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Which Trust Situs is Best in 2014?

The perfect storm or clouds on the horizon?

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In January 2013, the American Taxpayer Relief Act of 2012 made the $5 million gift, estate and generation-skipping transfer (GST) tax exemptions more or less "permanent." The combination of these generous tax exemptions, historically low interest rates and depressed asset values has provided an unprecedented opportunity for high-net-worth (HNW) individuals and families to engage in highly effective trust and asset transfer planning.

Competition for trust business among U.S. jurisdictions and institutions remains robust. The need for planning professionals to be aware of and understand the different trust laws and planning opportunities, particularly for their HNW clients, is vital. What was said to have been "the perfect storm" for clients two years ago remains true today, but there may be clouds on the horizon.

There's a cool caution in the wind about which planning tools will be available and which perceived loopholes Congress and the administration will choose to scrutinize. In the "best" trust jurisdictions, clients are able to provide their heirs with the most effective wealth transfer for generations, even perpetually, while eliminating current and future federal or state death taxes. So, which factors are most important to consider? In the January 2012 issue of *Trusts & Estates,* we provided a matrix for comparing the relative strengths of the then-28 jurisdictions that had repealed or modified their rules against perpetuities (RAP). In 2014, the number of perpetual or near-perpetual jurisdictions is 29.[1] In addition, other laws in several jurisdictions have changed, so we've updated the ranking matrix and expanded our discussion of those factors.[2]

We'll discuss and evaluate five broad categories as they relate to the strength of trust laws: (1) a jurisdiction's form of any applicable RAP or the law that determines how long a trust may legally exist; (2) whether a state has inheritance, income or premium taxes; (3) what modern trust laws have been adopted, how state courts have interpreted those laws and how accommodating the financial and legal systems are to trusts; (4) what asset protection laws exist and their legal interpretations; and (5) the effect of migration on the rights of beneficial interests.

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Top-tier Jurisdictions

In our view, the four top-tier jurisdictions for 2014 (listed by the year they adopted their perpetuities legislation) remain South Dakota,[3] Delaware, Alaska and Nevada. We rank New Hampshire in fifth place. Delaware has been in the top four jurisdictions consistently for the past 10 years, but we think its asset protection laws need to be strengthened for it to remain competitive. New Hampshire is a perpetual trust jurisdiction that has strengthened its trust laws similar to the top-tier jurisdictions. But, New Hampshire's domestic asset protection trust (DAPT) laws aren't, in our opinion, as strong as those of the highest ranked states.

Six jurisdictions have improved their laws and asset protection reputations in the past two years and round out the second and third tiers. These jurisdictions are: Wyoming, Florida and Ohio in our second tier; and Illinois, Tennessee and Utah in our third tier. Wyoming has a 1,000-year perpetuities period and other features, including, recently, a decanting statute. Florida has a 360 term-of-years perpetuities period and no state income tax but lacks domestic DAPT features. Tennessee has a 360 term-of-years perpetuities period and both decanting and directed trust statutes but can improve its asset protection laws. Utah has a 1,000 term-of-years perpetuities period and has adopted directed trust and self-settled trust legislation, but it has an income tax. Illinois is an opt-out jurisdiction and has added new directed trust and trust protector provisions. Ohio is also an opt-out jurisdiction, has adopted self-settled trust legislation and has strengthened its discretionary trust protection. Most of the remaining trust jurisdictions, however, have lagged behind with respect to modern trust laws or have less impressive DAPT laws.

We've created our rankings using objective criteria similar to those we used in the 2010 and 2012 articles in this journal. We have, however, modified the importance of several factors. We hope these changes will help bring more clarity and provide you with a balanced view as you consider the nuances of all the jurisdictions' laws and how those laws might serve your clients' needs—or adversely impact them.

RAP: Perpetual or Near-Perpetual

Under the common law RAP, an interest in trust must vest, if at all, within the period of a life in being, plus 21 years (plus a reasonable period for gestation). Several states have adopted the Uniform Statutory Rule Against Perpetuities (USRAP), which sets the duration of a trust to the greater of the RAP or 90 years. In those states that have repealed or modified the RAP, it's possible to exempt from gift, estate and GST taxes all trust assets for as long as the trust is permitted to exist. Over the past 62 years, 28 states and the District of Columbia have abolished or modified their RAP, in whole or in part, so that trusts created in those jurisdictions can last forever or, at least, for very long periods of time.

In 1986, Congress adopted the GST tax regime that incorporated some assumptions and safe harbors patterned after either the RAP or the USRAP. But, three jurisdictions already had abolished their RAP and, instead, adopted a more flexible Rule Against Alienation and Suspension of Powers (RAASP): Idaho (1957), Wisconsin (1969) and South Dakota (1983). These actions established the first perpetual trust jurisdictions.

Congress permanently extended and increased the GST tax exemption in 2012. Internal Revenue Code Section 2642 provides a GST tax exemption of $5.34 million (indexed for inflation) for each spouse in 2014 (a married couple may exempt up to $10.68 million). When these larger estate and GST tax exemptions are combined with effective perpetual trust planning strategies, most large estates may legally eliminate transfer taxes.

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Since the federal GST tax was adopted, 26 more jurisdictions have modified or repealed their RAP or USRAP. Of those, eight abolished their RAP and/or USRAP: Alaska,[4] Delaware, Missouri, New Hampshire, New Jersey, Pennsylvania, Rhode Island and North Carolina.

A growing number of other state legislatures, including California and New York, have considered some changes to their RAP or USRAP. There are 18 jurisdictions that didn't abolish it altogether—some because of longstanding policy concerns, constitutional barriers or political resistance. Rather, they've merely modified their RAP in some way. In those jurisdictions, it may be impossible to abrogate the rule fully. In eight of those states, the perpetuities periods have been extended to a term of years: Colorado (1,000 years), Florida (360 years), Nevada (365 years), Tennessee (360 years), Utah (1,000 years), Wyoming (1,000 years), Washington (150 years) and, most recently, Alabama (360 years). The remaining jurisdictions are what are known as "opt-out" jurisdictions. There, the RAP or USRAP is retained, and by statute, the interests in a trust are permitted to "opt-out" of or be exempted from the perpetuities period. These jurisdictions include: Arizona, the District of Columbia, Hawaii, Illinois, Maine, Maryland, Michigan, Nebraska, Ohio, Virginia and, most recently, Alabama. California considered promoting opt-out legislation, but there's been no change of law.

In 2003, author Garrett Moritz, in a *Harvard Law Review Note*,[5] outlined six approaches that jurisdictions have undertaken to create perpetual or long-term trusts. These approaches fall into three broad categories:

(1) the *Murphy* case perpetual trust approach,
(2) the term-of-years trust approach, and
(3) the opt-out trust approach.

Murphy Approach

In 1979, in *Murphy v. Commissioner,* the Tax Court affirmed Wisconsin's method of repealing its RAP. Known as "the *Murphy* approach," this case upholds a Wisconsin law that provided for the complete repeal of the RAP and substitution of a more flexible, alternate vesting statute. This approach addresses both the RAP's timing and vesting elements for GST tax exemption purposes. The *Murphy* approach is considered the best perpetual trust jurisdiction law method.

