets

conveyed to a survivor, heir, or assign of the deceased individual through joint tenancy, tenancy in common, survivorship, life estate, living trust, or other arrangement. 42 U.S.C. §1396p(b)(4).

4. Under current Florida law, public assistance payments constitute a debt of the recipient.

(a) Thus, under F.S. 414.28(1), the debt is enforceable by a claim filed against the estate of the recipient after his or her death or by a lawsuit to set aside a fraudulent conveyance.

(b) The debt is deemed to be discharged under F.S. 733.710 unless the applicable agency (the Agency for Health Care Administration) institutes probate proceedings as a creditor, files a timely claim against the estate of the debtor/recipient, or institutes a lawsuit to set aside a fraudulent conveyance. F.S. 414.28(2).

F. Spendthrift Trusts And The Marital Deduction.

1. The purpose of the marital deduction promulgated under §2056 of the Internal Revenue Code (which, as originally enacted, was limited to 50% of the decedent's adjusted gross estate) was to extend to spouses in common-law states advantages of married taxpayers in community property states by permitting the surviving spouse to acquire free of estate tax up to one half of the decedent's adjusted gross estate and to bring about a two-stage payment of estate taxes. The "terminable interest" limitation was intended to prevent an escape from tax liability of the second spouse, i.e., the passing of the surviving spouse's interest "to any other person" on termination of that spouse's life estate or other terminable interest without estate or gift tax.

2. However, exceptions to the terminable interest rule were engrafted into the scheme.

(a) One such exception is the life estate with a general power of appointment (IRC §2056(b)(5)).

(b) Another is the qualified terminable interest property, or “QTIP”, trust under IRC §2056(b)(7).

(c) Therefore, if limitations are imposed on the life tenant’s right to receive income, the exceptions to the terminable interest rule will be inapplicable.

(d) The particular requirement concerned is the requirement in IRC §2056(b)(5) that the “surviving spouse [be] entitled for life to all the income from the entire interest, or all of the income from a specific portion thereof, payable annually or at more frequent intervals”.

3. Treas. Reg. §20.2056(b)-5(f)7 provides:

“An interest passing in trust fails to satisfy the condition set forth in paragraph (a)(1) of this section, that the spouse be entitled to all of the income, to the extent that the income is required to be accumulated in whole or in part or may be accumulated in the discretion of any person other than the surviving spouse; to the extent that the consent of any person other than the surviving spouse is required as a condition precedent to distribution of the income; or to the extent that any person other than the surviving spouse has the power to alter the terms of the trust so as to deprive her of her right to the income. An interest passing in trust will not fail to satisfy the condition that the spouse be entitled to all the income merely because its terms provide that the right of the surviving spouse to the income shall not be subject to assignment, alienation, pledge, attachment or claims of creditors.”

4. The government, in effect, concedes that a spendthrift provision is not such a limitation that would cause the marital trust to fail to meet the requirement that the life tenant be entitled to income.

5. In *Miller v. United States*, 267 F.Supp. 326, 329 (M.D. Fla. 1967), the decedent’s will contained a provision that any attempt by a beneficiary to assign the right to

income or any levy on income by creditors of the beneficiary would cause the absolute right to income to “cease and terminate.”

(a) In that event, the trustee had discretion to pay funds for support of the beneficiary. Any income not so paid was to be accumulated in the corpus of the trust ultimately to be disposed of by the surviving spouse’s general power of appointment. The District Court for the Middle District of Florida held that the power to ultimately dispose of accumulated income at death is not equivalent to the right to receive income during life.

(b) Although the surviving spouse has some power of disposition over the trust income, that power is limited beyond the bounds permitted by the statute.

(c) Citing *Starrett v. Commissioner*, 223 F.2d 163 (1st Cir. 1955), in which the surviving spouse had already passed away and in fact the conditions and limitations imposed on her right to income had never become effective, the court decreed that “since the gift must satisfy the statutory requirements as viewed from the testator’s death, the mere possibility that a limitation would be imposed was sufficient to disallow the marital deduction.” 267 F.Supp. at 332.

G. Future Trends

1. On October 9, 1997, the Supreme Court of Mississippi ruled that the assets of a spendthrift trust may be reached by the beneficiary’s tort creditors. *Sligh v. First National Bank of Holmes County*, 704 So.2d 1020 (Miss. 1997), *reh. den.* 706 So.2d 251.

(a) Unlike the states of Georgia and Louisiana, which have legislated exceptions to the spendthrift clause as to claims for tort judgments, taxes, governmental claims, alimony, and child support, Mississippi is the first state to judicially decree a common-law exception to the spendthrift trust doctrine for tort creditors.

(b) The court held that the policy reasoning favoring spendthrift trusts should not apply to judgments for gross negligence and intentional torts.

(c) The court recognized the right of donors to place restrictions on the disposition of their property as not being absolute, and there are several generally recognized exceptions to the spendthrift trust doctrine.

(d) Rather, the court held, a donor may dispose of his property as he sees fit so long as such disposition does not violate the law or public policy; and it was determined against public policy to dispose of property in such a way that the beneficiary may enjoy the income from such property without fear that his interest may be attached to satisfy the claims of his gross negligence or intentional torts.

