After the Uniform Trust Code, Does an FLP Provide More Asset Protection Than a Non–Self Settled Trust?

By Mark Merric, Robert Gillen and Mark E. Osborne

Mark Merric, Robert Gillen and Mark Osborne examine whether or not the UTC has reduced the asset protection of almost all non–self settled trusts to less than that provided by a family limited partnership, comparing the asset protection effectiveness of a spendthrift trust and the creditor's ability to attach a beneficial interest to the asset protection effectiveness of an FLP subject to attack through charging orders.

I. Introduction

Prior to the modifications to the law made by the Uniform Trust Code (UTC), most estate planners considered a non–self settled discretionary dynasty trust one of the most powerful and effective tools to protect a child's inheritance. Although not quite as strong an asset protection tool, a non–self settled support trust, generally based on ascertainable standards[1] with age vesting provisions, was also regarded as a relatively strong asset protection planning vehicle. In a monumental departure from the common law of virtually every state, the UTC abolishes the distinction between discretionary and support trusts, now making all trusts rely solely on spendthrift provisions for asset protection. The UTC, through its interpretive companion,[2] the RESTATEMENT (THIRD) OF TRUSTS (RESTATEMENT THIRD), provides for an easy expansion of the class of creditors that may recover from a trust regardless of spendthrift provisions ("exception creditors") as well as greatly expanding the remedies available to all creditors of spendthrift trusts. As a consequence, the UTC has lowered the asset protection features behind almost all non–self settled trusts. The question addressed in this article is whether or not the UTC has reduced the asset protection of almost all non–self settled trusts to less than that provided by a family limited partnership (FLP). Prior to the amendment of the February 18, 2005, National Conference of Uniform State Laws (NCCUSL), the answer to this question depended on the interpretation of at least one key ambiguously[3] drafted provision in the UTC—whether or not all creditors may attach at the trust level and wait for satisfaction of their claims.

Fortunately, in response to our concerns, the NCCUSL UTC committee recently clarified this issue, as well as a few other asset protection deficiency issues that we have raised[4] in other articles.[5] While these changes appear to be a step in the right direction, these modifications are simply insufficient to resolve the decrease in asset protection created by the undefined "continuum of discretionary trusts."[6] In this respect, one still needs to address how much the UTC has reduced the asset protection provided by

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a discretionary and/or a spendthrift trust when compared to the asset protection provided by an FLP.

II. Hierarchy of Asset Protection Vehicles

For simplicity and discussion purposes, many estate planners have developed a hierarchy ranking the effectiveness of asset protection techniques. The hierarchy typically ranks the asset protection planning tools from least effective to most effective. While different estate planners may rank the asset protection tools shown in Chart 1 differently, the hierarchy presented below has been included for discussion purposes.[7]

Chart 1
Hierarchy of Asset Protection Vehicles Before the UTC

Combined Offshore/Domestic Asset Protection Trust	9
Discretionary Dynasty Trust	9
Offshore Asset Protection Trust	8
Spendthrift Trust (*i.e.*, Support Trust with Age Vesting)	7
Offshore LLC–Sole Remedy	6
Family Limited Partnership–Sole Remedy	5
Domestic APT	5
Exemption Planning	4
Family Limited Partnership–Judicial Foreclosure Sale	3

A. Before the UTC

It should be noted that the simplified table shown in Chart 1 does not take into account some of the design variables of an asset protection plan. For example, an offshore asset protection trust (APT) may be less effective if the underlying assets are real estate and more effective if the underlying assets are securities and liquid investments. Further, this hierarchy also does not take into account the increase in effectiveness when combining various other estate planning tools. For example, the offshore asset protection trust, the domestic asset protection trust, the discretionary dynasty trust and the spendthrift trusts are often combined with an FLP or LLC resulting in a higher level of protection. Finally, a domestic LLC for purposes of this article is considered equivalent to an FLP and the terms LLC and FLP will be used synonymously.

B. Brief Explanation of Each Tool

At the end of a legal conflict, the effectiveness of each planning tool is measured in part by the integrity of the overall plan as well as by the underlying assets held by each planning instrument. FLPs that are a sole remedy and those that are a not sole remedy are discussed in detail below. Discretionary dynasty trusts and spendthrift trusts are also discussed in detail below. However, since exemption planning, offshore LLCs and offshore APTs are not the focus of this article, they are only briefly addressed.

At first glance, the rating for exemption planning of "4" may seem quite low, however, this rating is based on the value of exemption planning as an overall tool and not as a sole asset protection plan in a particular jurisdiction. For example, the use of the homestead exemption in Florida as a specific planning tool could easily have a rating of "9" because Florida's unlimited homestead exemption even protects the homestead in Bankruptcy. Both Florida and Texas also allow unlimited exemptions for insurance, annuities and retirement plans in addition to the unlimited exemption for homesteads. In terms of state law, the Texas and Florida exemptions statutes overall may warrant a rank around "6." However, most clients do not wish to reposition all of their wealth and assets into insurance products or real estate to take advantage of current exemption planning. Unfortunately, on the opposite end of the spectrum, some states do not even have a state exemption for Individual Retirement Accounts. Accordingly, the exemption planning in states such as this may receive a rating close to "1."

The offshore LLC and the offshore APT are both excellent asset protection planning tools. In particular, the offshore LLC adds distinct benefits such as moving the legal controversy offshore to the strengths of an FLP. The offshore protection features may include a need to obtain jurisdiction over the manager of the LLC, to obtain jurisdiction over the underlying assets if they are liquid and to litigate in an offshore legal system. The offshore APT provides additional foreign jurisdiction protection such as the ability to shift legal battles outbound when the tool is a discretionary dynasty trust. However, many other issues such as "contempt-of-court" and taxation issues related to an offshore APT must be addressed, and in this respect, an in-depth discussion of an offshore APT is beyond the scope of this article.

C. After the UTC

The UTC makes several radical and potentially significant changes to the asset protection typically provided by non–self settled trusts. As previously mentioned, the UTC abolishes the 125-year-old distinction between a discretionary trust and a support trust forcing all trusts to merely rely on spendthrift provisions for asset protection.[8] Consistent with the support trust's current ranking, a discretionary dynasty trust in a UTC state immediately drops from a rating of "9" to "7" on the asset protection tool effectiveness scale. Additionally, compared to the common law of most states, the UTC expands the remedies available to exception creditors proceeding against spendthrift interests held in trust. These remedies are analogous to the remedies that a creditor has against an FLP. This article compares the asset protection effectiveness of a spendthrift trust and the creditor's ability to attach a beneficial interest (since all trusts must rely solely on spendthrift protection under the UTC) to the asset protection effectiveness of an FLP subject to attack through charging orders. Had it not been for the 2005 NCCUSL amendments that were responsive to our concerns, an estate planner may have concluded that the UTC reduced the asset protection of a spendthrift trust to less than that provided by an FLP when a "charging order" is the sole remedy.

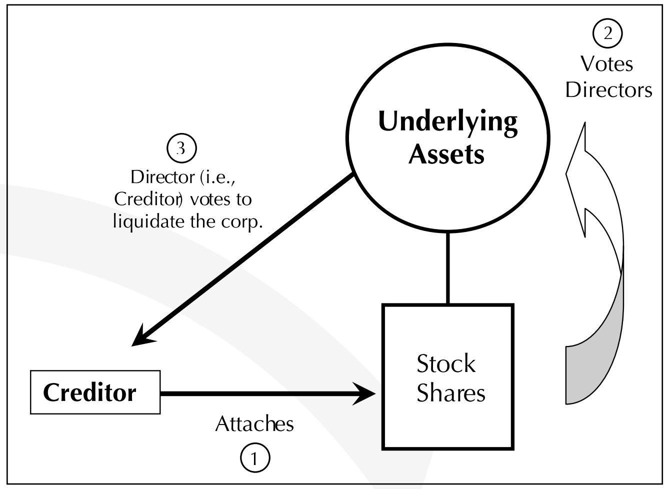
Chart 2
Hierarchy of Asset Protection Vehicles After the UTC

Combined Offshore/Domestic Asset Protection Trust	9
Offshore Asset Protection Trust	8
Offshore LLC–Sole Remedy	7
Discretionary Dynasty Trust	6–
Spendthrift Trust (*i.e.*, Support Trust with Age Vesting)	5+
Family Limited Partnership–Sole Remedy	5
Domestic APT	5
Exemption Planning	4
Family Limited Partnership–Judicial Foreclosure Sale	3