Delaware, New Hampshire and South Dakota are the strongest of these truly perpetual jurisdictions.[6] South Dakota is the only original *Murphy* jurisdiction of the three. Alaska is also a very strong contender, but has a 1,000-year power of appointment (POA) statute. Delaware has similar issues if a limited POA (LPA) is utilized. These four states, as a group, are the leaders in competitive trust legislation.

The remaining *Murphy* trust jurisdictions have done little to maintain their competitiveness in trust law or asset protection. Exceptions are Idaho, which has adopted a trust protector statute and, recently, North Carolina, which now has a directed trust statute.

Term-of-Years Approach

The second most utilized approach is the term-of-years approach. Nevada and Wyoming are the most progressive jurisdictions using this approach; they also keep their trust laws current, and neither state has an income tax. Utah added adopted self-settled trust legislation but has done little else in the asset protection arena.

Jurisdictions like Florida and Tennessee follow this approach too, but fall short of perpetual trust status because they still rely on a trust term limit. Florida, however, has adopted a directed trust statute, decanting and reformation and virtual

representation laws, and it has no state income tax. Tennessee has also adopted self-settled trust legislation.

As noted by trust expert Richard Nenno, the term-of-years approach isn't preferred to the *Murphy* approach. However, if a term-of-years jurisdiction has incorporated the safe harbor vesting provisions of *Murphy*, our opinion is that the result for GST tax exemption purposes may be the same as with other *Murphy* jurisdictions.[7] If the vesting and timing requirements of *Murphy* are met, the term-of-years period should work for the purposes of the GST tax and continue the GST tax exemption for the full term limit. For example, while the Tennessee statute limits the RAP period to 360 years, it also provides an alternate possible vesting at 90 years.[8]

Opt-out Approach

The opt-out RAP approach is the least favorable for trusts, primarily because the RAP or USRAP is maintained as part of state law, so the underlying perpetuities period is unchanged. While there are arguments about whether this statutory approach is effective for purposes of creating a truly exempt trust in perpetuity, the trust and DAPT laws of these jurisdictions aren't generally well developed when compared to the more competitive jurisdictions. But, there are some exceptions. While Arizona has an income tax, it now has directed trust, trust protector, decanting and reformation and virtual representation statutes. Illinois doesn't tax the income of trusts that were created by non-resident grantors; has among the lowest premium tax; has adopted both directed trust and trust protector elements in its laws; and provides a virtual representation feature (that is, provides for the administration and court supervision of trusts in which there are contingent, unborn or unascertainable beneficiaries). Ohio doesn't tax trusts created by non-resident grantors[9] and has a directed trust statute. It also added asset protection and self-settled trust legislation. Virginia, the District of Columbia and Maine also have directed trust statutes, and Virginia has added additional creditor protection and self-settled trusts.

The remaining opt-out jurisdictions lack any modern trust features that are important in our rankings. The result of these opt-out exception statutes remains unclear for the purposes of the continued GST tax exemption, beyond the stated underlying statute (RAP/USRAP) of the jurisdiction. While some opt-out states have attempted to blend the *Murphy* vesting exception into their statutes, it's unclear whether the *Murphy* vesting language is effective, unless the underlying RAP/USRAP is abrogated.[10]

A Federal RAP?

Among President Obama's 2014 budget proposals is a durational limit on the GST tax exemption of 90 years. If enacted, this would create an artificial federal RAP. This proposal is non-revenue producing because it won't generate any tax revenue for nearly a century. Since 28 states and the District of Columbia have already adopted perpetuities laws that have more liberal or unlimited periods, there should be strong Congressional push back against this proposal.[11]

The laws of the various states define property interests under constitutional notions of federalism. When Congress established the GST tax rules, the rules looked to state law to determine the actual perpetuities period that would or wouldn't apply in each jurisdiction. Prior to 1986, Idaho, South Dakota and Wisconsin had already repealed the RAP, in effect, establishing perpetual trusts. Congress created the GST tax exemption to shield a specific amount from the GST tax and to permit families to plan for future generations. And, multigenerational

trusts are often paired with family foundations and other charitable structures to teach the importance of philanthropy and connection to community.[12]

State Income/Premium Taxes

Whether a state imposes a state income tax and, to a lesser extent, taxes insurance premiums, are important issues. The state income taxation of a non-grantor trust accumulating income can have a deteriorating effect on trust corpus. This erosion is particularly evident with perpetual trusts. Often, clients choose to change the situs of their trust just to legally avoid the payment of state income taxes.

Six states—Alaska, Florida, Nevada, South Dakota, Washington and Wyoming—are the only perpetual or nearly perpetual jurisdictions with no state income tax. There are six additional jurisdictions that have a state income tax for residents, but exempt non-resident grantors and beneficiaries of perpetual trusts from state income tax: Delaware, Illinois, New Hampshire, Ohio, Tennessee and Wisconsin.

Income taxation of trusts is becoming a more complex question as a result of litigation in Connecticut and the District of Columbia, as well as proposed legislation and informational reporting requirements in New York and elsewhere.[13] A handful of states attempt to continue to tax a trust regardless of a change of situs to another jurisdiction. This trend has become more common as states have looked for additional tax revenues in a tight economy.

Taxes on insurance premiums are another factor to consider. The least expensive premium tax jurisdictions are South Dakota (8 basis points), Alaska (10 basis points), Illinois (50 basis points), Wyoming (75 basis points) and Nebraska (100 basis points).

The other highly ranked jurisdictions have higher premium taxes: New Hampshire (125 basis points), Florida (150 basis points), Delaware (200 basis points) and Nevada (350 basis points). (See "Situs at a Glance," pp. 68-71, for a list of premium taxes for all jurisdictions.)

Modern Trust Laws

During the past decade, competitive perpetuities jurisdictions have tried to keep pace with the development of modern trust laws. There are various elements to consider when drafting a trust in a perpetuities environment, including:

(1) Effectiveness of flexible trust planning and administration tools, including LPAs and the ability to decant or reform a trust if necessary;

(2) Ability to change situs for income tax and estate tax purposes without triggering a constructive addition problem;

(3) Presence of an effective directed trust statute so that investment and distribution direction may be separated from the duties of the administrative trustee;

(4) Statutory acknowledgment of the role of trust protector;

(5) Treatment of other non-resident fiduciaries doing business with the trust (often clients want to use multiple trust advisors). This element includes the use of special purpose entities to provide limited liability for such advisors;

(6) Situs rules under applicable law (including possible conflict-of-laws issues) and setting a clear standard for which situs to apply;

(7) Statutory authority for trust reformation and decanting, with clear access to courts;

(8) Virtual representation;

(9) Effective privacy laws; and

(10) Ability to facilitate and administer private family trust companies (PTFCs).