2. The precedent established has been sharply criticized by commentators who suggest that the court established a new presumption that the establishment of a spendthrift trust is itself a wrongful act merely because a beneficiary is subsequently found liable of gross negligence or an intentional tort. See Fox & Murphy, “Are Spendthrift Trusts Vulnerable to a Beneficiary’s Tort Creditors?”, 137 Trusts & Estates 57 (Feb. 1998).

3. Furthermore, the court seemed to make an unfair distinction among the rights of contract creditors, tort creditors generally, and tort creditors based on gross negligence and intentional torts.

4. Finally, the court failed to acknowledge the difference between a discretionary trust and other forms of trust, and the disregarded rights of the trust remaindermen just because the trustee had the authority to distribute all of the principal to the income beneficiary.

5. The decision of the Mississippi Supreme Court, if upheld, could be the first intrusion on the long-recognized status of the spendthrift trust.

X. DOMESTIC ASSET PROTECTION TRUSTS (“DAPT’s”)

A. As earlier discussed, the general rule in the United States provides for non-recognition of self-settled spendthrift trusts (i.e., trusts in which the settlor retains a beneficial interest, and the trust instrument states that his interest cannot be alienated, either voluntarily or involuntarily).

B. However, several states have now enacted legislation allowing self-settled asset protection trusts. Missouri was the first state to adopt asset protection trust legislation in 1989.

1. The legislature in Alaska enacted milestone legislation in 1997 in an attempt to compete with foreign situs asset protection trusts, and the legislature in Delaware quickly followed suit.

2. In 1999, asset protection trust legislation was adopted in Nevada and Rhode Island.

3. There are now 13 states which have adopted legislation validating self-settled spendthrift trusts (in addition to Alaska and Delaware, also included are Colorado, Missouri, Nevada, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Wyoming, New Hampshire, and most recently as of July, 2010, Hawaii).

C. As an example, the Delaware Qualified Dispositions in Trust Act applies to any “qualified dispositions” made after July 1, 1997. A qualified disposition is defined as a transfer to a trustee who is (1) a Delaware resident, bank, or institution authorized to act as a trustee; and (2) arranges for custody in Delaware of some or all of the trust corpus, maintains records, and prepares fiduciary tax returns or otherwise participates in the trust’s administration.

1. Although the Delaware asset protection trust must be irrevocable, it can contain some very favorable provisions for the settlor:

(a) The trust may provide that the settlor may retain the power to veto dispositions;

(b) The settlor may also retain a special power of appointment and receive income or corpus in the sole discretion of a trustee who is not a relative or subordinate of the settlor; and

(c) The Delaware Act also permits the settlor to retain current income distributions and a specific percentage, not to exceed 5%, of the principal annually.

2. *Assuming there was not a fraudulent conveyance*, no action to enforce a judgment shall be attached against a qualifying disposition under the Delaware Act.

(a) Like the Alaska asset protection trust statute, the Delaware statute provides a statute of limitations ending the later of *four years after the transfer* or *one year after the transfer was or could reasonably have been discovered by the creditor*.

(b) Any action, even one arising after the transfer, must be brought within four years of the transfer.

3. Finally, the Delaware statute provides that the creditor has the burden of proving the matter by *clear and convincing evidence*.

4. Despite the protection given by the Delaware statute, the assets may be reachable by certain creditors.

(a) A person to whom the settlor is indebted due to a contract or court order for support, alimony, or property distribution in favor of a spouse, former spouse, or children may be able to reach the assets in the trust.

(b) Also, any person who suffers death, personal injury, or property damage on or before the qualified disposition may be able to reach the assets if the settlor or another person for whom the settlor is liable caused the injury.

D. For purposes of comparison, a copy of the amendment to F.S. 736.0505 proposed by the Asset Preservation Committee of the Real Property, Probate and Trust Law Section of The Florida Bar was voted down at the August, 2010 meeting of its Executive Council, is attached as Exhibit A.

E. Notwithstanding Florida's refusal to modify its statutory spendthrift trust provisions to recognize self-settled spendthrift trusts, it is still possible for a Florida resident to indirectly create such a planning device.

1. Clarifying legislation has been adopted to provide that assets passing in trust for the settlor of the traditional "Inter Vivos QTIP Trust" after the death of the settlor's spouse are not considered to be held in a self-settled trust, if not part of a fraudulent scheme. For example, Husband creates an inter vivos trust for his spouse which entitles her to all of the income during her lifetime, and upon her death she has a limited power of appointment over the principal. If she fails to exercise the power, the trust continues for the benefit of Husband. Treasury Regulation Section 25.2523(f) - 1(f), Example 11, provides that the assets in the trust after the spouse's death will not be included in Husband's estate under IRC Section 2036 or 2038. However, F.S. 736.0505(1)(b) permits a creditor of the settlor to reach the maximum amount of the trust that can be distributed to the settlor. To conform Florida law to the applicable tax treatment of such trusts, new subsection (3) was added to F.S. 736.0505, as follows:

“(3) Subject to the provisions of s. 726.105, for purposes of this section, the assets in:

(a) A trust described in s. 2523(e) of the Internal Revenue Code of 1986, as amended, or a trust for which the election described in s. 2523(f) of the Internal Revenue Code of 1986, as amended, has been made; and

(b) Another trust, to the extent that the assets in the other trust are attributable to a trust described in paragraph (a), shall after the death of the settlor's spouse, be deemed to have been contributed by the settlor's spouse and not by the settlor.”

