WealthManagement.com

TRUSTS & ESTATES

WEALTH PLANNING > ESTATE PLANNING

Which Trust Situs is Best in 2022?

An updated ranking matrix

Daniel G. Worthington , Mark Merric | Dec 17, 2021

In our view, the four top-tier trust jurisdictions for 2022 (listed here by the year they adopted their rule against perpetuities (RAP) legislation) are South Dakota, Alaska, Nevada and Delaware. These states are followed by a second tier of jurisdictions: Tennessee, Wyoming, Ohio and New Hampshire. We've prepared a matrix that explains our factors in the ranking of the 35 jurisdictions that have modified or abrogated their RAP permitting long-term or perpetual trusts. In 2021, Texas was added to the list of trust jurisdictions with an extended perpetuities period (300 years);[1] it's yet to be determined just how competitive Texas will be among the jurisdictions mentioned in this article.[2] The top four tiers of trust jurisdictions are described below in this article, together with "Best Situs at a Glance ," p. 58, which is our updated matrix that highlights all the jurisdictions with a RAP permitting long-term or perpetual trusts.

Multigenerational Trust Planning

In 2022, the trust business in the United States continues to represent a multi-trillion dollar industry in assets under administration. Competition for trust business among U.S. jurisdictions and institutions remains robust. That trend should continue, but the focus on such competition will evolve because of the pressure to change the federal transfer tax and state statutory regimes. The political pressures are ever increasing as Congress seeks to create new tax revenue to pay for President Biden's infrastructure, social spending and climate initiatives. Not to mention the large unfunded liabilities of the United States.

There's an increased scrutiny on the financial affairs of the affluent around the world. Controversies and calls for greater transparency and social justice also impact the international wealth community.[3] Within the United States and elsewhere, there are further questions about equity and fairness in tax structures and who should pay and who shouldn't. Affluent U.S. families tend to be very charitably inclined when compared with other families in other parts of the world. In 2020, the largest source of charitable giving came from individuals with assets of $324.10 billion, representing 69% of total giving.[4] Ironically, because of tax rules and income taxation of trusts and estates, trusts already pay a disproportionate amount of federal income tax.

U.S. trust companies have remained mostly above the fray. This is due in part to the excellent tax and compliance systems in the United States. Know your customer and anti-money laundering rules have been long in place because of the war on terror and drugs. Trusts pay a disproportionate share of federal income taxes because of the smaller exemptions and lower tax thresholds imposed by Congress. This burden is expected to increase as a result of additional surtaxes proposed in new legislation by Congress and President Biden.

Over the past 25 years, the trust industry has evolved to be more responsive to the needs of its clients and advisors. Leaders in the top jurisdictions have worked very hard to promote laws that provide important flexibility to clients, while maintaining a vigilant regulatory system. These efforts should be lauded and not bemoaned. The present state of affairs is far superior to what the trust industry was like 25 years ago.

New Developments

In 2021, both the President and Congress proposed reducing the federal transfer tax exemptions from $11.58 million per individual in 2021 to half of that amount effective Jan. 1, 2021.[5] Also included in the proposal were a bevy of changes that would have been unwelcome news for the clients and the estate-planning community. The good news is that few of these tax law changes will impact trust and estate planning in 2022.

For the past eight years, we've reported that the federal tax regime represented "the perfect storm" for ultra-high-net-worth (UHNW) clients as a planning environment. President Biden's Build Back Better (BBB) framework proposed numerous changes that would have ended that perfect storm (for the most part). Yes, large trusts will pay higher income taxes if their income exceeds $200,000, but a series of other proposed changes that would have dramatically changed trust and estate planning were left on the edit room floor.

The BBB framework includes a new surtax on the income of multi-millionaires and billionaires—the wealthiest 0.02% of Americans—a 5% rate for income above $10 million and an additional
3% surtax on income above $25 million. The surcharge would be effective for tax years beginning after Dec. 31, 2021.[6]

The BBB framework intends to "close the loopholes that allows [sic] some wealthy taxpayers to avoid paying the 3.8% Medicare tax on their earnings."[7] But the results for the affluent could have been far worse.