LPA—This tool is included to create intergenerational flexibility by allowing a power holder to appoint assets to various beneficiaries. But, note IRC Section 2041 (a)(3),

which prevents the abuse known as the "Delaware tax trap,"[14] referring to the exercise of successive LPAs over successive generations, allowing for a virtual perpetual trust without federal transfer taxes. As such, the use of LPAs are generally reserved for beneficiaries and decedents who're ascertainable on the creation of the trust to prevent the inadvertent violation of Section 2041(a)(3). Otherwise, this action could be considered a constructive addition (that is, a material or substantial change in the beneficial interests of the beneficiaries) and potentially endanger a trust's zero GST tax-exempt inclusion ratio.

Flexibility for future generations is often achieved through other means for discretionary trusts, such as advisory committees, trust advisors with the power to invest and direct distributions and removal and replacement powers.

Alaska is the only perpetuities jurisdiction that has adopted a POA statute that exceeds what would be typically permitted under the safe harbor under Section 2041(a)(3). While Alaska is a *Murphy* jurisdiction for perpetuities purposes, at least one authority is concerned that the use of a POA provision beyond the safe harbor would create a constructive addition for GST tax purposes.

Change of situs—The ability to change the situs of trusts is often important to HNW clients who seek to shop for the most favorable laws. When considering a situs change, examine the wording of the trust's provisions, including perpetuities language and the applicable law. Look at a possible negative impact such a change would have on the GST tax-exempt status of the trust and its effect on beneficiary rights.

Another related issue is which law may apply to a trust that's changed its situs for the purpose of taking advantage of a perpetual state's trust laws. The recent *Peierls* decisions[15] make clear that Delaware law will govern the administration of any trust that allows for the appointment of a successor trustee without geographic limitation once a Delaware trustee is appointed and the trust is administered in Delaware, unless the choice-of-law provision expressly provides that another jurisdiction's laws shall always govern the administration (even if the place of administration or situs changes). According to *Peierls*, the ability to appoint a trustee in Delaware reflects the settlor's implied intent that Delaware law will govern the administration of the trust. This is the result when the trust instrument is silent as to governing law or even when the trust instrument provides that some other jurisdiction's laws shall govern.

A change of situs among *Murphy* states isn't likely to create a constructive addition because the perpetuities laws are the same. But, a change in situs may affect which state's law apply. It should be noted that, for example, a Florida trust with specific language requiring the Florida perpetuities period to apply, could be administered in another state that would continue to honor and apply Florida law.[16]

Directed trust statute—Such a statute permits bifurcating or even trifurcating the fiduciary responsibility among different advisors and directed trustee(s). This freedom allows the client to select an independent party, typically designated as a co-trustee or "trust advisor," to manage both closely held and investment assets, distributions or other fiduciary duties. This selection relieves the directed or administrative trustee from the duty and liability to manage the trust assets. Directed trusts also provide more flexibility and control over asset allocation, concentration and selection of investments. Directed trust fees are typically lower to reflect the fact that this trustee isn't liable for the trust's investment activities.[17]

Trust protector statute—A trust protector is any disinterested third party whose appointment is provided by the trust instrument and whose powers are provided in the governing instrument and in state law. Such powers may include: modification

or amendment of the trust instrument to achieve a favorable tax status or to address changes in the IRC, state law or applicable rules and regulations; the increase or decrease of the interest of any trust beneficiaries, including the power to add beneficiaries in some circumstances; and modifications of the terms of a POA. Such a statute recognizes the authority and limitations of a person or entity that's been appointed as a trust protector. This recognition provides greater flexibility for future generations as conditions change. A trust protector is a "must" for a purpose trust (that is, a trust that lacks beneficiaries and instead exists for advancing some non-charitable purpose of some kind). Delaware and South Dakota have special provisions for perpetual purpose trusts, and only Alaska, Arizona, Delaware, Idaho, Nevada, New Hampshire, South Dakota and Wyoming have trust protector statutes.[18]

Reformation and decanting statutes—Reformation and decanting statutes permit a trust to be reformed within certain parameters to better meet a family's needs. Historically, only judicial action could reform a trust; this process often required the consent of all the beneficiaries or a court-approved equitable deviation.[19] In addition, a trustee might, under common law, have the power to make distributions of trust property to another trust, even one created by that trustee. Under certain circumstances, this power may be inferred from the governing documents based on the trustee's discretion. Uniform Trust Code (UTC) Section 411(a) provides two options: modification with or without court approval. Older versions of the UTC didn't require court approval for a modification with the consent of the settlor and all the beneficiaries.[20]

Choosing the most appropriate decanting statute depends on the nature of the trustee's discretionary authority and whether the beneficiaries of the new trust include contingent beneficiaries of the original trust.[21] South Dakota's decanting statute appears to provide the best example of flexibility for trust remodeling.[22] Several states have followed this model.

Trustees or beneficiaries might wish to modify an irrevocable trust to:

(1) improve a trust's governance structure;
(2) change the law applicable to the trust when the terms of the trust don't facilitate a change to its governing law;
(3) change dispositive provisions;
(4) change the administrative terms of the trust to ensure that the trust provides the proper tools to its fiduciaries for the best management of the trust; or
(5) modernize an outdated trust agreement.

Another situs consideration: Advisors should check the respective state courts' experience with judicial reformation and modifications and the procedures, costs and time involved.[23]

Both reformation and decanting statutes provide trustees and trust beneficiaries flexibility without negative GST tax consequences if certain requirements are met. The final GST tax regulations create a safe harbor for four types of modifications, none of which affect the grandfathered status of a trust.[24] A decanting or modification that qualifies for one of these safe harbors won't cause a GST-exempt trust to lose its exempt status.[25]

Special purpose entities—Unregulated special purpose entities are, generally, business entities used in combination with a directed trust structure to limit the liability of fiduciaries and to more directly tie the trust to the chosen jurisdiction. These may include trust protectors, trust advisors and investment and distribution committees, as well as other individuals and professional entities that serve in advisory and investment roles on behalf of a directed trust. These entities are

typically in the form of a limited liability company (LLC) organized under the laws of the jurisdiction that permits the special purpose entity. The scope and purpose of such entities is generally limited to a single client or family group. Alaska, Delaware, Nevada, New Hampshire, South Dakota and Wyoming permit special purposes entities.

Some insurers provide coverage to an entity established specifically for these purposes, thus protecting the trust protector and committee members. Special purpose entities also provide legal continuity beyond any single individual's death, disability or resignation. The entity's bylaws generally allow for additional members to be added or removed so that the entity can continue along with the trust. These entities need to be properly structured to avoid estate tax inclusion issues.

Virtual representation statutes—Virtual representation statutes are important for discretionary multi-generational trusts. These statutes are designed to facilitate the administration and court supervision of those trusts in which there are contingent, unborn or unascertainable beneficiaries. Typically, if there's no person "in being" or ascertained to have the same or similar interests, it's necessary to appoint a guardian ad litem to accept service of process and to protect such interests.

The seven jurisdictions that have virtual representation statutes are: Alaska, Arizona, Florida, Illinois, Nevada, South Dakota and Washington. Delaware has a limited version of virtual representation. The UTC also provides a form of virtual representation.[26]

PFTCs—Many HNW families want to establish a PFTC to handle all of their trust work. In 2013, the most popular perpetual or near-perpetual jurisdictions that permitted PFTCs were: Nevada, New Hampshire, South Dakota and Wyoming. Of these jurisdictions, South Dakota and Nevada contain the greatest number of PFTCs.[27] Often, PFTCs are administered with the assistance of a local trust company that can provide situs-based administrative services at greater cost efficiencies.