2. Revenue Ruling 2004-64 (2004.27 I.R.B. 7, July 6, 2004) addressed the estate tax consequences to the settlor of a Defective Grantor Trust. Pursuant to the trust, the settlor reserved a right to be reimbursed the income tax he was required to pay resulting from his duty to report all income earned by the trust. Under the Ruling, estate tax inclusion of this right to reimbursement is required under IRC §2036(a)(I) if the Trustee is *required* by the trust agreement or state law to reimburse the settlor. Conversely, no portion of the trust need be included if the Trustee merely has the *discretion* under the terms of the trust agreement or state law to reimburse the settlor. Since the settlor is also a potential beneficiary, this would be deemed a self-settled spendthrift trust under F.S. 736.0505(1)(b), to which the settlor's creditors may have access (and upon which settlor may be required to pay estate tax). Consequently, F.S. 736.0505(1)(c) of the Florida Trust Code specifically excepts out of creditors' claims against settlors, the right of tax reimbursements from Defective Grantor Trusts.

“(c) Notwithstanding the provisions of paragraph (b), the asset;; of an irrevocable trust may not be subject to the claims of an existing or subsequent creditor or assignee of the settlor, in whole or in part, solely because of the existence of a discretionary power granted to the trustee by the terms of the trust, or any other provision of law, to pay directly to the taxing authorities or to reimburse the settlor for any tax on trust income or principal which is payable by the settlor under the law imposing such tax.”

3. (a) It was the intent of F.S. 733.707(3) to specifically target the traditional revocable inter vivos (“living”) trust as the type of trust on which is imposed the duty

to pay the expenses of administration and obligations if the assets of the probate estate are insufficient, and to specifically exclude irrevocable, charitable remainder, or lead trusts in which the settlor retains an interest, or other specific types of trusts or property ownership arrangements.

(b) However, F.S. 733.808, entitled “Death benefits; disposition of proceeds,” provides that death benefits of any kind, including insurance proceeds, may be made payable to the trustee under a trust agreement *in existence at the time of the death of the insured*, and the death benefits shall be held and disposed of as part of the trust assets in accordance with the terms of the trust. Clearly F.S. 733.808 is intended to distinguish trusts “in existence at the time of death of the insured” from testamentary trusts, which do not come into existence until the last will and testament under which the trust is established is admitted to probate. Subsection (4) specifically provides:

“Death benefits..., *unless paid to a personal representative...shall not be deemed to be part of the decedent’s estate, and shall not be subject to any obligation to pay the expenses of the administration and obligations of the decedent’s estate* or for contribution required from a trust under s.733.607(2) to any greater extent than if the proceeds were payable directly to the beneficiaries named in the trust.” (emphasis added)

(c) From an asset protection planning perspective, one could consider utilizing his revocable trust funded with a life insurance policy as an effective self-settled spendthrift trust which is not otherwise recognized as valid in Florida.

(i) By statute, a life insurance policy owned by a revocable trust is exempt from the claims of the settlor’s creditors under F.S. 222.14. And upon the settlor’s death, the death benefit payable to the revocable trust is similarly exempt from the creditors of the settlor’s probate estate pursuant to F.S. 733.808(4).

(ii) Therefore, assuming a lack of fraudulent intent, a Floridian who wishes to obtain the asset protection benefits of a self-settled spendthrift trust, can, in the alternative, fund his revocable trust with a policy or policies insuring his life, the premium or premiums of which have been paid with all or any part of his nonexempt property. The cash value of the policy is protected from the settlor's creditors during his lifetime (F.S. 222.13); the income and gain on the cash value of the policy is tax free during the settlor's lifetime and at his death (I.R.C. § 7702(g)). If properly structured, the settlor may withdraw assets from the trust tax free by borrowing against the cash value of the policy during his life; and, at death, the death benefit payable under the policy to the revocable trust is statutorily protected from the claims of his creditors and the creditors of his estate (F.S. 733.808(4)).

(iii) Therefore, although F.S. 736.0505(a) provides that the property of a revocable trust is subject to the claims of the settlor's creditors to the same extent the property would be exposed to such claims in the hands of the settlor, since neither an insurance policy insuring the settlor and owned by the revocable trust is subject to the claims of the settlor's creditors, nor are the proceeds paid upon the settlor's death, Florida has effectively adopted at least one form of self-settled trust as an asset protection strategy notwithstanding its overt attempt to discourage that result.

F. Potential Challenges to Domestic Asset Protection Trusts.

1. Full Faith and Credit Clause. The "Full Faith and Credit Clause" of the United States Constitution requires each state to recognize and enforce all validly rendered judgments of any other state in the union.

(a) If a creditor wants to pursue the assets in a self-settled trust, the creditor ultimately must involve a court that has jurisdiction over the trust assets or over a party in control of the assets.

(b) In most cases, an attack on an asset protection trust will be the second phase in a lawsuit or a second suit entirely.

(c) The first action will be the tort or contract cause that gave rise to the liability, and the second will be an action against the trust in an effort to satisfy the judgment.

