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ASSET PROTECTION PLANNING WITH TRUSTS

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ASSET PROTECTION PLANNING WITH TRUSTS

I. Introduction

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

II. Missouri Trust Code

The Missouri Uniform Trust Code ("MUTC") became effective on January 1, 2005 and applies to preexisting trusts.[1] Amendments to the MUTC went into effect August 2006.[2] The MUTC provides a detailed statutory framework covering most of the asset protection issues surrounding trusts. This law is a welcome addition and clarifies many issues that were unclear under prior law. Several articles take the position that the Uniform Trust Code reduces the asset protection benefits of trusts.[3] The authors' arguments are based on misinterpretations of the Uniform Trust Code and case law, and can safely be ignored. Two recent articles analyzed and dismissed these attacks on the Uniform Trust Code.[4]

III. Asset Protection For the Client's Beneficiaries (Third Party Trusts)

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

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[1] See Sections 456.11-1104 and 456.11-1106, RSMo 2000.

[2] The Technical Amendments take into account the 2004/2005 amendments to the Uniform Trust Code as well as other issues that have arisen since enactment of the MUTC. David M. English, *Missouri Uniform Trust Code*, St. Louis Estate Planning Council, December 2005. For the comments to the Technical Amendments, see Scot W. Boulton, Chapter 456 Missouri Revised Statutes Including the Missouri Uniform Trust Code With the 2006 Technical Corrections (the red book), published by the Missouri Bar Probate and Trust Committee.

[3] See Mark Merric and Steve J. Oshins, *How Will Asset Protection of Spendthrift Trusts Be Affected by the UTC?*, Estate Planning, October 2004; Mark Merric and Steve J. Oshins, *Effect of the UTC on the Asset Protection of Spendthrift Trusts*, Estate Planning, August 2004; Mark Merric and Steve J. Oshins, *UTC May Reduce the Asset Protection of Non-Self-Settled Trusts?*, Estate Planning, September 2004; Mark Merric, Carl Stevens and Jane Freeman, *The Uniform Trust Code: A Divorce Attorney's Dream*, Estate Planning, October-November 2004; Mark Merric and Douglas W. Stein, *A Threat to All SNTs*, Trusts & Estates, November 2004.

[4] Suzanne Brown Walsh, Richard E. Davis, Stanley C. Kent, and Alan Newman, *What Is the Status of Creditors Under the Uniform Trust Code*, Estate Planning, February 2005; Alan Newman, *Spendthrift And Discretionary Trusts: Alive And Well Under The Uniform Trust Code*, Real Property, Probate and Trust Journal, Vol. 40, No.3 (Fall 2005). Also see U.S. TRUST LAW EXPERTS RESPOND TO ATTACK ON THE UNIFORM TRUST CODE, available at http://www.nccusl.org/nccusl/utcresponse_feb04.htm.

A. Spendthrift Provision

The ability of creditors to reach an interest in a trust depends on the terms of the trust, most importantly, whether the trust contains a spendthrift provision. A spendthrift provision is language in the trust instrument providing that the interest of a beneficiary is held subject to a "spendthrift trust", or words of similar import.[5] A trust with a spendthrift provision is referred to herein as a "spendthrift trust".

1. Voluntary vs. Involuntary Restraints

In Missouri, a spendthrift provision is valid if it restrains either the voluntary or involuntary transfer (or both) of the beneficiary's interest.[6] In most states the spendthrift provision must restrain the voluntary and involuntary transfer of the beneficiary's interest.[7] Therefore in Missouri a grantor may provide that a beneficiary may assign, gift, sell, commute, encumber, or transfer the beneficiary's interest in the trust without limiting the asset protection benefits of the trust, as long as the involuntary transfer of the beneficiary's interest is prohibited. Consider the following spendthrift provision:

> No beneficiary shall have the power to assign, transfer, encumber or otherwise anticipate or dispose of any interest he or she may have in assets held in any trust estate governed by this Trust Agreement, either principal or income, and any such assignment, transfer, encumbrance, or other attempted anticipation or disposition thereof shall be void and of no effect.
>
> No interest or right of any beneficiary in and to any assets held in any such trust estate hereunder, either principal or income, shall be subject to garnishment, attachment or any other legal or equitable process based on or otherwise relating to any debt or liability of such beneficiary.

The first paragraph prohibits the beneficiary from transferring his interest in the trust or encumbering the beneficiary's interest by use of the trust as collateral for a debt. The second paragraph prohibits a creditor from attaching (i.e. an involuntary transfer) the beneficiary's interest in the trust. Under most circumstances the grantor will want to prohibit both the voluntary and involuntary transfer of the beneficiary's interest. If the voluntary transfer is not prohibited, then the terms of the trust are jeopardized in that the beneficiary may sell his right to future distributions, and the Trustee may commute the beneficiary's interest.[8] This may be contrary to the grantor's intent in limiting the beneficiary's access to the trust assets under the distribution standards of the trust. However, there are a few estate planning techniques that can only be implemented if the beneficiary can assign his interest in the trust.[9] If you are drafting a grantor retained annuity trust,

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[5] Section 456.5-502.2, RSMo 2000.
[6] Section 456.5-502.1, RSMo 2000.
[7] See § 502 of the Uniform Trust Code.
[8] See Peter J. Wiedenbeck, *Missouri's Repeal of the Claflin Doctrine—New View of the Policy Against Perpetuities*, 50 Mo. L. Rev. 805 (1985) ("Absent spendthrift restraint, a beneficiary can always accelerate or anticipate his interest by sale, notwithstanding the settlor's purpose to postpone enjoyment or withhold management").
[9] See David A. Handler and Steven J. Oshins, *The GRAT Remainder Sale*, Trusts & Estates, December 2002; Richard A. Oshins and Arthur D. Sederbaum, *Generation-Skipping and the GRAT: Sale or Gift of the Remainder*, Estate Planning, June 2003; Roger D. Silk and James W. Lintott, *Selling CRT Lead Interests*, Trusts & Estates (August 2005); David R.

charitable lead trust, or charitable remainder trust in which you would like to preserve the beneficiary's ability to use one of these techniques, while protecting the trust from creditor attacks and limiting the beneficiary's ability to voluntarily transfer his or her interest, then you may wish to consider the following language:

> No beneficiary of any trust may transfer, assign, anticipate, pledge or otherwise alienate or encumber his or her interest in the income or principal of such trust. Despite the preceding sentence, if there is any Trustee of such trust who is not such beneficiary, such beneficiary may transfer or assign his or her interest in the income or principal of such trust to or for the benefit of such one or more persons other than such individual, such individual's estate, such individual's creditors or the creditors of such individual's estate but only with the written consent of each such Trustee. Neither the income nor the principal of any trust shall be subject to any alimony or maintenance claims or to any legal or equitable claims of any creditor of any beneficiary.[10]

A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision.[11] However, under the Third Restatement of Trusts, a beneficiary's attempted transfer has the effect of an authorization to the trustee to distribute to the purported transferee whatever distributions the beneficiary is entitled to receive and has purported to assign, but the authorization is revocable at any time.[12] Under this approach, a spendthrift restraint merely prevents the beneficiary from making an irrevocable transfer of his or her beneficial interest. It is unclear whether Missouri courts will follow this approach.