The capital requirements for establishing a PFTC differ by jurisdiction and remain the same as they did in 2012. Currently, in capital, Nevada requires $300,000,[28] New Hampshire requires $500,000, South Dakota requires $200,000 and Wyoming requires $500,000. Increasingly, banking regulators are encouraging PFTCs to pledge larger capital requirements than just the minimum amount, especially as PFTCs mature.

Some commentators view lower capital requirements as an advantage because they're less of a barrier to entry into the PFTC arena. Others say that having larger capital requirements tends to weed out less serious and capable PFTC candidates.

Third-Party Trusts

When clients seek asset protection for their descendants, they're typically concerned about protecting a child's inheritance from: (1) claims of an estranged spouse; and/or (2) claims from third parties.

In our 2012 article,[29] we discussed the greater asset protection provided by a discretionary trust, particularly when states had codified the *Second Restatement of Trusts (Restatement Second)*.[30] This advantage arises because discretionary trust protection originated under English common law and has nothing to do with spendthrift protection. Rather, it's based on the fact that a beneficiary doesn't have an enforceable right to a distribution;[31] therefore, no creditor may stand in the shoes of a beneficiary. In this respect, the beneficiary's interest isn't a property interest[32] and is nothing more than an expectancy that can't be attached by any creditor.[33]

A discretionary trust under the *Restatement Second* protects against the most likely creditor, an estranged spouse, in three ways:

1. Since a beneficiary's interest in a trust doesn't rise to the level of property, it doesn't become marital property; therefore, it's not subject to division in a divorce.
2. An estranged guardian spouse can't stand in the shoes of a minor child beneficiary and force a distribution on behalf of a minor child.
3. Maintenance or child support is determined by historic distributions to a beneficiary, not an imputed amount that's based on what the trust could have distributed to a beneficiary.[34]

The key to asset protection planning regarding almost all of the aforementioned issues is to draft a discretionary trust in which the beneficiary doesn't have an enforceable right to a distribution.[35] Under English common law, the *Restatement of Trusts (Restatement First),* the *Restatement Second* and almost all case law on point, all of this law was relatively consistent, and estate planners could draft a discretionary distribution standard with relative certainty that a beneficiary didn't have an enforceable right to a distribution, and the beneficiary didn't hold a property interest. Unfortunately, with almost no case law to support its position, the *Restatement Third of Trusts (Restatement Third)* reverses how a court should interpret a distribution standard so that it will almost always create an enforceable right in a discretionary trust. Many estate planners believe that the national version of the UTC follows the *Restatement Third's* position regarding this issue. In response to this problem, jurisdictions (including some UTC states) have adopted statutes codifying the *Restatement Second* in this area. Absent a statute codifying the *Restatement Second*, even if a state has strong *Restatement Second* case law, a court may reverse its position and adopt the *Restatement Third's* newer view of discretionary trusts. Thus, a statute codifying the *Restatement Second* is the only sure method to preserve the asset protection of a common law discretionary trust.

When drafting a discretionary trust statute, the following four areas, listed in order of relative importance, must be included:

1. The legal ramifications of a discretionary interest. In other words, the statute must state that a beneficiary who holds a discretionary interest doesn't hold a property interest or an enforceable right to a distribution.
2. The concept that no creditor may attach a discretionary interest.
3. The *Restatement Second's* elevated judicial review standard for a discretionary interest, in which a judge would only review the trustee's distribution decision if the trustee acted: (1) with an improper motive; (2) dishonestly; or (3) without using its judgment.[36]
4. The definition of a discretionary trust, so planners will know the correct distribution language that should be used.

South Dakota and Oklahoma are the lead states that address all four of the above elements by statute. The Michigan UTC was modified to address all but the third factor. Likewise, in 2013, Alaska added AS Section 34.40.113, which incorporates all but the third factor. Delaware and Nevada are the only lead jurisdictions that don't specifically say that a discretionary interest isn't a property interest and don't give a beneficiary an enforceable right to a distribution. Delaware's proposed solution is to prohibit Delaware courts from using Articles 50 and 60 of the *Restatement Third* and have them use the judicial review standard of the *Restatement Second* Section 187.[37]

Other methods that a creditor might use to pierce a third-party trust are dominion and control and alter ego arguments. South Dakota has the best protection against these types of claims, followed by Indiana, Nevada and Oklahoma, which have "good" protection in this area. Delaware took a different approach. Its statute provides that a creditor has no more rights than provided by the trust document itself. On one hand, for so long as the drafting attorney is aware of the type of creditor language that needs to be added to a Delaware trust, this may prove to be a novel approach. On the other hand, whether it will prevent a Delaware court from using the equitable dominion and control remedy is uncertain.

Self-Settled Trust Legislation

Thirteen states have self-settled trust legislation. Space doesn't permit a detailed discussion of the pros and cons of each of these statutes, except for the limited discussion below. In this respect, "Situs at a Glance," pp. 68-71, has been limited to a "Best," "Yes" or "No" approach. For a detailed discussion of these statutes, please see the articles listed in the endnotes.[38] We find Alaska, Delaware, Nevada, Ohio and South Dakota have the best self-settled trust legislation.

In an article we wrote in January 2013 for this journal,[39] we also discussed that the existence of exception creditors, such as child support or maintenance, did little to weaken the asset protection of a DAPT. From a practical standpoint, we've never come across a situation in which a client was proposing to create a DAPT with the objective of shirking a child support obligation.

Estate Tax Inclusion

DAPTs are typically drafted one of two ways: (1) as an incomplete gift, in which all trust property will be included in the settlor's estate; or (2) as a completed gift, with the view that the trust assets will be excluded from the settlor's estate, even though the settlor is one of the beneficiaries. Planners have different views regarding whether a DAPT can escape estate tax inclusion. Our position is that the drafter, as well as the local law of the DAPT, would need to address all of the following issues under IRC Section 2036(a)(1) to avoid estate inclusion: (1) retained life interest, (2) the implied promise rule, and (3) the trust assets are used for a legal obligation of the settlor.

Retained life interest. To determine whether there's an estate inclusion issue under Section 2036(a)(1)
for a DAPT, one must look to the common law classification of trusts to determine if a beneficiary holds an enforceable right to a distribution. Generally, in determining whether a beneficiary has this right, there are primarily three classifications of trust interests: (1) mandatory;[40] (2) support; and (3) discretionary.