(d) In order to reach the trust assets, the creditor must sue in a court that has jurisdiction over some aspect of the trust. If the trust is a Delaware trust, this does not necessarily mean a Delaware court. Another state's court may have jurisdiction over the trustee, the settlor or the trust assets.

(e) A court could have jurisdiction over the trustee or settlor in several ways.

(i) First, all individuals are subject to the jurisdiction of courts within their domiciles.

(ii) This means that a non-Delaware trustee would be subject to the jurisdiction of his home state's court.

(iii) Jurisdiction may also exist under a long-arm statute if the individual has sufficient contacts with the forum state.

(f) Corporations are subject to the jurisdiction of the courts in the state of their incorporation, as well as any court in a state where they do business. Accordingly, jurisdiction could potentially be obtained over large corporate trustees in the courts of many states.

(g) A state's courts also have jurisdiction over all property within the state's borders.

(i) Such property may include real property, bank accounts, and shares of stock issued by corporations that are incorporated in that state.

(ii) Therefore, if a trust holds stock in many different corporations, components of its property may be subject to the jurisdiction of different states' courts.

2. Due Process Clause. Substantive due process protections from the Fifth and Fourteenth Amendments restrict a forum state's ability to apply its own law to disputes between outsiders.

(a) The forum state must have "significant contact" with the dispute that creates "state interests", such that the use of the forum's law is not "arbitrary or unfair".

(b) The Restatement of Conflict of Laws states that the forum state should apply another state's laws if that state has the dominant interest in the question of exemption. If the debtor and creditor are domiciled outside the forum state, "a state to which they both have substantial relationships . . . may be the state of dominant interest".

(c) Despite the Restatement's dominant interest test, it is possible for a Nevada court to apply its laws even if another state has a dominant interest.

(d) The Due Process Clause merely mandates that the forum state must have sufficient interests in the matter that the application of its laws would not be arbitrary or unfair.

3. Contract Clause. The Contract Clause of the Constitution prohibits states from enacting any law that impairs the "Obligation of Contracts".

(a) To violate the Contract Clause, the law must substantially impair the obligations of parties to existing contracts or make them unreasonably difficult to enforce.

(b) If a law meets this criterion, it is then subject to the “strict scrutiny” standard of review. To pass the test, the law must be narrowly tailored to promote a compelling government interest.

(c) A creditor could argue that asset protection laws violate the Contract Clause because they eliminate his ability to seize assets which otherwise would have been available.

(d) A creditor could further argue that the new laws alter the settlor’s substantive obligations.

(i) Since the settlor can continue to enjoy the assets which may later be discretionarily distributed without concern that creditors could presently reach the assets, the debtor’s contractual obligations become illusory.

(ii) He can refuse to pay the debts owed without the fear of repercussions.

(iii) On the other hand, fraudulent transfer laws should provide a viable remedy to creditors if the transfer was made simply to avoid repayment obligations.

4. Supremacy Clause. The final Constitutional problem with domestic asset protection trusts is found in the Supremacy Clause.

(a) If a creditor faces a debtor who has been rendered insolvent because his assets are in an asset protection trust, the debtor can be forced into involuntary bankruptcy.

(b) If there is a judgment against the settlor given by a U.S. Bankruptcy Court under Bankruptcy Code rules, the Constitution's Supremacy Clause may become an issue. The Supremacy Clause states that "this Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any State to Contrary notwithstanding". This means that the Bankruptcy Code takes precedence over any conflicting state law.

(c) §541(c) of the Bankruptcy Code provides:

“(c) (1) Except as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate... notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law –

(A) that restricts or conditions transfer of such interest by the debtor; or

(B) that is conditioned on the insolvency or financial condition of the debtor. . .

(2) 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.”

(i) If a creditor convinced a bankruptcy court that an interest in an asset protection trust should not be protected by §541(c)(2), the settlor would be forced to maintain that the asset protection trust legislation is an exception to be respected independently of §541(c)(2).

(ii) However, §541(b)(2) of the Bankruptcy Code provides that the only exceptions to be applied in bankruptcy are those of the debtor's domicile state, regardless of where the assets subject to the exception are located.

(iii) So unless the debtor's home state has an exemption for self-settled spendthrift trusts, the trust assets could then be reachable by the creditor.

(d) §548 of the Bankruptcy Code provides that the Bankruptcy Trustees may avoid any transfer of an interest of the debtor in property that was made as part of a fraudulent conveyance that was made on or within 10 years before the date of the filing of the petition if (i) such transfer was made to a *self-settled trust or similar device*; (ii) such transfer was made by the debtor; and (iii) the debtor is a beneficiary of such trust or similar device.

(e) The July 31, 2000 case of *In re Stephen Jay Lawrence, Debtor* (251 B.R. 630, Bkrcty. M.D. Florida 2000) may give some insight into the Bankruptcy Court's view of these arrangements.

(i) In Lawrence, the settlor established a self-settled spendthrift trust in the Republic of Mauritius two months prior to the conclusion of a 42-month arbitration dispute with Bear, Stearns & Co., Inc. that resulted in a \$20.4 million award in favor of Bear Stearns.