III. Asset Protection with a Family Limited Partnership

In general terms, many estate planners are of the opinion that the asset protection features of an FLP depend on the availability of a remedy known as a charging order. When a claim arises outside the partnership against one of the partners, the judicial remedy for a creditor attempting to reach the underlying assets of a partnership is significantly different than remedies afforded to corporate creditors. In the corporate setting, a creditor merely attaches the shareholder's stock. Upon attachment, a creditor receives the standard three corporate rights: (1) the right to vote the shares; (2) the right to receive dividends; and (3) the right to receive liquidation proceeds. The creditors can then vote to make themselves and their advisors controlling director(s) of the corporation. They then vote to liquidate the corporation. The intended result is a creditor who has the stock to receive all of the underlying assets of the corporation. In this respect, a corporation, including either a Nevada corporation or an offshore corporation, provides very little, if any, asset protection.[9]

Chart 3



A. Charging Order

A charging order is a significantly different remedy than attaching the shares of a corporation. The charging order is, in essence, an assignment of the right to receive distributions. However, it is an assignment that is limited to amounts that are required to be distributed pursuant to the terms of the partnership's operating agreement. Normally, an operating agreement requires either a majority vote of the partners or the consent of the general partner to authorize any distributions from the partnership. Unlike attaching shares in a corporation, the holder of a charging order receives neither voting rights nor does the holder have the right to vote itself as the general partner. The result is that a creditor who holds a charging order has a right to a distribution when and if the debtor partner and other partners vote for a distribution or whenever the general partner consents to a distribution. The distribution procedure will depend on how the partnership agreement was drafted.

When the charging order is a creditor's *sole* remedy, the creditor is forced to wait until such time as distribution from the partnership will be made. Only when the distribution is made may the partnership assets be used to satisfy the creditor's claim. Accordingly, the asset protection afforded by a charging order is primarily based on a waiting game. On the one hand, if a debtor does not need a distribution from the partnership to pay personal expenses, the debtor will be forced to wait for a long period of time. On the other hand, as soon as the debtor needs a distribution and such distribution is made from the partnership, it must then be made directly to the creditor pursuant to the charging order. Even when the charging order is the creditor's sole remedy, the question simply becomes, who can wait the longest without accessing the assets of the partnership— the debtor/partner or creditor? When the creditor is unwilling to wait, it is forced into a settlement posture and may accept a discounted amount because of the inability to reach the underlying assets of the partnership with no other judicial remedies.

B. Sole Remedy States

Some state laws provide that the charging order is the sole remedy that a creditor may pursue. A state may be classified as a sole remedy charging order state by statute or case law. Statutory law tends to provide a far higher degree of predictability of outcome than case law, which may have varying results based on different facts or interpretations of prior cases. The following states, by statute, are sole remedy charging order states:

Family Limited Partnerships by Statute

Alaska[10]	Nevada[12]
Arizona[11]	Oklahoma[13]

Limited Liability Companies by Statute

Alabama[14]	New Jersey[20]
Alaska[15]	North Dakota[21]
Arizona[16]	Oklahoma[22]
Kansas[17]	Tennessee[23]
Minnesota[18]	Wyoming[24]
Nevada[19]	

Most states that have not specified by statute that the state is a sole remedy charging order state have adopted the relevant portion of the Revised Uniform Limited Partnership Act of 1976 (RULPA). RULPA §703 states, "a court may charge the partnership interest of the partner with the payment of the unsatisfied amount of the judgment with interest." While this section of RULPA does not provide that this is the sole or exclusive remedy of a creditor, the following states' case law have interpreted this section to mean that a charging order *is* the sole remedy of a creditor.

Family Limited Partnerships by Case Law

Florida[25]	Virginia[26]

Limited Liability Companies by Case Law

North Carolina[27]

C. Judicial Foreclosure Sale States

In a state that is not a sole remedy charging order state, the planner must determine whether or not that state law allows for the judicial foreclosure sale of a partnership interest. If judicial foreclosure is permitted or when other remedies are available, a creditor may not have to wait until distributions are made to satisfy their claim. The creditor may instead petition the court to sell the debtor partner's interest at a judicial foreclosure sale. The judicial sale of the partnership interest would typically be at a substantially discounted value.[28] The sales proceeds would be delivered to the original creditor in full or partial satisfaction of the original claim.

After purchasing the debtor's interest, the purchaser would receive greater rights than the original creditor who previously had only possessed a charging order. While the original creditor only had the right to receive distributions until their claim was satisfied, the purchaser did not purchase the creditor's rights under the charging order. Rather, the purchaser bought the entire FLP interest, which includes the right to the partner's distributions until the FLP is liquidated. However, similar to the original creditor who held a changing order, the purchaser at the judicial foreclosure sale does not receive any voting rights and therefore may not liquidate or force a distribution from the FLP.

Following the judicial foreclosure sale, the debtor must then negotiate with two separate creditors: (1) the original creditor to the extent the proceeds from the sale of the partnership interest did not satisfy the creditor's claim; and (2) the purchaser of the partnership interest at the judicial sale. The debtor will never be able to enjoy its partnership property unless it buys it back from the purchaser. This is why virtually all of the reported cases have settled on what appears to be unfavorable terms when the court orders a judicial foreclosure sale of the limited partnership interest. The following states permit the judicial foreclosure sale of a limited partnership interest by statute.

Family Limited Partnerships by Statute

Hawaii[29]	Iowa[31]
Illinois[30]	Minnesota[32]

Limited Liability Companies by Statute

Colorado[33]	Rhode Island[38]
Delaware[34]	South Dakota[39]
Hawaii[35]	Vermont[40]
Illinois[36]	Virginia[41]
Montana[37]	West Virginia[42]

It should be noted that Hawaii, Illinois, Iowa and Minnesota have adopted the new 2001 version of the Uniform Limited Partnership Act (ULPA 2001). ULPA 2001 specifically allows for the judicial foreclosure sale of the limited partnership interest. As an example, under case law Minnesota was a sole remedy state until it passed ULPA 2001.

A state may not have any statutory enactments permitting judicial foreclosure sale, however, this issue may have been previously decided by case law. Some confusion exists under RULPA, because this legislation is not definitive on whether or not a charging order is the sole remedy. As noted above, Section 703 states that "a court may charge the partnership interest of the partner with the payment of the unsatisfied amount of the judgment with interest." Again this language does not indicate that a charging order is the sole remedy. Despite three states above concluding that this language means a charging order is the sole remedy, the majority of courts (ten out of thirteen courts listed below) have concluded that a charging order was a permitted remedy but not the sole remedy. Predictably, these ten courts allowed the judicial foreclosure sale as one of the other remedies.

Family Limited Partnerships by Case Law

California[43]	New Hampshire[48]
Connecticut[44]	New Mexico[49]
Georgia[45]	Ohio[50]
Missouri[46]	Pennsylvania[51]
Maryland[47]	Texas[52]

Limited Liability Companies by Case Law

None

The states that are not listed above have not decided whether or not a charging order is a permitted remedy or the sole remedy. It should be noted that, with the sole exception of North Carolina, in the last fifteen years whenever a state court has been confronted with the question of whether or not a charging order is the sole remedy, the state court has ruled in favor of permitting the judicial foreclosure sale of the limited partnership interest.[53] It should be further noted that Georgia was originally a sole remedy state by case law.[54] However, 13 years later, when the matter was reviewed by the state's appellate court, Georgia changed to a judicial foreclosure state.[55] Additionally, as was previously noted, ULPA 2001 specifically allows for the judicial foreclosure sale. Should a state court interpret RULPA in the future, the authors conclude it will most likely follow the trend and provide for the judicial foreclosure sale of the limited partnership interest.

D. Forcing a Distribution from the Partnership

One clear asset protection advantage of a partnership is that a creditor cannot force a distribution from the partnership to satisfy the claim. As noted above, a creditor does not obtain any voting rights with a charging order and consequentially cannot vote to either replace the general partner with the creditor or vote as a member for any distributions. This advantage of a partnership must be compared with a trust where certain creditors may force a distribution from the trust to satisfy the creditor's claim.

E. FLP in a Non–Sole Remedy State Only Received a Rating of "3"?

Some estate planning attorneys may question why an FLP that is not in a "sole remedy" state only received a rating of "3" out of "10" on the asset protection scale. The perception among these estate planning attorneys is that the FLP is a much stronger asset protection planning tool even if state law permits the judicial foreclosure of the limited partnership interest under one of two theories: (1) the phantom income theory and/or (2) the "porcupine theory."

1. Phantom Income Theory

The phantom income theory is based on Rev. Rul. 77-137.[56] In this revenue ruling, a partnership interest was gifted to Person X. Person X became an assignee, entitling Person X to a proportionate share of all items of income, loss and deduction, even though Person X did not become a substituted partner. The Revenue Ruling concluded that an assignee of a partnership interest must report his or her proportionate share of the partnership items of income, loss, gain and deduction of the partnership, regardless of whether or not there were distributions from the partnership.