Usually, a mandatory distribution standard requires that a fixed amount, percentage or definition of income be paid out annually. For tax purposes, a qualified terminable interest property trust, which requires all income to be paid to the surviving spouse, is a mandatory distribution. The annuity or unitrust interest in a grantor retained annuity trust or a charitable remainder unitrust is also a mandatory distribution. Similarly, a $100,000 distribution to a certain beneficiary that's required to be made each year is a mandatory distribution. If the settlor holds a mandatory distribution interest, there's an estate inclusion issue under Section 2036(a)(1).[41]

Under common law, the term "support trust" means that the distribution creates an enforceable right in a beneficiary based on a standard. Generally, a support trust is created with mandatory words, such as "shall" or "must," combined with a standard that's capable of judicial interpretation. For example, courts have determined the following language to create a support trust:

- "[T]he trustee *shall* pay … [to the settlor's] daughters such reasonable sums *as shall be needed* for their care, support, maintenance, and education" [emphasis added].[42]

- "[T]he Trustee *shall* use a sufficient amount of the income to provide for the grandchild's support, maintenance and education" [emphasis added].[43]

If the settlor/beneficiary has an enforceable right to a distribution, again, there's an estate inclusion issue.[44] But, if a settlor holds a discretionary interest that's neither an enforceable right to a distribution nor a property interest under local law, there's no estate inclusion issue under the retained life interest rule.[45] For purposes of this article, the term "common law discretionary trust" refers to a trust in which a beneficiary has neither an enforceable right to compel a distribution nor a property interest, and no creditor may attach such interest. Under common law, the term "purely discretionary trust" or "wholly discretionary trust" didn't require that the distribution interest have no standards. Rather, almost all common law discretionary trusts contained a standard for making distributions. Under the *Restatement Second*, the most important factor in determining a discretionary trust was granting the trustee sole, absolute or unrestricted discretion.[46] The discretionary statutes of Alaska, Michigan (non-DAPT state), New Hampshire, Ohio, Oklahoma (non-DAPT state) and South Dakota greatly clarify this issue when compared to the alternative of letting a court decide it under either the *Restatement Third* or the UTC.

Implied promise theory. Courts have used three fact scenarios to conclude that there was an oral (that is, implied) promise that a trustee would make a distribution to the settlor/beneficiary whenever he requested such a distribution.

Prior to the IRS' first successful attacks against partnerships under a Section 2036 implied promise theory, much of the case law for recovery under the implied promise theory dealt with a tax scam commonly known as the "Constitutional trust" (also known as a "pure trust," "equity trust," "apocalypse trust" or "contract trust"). With these trusts, a settlor was also the beneficiary of the trust (for example, in a self-settled trust). Promoters of Constitutional trusts claimed that neither the settlor (nor the trust) should pay any income tax because the settlor didn't control anything. Promoters also claimed that there should be no gift tax because the settlor was transferring property in exchange for beneficial shares. Finally, promoters claimed that there was no estate tax liability because the settlor, who was also a beneficiary of the trust, held nothing more than a mere expectancy of a distribution.

The income tax and gift tax conclusions were false for the following reasons. Notably, the income tax benefits were misstated because of the grantor trust rules. The transfers were, in fact, completed gifts (that is, the beneficial shares had no voting rights, no rights to profits and no rights to liquidation proceeds). The settlor's exchange of property for any beneficial shares was an exchange of property for a piece of paper with no value—that is, a gift. Conversely, the promoters were correct that there's no direct estate tax inclusion rule for a mere expectancy, even for a settlor/beneficiary.

Therefore, the IRS challenged the Constitutional trust indirectly under the implied promise theory that after formation, continuous distributions were made only to the settlor, as a beneficiary, to meet the settlor's personal expenses. So, the IRS argued, there must have been an oral promise between the settlor/beneficiary and the trustee for the trustee to make continuous distributions to the settlor

whenever he requested.[47] Thus, the trust should be includible in the settlor/beneficiary's estate.

The IRS has also argued in two other scenarios that an implied promise to make a distribution occurred whenever the trustee distributed a large part of the trust assets only to the settlor[48] and whenever a settlor transferred almost all of his net worth to a Constitutional trust, particularly in the elder years when he would need the assets the most.[49]

The good news is that these implied promise issues may be avoided with proper planning. First, a settlor should always leave enough assets in his estate for ordinary living expenses throughout the remainder of his expected life. Second, a trustee shouldn't make substantial distributions only to the settlor. Finally, the settlor shouldn't transfer almost all of his assets to a DAPT.

Legal obligation of the settlor. Some commentators have expressed concern that exception creditors or federal super creditors may result in an estate tax inclusion issue under some DAPT statutes because these types of creditors may reach the assets of a DAPT for a legal obligation of the settlor.

With respect to comparing third-party trusts to self-settled trusts, over half of the jurisdictions provide for a child support exception creditor. To a lesser extent, alimony is an exception creditor. Finally, to a much lesser extent, governmental claims, necessary expenses of a beneficiary and attorney's fees are exception creditors in some states.

As previously noted, a settlor's interest in a self-settled trust should be drafted so that the settlor/beneficiary doesn't have an enforceable right to a distribution under local law. However, unlike offshore APTs that address asset protection from the English discretionary nature of the beneficiary's interest, DAPTs relied on American spendthrift protection. As such, almost all DAPTs created exceptions to the spendthrift provision, allowing these exception creditors to reach a settlor's/beneficiary's interest. If an exception creditor can reach a beneficiary's interest, does this create an estate inclusion issue under Section 2036?

Treasury Regulations Section 20.2036-1(b) states:

> (2) The 'use, possession, right to the income, or other enjoyment of the transferred property' is considered as having been retained by or reserved to the decedent to the extent that the use, possession, right to the income, or other enjoyment is to be applied toward the discharge of a legal obligation of the decedent, or otherwise for his pecuniary benefit. The term 'legal obligation' includes a legal obligation to support a dependent during the decedent's lifetime.

At first glance, it appears that all DAPTs that provide for any exception creditor would be included in a settlor's estate. However, there's a position that certain exception creditors constitute "acts of independent significance." In the event an action is classified as an "act of independent significance," there's not an estate tax inclusion issue. For example, let's say a trust provides that the settlor's children are the beneficiaries. After the creation of the trust, the settlor and his spouse give birth to another child. By the terms of the trust, the newborn child is automatically added as a beneficiary. Unless childbirth (and adoption) are acts of independent significance, the act of childbirth would change the beneficial interests of the trust under Sections 2036(a)(2) and 2038(a)(1). That's why Revenue Ruling 80-255 was issued, holding that a trust beneficiary who's added through birth or adoption is an act of independent significance; therefore, there's no estate inclusion issue.

Related to a child support exception creditor, we question whether Rev. Rul. 80-255 is on point. Not paying child support is simply not paying a legal support obligation. It seems to be quite a bit of a stretch to analogize the birth or adoption of a child to not paying child support years later, presumably after a divorce.

Another act of independent significance occurs when a settlor changes a beneficial interest through the act of divorce. In *Estate of Tully,*[50] a decedent had entered into an employment contract whereby the employer promised to pay death benefits to his widow. The Court of Claims held that the decedent didn't have the power to revoke, within the meaning of Section 2038, even though the decedent could have divorced his spouse, thereby eliminating the spouse's possible status as widow. The court held, "In reality, a man might divorce his wife, but to assume that he would go through an entire divorce process merely to alter employee death benefits approaches the absurd."[51] A similar result was reached in Technical Advice Memorandum 8819001 (Jan. 6, 1988).