2. Powers of Appointment and Disclaimers

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

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

B. Creditor Remedies if No Spendthrift Provision

1. Mandatory Interests

With regard to trusts without a spendthrift provision, Missouri law now distinguishes between mandatory and discretionary interests. A mandatory distribution is a distribution of income or

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Hodgman, Scott Bieber and Michael J. Huft, *IRS Rulings Provide Guidance On Early Termination of CRUTs*, Estate Planning (January 2003).

[10] Roy M. Adams and Charles A. Redd, *Protecting Beneficiaries From Themselves*, Cannon Financial Institute 2004 Estate Planning Teleconference Series, September 8, 2004.

[11] Section 456.5-502.3, RSMo 2000.

[12] Restatement of the Law, Third, Trusts, Section 58, Cmt. d(1).

principal the trustee is required to make under the terms of the trust, including a distribution upon termination of the trust.[13] A mandatory distribution does not include a distribution subject to the exercise of the trustee's discretion even if (1) the discretion is expressed in the form of a standard of distribution, or (2) the terms of the trust authorizing a distribution couple language of discretion with language of direction.[14] Annuity (stated dollar amount) and unitrust (percentage of trust assets) interests are mandatory distributions. An all income requirement and an outright distribution upon termination of a trust -- whether upon another beneficiary's death or any other triggering event -- are also mandatory distributions.

Note that notwithstanding the amount of discretion conferred upon a Trustee, if a distribution standard is subject to an ascertainable standard, then the trustee must exercise such power in good faith.[15] If there is no ascertainable standard, then under the common law standard, a court must not interfere unless the trustee, in exercising his power, "willfully abuses his discretion or acts arbitrarily, fraudulently, dishonestly or with an improper motive".[16] An ascertainable standard is defined as a standard relating to an individual's health, education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or Section 2541(c)(1) of the Internal Revenue Code.[17]

If a trust has no spendthrift provision and the beneficiary is entitled to mandatory distributions, then an assignee or judgment creditor of the beneficiary may, without court order, reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means.[18] However, the court may limit a creditor's award to such relief, as is appropriate under the circumstances.[19] A creditor may not reach the underlying assets of the trust, as the beneficiary has no right to these assets. Similar to the charging order remedy with regard to a limited partnership or limited liability company, a creditor of a beneficiary may attach the right to future distributions from the trust, but may not attach the underlying assets of the trust. However, a creditor may reach a mandatory distribution of income or principal, if not made within a reasonable time after the required distribution date.[20] After the interest of a beneficiary has been attached, if the Trustee decides to make a distribution to, or for the benefit of, the beneficiary, then the distribution must be made directly to the creditor, rather than to the beneficiary.

If the beneficiary is not a current permissible distributee, then the beneficiary's interest may be too remote or contingent for the creditor to reach. A creditor may also reach the beneficiary's interest "by other means".[21] This may mean that the creditor can force a judicial sale of the beneficiary's interest in the trust.[22] If a buyer can be found, a sale of the beneficiary's interest may allow the creditor to reduce the judgment to cash much faster than waiting for distributions to be made. Typically no discretionary distributions will be made after the beneficiary's interest is attached.

[13] Section 456.5-506.1, RSMo 2000.
[14] Section 456.5-506.1, RSMo 2000.
[15] Section 456.8-814.1, RSMo 2000.
[16] Hammerstein v. Estate of Knoll, 631 S.W.2d 858 (Mo. Ct. App. 1981).
[17] Section 456.1-103(2).
[18] Section 456.5-501, RSMo 2000.
[19] Section 456.5-501, RSMo 2000.
[20] Section 456.5-506, RSMo 2000.
[21] Section 456.5-501, RSMo 2000.
[22] See Comment to § 501 of the 2003 version of the Uniform Trust Code.

2. Discretionary Interests

A beneficiary's interest is "subject to the trustee's discretion" if it is not a "mandatory distribution".[23] Distributions described in terms of the beneficiary's best interests, happiness, health, support, maintenance, education, or welfare are subject to a trustee's discretion. If a trust has no spendthrift provision and distributions are subject to the trustee's discretion, then the following rule applies:

> A beneficiary's interest in a trust that is subject to the trustee's discretion does not constitute an interest in property even if the discretion is expressed in the form of a standard of distribution or the beneficiary is then serving as a trustee or co-trustee. A creditor or other claimant may not attach present or future distributions from such an interest, obtain an order from a court ordering the judicial sale of the interest or order compelling the trustee to make distributions, or reach the interest by any other means, even if the trustee has abused the discretion.[24]

The Missouri Comment explaining this change states that "[t]his section was also altered to clearly state present Missouri law that discretionary interests in trusts are not property for any purposes, including bankruptcy, dissolution of marriage, Medicaid claims, or any other claims of creditors or others." This is a very powerful anti-creditor rule. This section appears to be subject to the same exceptions (explained below) that apply to spendthrift trusts[25], and may be subject to the more specific rule for self-settled trusts (also explained below). The only difference between trusts with and without spendthrift protection is that mandatory distributions from a spendthrift trust cannot be attached.