In the context of charging orders, the Uniform Partnership Act (UPA) §703 provides "the judgment creditor has only the rights of an assignee of the partnership interest." Some estate planners interpret this language to mean that, for income tax purposes and not just asset protection purposes, a creditor who obtains a charging order would be liable for the income tax on partnership income that was never distributed. In other words, proponents of the phantom income theory argue that a creditor may elect not to seek a charging order because the creditor would want to avoid the obligation to pay the income tax on undistributed income.

In contrast to the perceived tax liability of a creditor on undistributed partnership income, there is a strong argument that the judicial remedy of a charging order will be distinguished from an assignment. With an assignment, the assignee has rights to the proportionate share of any distributions until the partnership is liquidated. The charging order creditor has rights to distributions and possibly some liquidating distributions until the creditor's claim is satisfied. On the one hand, a creditor with a charging order holds less of an interest than an assignee because the assignee's interest is perpetual which apparently triggers an income tax liability even on undistributed income. On the other hand, the holder of the charging order is limited by the time it takes to obtain satisfaction of the claim and only taxed on the amounts received in such satisfaction. Accordingly, a charging order may be more analogous to a wage garnishment than an assignment, where the creditor holding the garnishment is not taxed until the income is actually received.[57]

The authors give little credence to the threat that creditors would be deterred from pursuing collection of their judgments based on fear of receiving taxable phantom income due to holding a charging order. First, through professional experiences and information obtained from consultation with other reputable asset protection attorneys, the authors are not personally aware of any case where a creditor has refrained from seeking a charging order under the perceived threat of receiving taxable phantom income. However, comments from a few national listservs indicate that some attorneys have had experiences where this has been the case. Second, the authors believe that the wage garnishment argument or the creditor receiving less than the entire assignee interest are more persuasive tax arguments than a possible determent feature through income tax liability suggested by the phantom income theory.

The authors give little credence to the threat that creditors would be deterred from pursuing collection of their judgments based on fear of receiving taxable phantom income due to holding a charging order.

2. Porcupine Theory

Other estate planners argue that an FLP interest will never be purchased at a judicial foreclosure sale under the porcupine theory. This theory advocates that while it is uncertain whether or not a charging order will result in phantom income to the person who obtains it, it is not uncertain whether or not the purchaser of a partnership interest must report his or her proportionate share of income from a partnership (because of the right to distributions for the full term of the partnership). Advocates of the porcupine theory, accordingly argue that virtually no one will buy the FLP interest at the judicial foreclosure sale due to the potential obligation to report possible phantom income.

Here the authors tend to disagree with the porcupine theory. Further, when discussing some of these issues with other attorneys who have represented creditors on the *reported* judicial foreclosure cases, this issue did not stop even one of the creditors from seeking the judicial foreclosure sale of the FLP interest. As was previously noted, however, all of these cases settled after the court ordered the judicial foreclosure sale and before the judicial foreclosure sale was consummated. Again, the authors are aware of a few asset protection planners that have had favorable results using the porcupine theory.

3. FLP Interests in the Bankruptcy Context

The court in the case of *In re Ehmann,*[58] held that an operating agreement was not an executory contract under Bankruptcy Code §365.[59] As a result, the Bankruptcy Court held that the LLC interest was nothing more than a property interest under Bankruptcy Code §541.[60] Accordingly, the Bankruptcy Trustee succeeded to all interests and rights that the debtor owned, including voting rights. Some planners would argue that this case greatly reduces the asset protection provided by an FLP, possibly even below a rating of "3."[61] Other planners[62] may argue that the facts of *Ehmann* turned on the drafting of the operating agreement, and that the outcome in *Ehmann* could be mitigated by requiring members to make mandatory capital contributions.

4. Other Remedies

Another reason the authors have found less merit with the asset protection provided by an FLP in a non–sole remedy state is that charging orders and judicial foreclosure sales are not the only remedies available to a creditor. First, transfers of property in exchange for partnership interests when a known creditor is seeking payment, raise possible fraudulent conveyance issues (although this should not be an issue where the property was transferred to the partnership before the claim arose). These conveyances could result in the creditor being able to unwind the initial transfer to the FLP. The transfer of a dollar amount of property in exchange for a percentage in a limited partnership is not considered a fair market value transfer necessary to avoid a fraudulent conveyance, because the value of the property received is determined based on the value to the creditor.[63]

Second, standard veil piercing arguments can also be used to penetrate partnerships. The reverse veil piercing arguments are also available in some situations. A reverse veil piercing argument occurs when a person transfers property into the partnership to hinder a creditor by availing himself or herself of charging order protection.[64] In some respects, the reverse veil piercing argument is similar to the fraudulent conveyance fact pattern. However, the reverse veil piercing argument is more common when one changes the form of a business and the creditor's attorney asserts an alter ego type of argument.

Third, several states permit a "creditor's bill" as another method of recovery. A creditor's bill is an equitable remedy and courts may generally only employ it when the judgment creditor's at-law remedies "are ineffectual to reach the property of the debtor, or the enforcement of the legal remedy is obstructed by some encumbrance upon the debtor's property, or some fraudulent transfer of it."[65] Generally, a creditor's bill allows a creditor to step into the shoes of the debtor and to exercise all the debtor's rights. Presumably, the creditor would also receive the right to vote the FLP interest. If so, an FLP would have no more asset protection than a corporation, which is virtually no asset protection at all. The creditor's bill would allow a creditor to simply step into the shoes of a debtor/partner and exercise all rights of the partner, including the ability to vote to liquidate the partnership and distribute all of the assets of the partnership to the creditor. Note, however, that this remedy would not be effective where the debtor did have the right to vote to remove the manager or sufficient voting power to do so.

The final concern troubles the authors the most. The following two legal arguments, advanced by a well-known international debtor/creditor attorney from Ohio, John Sullivan III, have been used against FLPs when Mr. Sullivan has represented creditors: (1) resulting trusts and (2) constructive trusts. The scope of this article does not include an in depth analysis on the nuances of resulting trusts or constructive trusts. However, in relatively simplistic terms, the resulting/constructive trust may be viewed as the issue of whether or not the partnership is really functioning as a self-settled trust with the client serving as the trustee. Often clients will have received disproportionate distributions or commingled personal assets with partnership assets. When this has occurred in recent FLP *tax* cases, the Tax Court held that the partnership was functioning more like a dispositive instrument.[66] The argument is that there should not be any different outcome in a creditor case. Further, unlike the fraudulent conveyance and reverse veil piercing arguments where some evidence of bad faith must be introduced, resulting trusts and constructive trusts are imposed irrespective of intention.[67] There is one final note regarding the authors' proposition that FLPs do not provide significant asset protection. Mr. Sullivan's rate of recovery, when using the resulting/constructive trust arguments in combination with all the other legal arguments, is typically between 70 and 85 percent of the underlying assets of the partnership.

IV. Asset Protection with a Non–Self Settled Trust Before the UTC

In order to discuss how the UTC and, its interpretive companion, the RESTATEMENT THIRD[68] have decreased asset protection for virtually all spendthrift trusts, the following history regarding asset protection prior to the UTC must be examined. Under common law, when a creditor was sought to recover from a trust, the courts almost always classified the trust as either a discretionary or a support trust. A creditor's possible remedies were dependant on this critical classification as well as whether or not the creditor was seeking to recover against a remainder interest.[69]

A. Discretionary Dynasty Trust

The asset protection feature of a discretionary trust is independent of any spendthrift provision. The protection is accomplished by the beneficiary not holding a sufficient enforceable right to force a distribution.[70] Because the beneficiary does not in fact have a sufficient enforceable right to attach or force a distribution, no creditor can stand in the beneficiary's shoes and attach or force a distribution.

The reason a beneficiary does not have a sufficient enforceable right with a discretionary trust is because the threshold for the judicial standard of review to review the trustee's discretionary distribution standard is so high. A court will only review a trustee's discretion if the trustee acts with an improper purpose, acts dishonestly or fails to act. These three criteria are sometimes referred to as a "bad faith standard."[71] As an illustration of the elevated standard, a court would not review a trustee's decisions to determine whether or not the trustee was acting reasonably.[72]

Once the threshold standard of review is lowered, case law has shown that the beneficiary begins to have an enforceable right. As an example, in *Kreitzer*,[73] the Ohio Courts lowered the judicial standard of review to just below the common law bad faith standard. The result, in the special needs trust (SNT) context, was that a destitute beneficiary obtained a right to force a minimal distribution pursuant to any standard that was contained in the trust. The same result occurred in Iowa,[74] and with a slightly different analysis in Pennsylvania.[75] Because the beneficiary had an enforceable right, the government, which had provided medical benefits, stood in the shoes of the beneficiary. Consequently, the government was allowed to attach and force a distribution to satisfy its claim. Later, in *Metz*,[76] which is also an SNT case, the court concluded that because a beneficiary had an enforceable right, the government could deny benefits, because the beneficiary had an available resource. The same problem has also occurred in the divorce context. *In Martin v. Martin*[77] and *Mason v. Mason,*[78] the judicial standard of review was lowered based on the same logic, which gave the beneficiary an enforceable right to demand a distribution pursuant to the standard. In that case, however, the court held that alimony was not within the meaning of support.