(ii) The trustee of the trust was authorized to distribute all or any portion of the trust income and/or principal to the settlor in its discretion, and was further authorized to amend the trust instrument to exclude any beneficiary; which power the trustee in fact exercised to exclude the settlor!

(iii) However, the settlor retained the power to change the trustees.

(iv) The Court held that both Federal and Florida law prohibit individuals from setting up self-settled spendthrift type trusts and maintaining the benefits of and ability to significantly control same, while keeping the assets away from creditors (citing *In re Cattafi*, 237 B.R. 853,856, Bkrcty. M.D. Fla. 1999, and *Croom* {supra}).

(v) Accordingly, the settlor's retained managerial control over the trust arising from his ability to remove and replace the trustee who could add or exclude beneficiaries, constitutes a legal or equitable interest in property, sufficient to bring such property within the scope of the settlor's bankruptcy estate.

(vi) Furthermore, the Court countered the settlor's argument that failure to join the trustee of the trust and the other beneficiaries thereunder violated his Due Process rights.

“The foreign trustee was intentionally chosen, and the trust created, by the Debtor in an attempt to thwart the jurisdiction of the bankruptcy court. The foreign trustee enjoys no rights independent of the Trust Indenture, under which he can be replaced at any time at the whim of the Debtor. As such, he does not qualify as even a necessary party under Fed.R.Civ.P. 19(b) standards, where “equity and good conscience” would nonetheless require the turn over to proceed without his joinder. The trustee can hardly claim standing to represent the beneficiaries' interests, where the Debtor, as Settlor, empowered him, in his sole discretion, to add a beneficiary or class of beneficiaries from the trust. *See* January 8, 2000 Declaration of Trust, Clauses 9 and 10(a)(ii). His power in that regard is directly affected by the Debtor, as Settlor who also enjoys these unfettered, absolute rights of appointment and exclusion pursuant to Sections 10 and 11 of the February 7, 1991 Deed of Appointment. Under the Settlor's reservation of powers, which is property of the estate, it is the Debtor/Settlor who remains the sole indispensable party. What we are left with is a foreign alleged trust with “at will” trustees, and “at Will” beneficiaries, who serve or benefit at the power of the Settlor/Debtor, who created the foreign trust to hid assets and protect himself from creditors. In these proceedings, the Debtor's “indispensable party” argument represents a guise to further shield himself from complying with the Turn Over Order, when, in reality, the so called ‘rights of third parties are no more than smoke’. (Id at 646).

XI. FOREIGN ASSET PROTECTION TRUSTS (“FAPT’s” or “OAPT’s”)

A. A new arrow becoming popular in the quiver of the overall estate or financial plan designed for wealthier clients is the establishment of an offshore asset protection trust (or “OAPT”), commonly referred to as a “nest egg trust.”

B. The sheer amount of wealth which has been transferred to offshore venues in the context of OAPT's is staggering. By some accounts, the figure is anywhere between \$2-6

Trillion. See John K. Eason, *Home From the Islands: Domestic Asset Protection Trust Alternatives Impact Traditional Estate and Gift Tax Planning Consideration*. 52 Fla. L. Rev. 41 , 42 and n.2 (Jan., 2000). OAPT's are nearly universally designed in the nature of spendthrift trusts which contain anti-duress and anti-coercion provisions by which the designated trustees of the trusts are authorized to disregard any requests for advancements or other entreaties by the settlor if those requests are deemed to be motivated by the pursuit of the settlor's creditors or the processes of the courts of the United States. Thus, by nature and design, a creditor stands little chance of reaching the assets which the settlor has placed into an OAPT unless he is willing to expend extraordinary time and effort to submit to the jurisdiction of the situs of the OAPT, with its laws specifically designed to protect OAPT's within its borders.

C. To begin this discussion, however, it must be clearly understood that if a transfer of assets is made *for the purpose of and with the intent to hinder, defraud or delay a creditor*, then any such transfer will be deemed a fraudulent transfer and can be overturned by a United States Court. Among the relevant “badges of fraud” are transfers of so much of one’s assets so that the individual will be rendered insolvent.

D. A nest egg trust is an irrevocable trust established in a jurisdiction outside the United States for the primary purpose of protecting assets of the individual creating the trust. The trust isn’t intended to shelter all of the individual’s assets, but only provide a level of financial security, or a “nest egg,” in the event of a catastrophic financial crisis.

E. The costs of establishing and maintaining an offshore trust are rather substantial.

1. The client should have sufficient assets to justify the start-up and ongoing expense, particularly in view of the fact that he will not be transferring all of his assets to the trust.

2. Practically, the offshore trust is suitable for consideration by professionals, such as doctors, who are concerned about potential malpractice exposure, businessmen who are concerned over the threat of increasing commercial litigation and retirees who wish to preserve and protect assets they've worked long and hard to accumulate.

F. It is important to remember that this is not a fraudulent scheme or a strategy to avoid creditors or evade taxes. In fact, a nest egg trust is not appropriate for an individual already engaged in litigation or actively trying to avoid payment of an enforceable obligation.

G. OAPT's are usually established with banks or trust companies which are chartered in foreign jurisdictions where local laws provide very favorable conditions.

1. For example, the Cayman Islands have very strict bank secrecy laws which statutorily prohibit any financial institution from divulging information pertaining to its customers and their accounts.