The above acts of independent significance directly deal with a spouse's beneficial interest in an employment contract or a trust that's terminated by a divorce. The court in *Tully* noted that the settlor would have the power to terminate the interest by filing for divorce; however, to do so solely for the purpose of altering beneficial interests would be absurd. We're in general agreement that a child support exception creditor should be considered an act of independent significance, and we're also hopeful for the same result with alimony. However, in addition to child support and alimony, the *Restatement Second* and *Restatement Third* include the following exception creditors:

1. governmental claims;
2. attorney's fees; and
3. necessary expenses of a beneficiary.

It's questionable whether the exception creditors of governmental claims, attorney's fees and necessary expenses of a beneficiary would be classified as acts of independent significance. Therefore, DAPT statutes with these exception creditors may have estate inclusion issues. Alaska, Nevada and South Dakota are currently the only states with no exception creditors.[52] Wyoming allows a child support exception creditor, and Delaware and New Hampshire allow both child support and alimony exception creditors.

Federal super creditors may be viewed as another type of exception creditor. Federal super creditors have their own federal statute under which they may collect. They don't collect under state procedures, as provided by Fed. R. Civ. Pro. 69(a)(1).[53] Examples of federal super creditors are the IRS, the Securities and Exchange Commission and environmental claims under the Comprehensive Environmental Response, Compensation and Liability Act. These creditors may reach any assets, regardless of state spendthrift protection, that rise to the level of a federal property interest. Fortunately, a common law discretionary interest is the only type of trust beneficial interest that's not a federal property interest. Again, this points to the importance of a discretionary trust statute that affirmatively states that a discretionary interest is neither an enforceable right nor a property interest.

Charging Order Protection

Often, either a family limited partnership (FLP) or LLC is owned partially or wholly by a trust. This situation strengthens the likelihood that an out-of-state judge will apply the governing law of the trust under conflict-of-laws principles. This result occurs because an LLC or FLP interest is personal property and, in addition to the factors of the governing law of the trust and the place of administration, some of the trust property is now held in the same state.

Endnotes

1. Jesse Dukeminier and James E. Krier, "The Rise of the Perpetual Trust," 50 UCLA Law Review 1303, 1316. See Idaho Code Section 55-111 (Michie 2000);

Wisconsin Statute Section 700.16(5) (1999); South Dakota Codified Laws Section 43-5-8 (Michie 1997). See also Delaware Code Ann. Tit. 25 Section 503 (a) (Supp. 2000); 765 Illinois Comp. Stat. Ann. 305/4 (West 2001); Alaska Stat. Section 34.27.100 et. al.; New Jersey Stat. Ann. Section 46:2F-9 (West Supp. 2002); Ohio Rev. Code Ann. Section 2131.08(B) (West Supp. 2003); Maryland Code Ann. Estates & Trusts Section 11-102(C) (2001); Florida Stat. Ann. Section 689.225 (West 2003); Arizona Rev. Stat. Ann. Section 14-2901 (A)(1) (West Supp. 2002); Missouri Ann. Stat. Section 456.025 (West Supp. 2003); Nebraska Rev. Stat. Sections 76-2001 (1996 and Supp. 2002); Colorado Rev. Stat. Sections 15-11-1102.5 (2006); Maine Rev. Stat. Ann. Tit. 33, Sections 101 (West 1964); Rhode Island Gen. Laws Section 34-11-38 (Supp. 2003); Virginia Code Ann. Section 55-13-3(C) (Michie Supp. 2002); District of Columbia Code Sections 19-904(a)(10), 19-901 (2002); Washington Rev. Code Ann. Section 11.98.130 (West 2002); Wyo. Stat. Ann. Section 34-1-139 (2003); New Hampshire Rev. Stat. Ann. Section 547:3-k and 564:24 (West, Westlaw through 2003 Sess.); Utah Code Ann. Sections 75-2-1201 (Lexis Supp. 2002); Nevada Rev. Stat. Sec-
tion 111.1031 (See Nev. Rev. Stat. Ann. 2 Sections 111.103-1039 (Michie Supp. 2004); Tennessee Code Ann. Section 66-1-202(f)(2007); North Carolina Gen. Stat. Section 41-15 (2007); 20 PSA Section 6107.1 (2007); MCLA Section 554.71 (2008); Haw. Rev. Stat. Section 525-4(6)(2010). We now add Alabama—Ala. Code Sec-
tion 35-4A-5(9). See generally Richard A. Oshins and Steven J. Oshins, "Protecting and Preserving Wealth into the Next Millennium [Part Two]," Trusts & Estates (October 1998) at p. 68; Daniel G. Worthington, "The Problems and Promises of Perpetual Trusts," Trusts & Estates (December 2004) at p. 15.

2. In our view, the methodology for ranking trust jurisdictions addresses two related questions: (1) Does the jurisdiction permit truly perpetual trusts or something less? and (2) does a jurisdiction have other trust laws and practices that give it an edge? We believe that experience with existing perpetual trust laws, administrative issues, ease of interaction with the courts and other trust law issues are all important considerations. See Daniel G. Worthington and Mark Merric, "Which Situs is Best in 2012?" Trusts & Estates (January 2012) at p. 51; Daniel G. Worthington and Mark Merric, "Which Situs is Best?" Trusts & Estates (January 2010) at p. 54; Daniel G. Worthington, "Latest Perpetual Trust States—Latest Rankings," Trusts & Estates (January 2007) at p. 59; Mark Merric, "How to Draft Distribution Standards for Discretionary Dynasty Trusts," Estate Planning, March 2009. Compare Steve J. Oshins, "1st Annual Dynasty Trust State Rankings Chart" (updated July 2013), http://wwwoshins.com/images; with " 4th Annual Domestic Asset Protection Trust State Rankings Chart" (updated July 2013), http://wwwoshins.com/images/ DAPT_Rankings.pdf.

3. In the interest of full disclosure, author Daniel G. Worthington served as associate dean of the University of South Dakota School of Law (1992 to 1994) and now serves on the audit committee and board of directors for the South Dakota Trust Company, located in Sioux Falls, S.D. He's a member of the Utah State Bar.

4. While Alaska adopted an "opt-out" type perpetuities statute in 1997 for certain trusts, it later adopted a Murphy-type statute (in 2000) to resolve the rule against perpetuities (RAP) problem. It also adopted a 1,000-year power of appointment (POA) statute that may effectively limit the generation-skipping transfer (GST) tax exemption of a trust. See Richard Nenno, "Relieving Your Situs Headache: Choosing and Rechoosing the Jurisdiction for a Trust," 2006 Heckerling Tax Institute.

5. See Garrett Moritz, "Dynasty Trusts and the Rule Against Perpetuities," 116 Harvard Law Review 8 (June 8, 2003). See also Daniel G. Worthington,

"Problems and Promises of Perpetuities Planning," Trusts & Estates (October 2005) at p. 10.

6. These jurisdictions often are referred to as the "original Murphy jurisdictions" after the case validated this approach. See Estate of Murphy v. Commissioner, 71 T.C. 671 (1979), in which the Tax Court held that the Delaware tax trap wasn't violated in Wisconsin. The Internal Revenue Service acquiesced in Murphy.