By Oct. 28, 2021, the Rules Committee website posted 1,684 pages of legislative text.[8] The tax provisions that would be of most interest to the estate-planning community and closely held businesses and their owners appear in "Subtitle G —Responsibly Funding Our Priorities." Fortunately, the following measures *weren't* in the bill:

(1) reduction by 50% of the unified estate and gift tax exclusion amount;

(2) the elimination of the basis step-up for property acquired from a decedent;

(3) the additional restrictions on profits interests;

(4) the limitation on the use of like-kind exchanges;

(5) the limitations on the use of grantor trusts;

(6) the elimination of valuation discounts for interests in business entities to the extent the value thereof is attributable to marketable securities or other liquid assets;

(7) the requirement that banks disclose information regarding certain transfers to and from accounts;

(8) the increased tax rate on the long-term capital gains of non-corporate taxpayers; and

(9) the increased top rate on the ordinary income of non-corporate taxpayers.[9]

The final bill is far from certain. The Democrats' thin majority in the Senate has yet to gain agreement. Sen. Ron Wyden (D.-Ore.) has already said that he intends to continue pushing for his wealth tax.[10] Sen. Bernie Sanders (I.-Vt.) has stated that he wasn't ready to support the smaller social welfare plan introduced by the President. The state and local tax (SALT) deduction caucus continues to insist that the budget bill should include meaningful relief from the $10,000 cap on the itemized deduction for SALT. Even Sen. Joe Manchin (D.-Va.) and Sen. Kyrsten Sinema (D.-Ariz.) haven't yet publicly endorsed the $1.75 trillion budget.[11]

What's the bottom line for clients? If they've already decided to transfer property to a trust in furtherance of their estate and asset protection planning goals, there's no reason to delay. However, the threat of losing the larger estate tax exclusion amount at the beginning of 2021 appears to have abated. Loss of the grantor trust advantages, reduction in the generation-skipping transfer (GST) and gift and estate tax exemptions appear to be off the table for now. However, remind clients that the transfer tax exclusions are still scheduled to sunset after 2025. We don't know where the political winds will be blowing at that time.

Wealth Preservation Opportunities

There continues to be marked differences between the laws of those jurisdictions that we consider "the best" for trusts and those that we deem less competitive. Planning professionals who cater to UHNW clients need to understand the different trust laws and planning opportunities and how they affect those clients and their beneficiaries. This is especially true when the landscape for planning strategies for their UHNW clients is under tremendous pressure to change.

In the January 2020 issue of *Trusts & Estates*, we provided a matrix to compare the relative strengths of the then-34 jurisdictions that had repealed or modified their RAPs. In 2022, the number of perpetual or near-perpetual jurisdictions is 35, with the addition of Texas (300 years).[12]

In addition, the laws in several jurisdictions have changed, and the factors that we consider important to compare have been modified, so we've updated the ranking matrix and expanded our discussion of those factors.

The Trust Matrix

In the design of the 2022 "Best Situs at a Glance " matrix, p. 58, we've outlined five broad categories (including 25 subcategories) as they relate to the strength of trust laws and how to evaluate them (1) a jurisdiction's form of any applicable RAP or the law that determines how long a trust may legally exist; (2) whether a jurisdiction 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 system is to trusts; (4) what asset protection laws exist and their legal interpretations; and (5) the effect of migration on the rights of beneficial interests from jurisdiction to jurisdiction.

Top-tier Jurisdictions

In our view, the four top-tier jurisdictions for 2022 (listed by the year they adopted their RAP legislation) are South Dakota, Alaska, Nevada and Delaware. Each of these jurisdictions scored high in most categories of the trust matrix.

We rank Wyoming, Tennessee, New Hampshire and Ohio in the second tier. Recently, Tennessee and Wyoming have done the most to strengthen their trust laws. While Tennessee has a 360 term-of-years RAP period, Tennessee has decanting and directed trust statutes and recently improved its asset protection laws. Tennessee, like Nevada, is one of the states that has a constitutional prohibition against perpetuities that may be of a concern. Wyoming has been in the second tier consistently for six years. Wyoming has a 1,000-year RAP period and other features, including a decanting statute and a revamped, significantly strengthened domestic asset protection trust (DAPT) law. Wyoming has both regulated and unregulated private family trust company (PFTC) statutes, which makes it one of the preferred choices for single PFTCs. New Hampshire is a perpetual trust jurisdiction that's strengthened its trust laws similar to the top-tier jurisdictions. However, New Hampshire's DAPT laws aren't, in our opinion, as strong as those of most of the highest ranked states. Ohio has strengthened its laws in the past several years and is an emerging jurisdiction. Ohio is an "opt-out" state but is similar to Tennessee and Wyoming in that it's adopted a stellar DAPT statute. Ohio's discretionary trust protection also remains problematic.

Three jurisdictions improved their laws and asset protection reputations in the past several years and round out the third tier: Florida, Illinois and Utah. Florida has a 360 term-of-years RAP period and no state income tax but lacks domestic DAPT features. Illinois is an opt-out jurisdiction and has added new directed trust and trust protector provisions. Utah has a 1,000 term-of-years RAP period and has adopted directed trust and self-settled trust legislation, but it has an income tax. Utah has recently adopted the Uniform Voidable Transfers Act, which contravenes its DAPT statute.