C. Creditor Remedies Against a Spendthrift Trust

1. General Rule

If a trust contains a valid spendthrift restraint on involuntary transfers, then a creditor "may not reach the interest or a distribution by the Trustee before its receipt by the beneficiary".[26] This means that a creditor cannot force a Trustee to make distributions directly to the creditor, and the creditor cannot force a judicial sale of the beneficiary's interest in the trust. A creditor may only attempt to collect directly from the beneficiary after payment is made. To avoid the reach of a creditor, a Trustee may purchase assets in the name of the trust and allow the beneficiary the use of the assets, or spend the trust assets for the benefit of the beneficiary, as opposed to making the distribution directly to the beneficiary. A creditor cannot compel a trustee to make a distribution

[23] Section 456.5-504.4, RSMo 2000.
[24] Section 456.5-504.1 RSMo 2000.
[25] The statute granting spendthrift protection provides an express exception for exception creditors. Section 456.5-502.3, RSMo 2000. Although the discretionary interests section does not provide such an express exception, the exception creditor statute is worded broadly enough that it should overrule the protection provided a discretionary interest. Section 456.5-503.2, RSMo 2000 ("Even if a trust contains a spendthrift provision" an exception creditor may attach present or future trust income).
[26] Section 456.5-502.3, RSMo 2000.

that is subject to the Trustee's discretion.[27] However, a creditor may reach a mandatory distribution of income or principal, if not made within a reasonable time after the required distribution date.[28]

2. Exceptions to Spendthrift Protection

Support or Maintenance Obligations. A beneficiary's child, spouse or former spouse who has a judgment against the beneficiary for support or maintenance, may attach the beneficiary's rights to present or future trust income.[29] However, this section does not grant a spouse or child any rights to attach a beneficiary's interest in distributions of principal. The child or spouse may not compel a distribution that is subject to the Trustee's discretion.[30]

Services For Protection of Beneficiary. A judgment creditor who has provided services for the protection of a beneficiary's interest in the trust may also attach the beneficiary's rights to present or future trust income.[31] An attorney's services for a beneficiary may fall within this exception.

Other State and Federal Laws (and Tax Liens). A spendthrift provision is unenforceable against a claim of the state of Missouri or the United States to the extent a statute of Missouri or federal law so provides.[32]

There is a separate body of case law that describes when a trust is subject to a federal tax lien (or a lien related to a federal crime). Generally, a spendthrift provision is not enough to prevent the attachment of a federal lien. A trust must provide for completely discretionary distributions to avoid attachment of a federal lien.[33] In other words, the beneficiary must have no rights to force a distribution. Distribution standards based on an ascertainable standard related to health, support, maintenance or education are not completely discretionary distributions. The following is an example of a completely discretionary distribution standard.

> The Trustee, in the Trustee's sole and absolute discretion, may distribute so much, none or all of the income and principal of the trust to, or for the benefit of, the beneficiary.

One should avoid planning against attachment of a federal lien, as the attorney and client may violate federal criminal statutes to do so.[34]

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[27] Section 456.5-504.1, RSMo 2000.
[28] Section 456.5-506, RSMo 2000.
[29] Section 456.5-503.2, RSMo 2000.
[30] Section 456.5-504.1, RSMo 2000.
[31] Section 456.5-503.2, RSMo 2000.
[32] Section 456.5-503.3, RSMo 2000.
[33] See *United States v. O'Shaughnessy*, 517 N.W.2d 574 (Minn. 1994); IRS CCA 200036045. The United States may attach future distributions a Trustee decides to make in the exercise of its discretion. *U.S. v. Cohn*, 855 F. Supp. 572 (D. Conn. 1994).
[34] William K. Norman and Howard S. Fisher, *Domestic Based Asset Protection Strategies: Realities Explained and Fantasies Exposed*, The Southern California Tax & Estate Planning Forum 2005.

3. Powers of Withdrawal

To the extent a beneficiary has a power of withdrawal, the beneficiary is treated in the same manner as the grantor of a revocable trust and the assets of the trust will be subject to creditor claims.[35] A "power of withdrawal" is a presently exercisable power of a beneficiary to withdraw assets from the trust without the consent of the trustee or any other person.[36] Upon the lapse, release, or waiver of a right of withdrawal, the beneficiary is treated as the grantor of the trust only to the extent the value of the property affected by the right of withdrawal exceeds the greater of the amount specified in sections 2041(b)(2) (estate tax lapse of five and five power), 2514(e) (gift tax lapse of five and five power) or 2503(b) (annual exclusion) of the IRC.[37]

4. Testamentary Powers of Appointment

The MUTC does not explicitly address the creditor protection effects of a testamentary power of appointment. It does not appear that the term "power of withdrawal" --the power of a beneficiary to "withdraw" assets -- includes a testamentary general power of appointment. Clearly a testamentary limited power of appointment does not fall within this definition, as the holder of a limited power of appointment may not appoint the assets for his/her own benefit.[38] Testamentary powers of appointment cannot cause a loss of creditor protection during the power holder's lifetime, as they are not "presently" exercisable during lifetime. However, a creditor could argue that the death of a beneficiary holding a testamentary general power of appointment may cause the trust assets subject to the power to be available to claims against the deceased beneficiary's estate. At the moment of death, a testamentary general power of appointment becomes exercisable. If the exercise or non-exercise of the power is considered a lapse, release or waiver of the power, then the power holder would be treated in the same manner as the grantor of a revocable trust (to the extent the value of the property affected by the lapse/release/waiver exceeds the greater of the amount specified in Sections 2041(b)(2), 2514(e) or 2503(b) of the IRC). If the deceased power holder's probate estate is insufficient to satisfy claims against the decedent's estate, then the assets of the irrevocable trust that were subject to the testamentary general power of appointment may be available for the payment of such claims.[39]

Under the Restatement of Donative Transfers an unexercised testamentary general power of appointment is not subject to claims against the deceased power holder's estate,[40] but assets covered by an exercised testamentary general power of appointment can be subjected to such claims.[41] The more recent Third Restatement of Trusts takes the position that upon the power holder's death, assets subject to a testamentary general power of appointment may be reached for payment of

[35] Section 456.5-505.5(1), RSMo 2000.
[36] Section 456.1-103(16), RSMo 2000.
[37] Section 456.5-505.5(2), RSMo 2000. It is unclear whether an election to split gifts will apply under this section, but one commentator assumes that it does not. Alan Newman, *Spendthrift And Discretionary Trusts: Alive And Well Under The Uniform Trust Code*, Real Property, Probate and Trust Journal, Vol. 40, No.3 (Fall 2005). This statute should be amended to make clear that gift splitting is to be taken into account so there are no negative asset protection consequences to a crummey withdrawal right that takes advantage of a donor and donor's spouse's annual exclusions.
[38] Also see Restatement of the Law, Second, Property (Donative Transfers) Section 13.1.
[39] Section 461.300, RSMo 2000.
[40] Restatement of the Law, Second, Property (Donative Transfers) Section 13.2.
[41] Restatement of the Law, Second, Property (Donative Transfers) Section 13.4.