2. Furthermore, the local laws of many of these jurisdictions make it more difficult for a creditor to challenge the validity of property transfers into the trust.

H. As in the U.S., however, the trust is established by the execution of a written trust agreement, or "settlement", between the creator of the trust and the financial institution serving as trustee.

I. From an income tax perspective, the arrangement is deemed a "grantor trust," which means that all of the income must be reported by the creator of the trust.

1. ***It must be clearly understood that there is no income tax benefit, shield or protection to be accomplished by establishing a nest egg trust.***

J. Furthermore, unless the trust is properly structured, the creator can be deemed to have made a completed gift for federal gift tax purposes at the time he transfers property into the trust.

1. Notwithstanding the gift tax issue, depending upon the rights the creator retains a right to income or any benefit from the trust, the value of the trust also could be included in his estate for federal estate tax purposes.

2. The trust, therefore, should be structured and coordinated as part of the creator's overall tax and estate plan.

K. These are 3 primary legal advantages of the OAPT over the DAPT.

1. DAPT's may be forced to recognize judgments in other states under the Full Faith and Credit clause.

2. OAPT's usually have a shorter statute of limitations on fraudulent conveyances, and the burden of proving a fraudulent conveyance is shifted to the creditor.

3. The laws of most OAPT jurisdictions do not except out child support claims, matrimonial rights, or other statutorily identified claims which may be enforceable against DAPT's in the United States.

L. A negative to this planning strategy is that a nest egg trust has to be irrevocable, because if the individual retains the power to change or revoke the terms of the trust, a court will generally allow a creditor the same access to the trust as reserved by the debtor.

M. To preserve some degree of indirect control and accountability, the trust arrangement can be structured to allow the creator to appoint a "trust protector", who must approve all actions taken by the trustee. So long as the protector is independent from the creator, the trust will maintain its irrevocability insofar as the creator is concerned.

N. Among the general considerations and factors which may affect the choice of states are political stability, economic stability, taxes, fees and costs, business environment, legal framework, transportation and communication facilities and language. Following is a checklist of suggested factors to consider in choosing a jurisdiction in which to establish a FAPT:

A. General

1. History and Culture
2. Political Stability
3. Economic Stability
4. Business Environment
5. Currency/Exchange Controls
6. Language
7. Location; Transportation
8. Telecommunications; Postal Service; Time Zones
9. Legal, Financial and Military Ties to Larger Countries
10. Economic Treaties
11. Governmental Issues
 - (a) Structure of the Government
 - (b) Integrity of the Government
 - (c) Economy
 - (d) Manner of Elections
 - (e) Reputation and Payment of Officials

B. Financial

1. Costs and Fees – In General
 - (a) Formation Costs
 - (b) Trustees' Fees
 - (c) Registration Fees
2. Advantages of Using a Trust in that Jurisdiction
3. Companies
4. Attorney's Fees
5. Accounting Fees
6. Money Manger's Fees
7. Taxation in the Bahamas
 - (a) Non-Resident Entity
 - (b) Resident Entities
8. Guarantees Against Future Taxes

C. Banks

1. Structure and Regulations

2. Banks and Trust Companies Dealing with the Public
 3. Reputation
 4. Confidentiality
- D. Professionals
1. Trustees
 2. Attorneys
 3. Accountants
 4. Bankers
 5. Portfolio Managers
 6. Investigation of Professionals
- E. Legal
1. General Legal Framework – Common Law
 - (a) Origins of Laws and Factors of Influence
 - (b) Court System
 - (c) Parliament
 2. Banking Laws – in General
 - (a) Reporting Requirements
 - (b) Secrecy Laws and Penalties for Disclosure
 - (c) Exchange of Information Treaties and Confiscation
 3. Trust Law – in General
 - (a) Self Settlement
 - (b) Asset Protection Features
 - (c) Rule Against Perpetuities
 - (d) Redomiciliation
 - (e) Protection Against Forced Dispositions
 - (f) Rules Governing Trustees and Protectors
 - (g) Jurisdiction of Local Courts over Trusts
 - (h) Choice of Law Provisions
 - (i) Registration Requirements
 4. Fraudulent Disposition Laws – in General
 - (a) Statute of Limitations
 - (b) Burden of Proof
 - (c) Protection Against Future Creditors
 - (d) Conflict of Laws
 - (e) Interaction with Foreign Legal Systems
 - (f) Treaties with Other Countries
 - (g) Common Law Action
 - (h) Registration of Foreign Judgments
 - (i) Injunctive Relief

- (j) Local Bankruptcy
- (k) Corporate Laws
- (l) Offshore Companies

The 2010 Florida Statutes

Title XLII
ESTATES AND TRUSTS

Chapter 736
FLORIDA TRUST CODE

736.0505 Creditors' claims against settlor.--

(1) Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

(a) The property of a revocable trust is subject to the claims of the settlor's creditors during the settlor's lifetime to the extent the property would not otherwise be exempt by law if owned directly by the settlor.

(b) With respect to an irrevocable trust *that does not contain a spendthrift provision*, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

(c) Notwithstanding the provisions of paragraph (b), the assets of an irrevocable trust may not be subject to the claims of an existing or subsequent creditor or assignee of the settlor, in whole or in part, solely because of the existence of a discretionary power granted to the trustee by the terms of the trust, or any other provision of law, to pay directly to the taxing authorities or to reimburse the settlor for any tax on trust income or principal that is payable by the settlor under the law imposing such tax.