Most of the remaining trust jurisdictions are lagging behind with respect to modern trust laws or have less impressive DAPT laws. As a new near perpetual jurisdiction, Texas bears watching as time tests the merits of its new trust laws. Texas has no income tax, but its premium tax isn't competitive. It permits discretionary trusts, decanting and has a limited trust protector statute, but doesn't have a DAPT statute.

Perpetual Trusts

We've created our rankings using objective criteria similar to what we used in our past *Trusts & Estates* articles. We've streamlined this article to omit the description of the differences in the perpetual trust jurisdictions, although the principal difference among perpetual or nearly perpetual jurisdictions boils down to whether the RAP has been abrogated completely, modified to include a term of years only or provided an "exception-only statute." We've opined in previous articles that the best perpetual jurisdictions are the ones that have completely abrogated the rule.[13] Term of years and exception-only statutes present their own set of issues that complicate future choices for affluent clients.

Perpetual trusts are particularly effective for UHNW families who are intergenerationally minded. They protect and preserve family assets and businesses from disparate claims of creditors and erosion due to estate taxes over the generations. Perpetual trusts are often paired with family charitable entities to help preserve intergenerational purposes and values and to create a matrix for family governance and accountability.

We focus the remainder of our discussion on the other factors provided in the chart that define which trust situses are the best.

Pre-1986 Perpetual Trust States

The three pre-1986 jurisdictions, Idaho, South Dakota and Wisconsin abrogated their RAP before the enactment of the GST tax by Congress. Because the GST tax wasn't the reason for the abrogation of the RAP in these jurisdictions, they had no GST tax-avoidance purpose in enacting legislation.

Estate of Murphy

The *Murphy*[14] case tested Wisconsin's approach to the abrogation of its RAP and substitution of a more flexible, alternate vesting statute. The Internal Revenue Service acquiesced. The case applies to states that have abrogated their RAP and have elected to establish an alternative vesting statute, the rule against alienation and suspension of powers. The nine *Murphy* states are: Delaware, Idaho, Kentucky, Maine, New Hampshire, New Jersey, North Carolina, South Dakota and Wisconsin.

Constitutional Prohibition

Six nearly perpetual jurisdictions have constitutional prohibitions against the creation of perpetual trusts. They are: Arizona, Nevada, North Carolina, Tennessee, Texas and Wyoming. All but one of these states have limited their RAP to a term of years. North Carolina has abrogated the rule. Whether the extended term of years passes constitutional muster is yet to be tested.[15]

State Income Tax

Seven states—Alaska, Florida, Nevada,[16] South Dakota, Texas, Washington and Wyoming—are the only perpetual or nearly perpetual jurisdictions with no state income tax. Eight additional jurisdictions have a state income tax for residents, but exempt non-resident grantors and beneficiaries of perpetual trusts from state income tax: Connecticut, Delaware, Georgia, Illinois, New Hampshire, Ohio, Tennessee and Wisconsin.

Income taxation of trusts has become a more complex question, with states eager to extend the reach of their taxing authority. The U.S. Supreme Court case, *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust,* is a punctuation mark with this issue. While *Kaestner* is important, it relied on the laws of North Carolina and Georgia.[17]

A handful of states still attempt to tax a trust regardless of a change of situs to another jurisdiction. This trend has become more common in a tight economy.

Premium Taxes

Taxes on insurance premiums are another factor to consider with billions of insurance premium dollars at play. Delaware's premium tax is 200 basis points (bps) on the first $100,000 of premiums for policies in trust and is 0 bps thereafter.[18] Policies owned by limited liability companies (LLCs) are still subject to Delaware's higher premium tax. South Dakota continues to be 8 bps for all insurance premiums; other low premium states include Alaska (8 bps), Illinois (50 bps), Wyoming (75 bps) and Nebraska (100 bps). The other highly ranked states have higher premium taxes: New Hampshire (125 bps), Ohio (140 bps), Florida (175 bps), Tennessee (175 bps), Utah (225 bps) and Nevada (350 bps). (See "Best Situs at a Glance," p. 58, for a list of premium taxes for all jurisdictions.)[19]

The premium tax issue becomes important when considering entities like LLCs in private placement life insurance programs. Properly sitused and administered LLCs allow clients to pay lower premium taxes and be a look-through "qualified purchaser" for securities law purposes; otherwise, additional funding is needed to qualify.[20]

Modern Trust Laws

Flexibility is a key concern when considering the creation and administration of multigenerational trusts. Consider laws that provide:

1. Effective flexible trust planning and administration tools, including limited power of appointments (LPOAs) and the ability to decant or reform a trust if necessary;
2. The ability to change situs for income tax and estate tax purposes without triggering a constructive addition for GST tax exemption purposes;

3. 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. Statutory ability to change provisions in an irrevocable trust through decanting or reformation;

6. Clear situs rules (including possible conflict-of-laws issues) and setting unambiguous standards for which situs' laws to apply;

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

8. Statutory authority for virtual representation of all beneficial interests;

9. Effective privacy laws and beneficiary quiet statutes;

10. The ability to facilitate and administer PFTCs in a Securities and Exchange Commission-exempt environment;

11. Asset protection features of the jurisdiction's trust laws, including discretionary beneficiary definitions and self-settled trust statutes.