claims against the power holder's estate, whether the power was actually exercised or not.[42] A court may look to these rules for guidance, as the common law of trusts applies to the extent the MUTC does not provide a different rule.[43]

5. Beneficiary as Trustee

No provision of the MUTC allows a creditor to attack a third party trust solely on the basis of the beneficiary serving as Trustee. The definition of power of withdrawal was amended by the 2006 technical amendments to make clear that the definition only applies to a beneficiary, not a trustee. In addition, as explained above, a creditor has no avenues of attack over a discretionary interest in a trust, "even if … the beneficiary is then serving as a trustee or co-trustee". The 2004 Amendments to the Uniform Trust Code take a different approach, providing protection to a beneficiary/Trustee only if the distribution standard is limited by an ascertainable standard.[44] Due to the states' different

[42] Restatement of the Law, Third, Trusts Section 56, cmt b.
[43] Section 456.1-106, RSMo 2000.
[44] Under the 2004 Amendments, the following statement was added: "If the trustee's or cotrustee's discretion to make distributions for the trustee's or cotrustee'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 or cotrustee." Uniform Trust Code section 504(e). The comment to the 2004 amendment to section 504 is as follows:

> Trusts are frequently drafted in which a trustee is also a beneficiary. A common example is what is often referred to as a bypass trust, under which the settlor's spouse will frequently be named as both trustee and beneficiary. An amount equal to the exemption from federal estate tax will be placed in the bypass trust, and the trustee, who will often be the settlor's spouse, will be given discretion to make distributions to the beneficiaries, a class which will usually include the spouse/trustee. To prevent the inclusion of the trust in the spouse-trustee's gross estate, the spouse's discretion to make distributions for the spouse's own benefit will be limited by an ascertainable standard relating to health, education, maintenance, or support.
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> The UTC, as previously drafted, did not specifically address the issue of whether a creditor of a beneficiary may reach the beneficial interest of a beneficiary who is also a trustee. However, Restatement (Third) of Trusts §60, comment g, which was approved by the American law Institute in 1999, provides that the beneficial interest of a beneficiary/trustee may be reached by the beneficiary/trustee's creditors. Because the UTC is supplemented by the common law (see UTC Section 106), this Restatement rule might also apply in states enacting the UTC. The drafting committee has concluded that adoption of the Restatement rule would unduly disrupt standard estate planning and should be limited. Consequently, Section 504 is amended to provide that the provisions of this section, which generally prohibit a creditor of a beneficiary from reaching a beneficiary's discretionary interest, apply even if the beneficiary is also a trustee or cotrustee. The beneficiary-trustee is protected from creditor claims to the extent the beneficiary-trustee's discretion is protected by an ascertainable standard as defined in the relevant Internal Revenue Code sections. The result is that the beneficiary's trustee's interest is protected to the extent it is also exempt from federal estate tax. The amendment thereby achieves its main purpose, which is to protect the trustee-beneficiary of a bypass trust from creditor claims.
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> The protection conferred by this subsection, however, is no greater than if the beneficiary had not been named trustee. If an exception creditor can reach the beneficiary's interest under some other provision, the interest is not insulated from creditor claims by the fact the beneficiary is or becomes a trustee.
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> In addition, the definition of "power of withdrawal" in Section 103 is amended to clarify that a power of withdrawal does not include a power exercisable by the trustee that is limited by an ascertainable standard. The purpose of this amendment is to preclude a claim that the power of a trustee-beneficiary to make discretionary distributions for the trustee-beneficiary's own benefit results in an enforceable claim of the trustee-beneficiary's creditors to reach the trustee-beneficiary's interest as provided in Section 505(b). Similar to the amendment to Section 504, the amendment to "power of withdrawal" is being made because of concerns that Restatement (Third)

approaches to this issue, it is important to ensure trusts are governed by Missouri law if a beneficiary may serve as trustee.

6. Drafting and Administration Suggestions for Third Party Spendthrift Trusts

Consider the following when drafting or administering third-party spendthrift trusts:

Multiple Current Beneficiaries. Allow the Trustee to make discretionary distributions to additional beneficiaries, such as the primary beneficiary's descendants.

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

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

Avoid Rights of Withdrawal and Lifetime General Powers of Appointment. Many trusts allow the beneficiary to withdraw assets at a certain age or ages. A right of withdrawal causes a loss of creditor protection, as the beneficiary will be treated in the same manner as the grantor of a revocable trust to the extent of the right of withdrawal. Other trusts provide that the trust will terminate at a certain age and distribute outright to the beneficiary. For asset protection planning it is best to provide that the trust will last indefinitely, not only for the lifetime of the current beneficiary, but for the lifetimes of all of the future contingent beneficiaries.[45]

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

Avoid Testamentary General Powers of Appointment. A testamentary general power of appointment may cause the trust assets to be subject to claims against the beneficiary's estate upon the beneficiary's death. It is best to avoid general powers of appointment, unless necessary for estate tax reasons.[46]

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of Trusts Section 60, comment g, otherwise might allow a beneficiary-trustee's creditors to reach the trustee's beneficial interest.

The Code does not specifically address the extent to which a creditor of a trustee/beneficiary may reach a beneficial interest of a beneficiary/trustee that is not limited by an ascertainable standard.

For the definition of "ascertainable standard," see Section 103(2).

[45] See Section 456.025, RSMo 2000.

[46] It is common practice to give a beneficiary a testamentary general power of appointment over assets that are not exempt from the generation-skipping transfer ("GST") tax, to cause the assets to be subject to estate tax, rather than GST tax, at the beneficiary's death. This allows the deceased beneficiary to apply his unified credit to the value of the assets, and allows allocation of his GST exemption to the trust.

Governing Law Clause. As explained in more detail in the Mulit State Conflicts of Law section below, a state governing law clause should be placed in all trusts to provide, to the extent possible, that Missouri law will apply. This is especially important if the beneficiary will serve as a trustee, as the Restatement (Third) of Trusts and the Uniform Trust Code take different approaches to this issue. If there is no governing law clause, whether the trust assets can be reached by the beneficiary's creditors will usually be determined by the law of the state in which the trust is being administered. Often upon the death of the grantor of a revocable trust, a separate trust for a child will be administered in the state in which the child then lives, which is often different from the state in which the parent lived. If upheld, a governing law clause will alleviate the problem of another state's laws becoming applicable to the creditor protection aspects of the trust.