Ohio's line of cases illustrate why the high threshold in a discretionary trust is the cornerstone for greater asset protection. The threshold simply must be crossed before a beneficiary even has any claim in court. As long as the common law standard that a court will not review the trustee's discretion unless the trustee acts with an improper motive, acts dishonestly or fails to act is upheld, then the beneficiary has an incredibly strong asset protection tool as shown in Chart 1. However, as soon as the threshold of review is lowered below this standard, then the discretionary trust resembles a support trust to a much greater extent. In such cases, the trust's asset protection ability no longer relies on the discretionary nature of the interest, but rather it relies on spendthrift provisions.

B. Support Trust Relies on Spendthrift Protection

The judicial review standard for a support trust is *reasonableness*. Although a judge is not supposed to substitute his or her judgment for that of the trustee, a judge may question a trustee's distribution decision for reasonableness. Due to the much lower threshold of judicial review, the beneficiary of a support trust has an enforceable right to a distribution. In the context of creditor rights, once a beneficiary has an enforceable right,[79] the question becomes, does a creditor stand in the shoes of the beneficiary? Absent spendthrift provisions, the creditor would have the same rights to distributions as the beneficiary.

Under American law, spendthrift provisions protect beneficial interests from creditor attachment.[80] However, over time, the courts have developed exceptions to spendthrift provisions. The Restatement Second §157 lists the following four exception creditors:

1. Child support and alimony
2. Necessary expenses of a beneficiary
3. Attorney fees to protect a beneficial interest
4. Any federal or state governmental claim[81]

Fortunately, the third exception has gained little acceptance by the courts. This is most likely due to potential unnecessary and wasteful litigation that would be incurred, coupled with the court's natural inclination to protect the beneficial interest. This exception would have created a "piggy back" effect where estranged spouses and other creditors would seek recovery directly from the trust.

Spendthrift provisions also only protect assets while they are held in trust. Since the Restatement (Second) of Trusts, spendthrift provisions do not protect assets once they have been distributed to the beneficiary, even if held in a segregated account.[82] Prior to the UTC and Restatement Third, this was not an issue, because the trustee could continue to directly pay expenses on behalf of the beneficiary. Further, only exception creditors could attach the trust and possibly force a distribution. With the UTC and RESTATEMENT THIRD's attempts to change the law, this will no longer be the case.

C. Judicial Foreclosure Sale of Remainder Interests

In general, the common law did not allow for the judicial foreclosure sale of remainder interests for the following reasons:

1. Under the RESTATEMENT SECOND §161, "if a remainder interest is so indefinite or contingent that it cannot be sold with fairness to both the creditors and beneficiary, it cannot be reached by his creditors."[83]
2. Spendthrift protection should also protect remainder interests.

Regarding the first rule, there are two separate tests. If either test is met, a creditor should not be able to reach a remainder interest. The first test is if the interest is indefinite or contingent, it cannot be reached by creditors. Under the RESTATEMENT SECOND, outliving a parent is not considered so remote that it should qualify under this rule.[84] Therefore, there are few times this part of the rule prevents a creditor from possibly selling the remainder interest.

The second test is if the interest cannot be sold with fairness, it cannot be reached by a creditor. The ability to sell a remainder interest with fairness to the beneficiary, must take into account all of the contingencies of outliving a parent, the parent consuming all of the assets, or possibly the parent exercising a special power of appointment. These remote contingencies make this one of the largest hurdles that a creditor would need to cross to force the judicial foreclosure sale of the remainder interest.

Finally, even if a creditor was able to surmount the aforementioned two hurdles, spendthrift protection shall apply to interests in trust. Therefore, only exception creditors should be able to force the judicial foreclosure sale of a remainder interest. Most states followed a majority or all of the above rules. Under common law, however, a minority trend has developed that classified remainder interests as marital property. In these cases, it appears that common law is carving out another exception creditor in the case of a remainder interests in the context of the division of marital property.[85]

D. Summary of Asset Protection for Trusts Under Common Law

Under common law, few, if any, creditors could ever reach a discretionary interest in trust, regardless of whether or not there was any spendthrift protection. This was true even in the bankruptcy context. If a discretionary trust were also designed to be a dynasty trust, there was no remainder for a creditor to attach.[86] This is why a discretionary dynasty trust has traditionally been ranked at the top of the asset protection tool scale.

In contrast, a support trust has always relied on spendthrift protection to determine its asset protection value. With a support trust, only an exception creditor could attach a beneficial interest and, depending on state law, could often force a distribution in satisfaction of the creditor's claim. Usually with a support trust, the beneficiary would also hold a remainder interest. Except for the emerging trend in the case of marital property, very few creditors were able to reach a remainder interest at common law.

V. Asset Protection with a Non–Self Settled Trust After the UTC

First, both the UTC and RESTATEMENT THIRD greatly reduce the asset protection provided by a discretionary trust by abolishing the distinction between discretionary and support trusts, forcing all trusts to rely on spendthrift protection. Second, it appears in the long run the UTC will have many more exception creditors to spendthrift protection than under prior law. Third, under the newly created and undefined "continuum of discretionary trust" theory, two income imputation arguments are created. Finally, as discussed in section VI, the UTC also provides new remedies for a creditor, thereby further reducing the protection of all spendthrift trusts.

A. Abolishing the Difference Between Discretionary and Support Trusts

Both the UTC and the RESTATEMENT THIRD change 125 years of established trust law by eliminating the discretionary-support dichotomy.[87] The provisions in the RESTATEMENT THIRD also make it clear that asset protection will be based solely on the same spendthrift protection analysis.[88]

In order to completely topple the asset protection provided by a discretionary trust under common law, in addition to abolishing the discretionary/support distinction, one must shatter the cornerstone or the foundation of asset protection behind a discretionary trust—the high threshold for the judicial standard of review. Evidently, this is exactly what the UTC does by reducing the threshold of the judicial standard of review from the trustee acting dishonestly, acting with an improper motive or failing to act to the trustee acting in good faith.[89] The RESTATEMENT THIRD provides a "reasonableness" standard for judicial review.[90] As discussed in detail later in this article, the troublesome results of governmental agencies reaching assets of discretionary trusts, the trustee of a discretionary trust being required to exercise its discretion pursuant to the distribution standard[91] and income being imputed from a trust to compute alimony are all based on the creation of an enforceable right.[92] This occurred when courts strayed away from the bad faith standard of common law and moved toward the approach adopted by the UTC.

B. Spendthrift Protection

At first blush, one might compare the exception creditors under the UTC to those provided in the RESTATEMENT SECOND and conclude that the UTC has actually increased asset protection by providing for slightly fewer exception creditors. This is because the RESTATEMENT THIRD lists the following exception creditors:

1. "[A] beneficiary's child, spouse, or former spouse who has a judgment or court order against the beneficiary for support or maintenance"
2. "[A] judgment creditor who has provided services for the protection of a beneficiary's interest in the trust, may obtain from a court an order attaching present or future distributions to or for the benefit of the beneficiary."[93]
3. "A spendthrift provision is unenforceable against a claim of this State or the United States to the extent a statute of this State or federal law so provides."

First, as noted in Item 3 above, upon passage of the UTC, federal and state governmental claims would not be classified as exception creditor claims, until the government provided that it could recover by a future statute. At this point in time, federal and state governments have not had the opportunity to respond. It appears, therefore, that this temporary possible increase in asset protection will have a fairly short life.

Second, UTC §503(c) creates another potential issue that was not a problem under common law. Suppose the federal Bankruptcy Code adds a section similar to the following provision:

> The bankruptcy trustee is an exception creditor pursuant to UTC §503(c).

In this instance, asset protection under common law trusts would be significantly impaired, if not arguably terminated. Such a provision would allow the bankruptcy trustee to attach the trust, at the trust level, on behalf of all creditors. In many cases, credit card companies would have large enough debt that would enable them to recover from a trust through the bankruptcy proceeding.[94]

Third, the UTC codifies one of the listed RESTATEMENT SECOND exception creditors that has seldom gained any judicial acceptance. This was the attorney fee exception for services provided in protecting a beneficial interest in a trust. By adding such an exception creditor, beneficiaries or creditors standing in the beneficiary's shoes would have been encouraged to challenge the wishes of the settlor. In this respect, the UTC expands the common law exception creditors.