7. The result in the term-of-years states should be no different from the result in Murphy states (with the exception that the term of years is set) if:
(1) there's a real possibility of a vesting or alienation of the trust interests; and
(2) that method of vesting is described in the statute (for example, vesting or alienation occurs with the trustee's ability to sell or distribute assets). If these conditions are met, the term-of-years period should work for purposes of the GST tax and continued GST tax exemption for the full term limit. For a contrary view, see Nenno, supra note 4 at 3-1; 3-51.

8. See TCA Section 66-1-202(f). The common law rule is generally applicable, but:

[a]s to any trust created after June 30, 2007, or that becomes irrevocable after June 30, 2007, the terms of the trust may require that all beneficial interests in the trust vest or terminate or the power of appointment is exercised within three hundred sixty (360) years. Provided, however, this section (f) shall only apply to trusts that grant a power of appointment at death to at least one member of each generation of beneficiaries who are beneficiaries of the trust more than ninety (90) years after the creation of the interest. The permissible appointees of each such power of appointment must at least include all descendants of the beneficiary, yet may include other persons.

9. Residency is determined by the domicile of the person who transferred the net assets to the trust. See OHIO R.C. 5747.01(A)(6), (I) and (S), 5747.02 and 5747.05 at Section 5.

10. See Arizona's ARS Section 14-2901(A)(3) and compare with Illinois' IL ST Ch. 765, Section 305/4 and Maine's 33 ME RSA Section 101-A. See also Maryland's MD Est. & Trust Section 11-102(5); Missouri's V.A.M.S. Section 456.025(1); and Elizabeth M. Schurig and Amy P. Jetel, "Summary of State Rule Against Perpetuities Laws,"
www.abanet.org/rppt/meetings_cle/2007/Jointfall/Joint07/JointEstateandGi... ofspendthrifttrustlaws.pdf.

11. Eileen Reichenberg Sherr, "A look at the estate tax provisions in the president's FY 2014 budget proposal," Journal of Accountancy (April 2013), www.journalofaccountancy. com/News/20137766.

12. Daniel G. Worthington and Daniel D. Mielnicki, "In Defense of Multigenerational Trusts," Trusts & Estates (January 2011) at p. 60.

13. See Paul Comeau and Jack Trachtenberg, "Corporate Fiduciaries, Advisors and Other 'Co-Trustees'—Perhaps Your Trust Isn't Exempt from New York Income Tax," 38 NYSBA Trusts & Estate Law Section Newsletter 1 (Spring 2005).

14. The so-called "Delaware tax trap" is one example of how the federal and state laws may interact to create unexpected results. It may be a concern for a trust created in a state where a trust might last beyond the common law RAP or the Uniform Statutory Rule Against Perpetuities (USRAP). Prior Delaware law provided the opportunity for a perpetual trust without federal transfer taxes through the exercise of successively limited POAs over generations. Internal Revenue Code Section 2514(d) was enacted to prevent this result from happening. The current section dealing with this issue is IRC Section 2041(a)(3).

15. See In the Matter of Peierls Family Inter Vivos Trusts, No. 16812 (Del. Oct. 4, 2013); In the Matter of Ethel F. Peierls Charitable Lead Trust, No. 16811 (Del. Oct. 4, 2013); and In the Matter of Peierls Family Testamentary Trusts, No. 16810 (Del. Oct. 4, 2013). "Todd Flubacher & the Delaware Supreme Court's Opinions in Peierls," Steve Leimberg's Estate Planning Email Newsletter (Archive Message #2152). See also Nenno, supra note 4; Dukeminier and Krier, supra note 1 at p. 1316.
16. Some states require a trust be administered in the state for the laws of the state to apply. This requirement is important because one can't merely say in a trust instrument that the laws of State X will apply, if State X has rules that govern the situs of trusts. See Peierls, ibid.
17. See, for example, SDCL 55-1B et seq. Similar directed trust statutes were patterned after the South Dakota law in other jurisdictions, including Nevada, New Hampshire, Utah, Wyoming, and most recently, Alaska's newest statute patterned after the South Dakota law. See "Situs at a Glance," pp. 68-71.
18. See, for example, SDCL 55-1B-6 (South Dakota). This is the first trust protector statute adopted by a U.S. jurisdiction. Also, South Dakota has the most expansive quiet trust statute, allowing the protector to keep the trust quiet after a grantor's death or disability, if desired. In addition, trust protectors are required for purpose trusts. Only Delaware and South Dakota have the special dynasty provisions for purpose trusts.
19. See Rashad Wareh, "Trust Remodeling," Trusts & Estates (October 2007) at p. 18. Restatement (Third) of Trusts (Restatement Third), Section 66, provides:

> The court may modify an administrative or distributive provision of a trust, or direct or permit the trustee to deviate from an administrative or distributive provision, if because of circumstances not anticipated by the settlor the modification or deviation will further the purposes of the trust.

This section presents an interpretation of the doctrine of equitable deviation. See also Jonathan G. Blattmachr, Diana S.C. Zeydel and Michael L. Graham. "The Act of Decanting: Amending Trusts Without Going to Court," InterActive Legal (2009) at pps. 1-5.

20. Wareh, ibid at note 19, p. 14. The Uniform Trust Code (UTC) was amended at the request of the American College of Trust and Estate Counsel (ACTEC) to include an option requiring court approval. ACTEC's concern was that if court approval wasn't required, IRC Section 411(a) might expose irrevocable trusts in those states that previously required court approval to estate tax. See Blattmachr, ibid, at p. 3. See Diana S.C. Zeydel, LISI Estate Planning Newsletter #2139 (Sept. 10, 2013) at www.LeimbergServices.com, citing Morse v. Kraft, 466 Mass. 92 (2013); Phipps v. Palm Beach Trust Company, 142 Fla. 782 (1940); Wiedenmayer v. Johnson, 106 N.J. Super. 161 (App. Div.), aff'd sub. nom., Wiedenmayer v. Villaneuva, 55 N.J. 81 (1969); Restatement Third; Treasury Regulations Section 26.2601-l(b)(4)(i)(A)(l)(i).
21. Wareh, supra note 19 at note 3. First New York (1991), then Alaska (1998), Delaware (2003), Tennessee (2004) and, most recently, South Dakota (2007) and North Carolina (2009) enacted decanting statutes. See New York Estates Powers & Trusts Law 10-6.6(b); Alaska Statutes Section 13.36.157; Delaware Code Annotated 12 Section 3528; Tennessee Uniform Trust Code Section 816(b)(27); South Dakota 2007 Session Laws HB 1288; North Carolina General Statutes, Section 36C-8-816.1. See also Blattmachr, supra note 19 at p. 1 (Arizona and Florida as additional states that have adopted decanting statutes).
22. Blattmachr, supra note 19 at p. 19 (South Dakota's decanting statute, effective July 1, 2007, provides the most flexibility for trust remodeling). Compare Jonathan G. Blattmachr, Bethann B. Chapman, Mitchell M. Gains and David D. Shaftel, "New Alaska Law Will Enhance Nationwide Estate Planning—Part 1," Estate Planning, Vol. 40/No. 9 at p. 3 (September 2013).