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

Trust Protector. A trust protector is an extremely valuable tool for providing flexibility. A trust protector is an individual or entity appointed with the authority to take certain actions under special circumstances. A trust protector may have the ability to amend the terms of the trust in response to a change in circumstances (such as creditor problems) or a change in the law.

Avoid Distributions Directly to Beneficiary. A Trustee should take steps to avoid a creditor collecting directly from the beneficiary after a distribution is made from a spendthrift trust. To avoid the reach of a creditor, a Trustee may purchase assets in the name of the trust and allow the beneficiary the use of the assets, or spend the trust assets for the benefit of the beneficiary, as opposed to making the distribution directly to the beneficiary. The drafting attorney should consider altering the applicability of the prudent investor rule[47] if it is expected that the trust will purchase personal use, or other noninvestment assets, in order to protect such assets from current or potential creditors.

D. Other Specific Creditor Rules

1. Bankruptcy

A "restriction on the transfer of a beneficial interest . . . in a trust that is enforceable under applicable non-bankruptcy law" is enforceable in bankruptcy.[48] The beneficiary's interest in a spendthrift trust will not become part of the bankruptcy estate. A discretionary interest in a trust without a spendthrift clause may also be excluded from the bankruptcy estate.[49]

[47] See section 469.901, RSMo 2000.
[48] See 11 U.S.C. § 541(c)(2).
[49] In re Britton, 300 B.R. 155 (Bankr. D. Conn. 2003); In re Knight, 164 B.R. 372 (Bankr. S.D. Fla. 1994); In re Pechenec, 59 B.R. 899 Bankr. (D. Kan. 1986); but see In re Katz, 203 B.R. 227 (Bankr. E.D. Pa. 1996).

2. Special Needs Trusts

In order to prevent trust assets from being considered for purposes of Medicaid and SSI, the trust (a "special needs trust") must provide that distributions may only be used to supplement, but not supplant, government benefits.[50]

If the beneficiary will contribute his own assets to the trust, then the trust instrument must provide that the government will be repaid at the beneficiary's death. These trusts must be drafted to comply with 42 U.S.C. section 1396p(d)(4).

If the trust will be funded with assets from a third party (i.e. the beneficiary will not contribute his own assets to the trust), then a properly drafted irrevocable trust is not required to repay the government at the beneficiary's death (sometimes referred to as a third party special needs trust).

The MUTC makes no changes to special needs trusts.[51]

IV. Asset Protection For the Client (Self Settled Trusts)

A. Generally

The property of a revocable trust is subject to claims of the grantor's creditors, whether or not the trust contains a spendthrift clause.[52] The general rule for irrevocable trusts in most states is that if a trust grantor (someone who has contributed assets to the trust) is a beneficiary, then a creditor can reach the maximum amount that can be distributed to or for the grantor's benefit.[53] However, nine states, including Missouri, have altered this rule.[54] A self-settled irrevocable spendthrift trust created to meet the statutory requirements of one of these nine states is often referred to as a domestic asset protection trust ("DAPT"). The relevant Missouri statute provides that if certain requirements are met, then the third party spendthrift trust rules, as explained above, will apply.[55] If the grantor is a beneficiary and these requirements are not met, then a creditor "may reach the maximum amount that can be distributed to or for the grantor's benefit."[56] Common self-settled

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[50] See Tidrow v. Missouri State Division of Family Services, 688 S.W.2d 9 (Mo.Ct. App. 1985); Couch v. Missouri State Division of Family Services, 795 S.W.2d 91 (Mo. Ct. App. 1990); Missouri Division of Family Services v. Wilson, 849 S.W.2d 104, (Mo. Ct. App. 1993); Masterson v. Department of Social Services, 969 S.W.2d 746 (1998).

[51] See Alan Newman, *Spendthrift And Discretionary Trusts: Alive And Well Under The Uniform Trust Code*, Real Property, Probate and Trust Journal, Vol. 40, No.3 (Fall 2005).

[52] Section 456.6-505.1, RSMo 2000.

[53] Uniform Trust Code § 505(a)(2).

[54] The primary eight states in the order they adopted such legislation are as follows: Missouri (1986) (reenacted with minor modifications in 2005) (Mo. Rev. Stat. § 456.5-505.3), Alaska (1997) (Alaska Stat. § 34.40.110), Delaware (1997) (Del. Code Ann. tit. 12, § 3571), Nevada (1999) (Nev. Rev. Stat. § 166.040), Rhode Island (1999) (R.I. Gen. Laws § 18-9.2-2), Utah (2004) (Utah Code Ann. § 25-6-14), Oklahoma (2004) (Oklahoma Stat. § 31-10), and South Dakota (2005) (S.D. Codified Laws § 55-16-12). The 1863 Colorado law (Colo. Rev. Stat. § 38-10-111) has been questioned by the Colorado Supreme Court. In re Cohen, 8 P.3d 429 (Colo. 1999); but see Connolly v. Baum, 22 F.3d 1014 (10th Cir. 1994) (holding that assets of a self-settled trust were immune from future creditor claims).

[55] Section 456.5-505.3, RSMo 2000.

[56] Section 456.5-505.2, RSMo 2000. The rights of a creditor under this provision are greater than those of a creditor of a non-spendthrift third party trust that may only "reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means". The creditor of a self-settled trust may reach as

irrevocable trusts include charitable remainder trusts, grantor retained annuity trusts, and qualified personal residence trusts.

B. Statutory Requirements

With regard to self-settled trusts, a spendthrift provision is effective except:[57]

(1) Where the conveyance of assets to the trust was fraudulent as to creditors pursuant to the provisions of chapter 428, RSMo, or

(2) To the extent of the settlor's beneficial interest in the trust assets, if at the time the trust became irrevocable:

(a) The settlor was the sole beneficiary of either the income or principal of the trust or retained the power to amend the trust; or

(b) The settlor was one of a class of beneficiaries and retained a right to receive a specific portion of the income or principal of the trust that was determinable solely from the provisions of the trust instrument.

It is not entirely clear what it means for the settlor to be the sole beneficiary of either the income or principal of the trust. The most conservative approach is to have additional current beneficiaries, as well as remainder beneficiaries.