Fourth, the number of permitted exception creditors under the UTC may be expected to increase at a much greater rate than under the common law, because the UTC permits exception creditors to be added by both the judiciary and the legislature. In fact, the reporter's notes from the RESTATEMENT THIRD even encouraged adding further judicial exceptions and goes on to state "the distinctly limited protection afforded spendthrift-trust beneficiaries"[95] and "in some circumstances, to permit attachment despite the spendthrift restraint may not undermine, *and may even support, the protective purposes of the trust* or some policy of law."[96] The authors have never come across a case where the settlor intended to have spendthrift protection defeated under the notion that this would support the protective purposes of the trust.

Fifth, when legislatures have created exception creditors, the possible results can vary significantly. Six states have created an exception creditor for *any* creditor to the extent of the excess over the beneficiary's reasonable needs. [97] Fortunately, under common law, the exception creditors were limited to support trusts. In contrast, under the UTC and jurisdictions that might adopt the RESTATEMENT THIRD, if an exception creditor with these limitations is added, it also would generally end asset protection of spendthrift trusts as known under common law. As discussed in the remedies section below, distributions on behalf of a beneficiary or payment by the trustee of any such expenses would in essence be frozen, and the creditor would merely wait for the satisfaction of his or her claim.

C. Imputation of Income Issues Created by the "Continuum of Discretionary Trusts"

In place of the discretionary/support dichotomy that was developed by the judicial wisdom over the last 100 years, both the UTC and RESTATEMENT THIRD create a new and untested theory of creditor recovery known as the "continuum of discretionary trusts." Under this creditor-favorable theory, supposedly all trusts are classified as "discretionary trusts," regardless of whether or not the trust was classified as a support trust under common law. Further, each "discretionary trust" now lies somewhere on a continuum from the most discretionary to the least discretionary. Unfortunately, neither the UTC nor the RESTATEMENT THIRD provides any definition of the beginning, middle or end of this continuum. The definitions of this new continuum will need to be provided by the courts through a wave of future litigation. Further, in many respects, the title "continuum of discretionary trusts" appears to be a misnomer. This is because from a creditor perspective, all trusts must now rely solely on spendthrift protection. At first glance and possibly upon final analysis, the continuum appears to be much more appropriately titled a "continuum of support trusts" rather than a "continuum of discretionary trusts." In this respect, the term "continuum of discretionary trusts" is a complete misnomer.

The reason a beneficiary does not have a sufficient enforceable right with a discretionary trust is because the threshold for the judicial standard of review to review the trustee's discretionary distribution standard is so high.

If for creditor purposes, the continuum functions as a "continuum of support trusts," how does a continuum of discretionary trusts provide any asset protection? An exception creditor either attaches or does not attach a beneficial interest. In trusts that do not contain a spendthrift provision,[98] a court either allows the current and/or remainder beneficial interest to be sold at a judicial foreclosure sale or it does not allow the sale. In either instance, a beneficiary cannot continue to enjoy the trust property. Further, a former spouse is allowed to directly force a distribution from any trust, discretionary or support, under common law for child support or alimony.[99] These creditor remedies apply regardless of whether or not the trusts are viewed as a "continuum of discretionary trusts" or a "continuum of support trusts."

In this new area of creditor recovery, the imputation of income from a trust on the "continuum of discretionary trusts" may provide a small degree of asset protection from one type of a discretionary trust when compared with another type of discretionary trust. Prior to the UTC and RESTATEMENT THIRD, the concept of the imputation of income from a trust was almost unheard of, particularly in the case of a discretionary trust. However, the continuum of discretionary trusts is built with an underlying assumption that a beneficiary has an enforceable right to demand a distribution pursuant to the distribution standard.[100] Accordingly, in most cases, a beneficiary will hold a property interest or a sufficient enforceable right under state law[101] to force some type of distribution. If a beneficiary holds this right, then which creditors stand in the shoes of a beneficiary to enforce this right?

In the special needs context, if a beneficiary has an enforceable right to demand a distribution from a discretionary trust, wouldn't this enforceable right be considered an available resource, and most likely disqualify the beneficiary from governmental aid? As noted by the Ohio, Iowa and Pennsylvania line of cases in this area, disqualification is precisely the result depending on how the trust was drafted.[102]

Second, does the UTC support the argument that income should be imputed from a trust for the purpose of computing alimony or child support? Based on *Dwight v. Dwight,* the only case referencing the RESTATEMENT THIRD in this area, the answer simply is yes.[103] In *Dwight,* a beneficiary had received $7,000 as a distribution from a discretionary trust over a nine-year period. However, for purpose of alimony, he was imputed with income from the trust to support a $30,000 a year alimony obligation. Although some will cite *Dwight* as a bad fact case making bad law, both the UTC and RESTATEMENT THIRD provide the complete framework where such a decision would be possible, if not ultimately common place.

If a beneficiary has an enforceable right to demand a distribution, under a constructive receipt type of argument, why wouldn't income be imputed in such a situation? If case law follows the trend in the SNT context, the new theory in the divorce context, or just a plain reading of the possible arguments under Restatement Third §60 comments e and e(1), most, if not all trusts under the UTC may be subject to imputation of income arguments.

VI. Comparison to the Family Limited Partnership and New UTC Remedies for Creditors

While the expansion of exception creditors under the UTC, as well as imputed income arguments may soon result in greatly decreased asset protection for all spendthrift trusts (*i.e.,* both discretionary and support trusts under common law), the new remedies created by the UTC immediately result in a considerable decrease in asset protection in UTC states. These new remedies may be classified into the following four categories:

1. Attachment of present and future distributions
2. Trustee may no longer pay the expenses directly
3. Judicial foreclosure sale of current and remainder interests
4. Forcing a distribution for child support and alimony form all trusts

A. Attachment of Present or Future Distributions

Exception creditors may attach a beneficiary's interest, including all discretionary trusts at the trust level. This is another area of the law where the UTC and the Restatement Third decided to follow a minority line of cases.[104] Prior to the UTC and the Restatement Third, the strong majority rule was that an exception creditor had to wait until the beneficiary received the distribution before he or she could attach.

Professor Charles E. Rounds, the current author of Loring, A Trustee's Handbook, refers to this new remedy as a judicially granted *charging order*.[105] This is an insightful analogy. In layman's terms, a charging order is a right to receive a distribution when and if ever made as decided by the general partner or partnership vote and as required by the operating agreement. All creditors of a partner may seek a charging order. In comparison and after NCCUSL responded to our concerns,[106] it is now clear that only exception creditors may attach at the trust level. So while any creditor may obtain a charging order against an FLP, only exception creditors may obtain a charging order against a trust.

B. Trustee May No Longer Pay Expenses Directly

Another change that affects creditor remedies in the UTC §501 is that trustees may no longer directly pay a beneficiary's expenses upon attachment by an exception creditor. Obviously, this is an incredible issue in the context of third party special needs trusts because any distributions to the beneficiary would be counted as an available resource and may result in disqualification of the beneficiary from governmental assistance. However, it is also another major decrease in asset protection under the UTC for all spendthrift trusts. Under the Restatement Third §60 comment c, "if a trustee has been served with process in a proceeding by a creditor to reach the beneficiary's interest, the trustee is personally liable for any amount ... applied for the benefit of the beneficiary ... " Under common law, the ability to directly pay the expenses of the beneficiary was an incredible advantage to trusts when compared to the asset protection of an FLP.

C. Judicial Foreclosure Sale

In the discussion of FLPs, recall that some states allowed only a charging order as a creditor remedy. However, other states allowed the judicial foreclosure sale of the partnership interest and many states have not yet addressed the issue. On the asset protection scale, a state where a charging order was the sole remedy provided significantly greater asset protection than a state that allowed the judicial foreclosure sale of the limited partnership interest.

In further response to our concerns voiced in previous articles, the February 18, 2005, NCCUSL amendments attempt to provide that an exception creditor may no longer force the judicial foreclosure sale of either a beneficiary's current distribution interest or a beneficiary's remainder interest.[107] Despite this general rule, there is an exception under UTC §503(b)(3). At the time the federal or state government adds itself as an exception creditor by statute, the federal or state government may also specify the remedy. Therefore, it is possible that certain federal or state statutes will allow the judicial foreclosure sale of the current beneficial interests as well as remainder interests.