LPOA. This tool is included to create intergenerational flexibility by allowing a powerholder to appoint assets to various beneficiaries. But note that Internal Revenue Code Section 2041(a)(3) prevents the abuse known as the "Delaware tax trap," referring to the exercise of successive LPOAs over successive generations, allowing for a virtual perpetual trust without federal transfer taxes. This action could be considered a constructive addition (that is, a material or substantial change in the beneficial interests) and may 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 decanting, reformation, advisory committees, trust advisors with the power to invest and direct distributions and removal and replacement powers.

Change of situs. A change in situs may affect which jurisdiction's law applies. The ability to change the situs of trusts is often important to UHNW 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 to take advantage of a perpetual state's trust laws. The Delaware Supreme Court decision in *In re Peierls Family Inter Vivos Trust*[21] is an example. 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.[22]

Directed trust statute. This type of statute provides that an administrative or directed trustee be appointed and then permits allocating fiduciary responsibility among multiple trust advisors. This freedom allows the client to select independent parties, typically designated as co-trustees, trust protectors or trust advisors, 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 and concentration and selection of investments. It also allows the client to continue to employ trusted advisors in the professional roles to which the client is accustomed.

Trust protector statute. Such a statute recognizes the authority and limitations of an individual or entity that's been appointed as a trust protector. 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. This recognition provides greater flexibility for future generations as conditions change. The strongest trust protector statutes are in Alaska, Delaware, Nevada, New Hampshire, South Dakota and Wyoming.[23]

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; removal and replacement of a trustee; and modification of the terms of a POA.

Non-charitable purpose trusts (NCPTs). NCPTs require a trust protector and trust enforcer because these trusts aren't required to have beneficiaries. Their sole purpose is to care for the underlying property that's the corpus of the trusts. Delaware and South Dakota allow broad NCPTs. Some of the common purposes for establishing an NCPT are: (1) pet care (including offspring); (2) support of religious gravesite ceremonies; (3) maintenance of: gravesites, honorary trusts, family property (for example, antiques, cars, jewelry and memorabilia), art collections, family homes (residence and vacation), buildings, property or land and PFTCs; (4) protection of business interests, royalties and digital assets; and (5) to provide for a philanthropic purpose not qualifying for a charitable deduction.[24]

Changing Irrevocable Trusts

Changing irrevocable trusts is done carefully because gift, estate and GST tax issues may be triggered. There are certain ways to modify an irrevocable trust: (1) trusts settling trusts;
(2) decanting; (3) distributing property to a beneficiary in trust; (4) trust protector amendment powers; and (5) reformation. The first three methods involve the creation of a new trust. The latter two involve amendment of the current trust. Historically, only judicial action could reform a trust; this process often required the consent of all the beneficiaries or a court-approved equitable deviation.[25]

Estate Inclusion Issues

With these methods of creating new trusts or modifying a current trust, there's the question of whether such creation or modification creates an estate tax, gift tax or GST tax issue. Specifically, does changing the dispositive provisions in a trust create a tax issue to the settlor or a beneficiary?

You can remove this estate tax inclusion issue if the settlor's power is limited by an ascertainable standard. While it's a remote argument, if the settlor is attributed the powers of the trustee or protector under an implied (generally oral) promise, and the trustee or protector has the ability to create a new trust or modify a current trust, then there's an estate tax inclusion issue under IRC Section 2036(a)(1).[26]

If an independent trustee exercises the power to create or modify the dispositive provisions, there shouldn't be an estate tax inclusion issue, unless the implied promise argument is used to attribute the trustee or protector powers to the beneficiary.

Change of situs, standards and Covey provisions. State law may actually change the dispositive provisions when a trust changes its governing law. Or the trustee or protector adding or removing any standard may change the dispositive provisions.