Some commentators express concern that a settlor's testamentary power of appointment may be considered the "power to amend the trust." However, the MUTC uses the term power of appointment in other sections, so this provides some assurance that a power to amend the trust means exactly what it says, and does not include a testamentary power of appointment.[58]

It is also not clear when a settlor has "retained a right to receive a specific portion of the income or principal of the trust that was determinable solely from the provisions of the trust instrument". The Missouri comment to section 456.5-505 refers to the requirement that the settlor must be "entitled to trust income or principal in the trustee's discretion", and states that a settlor's interest in a "wholly discretionary" irrevocable trust is clearly protected. The comment also states that the original purpose of this statute was "to allow the settlor of an irrevocable trust to retain an interest in an irrevocable trust that would not result in the inclusion of the assets of that trust in the grantor's gross estate for federal estate tax purposes on the grantor's death." The comment cites two tax cases both of which contain completely discretionary distribution standards.[59] The following completely discretionary distribution standard clearly satisfies this requirement:

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much of the underlying assets of the trust that could have been distributed to the beneficiary, which will be the entire trust under most discretionary standards. See Uniform Trust code § 505 cmt (amended 2005).

[57] Section 456.5-505.3, RSMo 2000.

[58] Section 456.3-302, RSMo 2000.

[59] Estate of Gizella Wells, 42 TCM 1305 (1981); Mary M. and Edson S. Outwin, 76 TC 153 (1981).

> The Trustee, in the Trustee's sole and absolute discretion, may distribute so much, none or all of the income and principal of the trust to, or for the benefit of, the beneficiary.

However, it is unclear whether any distribution that is subject to the trustee's discretion, such as an ascertainable standard, would qualify. Consider the following typical ascertainable standard distribution provision:

> The Trustee may distribute the net income and principal to provide for the health, education, support, and maintenance of the beneficiary.

The beneficiary does not have the right to receive a specific portion of the trust that is determinable solely from the provisions of the trust instrument. The trustee can only determine how much to distribute after considering the beneficiary's health, education, support, and maintenance needs – which are not apparent from the provisions of the trust. Nevertheless, this does not appear to be the type of distribution standard contemplated by the drafters of the original legislation.[60] The conservative approach would be to use a completely discretionary standard for the settlor's interest, to ensure the trust meets this statutory requirement.

If the settlor's interest is completely discretionary, then there is a risk that a court may not apply the statute if the settlor/beneficiary is the sole Trustee, due to the settlor/beneficiary/trustee's near unlimited control of distributions.[61]

The comments to the MUTC acknowledge that several cases brought into question whether self-settled trusts could actually be used for asset protection in Missouri.[62] The comments clarify that the incorporation and reenactment of Missouri's DAPT law was intended to overrule any holding that would render the creditor protection aspects of the statute meaningless.

As noted above, Missouri Revised Statute Section 456.5-504.1 provides that a creditor has no rights over a beneficiary's interest that is subject to the trustee's discretion. This statute does not have an exception for self-settled trusts. If 456.5-504.1 applies to self-settled trusts, then 456.5-505.3 (the Missouri DAPT statute) would be meaningless. The Missouri legislature should clarify this issue. Until we have further guidance the conservator approach will be to proceed on the assumption that 456.5-504.1 does not apply to self-settled trusts.

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[60] The original statute was RSMo Section 456.080.3 and was nearly identical to Section 456.5-505.

[61] Also see James G. Blase, *The Missouri Asset Protection Trust*, Journal of the Missouri Bar, March-April 2005. No state's DAPT law allows the grantor/beneficiary to serve as sole Trustee, although some, such as Alaska, allow the grantor to serve as a co-trustee with limited authority.

[62] See Markmueller v. Case, 51 F.3d 775 (8th Cir. 1995) ("[w]e note that the common-law rule against self-settled spendthrift trusts is apparently still valid in Missouri to the extent it permits creditors to reach a beneficiary's income interest. Furthermore, spendthrift provisions will only be upheld if they contravene 'neither a statute nor public policy'. The public policy of Missouri is that one may not settle their own spendthrift trust and avoid their creditors.") ; In re Enfield, 133 B.R. 515 (Bankr. W.D. Mo. 1991) (the Missouri DAPT statute "simply codifies the traditional prohibition against extending spendthrift protection to a trust beneficiary who is also the settlor of the trust. Certainly, it is inequitable to allow an individual to put his assets beyond reach of creditors through the simple expedient of creating a spendthrift trust."); Citizens Nat. Bank v. Cook, 857 S.W.2d 502 (Mo. Ct. App. W.D. 1993) ("The apparent reason for [the Missouri DAPT statute] was to allow a spendthrift provision to protect the interest of a vested remainderman, while permitting creditors to reach a grantor's income interest ...").

C. Tax Consequences

In order to avoid a completed gift upon the funding of a Missouri DAPT, the grantor will often retain a testamentary limited power of appointment.[63] This also gives the grantor the added flexibility of rewriting the terms of the trust, and changing the beneficiaries, upon his death. If the grantor retains a limited power of appointment, the assets of the trust will be subject to estate tax upon the grantor's death.[64] If the grantor does not retain a power of appointment, it is unclear whether the grantor's retained right to receive discretionary distributions and the possibility of a creditor reaching the trust assets due to a conflict of laws (as explained below), will cause an incomplete gift and the trust assets to be subject to estate tax at the grantor's death.[65] The tax apportionment clauses in revocable trusts and DAPTs should be coordinated, and in many cases the DAPT should provide that upon the grantor's death the Trustee will reimburse the personal representative for the portion of the grantor's estate tax bill that is attributable to the DAPT assets.

A DAPT will be a grantor trust for income tax purposes, meaning that the grantor will continue to report the income, deductions and credits of the trust as if the grantor owned the assets outright.[66] Before creating a DAPT, the grantor should be advised that he will have no guarantee that the Trustee will make a distribution to cover his tax bill and may have to pay such taxes out of his other assets. If the grantor does not want to be taxed on the trust income, the trust may be drafted to provide that all distributions are subject to the consent of an adverse party (another current beneficiary or a vested remainder beneficiary).[67]

D. Multi-State Conflicts of Law

1. Missouri DAPTs Have Benefits for Missouri Residents

Several state acts provide more detailed statutes for self-settled trusts than Missouri. Some commentators feel that Missouri's self-settled trust statute is not up to par with other states such as Delaware and Alaska.[68] However, for Missouri residents, there are advantages to using Missouri's DAPT statute. For example, an out-of-state Trustee is not required for a Missouri trust. Invoking another state's DAPT law will require a Missouri resident to transfer trust assets to an out-of-state Trustee.[69] Most importantly, keeping all trust assets in Missouri, using a Missouri Trustee, and taking advantage of Missouri law, will make it unlikely that an out of state court will find their law applicable to the Missouri trust.