Therefore, when comparing the judicial foreclosure sale under the UTC to judicial foreclosure sale of an FLP, any creditor could request the judicial foreclosure sale of a partnership interest. Hopefully, an exception creditor cannot force the judicial foreclosure sale of a beneficial interest. This rule may change, however, as state and federal governments add themselves as an exception creditor through legislation.

D. Forcing a Distribution

With a partnership, a creditor has no voting rights and may not force a distribution to reach the underlying assets. Under the UTC, a creditor has two possible avenues to force a distribution:

1. An estranged spouse for child support or alimony[108]
2. A bankruptcy trustee standing in the shoes of the debtor

The first exception creditor is limited to only a spouse. However, there has been a growing minority trend that allows for remainder interests to be classified as marital property eligible for division in the event of a divorce. With an estranged spouse becoming a creditor in over 50 percent of marriages, this is a major concern. As an undefined mandatory distribution, this is also a major concern because of the greatly increased litigation where all creditors must now go to court to determine how much should be distributed from the trust based on the undefined continuum of discretionary trusts. Finally, should a bankruptcy trustee standing in the shoes of the bankrupt, be allowed to force a distribution on behalf of all creditors? This power alone would greatly reduce the protection afforded by a spendthrift trust because virtually every creditor, including creditor card companies, would be able to use this method of recovery against beneficial interests.

VI. Conclusion

When compared to the common law asset protection for discretionary trusts, the UTC has substantially weakened the asset protection of discretionary trusts by equating them to support trusts that previously relied solely on spendthrift provisions. With regard to all spendthrift trusts, both the UTC and the RESTATEMENT THIRD's favorable creditor remedies have further reduced the asset protection of almost all spendthrift trusts. At first blush under the UTC, it appears that a discretionary or a spendthrift trust currently is a stronger asset protection tool than an FLP in a sole remedy state. On the other hand, in the future, if any one or more likely combinations of the following decreases in asset protection occurs, then the UTC will have been the primary cause for the reduction in the asset protection provided by spendthrift trusts to a level that is less than the asset protection provided by an FLP in a sole remedy jurisdiction:

- The bankruptcy trustee is added as an exception creditor under UTC §503(c).
- The bank lobby is successful in arguing for further exception creditors such as any exception creditor in excess of the reasonable needs of a beneficiary.
- Judges follow the "blank check" spirit of the RESTATEMENT THIRD to add more exception creditors.
- An "available resource" is created for many SNTs.
- A beneficiary is imputed income for the purpose of determining alimony or child support.

Unfortunately, the UTC makes radical changes to the asset protection of beneficial interests in trust to the detriment of almost all settlors and all beneficiaries. A graphical representation of the decrease in asset protection under the UTC for discretionary trusts and spendthrift trusts when compared to other tools is provided in Chart 4.

Chart 4

Combined Offshore/Domestic Asset Protection Trust	9
Offshore Asset Protection Trust	8
Offshore LLC–Sole Remedy	7
Discretionary Dynasty Trust	6–
Spendthrift Trust (*i.e.*, Support Trust with Age Vesting)	5+
Family Limited Partnership–Sole Remedy	5
Domestic APT	5
Exemption Planning	4
Family Limited Partnership–Judicial Foreclosure Sale	3

ENDNOTES

1 For a detailed analysis of the difference between discretionary and support trusts as well as their relationship to ascertainable standards, please see Chapter 3 of the treatise ASSET PROTECTION STRATEGIES, VOLUME II, Alexander A. Bove, Jr., editor, Mark Merric Author, American Bar Association 2004. For more information about this book, please contact the American Bar Association at *www.ababooks.org* or (800) 285-2221. Mark Merric and Douglas W. Stein, *The UTC Threatens Special Needs Trusts,* TRUSTS & ESTATES, Nov. 2004; Mark Merric and Steven J. Oshins, *The Effect of the UTC on the Asset Protection of Spendthrift Trusts,* 31 EST. PLAN. 375 ; Mark Merric and Steven J. Oshins, *UTC May Reduce Asset Protection on Non–Self Settled Trusts,* 31 EST. PLAN. 411; Mark Merric and Steven J. Oshins, *How Will Asset Protection of Spendthrift Trusts Be Affected by the UTC?* 31 EST. PLAN. 478. *See also* Mark Merric, Carl Stevens and Jane Freeman, *The Uniform Trust Code: A Divorce Attorney's Dream,* J. PRAC. EST. PLAN., Oct.–Nov. 2004, at 33; Mark Merric, Douglas Stein and Michelle Berger, *The Uniform Trust Code: "A Continuum of Discretionary Trusts" or "A Continuum of Continuing Litigation"?* J. PRAC. EST. PLAN., Dec. 2004–Jan. 2005, at 33; Mark Merric, Robert Gillen and Jane Freeman, *Malpractice Issues and The Uniform Trust Code,* EST. PLAN., Dec. 2004; Mark Merric and Robert F. Collins, *Can the Uniform Trust Code be Fixed?* LAW. WKLY.—Heckerling Ed., Jan. 3, 2005; Mark Merric and Douglas Stein, *The UTC: A Continuing Threat to Estate Planning,* EST. PLAN. REV., Jan. 21, 2005, at 1; Mark Merric and Douglas Stein, *The Uniform Trust Code and*

ENDNOTES

Asset Protection in Non–Self Settled Trusts, Steve Leimberg's ASSET PROTECTION NEWSLETTER #53; and Mark Merric, Douglas Stein and Robert Gillen, *The Effect of the UTC on ILITs,* Steve Leimberg's ESTATE PLANNING NEWSLETTER #733, at *www. leimbergservices.com,* Leimberg Information Services, Inc. (LISI). To download a copy of any of these articles on the UTC, please go to *www.internationalcounselor.com,* then to "Publications" and then to "Articles."

2 Both committees of the UTC and RESTATEMENT THIRD worked together to form the basis for these two promulgations. David M. English, *The Uniform Trust Code (2000): Significant Provisions and Policy Issues,* 67 MO. L. REV. 143 (Spring 2002), at 144. Unfortunately, in a few key areas, these committees created new theories of trust law as well as adopted several minority opinion views as their preferred view of trust law. Further, in many areas, the UTC is nothing more than a skeleton statute, where the tendons are the UTC comments with over one hundred specific references into the RESTATEMENT THIRD as well as a general interpretive reference in the comment to UTC §107. The RESTATEMENT is the real meat of many areas of interpretation in the UTC.

3 The UTC has begun to receive sharp criticism for a number of ambiguously drafted provisions. A fair amount of discussion regarding this issue has been on the ACTEC listserv Wealth Counsel and the ABA listservs.

4 Based on the issues voiced by those of us expressing of the UTC, the following amendments have been made by NCCUSL:

a. UTC §504(e) was added so that *any* creditor could not attach a sole trustee's interest. The ability for a creditor to attach a sole trustee's interest in a trust had no basis in common law.

b. UTC §501 was modified and a comment added in the hope that a judge would not interpret UTC §501 to mean that all creditors could attach at the trust level.

c. The comment under UTC §501 appeared to allow for the judicial foreclosure sale of current beneficial interests as well as remainder interests. Allowing the judicial foreclosure sale of current beneficial interests is a position that had virtually no legal support in common law. This comment has now been deleted. The UTC committee has added language referring to both the THIRD RESTATEMENT and SECOND RESTATEMENT regarding the judicial foreclosure sale of remainder interests. Regrettably, the UTC comment does not disclose that the RESTATEMENT THIRD has changed the strong presumption against the judicial foreclosure sale of a remainder interest to a presumption of a judicial foreclosure sale in favor of the creditor.

d. UTC §503(c) was added and the comment modified with the hope that the only remedy granted to an exception creditor was the ability to attach present and future distributions. After this amendment, hopefully an exception creditor, such as an estranged spouse, may no longer force the judicial foreclosure sale of a beneficiary's interest. Unfortunately, the specific language of the amended UTC does not reflect the intent of the amended comment. The specific language does not provide that attachment of present and future distributions is the sole remedy.

e. UTC §506 was modified so that an "undefined distribution" would not include a distribution to any standard where the trustee had any discretion regarding the amount or timing of a distribution.

5 *Supra* note 1.

6 *Supra* note 1.

7 For example, Chris Riser has had a much more positive practical experience with using FLPs as asset protection tools. Whereas the other authors have found the "porcupine theory" discussed later to be largely ineffective, Mr. Riser has found it to be effective. In this respect, Mr. Riser would rank an FLP event with the judicial foreclosure sale of the partner's interest higher than 3+.