For example, Ohio's Uniform Trust Code (UTC) uses the most restrictive definition of a "discretionary trust."[27] Under common law, a beneficiary of a discretionary trust didn't have an enforceable right to a distribution or a property interest, and the trustee's discretion could only be challenged for: (1) improper motive; (2) dishonesty; and (3) failure to act.[28] The Ohio UTC restricts a discretionary trust to one that has no standards or guidelines. Conversely, the top trust jurisdictions define a "discretionary trust" as one that gives the trustee any discretion in making a distribution, regardless of whether there's a standard or guideline. For example, in Alaska, South Dakota, Tennessee and Wyoming, the following language would be classified as a common law discretionary trust: "The trustee may make distributions to the beneficiaries in Section 2.01 for health, education, maintenance, and support."

Therefore, when a trust that has any standards or guidelines moves from Ohio to Alaska, South Dakota, Tennessee or Wyoming, the beneficiary's interests are reduced from having an enforceable right to a distribution, which most likely is a property interest, to no enforceable right to a distribution and no property interest. That is, the beneficial interests have been changed. For conservative practitioners who don't want any change in beneficial interests, the state statute must provide for keeping an enforceable right. Only South Dakota and Tennessee provide such a provision, which is contained in its discretionary support trust. This provision was recommended by Richard Covey, when he reviewed the South Dakota discretionary support statute. Hence, we use the term "Covey provision" in one of the columns in "Situs at a Glance."

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

1. Improve its governance structure;
2. Change the law applicable to the trust when its terms don't facilitate a change to its governing law;
3. Change dispositive provisions;
4. Change the administrative terms of the trust to ensure that it 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 modification of trusts and the procedures, costs and time involved.

Both reformation and decanting statutes provide trustees and trust beneficiaries flexibility without negative GST tax consequences if certain requirements are met. The GST tax regulations create a safe harbor for four types of modifications, none of which affect the grandfathered status of a trust. A decanting or modification that qualifies for one of these safe harbors won't cause a GST tax-exempt trust to lose its exempt status.[29] In 2015, the National Conference of Commissioners on Uniform laws issued a Uniform Trust Decanting Act.[30] (See "Best Situs at a Glance," p. 58, for the jurisdictions that have adopted decanting statutes.)

Special purpose entities (SPEs). New Hampshire and South Dakota have specific SPE statutes. SPEs are important because unregulated SPEs are business entities used in combination with a directed trust structure to limit the liability of fiduciaries and 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 or the family. These entities are typically in the form of an LLC organized under the laws of the jurisdiction that permits them. The purpose of such entities is limited by statute to a single client or family group. SPEs can be created to act on behalf of a family or family group to provide non-trustee fiduciary services akin to a family office. Only Alaska, Arizona, Delaware, Illinois, Nevada, New Hampshire, South Dakota, Tennessee and Wyoming permit SPEs.[31]

Virtual representation statutes. These statutes are important for discretionary multigenerational trusts. They're 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 individual "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. Alaska, Arizona, Florida, Georgia, Illinois, Nevada, South Dakota and Washington have specific virtual representation statutes. Delaware has a limited version of virtual representation. The UTC also provides a form of virtual representation.[32] South Dakota's virtual representation statute[33] service of process is limited to persons in being and parties to the proceeding when notifying beneficiaries.

Privacy laws and quiet statutes. Of the top-tier jurisdictions, South Dakota has the best trust privacy laws. For example, its quiet statute not only allows a trust to be quiet during the grantor's life but also applies after the grantor's death or disability, which is unique. Delaware and Alaska's privacy laws aren't as extensive.[34] Delaware only provides a 3-year seal period, for example. In South Dakota, the privacy seal also extends to any potential future litigation or court reformation, which is a significant advantage.[35]

PFTCs. Many UHNW families want to establish PFTCs to manage administration of all their family trusts. Often, PFTCs are administered with the assistance of a local trust company that can provide situs-based administrative services at greater cost efficiencies.

In 2022, the most popular perpetual or near-perpetual jurisdictions that permitted PFTCs were Nevada, New Hampshire, South Dakota and Wyoming. Tennessee's PFTC statute attempts to permit a PFTC and business in one entity. Missouri is the most recent state to enact PFTC legislation.[36] Of all these jurisdictions, Nevada and South Dakota have historically contained the greatest number of PFTCs.[37]

Only Florida, Ohio, South Dakota, Tennessee and Wyoming are accredited by the Conference of State Bank Supervisors. New Hampshire and Nevada aren't accredited; only four of the 50 states aren't accredited. This accreditation may be a key point if a family is seeking to qualify from SEC exemption via a regulated PFTC.[38]

Asset Protection Third-Party Trusts

More jurisdictions continue to adopt discretionary trust asset protection statutes codifying the *Restatement (Second) of Trusts (Restatement Second)*. In particular, one of the top trust law states, Wyoming, has recently significantly expanded its protection in this area.