(d) *With respect to an irrevocable trust that contains a spendthrift provision, a creditor or assignee of the settlor may not satisfy a claim, or liability on a claim, in either law or equity, out of the assets the settlor transfers to, or the settlor's beneficial interest in, the trust.*

1. This paragraph shall not apply to assets transferred to the trust if:

a. the claim results in a judgment, order, decree, or other legally enforceable decision or ruling arising from a judicial, arbitration, mediation, or administrative proceeding commenced by a creditor of the settlor who is a creditor of the settlor before the settlor's transfer to the trust of the assets that are the subject of the claim and the claim is made within the later of (I) four years after such transfer is made or (II) one year after such transfer is or reasonably could have been discovered by the creditor if the creditor can demonstrate by clear and convincing evidence that the creditor asserted a specific claim against the settlor before the transfer, but in all events prior to the expiration of the statute of limitations applicable to the underlying claim.

b. the settlor's transfer to the trust is made with actual intent to hinder, delay, or defraud that creditor;

c. the trust provides that the settlor may revoke, terminate, or withdraw all or part of the trust without the consent of a person who has a substantial beneficial interest in the

trust and the interest would be adversely affected by the exercise of the settlor's power to revoke or terminate all or part of the trust;

d. the trust requires that all or part of the trust's income or principal, or both, must be distributed to the settlor as beneficiary;

e. the claim is for a payment excepted under s. 736.0503;

f. the transfer is made when the settlor is insolvent or the transfer renders the settlor insolvent; or

g. the claim is for recovery of public assistance received by the settlor under s. 409.9101.

2. This paragraph also shall not apply to assets transferred to the trust unless the settlor has signed a verified document that to the knowledge of the settlor is substantially accurate and complete as to all material representations as of time of the transfer to the trust and is delivered to the qualified trustee before or at the time of the transfer of assets to the trust, or at the time the principal place of administration of the trust is moved to this state, if later, which must state:

a. the settlor has full right, title, and authority to transfer the assets to the trust;

b. the transfer of the assets to the trust will not render the settlor insolvent;

c. the settlor does not intend to defraud an existing creditor by transferring the assets to the trust;

d. there is no pending or threatened court actions against the settlor, except for those court actions identified by the settlor on an attachment to the verified document;

e. the settlor is not involved in any governmental administrative proceedings relating to assets the settlor transfers to the trust or the settlor's beneficial interest in such assets, except for those administrative proceedings identified by the settlor on an attachment to the verified document;

f. at the time of the transfer of the assets to the trust, the settlor is not currently in default by more than 30 days of a child support obligation imposed by order of a court of competent jurisdiction;

g. the settlor does not contemplate filing for relief under the provisions of 11 U.S.C. (Bankruptcy Code); and

h. the assets being transferred to the trust were not derived from unlawful activities.

3. *This paragraph also shall not apply to assets transferred to the trust with respect to a creditor:*

a. *to whom the settlor gave a written representation containing such assets to the extent that the existence and value of such assets were reasonably relied upon by the creditor to make any credit decision or*

b. *that were transferred in breach of any written agreement, covenant, or security interest between the settlor and that creditor.*

4. *This paragraph also shall not apply to assets transferred to the trust unless the trust instrument appoints a qualified trustee for the assets the settlor transfers to the trust. A power to distribute the income or invade the principal of such trust to or for the benefit of the settlor in the exercise of a trustee's discretion may be exercisable only upon consent of the qualified trustee.*

5. *For purposes of this paragraph:*

a. *the term "insolvent" means that the sum of the settlor's debts is greater than all of the settlor's assets at fair valuation and that the settlor is generally not paying his or her debts as they come due.*

b. *the term "assets" shall have the meaning given the term in s. 726.102(2).*

c. *the term "qualified trustee" refers to a bank or trust company described in c. 658 authorized to engage in trust businesses and that maintains or arranges for custody in this state of some or all of the assets transferred to the trust, maintains records for the trust on an exclusive or nonexclusive basis, prepares or arranges for the preparation of fiduciary income tax returns for the trust, or otherwise participates in the administration of the trust.*

(2) For purposes of this section:

(a) During the period a power of withdrawal may be exercised, the holder of such a power is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power.

(b) Upon the lapse, release, or waiver of a power of withdrawal, the holder is treated as the settlor of the trust only to the extent the value of the property affected by the lapse, release, or waiver exceeds the greater of the amount specified in:

1. Section 2041(b)(2) or s. 2514(e) or

2. Section 2503(b) and, if the donor was married at the time of the transfer to which the power of withdrawal applies, twice the amount specified in s. 2503(b).

(3) Subject to the provisions of s. 726.105, for purposes of this section, the assets in:

(a) A trust described in s. 2523(e) of the Internal Revenue Code of 1986, as amended, or a trust for which the election described in s. 2523(f) of the Internal Revenue Code of 1986, as amended, has been made; and

(b) Another trust, to the extent that the assets in the other trust are attributable to a trust described in paragraph (a), shall, after the death of the settlor's spouse, be deemed to have been contributed by the settlor's spouse and not by the settlor.