8 UTC §504 first comment, RESTATEMENT (THIRD) OF TRUSTS, at §60, comment a.

9 For a discussion regarding the asset protection of a Nevada corporation as based on nothing more than perjury, please refer to the outline, *Perjury and the Nevada Corporation* at *www.internationalcounselor.com.*

10 Alaska Stat. §32.11.340.

11 Ariz. Rev. Stat. §29-341.

12 Nev. Rev. Stat. §88.535.

13 Okla. Stat. tit. 54, §342.

14 Ala. Code §10-12-35.

15 Alaska Stat. §10.50.380.

16 Ariz. Rev. Stat. Ann. §29-655.

17 Kan. Stat. Ann. §17-76,113.

18 Minn. Stat. §322B.32.

19 Nev. Rev. Stat. §86.401.

20 N.J. Stat. Ann. §42:2B-45.

21 N.D. Cent. Code §10-32-34.

22 Okla. Stat. Tit. 18, §2034.

23 Tenn. Code Ann. §48-218-105.

24 Wyo. Stat. § 17-15-145.

25 Fla. Stat. ch. 620.153; *In re Stocks,* BC DC Fla., 110 BR 65 (1989); *Givens v. National Loan Investors L.P.,* Fla. CtApp, 724 So2d 610 (1998).

26 Va. Code Ann. §50-73.46; *In Re Pischke,* BC DC Va., 11 BR 913.

27 *Herring v. Keasler,* N.C. App, 563 SE2d 614 (2002).

28 It should be noted that in the reported cases, the sale of the partnership interest was never consummated, because the debtor/partners agreed to settle the cases once the judge ordered the judicial foreclosure sale.

29 Haw. Rev. Stat. §425D-703.

30 2004 Ill. Laws 093-0967, §703 (Aug. 20. 2004).

31 2004 Iowa Acts ch. 1021 (Mar. 31, 2004).

32 Minn. Stat. Ann. §322A.57.

33 Colo. Rev. Stat. §7-80-703.

34 Del. Code Ann. tit. 6 §18-703.

35 Haw. Rev. Stat. §428-504.

36 805 Ill. Comp. Stat. 180/30-20.

37 Mont. Code Ann. §35-8-705.

38 R.I. Gen. Laws §7-16-37.

39 S.D. Codified Laws §47-34A-504.

40 Vt. Stat. Ann. tit. 11, §3074.

41 Va. Code Ann. §13.1-1040.1(4)(b)—Judicial foreclosure sale is implied by statute.

42 W. Va. Code §31B-5-504.

43 *Hellman v. Anderson,* Cal. CtApp, 233 CalApp3d 840, 284 CalRptr 830 (1991); *Crocker National Bank v. Perroton,* Cal. CtApp, 208 CalApp3d 1, 255 CalRptr 794 (1989).

44 *Madison Hills Limited Partnership II v. Madison Hills, Inc.,* Conn. AppCt, 35 ConnApp 81, 644 A.2d 363 (1994).

45 Ga. Code Ann. §14-9-703; *Nigri v. Lotz,* Ga. CtApp, 216 GaApp 204, 453 SE2d 780 (1995); *Stewart v. Lanier Medical Office Building, Ltd.,* Ga. CtApp, 259 GaApp. 898, 578 SE2d 572 (2003).

46 *Deutsch v. Wolf,* Mo. CtApp, 7 SW3d 460 (1999).

47 *Lauer Construction, Inc. v. Claude Schrift,* Md. App, 123 MdApp 112, 716 A2d 1096 (1998); *Gibson's Lodging v. Lauer,* Md. App, 352 Md. 310, 721 A2d 989 (1998).

48 *Baybank v. Catamount Construction, Inc.,* NH SCt, 141 NH 780, 693 A2d 1163 (1997).

49 *In re Priestley,* BC DC N.M., 93 BR 253 (1988).

50 *Larson v. Larson,* Ohio App., 2000 Ohio App. LEXIS 4788, 2000 WL 1566522.

51 *In re Allen,* BC DC Pa., 228 BR 115 (1998); *Auburn Steel Company v. American Steel Engineering Co.,* DC Pa., 1993 U.S. Dist. LEXIS 8971 (1993).

52 *Equitable Trust v. Roland,* Tex. CtApp, 644 SW2d 46 (1982). (This case did not directly rule on the issue of whether or not a creditor may foreclose on the limited partnership. Rather, when noting the facts, the court mentioned the trial court "entered an order foreclosing the interest." The Appellate Court did not disturb this holding.)

53 It should be noted that during this 15-year period, Florida has consistently held that a charging order was the sole remedy.

54 *In re Smith,* BC DC Ga., 17 BR 541, BANKR. L. REP. ¶68,637.

55 *Nigri, supra* note 45.

56 Rev. Rul. 77-137, 1977-1 CB 178.

57 For a detailed analysis of this issue, *see* Christoper M. Riser, *Tax Consequences of Charging Orders: Is the "K.O. by the K-1" K.O.'d by the Code,* ASSET PROTECTION J., Winter 2000, Volume I, Number 4.

58 *In re Ehmann,* BC DC Ariz., 319 BR 200 (2005).

59 11 USC §365.

ENDNOTES

[60] 11 USC §541.

[61] Distinguished colleague, John Sullivan, while at the bar drinking that fermented pond scum Irish beer.

[62] Distinguished colleagues Jay Adkisson and Chris Riser, *Ehmann—Bankruptcy Trustee Gets Debtor's Non-Economic Rights,* Steve Leimberg's ASSET PROTECTION PLANNING NEWSLETTER #59 (Feb. 8, 2005).

[63] *BayBank v. Catamount Const., Inc.*, SCt N.H., 141 NH 780, 693 A2d 1163 (1997); *Interpool Ltd. v. Patterson,* DC N.Y., 890 FSupp 259 (1995) and *Firmani v. Firmani*, SupCt N.J., 332 NJSuper 118, 752 A2d 854 (2000).

[64] *Litchfield Asset Management v. Howell*, SupCt Conn., CV980076827, 2000 Conn. Super. LEXIS 299.

[65] *Graybar Elec. Co. v. Keller Elec. Co.,* AppCt Ohio, 113 OhioApp3d 172, 680 NE2d 687, 689 (1996).

[66] *C.E. Reichardt Est.,* 114 TC 144, Dec. 53,774 (2000); *M.B. Harper Est.,* 83 TCM 1641, Dec. 54,745(M), TC Memo. 2002-121; *T.R. Thompson Est.,* 84 TCM 374, Dec. 54,890(M), TC Memo. 2002-246; *A. Strangi Est.,* 85 TCM 1331, Dec. 55,160(M), TC Memo. 2003-145; *L.K. Hillgren Est.,* 87 TCM 1008, Dec. 55,555(M), TC Memo. 2004-46, *I. Abraham Est.,* 87 TCM 975, Dec. 55,546(M), TC Memo. 2004-39.

[67] *Peterson v. Teodosio,* SCt Ohio, 34 OhioSt2d 161, 297 NE2d 113 (1973); *Bilovocki v. Marimberga,* 62 OhioApp2d 169, 405 NE2d 337 (1979).

[68] *Supra* note 2.

[69] *Supra* note 1.

[70] *In re Marriage of Jones*, SCt Colo., 812 P2d 1152 (1991); GEORGE G. BOGERT, THE LAW OF TRUSTS AND TRUSTEES, at §228 (2nd ed. 1979).

[71] Different courts define the term "bad faith" slightly differently. As used in this article, the term bad faith means the trustee (1) acts dishonestly, (2) acts with an improper motive, or (3) fails to use his or her judgment. *In Re Jones, id.* (citing *Scott on Trusts,* Section 130 at Page 409 (4th ed. 1989)). *See also* the detailed analysis of MARK L. ASCHER, AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, SCOTT ON TRUSTS, §187, at 15, where it is noted that if the distribution standard includes enlarged or qualifying adjectives such as "sole and absolute discretion" combined with "no fixed standard by which the trustee can be determined is abusing his discretion … the trustee's discretion would generally be deemed final."

[72] SCOTT ON TRUSTS, *id.* Section 187.2 provides, "Even though there is no standard by which it can be judged whether the trustee is acting reasonably or not, or though by the terms of the trust he is not required to act reasonably, the court will interfere where he acts dishonestly or in bad faith, or where he acts from an improper motive."

[73] *Bureau of Support in the Department of Mental Hygiene and Correction v. Kreitzer,* SCt Ohio, 16 OhioSt2d 147, 243 NE2d 83 (1968).

[74] *Strojek v. Hardin County Board of Supervisors,* AppCt Iowa, 602 NW2d 566 (1999) *see also* the follow-up unpublished opinion where the Iowa Appellate Court expanded the definition of the distribution language as much broader than "basic needs." *Strojek v. Hardin County Board of Supervisors,* AppCt Iowa, 2002 Iowa App. LEXIS 183, 2002 WL 180377; *see also* the unpublished opinion of *McCabe v. McKinnon,* AppCt Iowa, 2002 Iowa App. LEXIS 1326, 2002 WL 31757533.