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[63] See Treas. Reg. § 25.2511-2(b). However, distributions made to beneficiaries other than the grantor will be completed gifts.
[64] IRC §§ 2036 & 2038.
[65] See Richard W. Nenno, *Planning with Domestic Asset Protection Trusts: Part I*, Real Property, Probate and Trust Journal, Summer 2005.
[66] IRC § 677.
[67] IRC § 677(a).
[68] See Richard W. Nenno, *Planning with Domestic Asset Protection Trusts: Part I*, Real Property, Probate and Trust Journal, Summer 2005 ("Although he or she also might be able to create this type of trust in Oklahoma, Missouri, or Colorado . . . the statutes in question are either flawed, not fully developed, or both."); John K. Eason, *Trust Law in the 21st Century: Policy, Logic, and Persuasion in the Evolving Realm of Trust Asset Protec*tion, 27 Cardozo L. Rev. 2621 (April, 2006) ("Missouri has yet to truly join the DAPT trend via the adoption of detailed legislation stating the requirements for self-settled trust protections in the nature of the local, business-enhancing models seen in Alaska, Delaware, Rhode Island, Nevada, and Utah.").
[69] See § 3570(9) of the Delaware Qualified Dispositions in Trust Act.

2. Risk That Non-DAPT State Will Obtain Jurisdiction

It is unclear whether a state that does not allow DAPTs will apply the DAPT law of the state designated in the trust. Two bankruptcy cases have applied the law of the forum state, as opposed to the law selected by the grantor in the trust instrument, in order to avoid finding that "applicable non-bankruptcy law" exempted off-shore self-settled trusts from the bankruptcy estate.[70] However, it would be difficult for a court to find another state's law applicable to a Missouri resident that creates a Missouri DAPT consisting of assets located in Missouri with a Missouri Trustee.[71] Other than in a bankruptcy proceeding (as Bankruptcy courts have national jurisdiction), it would be difficult for a non-Missouri court to obtain in rem jurisdiction over trust assets or personal jurisdiction over the Trustee, if the Trustee and all trust assets are located in Missouri. One should avoid naming an individual Trustee who resides in a state that does not recognize the validity of DAPTs, or a corporate Trustee that does business in such a state.

3. Missouri's Choice of Law Rule

Missouri's choice of law statute provides that the "meaning and effect" of the terms of a trust are determined by "the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue".[72] Presumably, whether the interest of a grantor/beneficiary can be reached by creditors is a question of the legal "effect" of the terms of the trust, which would be covered by Missouri's choice of law statute. Therefore, if a controversy is litigated in a Missouri court and the trust provides that the meaning and effect of its terms are to be governed by Missouri law, then this will be sufficient to take advantage of Missouri's self-settled trust statute (whether the grantor is a Missouri resident or otherwise), unless a court finds that to do so would be contrary to the strong public policy of the state with the most significant relationship to the trust. No cases have found, in this context, that taking advantage of a DAPT statute is contrary to the public policy of another state.[73]

Fixing the state in which a creditor claim will be litigated would have great value in this context. However, forum selection clauses are only valid if agreed upon by the parties to the litigation.[74] If a forum selection clause is placed in a trust agreement, then only the grantor and trustee will be parties to the agreement, and it will not be binding upon a creditor of the beneficiary.[75]

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[70] *In re Portnoy*, 201 B.R. 685 (Bankr. S.D.N.Y. 1996); *In re Brooks*, 217 B.R. 98 (D. Conn. Bkrpt. 1998); Gideon Rothschild, Daniel S. Rubin and Jonathan G. Blattmachr, *Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch?*, Journal of Bankruptcy Law & Practice (Vol. 9, No. 1).

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

[72] Section 456.1-107, RSMo 2000.

[73] See Richard W. Nenno, *Planning with Domestic Asset Protection Trusts: Part I*, Real Property, Probate and Trust Journal, Summer 2005, p. 303-304.

[74] See High Life Sales Company v. Brown-Forman Corporation, 823 S.W.2d 493 (Mo. 1992); Whelan Security Company v. R. Andrew Allen, 26 S.W.3d 592 (Mo. Ct. App. 2000).

[75] See Beaubien v. Cambridge, 652 So. 2d 936 (Florida Ct. of Appeals, 1995).

4. Restatement's Choice of Law Rules

If the question of whether the interest of a grantor/beneficiary can be reached by creditors arises in a non-Missouri court, then the forum state's choice of law rule will apply. The general rule under the Second Restatement of Conflict of Laws, is that whether the interest of a beneficiary of a trust of movables (i.e., anything other than land[76]) can be reached by creditors is determined by the law of the state in which the grantor has specified that the trust is to be "administered".[77] Note that this section does not contain the public policy exception the Restatement allows for questions concerning the validity of a trust.[78] Therefore, Missouri DAPTs should direct that the trust be administered in Missouri. In Missouri, a designation as to the trust's principal place of administration will be valid if (i) a trustee's principal place of business is located in or a trustee is a resident of Missouri, or (ii) all or part of the trust's administration actually occurs in Missouri.[79] Appointing a Missouri resident as Trustee and/or actually administering the trust in Missouri, will increase the chances of an out of state court applying Missouri law.

Under the Restatement, with regard to a trust of an interest in land, whether the beneficiary's interest can be reached by creditors is determined by the law that would be applied by the courts of the situs as long as the land remains subject to the trust (i.e., a court should apply the law of the state the land is in).[80] A Missouri DAPT should not be funded with real estate, or any other assets, located in another state over which a non-Missouri court may obtain in rem jurisdiction.

5. Example of Non-DAPT State Obtaining Jurisdiction

For example, assume a DAPT provides that the meaning and affect of the terms of the trust are to be governed by Missouri law, and that the trust is to be administered in Missouri. If a creditor obtains personal jurisdiction over the Trustee in Illinois and sues claiming that the trust assets should not be protected, then the Illinois court must decide whether to apply Missouri or Illinois law.[81] As Illinois does not have any statute or caselaw that would apply to this specific choice of law question, the court may apply section 273 of the Restatement of Conflict of Laws and find that the creditor protection issue is to be determined by Missouri law, the state in which the grantor has specified that the trust is to be administered. Note that under this Restatement section, this analysis should apply whether the trust was created by a resident of Missouri, Illinois, or some other state. If such a controversy is being litigated in the court of a state that has adopted the Uniform Trust Code, then the court will apply Missouri law, unless the designation of Missouri law is contrary to a strong