In our 2012 article,[39] we discussed in detail the greater asset protection provided by a discretionary trust, particularly when states had codified the *Restatement Second*.[40] This is 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,[41] and therefore, no creditor may stand in the shoes of a beneficiary. In this respect, the beneficiary's interest isn't a property interest[42] and is nothing more than an expectancy that can't be attached by any creditor.[43] We refer our readers to our 2012 article to better understand the importance of a discretionary support statute.

Anti-Alter Ego Arguments

In our 2021 article,[44] we discussed the Tax Court decision in *Campbell v. Comm'r*,[45] stressing both the need for a discretionary support statute as well as the need for an anti-alter ego statute. We stated:

The Tax Court next looked at the alter ego issue and noted that the settlor had the power to remove the trustee, but only with the consent of the protector. We're not aware of any case that holds that the mere ability to remove and replace a trustee with someone who's independent is sufficient control to invoke an alter ego argument. The Tax Court held that John, settlor/beneficiary, maintained no control over the trustee to make distributions or investments. Further, it stated, 'Through the Trust Protector, petitioner can request that the trustee be changed, he cannot force such action.' Therefore John's power to remove/replace a trustee is slightly less than found in most asset protection trusts and underscores one of the reasons for the necessity of anti-alter ego statutes.

Naturally, there's no guarantee that a judge somewhere, someday, won't find that an unconditional removal/replacement power over a trustee may well be too much control. This is particularly the case should there be other factors indicating some other degree of influence over the trust, such as the settlor/beneficiary holds a POA, the settlor is the manager or president of an entity owned by the trust, the settlor requests that certain distributions be made to certain beneficiaries and the trustee agrees or the settlor requests that the trustee invest in certain assets and the trustee agrees. This was the reason anti-alter ego statutes have been adopted. These statutes don't completely eliminate the alter ego argument; rather, they list quite a few factors that alone or in combination don't rise to the level of supporting an alter ego piercing of the trust.

Several of the lead trust jurisdictions have passed statutes in this area, and these statutes continue to evolve. South Dakota proposed the latest evolution and substantial improvement of this statute by providing a better definition of the concepts of "alter ego," "dominion and control" and "sham trust." All readers are familiar with the concept that an entity may be disregarded and the owners held liable under a pierce the veil/alter ego type of argument.[46] What about the terms "dominion and control" or "sham trust?" These terms appear to be nothing more than a subset or possibly a synonym to the term "alter ego."

To date, we haven't been able to find one case in which a trust was pierced solely by a dominion and control argument. In fact, the *Miller v. Kresser* decision in Florida states, "There is no law in Florida suggesting that a beneficiary's creditors may reach trust assets in a discretionary trust simply because the trustee allows the beneficiary to exercise significant control over the trust."[47] In this case, the District Court reversed the trial court finding that a dominion and control argument couldn't pierce the trust. Had the plaintiff brought the argument under an alter ego theory, it may have prevailed because Florida has some case law showing that alter ego arguments apply to trusts. Conversely, while we haven't been able to find a single case relying solely on dominion and control over the trustee, there are alter ego cases that mention either dominion or control as some of the facts supporting an alter ego argument.

At the same time, the term "sham trust" is sometimes mentioned as a way to pierce a trust. However, case law on this theory outside of tax cases appears to be missing. The terms "sham trust" or "sham transaction" are primarily used in Tax Court cases, like *Loving Savior Church v. United States*[48] and *Dean v. U.S.*[49] Because the term "sham trust" is being mentioned in asset protection circles, it's only a matter of time before cases will probably refer to this as a method of piercing a trust.

The proposed South Dakota statute addresses alter ego, pierce the veil and dominion and control as the same type of a claim and then defines a long list of items that don't constitute any of these claims.

Here's what it says:

Proposed S.D. St. 55-1-32.

Alter Ego; Pierce the Veil; and Dominion and Control Claims

Pierce the veil and dominion and control claims by a party are, in essence, a variation of the alter ego common law doctrine. This section covers all of these types of claims.

In the event that a party brings an action against a trustee, beneficiary, trust advisor, or trust protector under an alter ego claim, none of the following factors, alone or in combination, may be considered as resulting in the alter ego theory being applied to a trustee or the person being claimed to be the alter ego:

(1) The settlor or a beneficiary serving as a trustee or a co-trustee as described in § 55-1-28;

(2) The settlor or a beneficiary holds an unrestricted power to remove or replace a trustee;

(3) The settlor or a beneficiary is a trust administrator, a general partner of a partnership, a manager of a limited liability company, an officer of a corporation, or any other managerial function of any other type of entity, and part or all of the trust property consists of an interest in the entity;

(4) A person related by blood or adoption to the settlor or a beneficiary is appointed as trustee;