[75] *Estate of Taylor v. Department of Public Welfare,* Pa. CommwCt, 825 A2d 763 (2003); *Shaak v. Pennsylvania Department of Public Welfare,* SCt Pa., 561 Pa. 12, 747 A2d 883 (2000); *Rosenberg Est.,* SCt Pa., 545 Pa. 27, 679 A2d 767 (1996); *Commonwealth Bank and Trust Co. v. Pennsylvania,* SCt Pa., 528 Pa. 482, 598 A2d 1279 (1991).

[76] *Metz v. Ohio Dept. of Human Services*, 762 AppCt Ohio, 145 OhioApp3d 304, 762 NE2d 1032 (2001).

[77] *Martin v. Martin,* SCt Ohio, 54 OhioSt2d 101, 374 NE2d 1384 (1978).

[78] *Mason v. Mason,* CtApp Fla., 798 So2d 895 (2001).

[79] *Chenot v. Bordeleau,* SCt R.I., 561 A2d 891 (1989); *Eckes v. Richland County Social Services,* SCt N.D., 2001 ND 16, 621 NW2d 851 (2001); RESTATEMENT (SECOND) OF TRUSTS, at §128, comments d and e.

[80] *In Re Graham,* CA-8, 726 F2d 1268, BANKR. L. REP. ¶69,705 (1984); *In re Stephens*, BC DC Vt., 47 BR 85 (1985).

[81] RESTATEMENT (SECOND) OF TRUSTS, at §157.

[82] *Guidry v. Sheet Metal Workers, Int'l Ass'n*, CA-10, 10 F3d 700 (1993); *Lundgren v. Hoglund*, SCt Mont., 219 Mont 295, 711 P2d 809 (1985). *But see* early common law held that a spendthrift provision generally protects a distribution received by a beneficiary from attachment. *Bucknam v. Bucknam*, SCt Mass., 294 Mass 214, 200 NE 918 (1936); *Jackson Square Loan & Sav. Ass'n v. Bartlett,* CtApp Md., 95 Md. 661, 53 A. 426 (1902); *Boston Safe Deposit & Trust Co. v. Collier*, SCt Mass., 222 Mass 390, 111 NE 163 (1916).

[83] RESTATEMENT (SECOND) OF TRUSTS, at §161.

[84] RESTATEMENT (SECOND) OF TRUSTS, at §162, Illustration 1. *See also, In Re Neuton,* CA-9, 922 F2d 1379, BANKR. L. REP. ¶73,788 (1990) (where the fact that the debtor would need to outlive his mother in order to take the trust property was not so contingent as to prevent the judicial foreclosure sale of a 25 percent of the debtor's interest by a bankruptcy trustee).

[85] For a detailed explanation of this emerging trend under common law, *see* Mark Merric, Carl Stevens and Jane Freeman, *The Uniform Trust Code: A Divorce Attorney's Dream*, J. PRAC. EST. PLAN., Oct.–Nov. 2004, at 33.

[86] RESTATEMENT (SECOND) OF TRUSTS*, at* §160. In the following cases, the court noted that the intergenerational nature of a dynasty interest prevented attachment by an estranged spouse. *In re Marriage of Guinn*, CtApp Colo., 93 P3d 568, (2004); *In re Marriage of Muelhaupt,* SCt Iowa, 439 NW2d 656 (1989); *D.L. v. G.L.,* AppCt Mass., 61 Mass. App. Ct. 488, 811 NE2d 1013 (2004).

[87] UTC §504, comment.

[88] RESTATEMENT (THIRD) OF TRUSTS, at §60, comment a.

[89] UTC §814(a). For a further discussion of this issue, please see Mark Merric, Douglas Stein, Carl Stevens, Eric Solem, Wayne Stewart and Mark Osborne, *The UTC Continues to Threaten SNTs Even After Amendment,* J. PRAC. EST. PLAN., Apr.–May 2005.

[90] Although comment b of the RESTATEMENT THIRD provides that "judicial intervention is not warranted merely because the court would have differently exercised its discretion," §50, comment b provides that "a court will not interfere with a trustee's exercise of a discretionary power when that exercise is reasonable and not based on an improper interpretation of the terms of the trust." RESTATEMENT (THIRD) OF TRUSTS, at §60, comment a. The comment continues, "[a] court will also intervene if it finds the payments made, or not made, to be *unreasonable* as a means of carrying out the trust provisions." (Emphasis added.) It should be noted that the RESTATEMENT THIRD, §50, comment c holds out the promise that the grant of extended discretion might provide some relief. However, this comment makes clear that it will be a matter of judicial interpretation whether or not such discretions "manifests an intention to relieve the trustee of *normal judicial supervision and control* in the exercise of a discretionary power over trust distributions" (emphasis added).

[91] *Martin, supra* note 77.

[92] *Dwight v. Dwight,* AppCt Mass., 52 MassAppCt 739, 756 NE2d 17 (2001).

[93] UTC §503.

[94] If there are 12 or fewer creditors, any one creditor with a claim greater than $11,625 may file an involuntary bankruptcy. If there are more than 12 creditors, then any three with claims aggregating greater than $11,625 may file an involuntary bankruptcy. 11 USC §303(b).

[95] RESTATEMENT (THIRD) OF TRUSTS, at §58, Reporter Comment a.

[96] RESTATEMENT (THIRD) OF TRUSTS, at §59, Comment a(2) (emphasis added). Should one wish to read the disdain the authors of the

ENDNOTES

RESTATEMENT THIRD have for spendthrift protection, please see §58, Reporter Comment a, at 367–78.

97 California—Cal. Prob. Code §15307; Connecticut—Conn. Gen. Stat. §52-321 (1991); Michigan—Mich. Comp. Laws §555.13 (1988). With respect to a trust that holds real estate, the rents and profits from the real estate may be reached by a creditor unless the trust provides that the rents and profits may be accumulated. New York—N.Y. Est. Powers & Trust Law §7-3.4; North Dakota—N.D. Cent. Code §59-03-10 (1995); South Dakota—S.D. Codified Laws §43-10-13 (1997).

98 *Supra* note 4, Item c.

99 UTC §504(c)(1).

100 UTC §504(d) recognizes that a beneficiary may always maintain an action to force a distribution for "abuse." Unfortunately, the UTC has redefined the word "abuse" to mean not acting in "good faith" under UTC §814(a).

101 For a further analysis of the property interest or sufficient enforceable right issue, *see* Mark Merric and Steven J. Oshins, *The Effect of the UTC on the Asset Protection of Spendthrift Trusts,* EST. PLAN., Aug.–Oct. 2004. *See also* RESTATEMENT (THIRD) OF TRUSTS, at §60, comment e and e(1).

102 For a further discussion of the UTC and the drafting options used by SNT attorneys, *see* Mark Merric and Douglas W. Stein, *The UTC Threatens Special Needs Trusts,* TRUSTS & ESTATES, Nov. 2004. *Supra* note 89; *see also* Metz, *supra* note 76.

103 *Dwight, supra* note 92. Also, for a further analysis of this issue, *see* Mark Merric, Carl Stevens and Jane Freeman, *The Uniform Trust Code: A Divorce Attorney's Dream,* J. PRAC. EST. PLAN., Oct.–Nov. 2004, at 33.

104 Sections 149-162 of the RESTATEMENT SECOND exclude the following types of trusts from this rule: (1) spendthrift trusts; (2) trusts for support; (3) and discretionary trusts from attachment at the trust level under §147. *In the Matter of Bass v. Denney,* CA-5, 171 F3d 1016 (1999) ("A universal cannon of Anglo-American trust law proclaims that when the trustee's powers of distribution are wholly discretionary the beneficiary has no ownership interest in the trust or its assets ..."); *In re Shurley*, CA-5, 115 F3d 333, BANKR. L. REP. ¶77,423 (1997) ("No part of a spendthrift trust or estate can be taken on execution or garnishment by creditors of the beneficiary"). Please *also see* Westlaw key note 189 K 32 where almost all of the cases cited support under the most frequently cited case listing support the rule that a creditor cannot garnish the funds at the trust level. This again points out the problem when one cites the RESTATEMENT THIRD as authority. The Reporter's notes do not disclose when the RESTATEMENT THIRD chose to follow a distinctly minority view, one which contradicts the RESTATEMENT SECOND, and common law in general.

105 LORING, A TRUSTEE'S HANDBOOK, §5.3.3, at 171 (Rounds ed. 2004).

106 *Supra* note 4.

107 *Supra* note 4, d.

108 UTC §503(c).