(4) For the purposes of this section, the words “revoke, terminate, or withdraw” do not include:

(a) A power to veto a distribution from the trust;

(b) Any power of appointment that is not a general power of appointment as described in s. 736.0103(7);

(c) Unless the trust instrument refers specifically to this paragraph and provides expressly to the contrary, the right to receive a distribution of income, principal, or both in the exercise of the discretion of another person only upon the consent of a trustee who is not related or subordinate to the settlor as determined in s. 672(c) of the Internal Revenue Code;

(d) A right to receive a distribution of principal subject to an ascertainable standard set forth in the trust instrument;

(e) The power to appoint or remove trust advisors, designated representatives, or other agents who are not related or subordinate to the settlor as determined in s. 672(c) of the Internal Revenue Code who can remove and appoint a qualified trustee;

(f) A right to receive income or principal from a charitable remainder unitrust or charitable remainder annuity trust as defined in s. 664 of the Internal Revenue Code; or

(g) A right to use real property held in a qualified personal residence trust described in s. 2702(c) of the Internal Revenue Code.

(5) The satisfaction of a claim under this paragraph is limited to that part of the trust or transfer to which it applies.

(6) If a trust instrument has a spendthrift provision as provided under s. 736.0502, a creditor of the settlor has only the rights that are provided in this section, and no creditor shall have any cause of action or claim for relief against a trustee, trust advisor, designated representative, attorney, auditor, or other agent or assistant involved in the counseling, drafting, preparation, execution, or funding of the trust.

(7) In any action brought under this section, the burden of proof shall be upon the creditor by clear and convincing evidence.

(8) For purposes of this section:

(a) The transfer shall be considered to have been made on the date the asset originally was transferred to the trust.

(b) With respect to an irrevocable trust registered or having its principal place of administration in another state that contains a spendthrift provision restraining both voluntary and involuntary transfers of a settlor's interest as a beneficiary of such trust, and if such a provision is valid in such state, the transfer for purposes of this section shall be deemed to have been made on the date (whether before, on or after [the effective date of this section]) the asset originally was transferred to such trust.

(c) If a trustee of a trust described in the foregoing paragraph (7)(b) proposes to change the principal place of administration and governing law of such trust to this state, but the trust would not conform to the requirements of paragraph (d) of subsection (1) as result of the settlor's nonconforming powers of appointment, then, upon the trustee's delivery to the qualified trustee of (1) an irrevocable written election to have this subsection apply to the trust and (2) the settlor's verified document described in subparagraph (d)2. of subsection (1) with respect to the settlor's transfer of the assets, the nonconforming powers of appointment shall be deemed modified to the extent necessary to conform to paragraph (d) of subsection (1).

(9) The courts of this state shall have exclusive jurisdiction over any action brought under this section.

(10) If a trust or an asset transfer to a trust is voided or set aside under this paragraph, the trust or asset transfer shall be voided or set aside only to the extent necessary to satisfy:

(a) The settlor's debt to the creditor or other person for whose benefit the trust or asset transfer is voided or set aside and

(b) Such other relief allowed by law and awarded by the court.

(11) If a trust or an asset transfer to a trust is voided or set aside under this paragraph and the court determines that the trustee did not act in bad faith in accepting or administering the asset that is the subject of the trust:

(a) Subject to any prior perfected security interest, the trustee has a first and paramount lien against the asset that is the subject of the trust in an amount equal to the entire cost properly incurred by the trustee in a defense of the action or proceeding to void or set aside the trust or asset transfer, including attorney fees;

(b) The trust or asset transfer that is set aside is subject to the proper fees, costs, preexisting rights, claims, and interest of the trustee and any predecessor trustee if the trustee and predecessor trustee did not act in bad faith; and

(c) Any beneficiary, including the settlor, may retain a distribution made by exercising a trust power or discretion vested in the trustee of the trust, if the power or discretion was properly exercised before the commencement of the action or proceeding to void or set aside the trust or asset transfer.

(12) If, in any action brought against a trustee of a trust that is the result of a transfer, a court takes any action whereby such court declines to apply the law of this state in determining the validity, construction, or administration of such trust, or the effect of a spendthrift provision thereof, such trustee shall immediately upon such court's action and without the further order of any court, cease in all respects to be trustee of such trust and a successor trustee thereupon shall succeed as trustee in accordance with the terms of the trust instrument or, if the trust instrument does not provide for a successor trustee and the trust otherwise would be without a trustee, upon the application of any beneficiary of such trust, the court in this state with jurisdiction over the trust shall appoint a successor trustee upon such terms and conditions as it determines to be consistent with the purposes of such trust and this statute. Upon the terminating trustee's ceasing to be trustee, the terminating trustee shall have no power or authority other than to convey the trust property to the successor trustee named in the trust instrument or appointed by the court with jurisdiction over this trust in accordance with this section.

(13) Except as otherwise provided in this section, this section also governs the construction, operation, and enforcement, outside of this state of all spendthrift trusts created in this state, except so far as prohibited by valid laws of other states. Unless the trust instrument declares expressly to the contrary, it shall be deemed to be made in the light of this chapter and all other acts relating to spendthrift provisions enacted in this state.