[76] Restatement (Second) of Conflict of Laws, § 267 (Introductory Note to "Topic 1. Movables").
[77] Restatement (Second) of Conflict of Laws, § 273.
[78] Restatement (Second) of Conflict of Laws, § 270; See Gideon Rothschild, Daniel S. Rubin and Jonathan G. Blattmachr, *Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch?*, Journal of Bankruptcy Law & Practice (Vol. 9, No. 1).
[79] Section 456.1-108.1, RSMo 2000. Under the Uniform Trust Code, fixing the principal place of administration is important to determine where the Trustee and beneficiaries have consented to suit, and the rules for locating venue within a particular state. Sections 202 and 204 of the Uniform Trust Code. However, the place of administration may also be considered by a court in another jurisdiction in determining whether it has jurisdiction, and if so, whether it is a convenient forum. Comment to section 108 of the Uniform Trust Code.
[80] Restatement (Second) of Conflict of Laws, § 280.
[81] Under Illinois law, if the grantor is a beneficiary of a trust, the trust is not protected from the grantor's creditors. 735 ILCS 5/2-1403; In re Marriage of Chapman, 697 N.E.2d 365 (IL App. Ct. 1998).

public policy of the jurisdiction having the most significant relationship to the matter at issue.[82] Presumably, if the trust is being administered in Missouri then Missouri would have the most significant relationship to the trust, unless the Trustee or a majority of the assets were located in another state.

E. Bankruptcy

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

F. Drafting and Administration Suggestions for Missouri DAPTs

When implementing or drafting a Missouri DAPT, in addition to ensuring the trust meets the statutory requirements explained above, the following items should be considered:

Choose Trustee Carefully. One should appoint a Missouri individual resident, or bank or trust company that only does business in Missouri, Trustee. To be conservative the grantor/beneficiary should not serve as Trustee. Avoid a Trustee that resides or does business in a state that does not recognize the validity of DAPTs. The grantor should not retain the authority to remove and replace Trustees.[83] One author suggests that spouses and adult children should not serve as Trustees, to avoid an argument that the grantor had an implied agreement with the Trustee to make distributions.[84]

Trust Assets. To avoid the possibility that a court in an unfriendly state could obtain in rem jurisdiction over the trust assets, the trust should not be funded with real estate, or any other assets, located in a state that does not recognize the validity of DAPTs. Out of state real estate may be contributed to a Missouri LLC or FLP, to attempt to avoid this problem. The trust should only be funded with assets that the grantor does not expect to need access to. One commentator suggests that to be conservative, the trust should be funded with less than one-third of the grantor's total assets.[85]

Governing Law Clause. The governing law clause should provide that Missouri law governs the (i) validity of the trust, (ii) the administration of the trust, (iii) the construction of the trust terms, and

[82] Uniform Trust Code § 107.
[83] No DAPT law authorizes a grantor to retain the right to remove and replace trustees. However, several states allow the grantor to appoint a trust protector with such discretion.
[84] David G. Shaftel, *Everything You Always Wanted To Know About Domestic Asset Protection Trusts But Could Never Find Out*, University of Miami Heckerling 2004 Institute On Estate Planning, Special Session I-C.
[85] David G. Shaftel, *Everything You Always Wanted To Know About Domestic Asset Protection Trusts But Could Never Find Out*, University of Miami Heckerling 2004 Institute On Estate Planning, Special Session I-C.

(iv) the legal effect of the trust terms, including the effect of the spendthrift provision.[86] For flexibility, the trust should also provide the Trustee with the authority to change the designation of the state's governing law as to any one or more of these four issues.

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

Avoid Violating Other Laws. Ensure that the transfer of assets to a self-settled trust does not violate the Missouri Uniform Fraudulent Transfer Act, and that the attorney's assistance with the creation of the trust does not violate any state or federal criminal statute or the Missouri Rules of Professional Conduct. [87] In this regard, the client should complete a questionnaire listing all of the client's assets and liabilities (current and potential), to ensure the client is not insolvent.

Additional Beneficiaries. The trust should provide that individuals other than the grantor are also current permissible distributees of income and principal. The trust should also provide for contingent remainder beneficiaries to take the remaining assets upon the grantor's death.

Limited Power of Appointment. The grantor should retain a testamentary limited power of appointment to avoid a completed gift upon the funding of the trust, and to maintain the ability to rewrite the trust upon the grantor's death.

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

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

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

G. DAPT Alternative

Many clients are unwilling to make an irrevocable transfer to a trust in which the client retains no rights to compel a distribution. An alternative to a DAPT is a trust for a spouse. If a client is not willing to make an irrevocable transfer to a third party Trustee, then the client should consider creating a spendthrift trust for the client's spouse. If the trust is drafted as a QTIP trust or incomplete gift, then there will be no gift tax consequences. The client may serve as the sole Trustee. The assets transferred to the trust will not be subject to the client's creditors, as he no longer owns the assets. If the client needs access to the trust assets, he may make a distribution for the benefit of his spouse that he also benefits from. Or he may distribute assets directly to his spouse

[86] Under Missouri law a designation of the state to govern the validity of the trust has no effect, but such a designation should be included as it may be useful in a non-Missouri court proceeding. See Section 456.4-403, RSMo 2000.
[87] Richard W. Nenno, *Planning with Domestic Asset Protection Trusts: Part I*, Real Property, Probate and Trust Journal, Summer 2005 (This article contains an excellent discussion of the Uniform Fraudulent Transfer Act, the Model Rules of Professional Conduct and the potential liability for attorneys who assist with the creation of domestic asset protection trusts.)

and ask his spouse to gift them back to him. Of course, the trust should be drafted to protect against an unexpected divorce[88], and the trust instrument may be drafted to automatically take into account remarriage (by treating a future spouse as a beneficiary).

One may take this technique one step further by client's spouse creating a trust for client with similar terms. Although there is a judicially created "reciprocal trust doctrine" in the context of estate/gift tax transfers that would unwind this type of technique, there does not appear to be a similar doctrine for creditor protection purposes.

H. Conclusion

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

V. Summary

Attorneys should consider asset protection issues when preparing a client's estate plan. A client with potential creditor problems should consider a DAPT or a spendthrift trust for a spouse. When drafting the dispositive provisions of a Will or trust, consider the asset protection benefits of a lifetime trust (with no rights of withdrawal) for the beneficiary with the beneficiary as sole Trustee. Lastly, attorneys should always be mindful of planning techniques that may violate the Missouri Uniform Fraudulent Transfer Act.[89]

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[88] See Section 456.1-112.1, RSMo 2000.
[89] See Section 428.005, RSMo 2000, et seq.