(5) The settlor's or a beneficiary's agent, accountant, attorney, financial advisor, or friend is appointed as trustee;

(6) A business associate is appointed as a trustee;

(7) A beneficiary holds any power of appointment over any or all of the trust property;

(8) The settlor holds a power to substitute property of equivalent value;

(9) The trustee may loan trust property to the settlor for less than a full and adequate rate of interest or without adequate security;

(10) The distribution language provides any discretion;

(11) The trust has only one beneficiary eligible for current distributions;

(12) The beneficiary serving as a trust advisor for investments under subdivision 55-1B-1(6);

(13) Isolated occurrences where the settlor has signed checks, made disbursements, or executed other documents related to the trust as a trustee, when in fact the settlor was not a trustee;

(14) Making any requests for distributions on behalf of beneficiaries;

(15) Making any requests to the trustee to hold, purchase, or sell any trust property; or

(16) Beneficiary serves as a trust protector or trust advisor.

A slight improvement may be made to the above statute by adding the words "sham trust" into the first sentence.

Endnotes

1. However, the Texas Constitution prohibits perpetuities: "Perpetuities and monopolies are contrary to the genius of a free government and shall never be allowed . . . ." Tex. Const. art. I, Section 26. A perpetuity is a restriction on the power of alienation that lasts longer than a prescribed period. ConocoPhillips Co. v. Koopmann, 547 S.W.3d 858, 866-67 (Texas 2018). The rule against perpetuities (RAP) "should be a check on vain, capricious action by wealthy empire builders. But it should not be a constantly present threat to reasonable dispositions which slightly overstep a technical line." *Rekdahl v. Long*, 417 S.W.2d 387 (1967) (Steakley, J., dissenting) (citing W. Barton Leach and Owen Tudor, "The Rule Against Perpetuities," Washington University Law Review, at p. 43 (1958)); www.txfiduciarylitigator.com/2021/05/texas-legislature-extends-the-rule-against-perpetuities-to-300-years-for-trusts/.

2. Texas HB654 (effective Sept. 21, 2021) Section 112.036:

RULE AGAINST PERPETUITIES. (a) The rule against perpetuities applies to an interest in a trust [trusts] other than a charitable trust [trusts]... (c) An interest in a trust must vest, if at all: (1) not later than 300 years after the effective date of the trust, if the effective date of the trust is on or after September 1, 2021 ... *Texas-2021-HB654-Introduced.html* ; On June 19, 2015, House Bill 3190 amended Texas Property Code Section 114.003, Powers to Direct, adding a new Section 114.0031, Directed Trusts; Advisors.

3. For example, in the United States, the new Corporate Transparency Act (CTA), which was adopted as part of the National Defense Authorization Act of 2021, will create a federal registry of the ultimate beneficial owners of many closely held businesses and entities and calls for an official federal study of the possibility of creating a similar registry for trust beneficiaries. See new 31 U.S.C. Section 5336, adopted as Section 6401, et seq., of H.R. 6395 (2020), more commonly known as the "National Defense Authorization Act for Fiscal Year 2021." The regulations for the CTA are due to be published sometime around Jan. 1, 2022.

4. In five of the last six years, charitable giving by individuals has grown; 86% of affluent households maintained or increased their giving despite uncertainty about further spread of COVID-19. See Giving USA 2021 Annual Report.

5. *www.congress.gov/bill/117th-congress/house-bill/5376* .

6. At present, it appears that the surcharge would be added to an individual taxpayer's regular income tax rate plus the rate of the surtax on net investment income. The imposition of the surcharge, together with the 3.8% surtax would likely be felt most keenly on the sale of a closely held business; gains that would typically have been taxed at a rate of 20% would instead be taxed at a rate of 23.8% for the first $10 million of long-term capital gains (assuming no other income for the year); at a rate of 28.8% on the next $15 million; and at a rate of 31.8% for any additional gains recognized.

7. *www.whitehouse.gov/briefing-room/speeches-remarks/2021/10/28/remarks-by-president-biden-announcing-the-framework-for-his-build-back-better-agenda-and-bipartisan-infrastructure-bill/* .

8. *https://rules.house.gov/sites/democrats.rules.house.gov/files/BILLS-117HR5376RH-RCP117-17.pdf* .

9. *Ibid*.

10. As regards the wealth tax, Sen. Wyden and Sen. Warren proposed the imposition of an annual tax on the year-to-year appreciation in the fair market value of any marketable security owned by any billionaire. In the case of all other assets owned by such an individual, the appreciation thereon would be taxed on the sale of the asset, but an additional tax (basically, an interest charge (*see* Internal Revenue Code Section 453A, or the throw-back rules for interpretations of the concept)) would be imposed to defeat the deferred recognition and taxation of such gains.