23. In addition, some states may have newer statutes that may have never been fully tested in the courts. Some of the more established jurisdictions have more streamlined procedures. Legal fees and other considerations may differ based on the court required process and delays. See Wyo. Stat. Ann Section 4-10-816(a)(xxviii) for an example of a new basic decanting statute.
24. Wareh, supra note 19 at note 25; Treas. Regs. Section 26.2601-1(b)(4). One safe harbor applies to the exercise by a trustee of a discretionary power to distribute trust principal from a grandfathered trust to a new trust, but only if the discretionary power is pursuant either to the terms of the trust instrument or to the state law in effect at the time the trust became irrevocable. Another safe harbor applies to a modification of a grandfathered trust that doesn't shift a beneficial interest to a lower generation or postpone vesting.
25. ACTEC's concern was that if court approval wasn't required by state law, then IRC Section 411(a) might expose irrevocable trusts in those states that previously required court approval to estate tax under an IRC Section 2038 theory. South Dakota has modified its law to require court approval. Telephone discussion between Daniel G. Worthington and Al King, CEO, South Dakota Trust Company, Oct. 26, 2009, discussing Wareh's concern (see note 19).
26. The UTC, which has virtual trust provisions, has been adopted by 22 states.
27. South Dakota and New Hampshire have regulated private family trust companies (PFTCs), while Nevada and Wyoming focus on unregulated PFTCs for families, even though they have regulated statutes. While Texas isn't a perpetual jurisdiction, it ranks third with Nevada as the state that has the largest number of PFTCs. See John P.C. Duncan, "The Private Trust Company, Single Family PTC Formations in Key States," Fall Forum (October 2009).
28. See Nevada Senate Bill 310, Section 26, 3(a), which amends NRS Section 669.100.
29. Worthington and Merric, supra note 2.
30. Restatement (Second) of Trusts (Restatement Second), Section 155(1) and comment (1)b.
31. Ibid.
32. Mark Merric, "How to Draft Distribution Standards For Discretionary Dynasty Trusts," Estate Planning (March 2009) endnote 41, lists cases from 16 states, noting that a discretionary distribution interest isn't a property interest.
33. Under common law, the majority rule was that a discretionary interest couldn't be attached. Note that the Restatement Third and the UTC reverse common law in this area allowing a creditor to attach a discretionary interest. However, five UTC states have modified the national version of the UTC to retain common law in this area.
34. Tannen v. Tannen, 31 A.3d 621 (N.J. 2011) affirming the appellate court, 3 A.3d 1229 (2010), for substantially the same reasons. The appellate court discusses, in detail, the proposed change to discretionary trust law by the Restatement Third and concludes that it would create an enforceable right in all discretionary trusts for imputing maintenance and declines to adopt the new position.
35. One of the other issues is a remainder interest being considered a future marital property interest under some states laws. The solution is to draft dynasty trusts.
36. Restatement Second Section 187 comment j and Section 122. While this isn't the judicial standard of review adopted by all courts, it's by far the most common discretionary trust judicial review standard (courts from 14 states and two other countries use it). See Merric, supra note 32.
37. Delaware originally had specific language that stated, "A discretionary interest is neither an enforceable right nor a property interest." SB 117, passed in 2007. However, SB 247 was passed that deleted the legal result of a discretionary trust

under 12 Del.Code Section 3313(f) and replaced it with the Restatement Second's judicial review standard. Whether a Delaware court will see the 2008 legislation as rejecting the proposition that a discretionary beneficiary doesn't have an enforceable right to a distribution or a property interest is uncertain.

38. Mark Merric and Daniel G. Worthington, "Domestic Asset Protection Trusts," Trusts & Estates (January 2013) at p. 52; David Shaftel, "Comparison of Domestic Asset Protection Trust Statutes," Estate Planning (March 2008); Mark Merric, John E. Sullivan, III and Robert D. Gillen, "Wyoming Enters the DAPT Legislation Arena," Steve Leimberg's Asset Protection Planning Email Newsletter #109 and "Searching For Favorable DAPT Legislation: Tennessee Enters the Arena," Steve Leimberg's Asset Protection Planning Email Newsletter #105.
39. Merric and Worthington, ibid.
40. For creditor purposes, the Restatement Second provided spendthrift protection to both mandatory and support trusts and, therefore, doesn't make a distinction between these two types of trusts. The Restatement Third and UTC don't provide protection for a mandatory distribution that's overdue, thereby reducing the asset protection under common law and creating a third classification for creditor purposes.
41. Estate of Uhl, 241 F.2d 867 (7th Cir. 1957) as to the $100 mandatory income distribution that resulted in estate inclusion of the corpus necessary to produce the $100 payment.
42. In re Carlson's Trust, 152 N.W.2d 434 (S.D. 1967).
43. McElrath v. Citizens and Southern Nat. Bank, 189 S.E.2d 49 (Ga. 1972). In re Carlson's Trust, ibid.
44. Estate of Boardman v. Comm'r, 20 T.C. 871 (1953); Estate of John J. Toeller, 165 F.2d 665 (7th Cir. 1946); and Blunt v. Kelly, 131 F.2d 632 (3rd Cir. 1941). For creditor purposes, when a beneficiary has an enforceable right to a distribution, it's referred to as a "support trust."
45. Estate of Uhl, supra note 41, as to the principal that was wholly in the discretion of the trustee "the settlor reserved no right to compel the trustee to pay him any sums . . ." Both Estate of German, 7 Cl. Ct. 641 (1985) and Estate of Wells, 475 F.2d 1142 (Ct. of Claims 1964) are self-settled discretionary trust cases in which the court held in favor of the taxpayer, and it appears the IRS didn't attempt to argue that there was an enforceable right in a discretionary trust.
46. For further discussion on drafting discretionary dynasty trusts, see the three-part series, Mark Merric, "How to Draft Distribution Standards For Discretionary Dynasty Trusts," Estate Planning (February 2009, March 2009, April 2009), www.InternationalCounselor.com.
47. Estate of Skinner, 197 F. Supp. 726 (3rd Cir. 1963); Estate of Marguerite Green,
64 TC 1049 (1971), but see Estate of Wells, T.C. Memo. 1981-574, in which all income was paid to the settlor, but she used such distributions only for travel, not ordinary and necessary expenses.
48. Estate of McCabe, 475 F2d 1142 (Ct.Cl. 1964).
49. Estate of Paxton, 86 T.C. 785 (1986).
50. Estate of Tully, 528 F.2d 401 (Ct. Cl. 1976).
51. Ibid.
52. Ala. St. 34.40.110 creates an exception creditor for child support if the settlor is in default at the time of the transfer; SD. St. 55-16-55 creates an exception creditor for child support and alimony to the extent of an amount owed at the time of the transfer; and Nevada leaves the issue silent, allowing a court to decide whether these are exception creditors at a later date. From a practical standpoint, a settlor will almost always be current with child support and/or

alimony at the time of the transfer. Therefore, these three states, in practice, don't have any exception creditors.

53. For a detailed discussion of federal super creditors, see Mark Merric, Michael J. Bland and Mark Monasky, M.D., "Beware of Federal Super Creditors," Trusts & Estates (July 2010) at p. 14.

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