11. *Supra*, note 5.

12. *See* Daniel G. Worthington, Mark Merric, Ryan L. Thomas and John E. Sullivan, III "Which Trust Situs is Best in 2020?" *Trusts & Estates* (January 2021); *see also supra* note 2.

13. *Supra* note 9. *See also* Garrett Moritz, "Dynasty Trusts and the Rule Against Perpetuities," 116 *Harv. L. Rev*. 8 (June 8, 2003). *See also* Daniel G. Worthington, "Problems and Promises of Perpetuities Planning," *Trusts & Estates* (October 2005). The generation-skipping transfer (GST) tax result in the term-of-years states may be different from the result in *Murphy* unless there's a real possibility of a vesting or alienation of the trust interests and 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 term of the trust. For a contrary view, *see* Richard Nenno, "Relieving Your Situs Headache: Choosing and Re-choosing the Jurisdiction for a Trust," Heckerling Tax Institute (2006); *See also 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.

14. *See Murphy*, *ibid*., in which the Tax Court held that the Delaware tax trap wasn't violated in Wisconsin.

15. Steven J. Horowitz and Robert H. Sitkoff, "Unconstitutional Perpetual Trusts," *Vanderbilt Law Review*, at pp. 1788-1795.

16. However, Nevada enacted a commerce tax several years ago that taxes business activity in the state when revenues are in excess of $4 million annually. The applicable tax rate differs depending on the primary market sector in which business activity is engaged.

17. *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*, 139 S. Ct. 2213 (2019).

18. Delaware Code Section 701:

Fee schedule. …the premium tax rate shall be 2% on the first $100,000 of net premiums and 0.0% for the net premium exceeding $100,000 for trust-owned life insurance policies covering the life of an individual that participate in private placement under federal securities laws.

19. Texas Section 222.003:

TAX RATES. (a) Except as provided by Subsection (b), the rate of the tax imposed by this chapter on an insurer is 1.75 percent of the insurer's taxable gross premiums received during a calendar year.(b) The rate of the tax imposed by this chapter on an insurer that receives taxable gross premiums from the business of life insurance is: (1) 0.875 percent of the first $450,000 of taxable gross premiums received during a calendar year from the business of life insurance; and (2) 1.75 percent of the remaining taxable gross premiums received during that calendar year from the business of life insurance.

20. *See* Al W. King III, "Zero Tax Trusts?" *Trusts & Estates* (September 2021); Al W. King III and Pierce H. McDowell III, "Powerful Private Placement Life Insurance Strategies With Trusts," *Trusts & Estates* (April 2016); Al W. King III and Pierce H. McDowell III, "State Premium Tax Planning?" *Trusts & Estates* (June 2011).

21. *In re Peierls Family Inter Vivos Trusts*, 77 A.3d 249 (Del. 2013). This case makes it 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).

22. *Ibid.*

23. South Dakota is followed by Idaho, Alaska, Wyoming, New Hampshire, Tennessee, Delaware, Arizona, Michigan, Nevada and Vermont in adopting a modern trust protector statute. Connecticut's statute dealing with the creation of a trust to provide for the care of animals contains the concept of a trust protector, but otherwise there isn't a specific trust protector statute. Alaska Stat. Section 13.36.370; Ariz. Rev. Stat. Ann. Section 14.10818; 12 Del. C. Section 3570(8)c; Idaho Code Ann. Section 15-7-501; Nev. Rev. Stat. Section 163.5553; N.H. Rev. Stat. Ann. Section 564-B:12-1201(a); S.D. Codified Laws Section 55-1B-6; Vt. Stat. Ann. Section 1101(a); and Wyo. Stat. Section 4-10- 710(a). Uniform Trust Code (UTC) trust protectors permitted: Alabama, Arizona, Arkansas, Florida, Kansas, Maine, Michigan, Missouri, Nebraska, New Hampshire, New Mexico, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Utah, Vermont, Virginia, West Virginia and Wyoming. Six of these states, Arizona, Michigan, New Hampshire,

Tennessee, Vermont and Wyoming and the District of Columbia, also have a specific trust protector statute; *www.naela.org/Public/Library/ResourceDatabase/Topics/5Estate_Planning/5a_Trusts_Wills/Designing_Trus Protectors_and_Their_Powers.aspx* . *See* Al W. King III, "Trusts Without Beneficiaries—What's the Purpose?" *Trusts & Estates* (February 2015).

24. King, *ibid*.

25. Mark Merric, "How to Draft Distribution Standards for Discretionary Dynasty Trusts," *Estate Planning* (March 2009). Endnote 33 of the article cites both *Restatement (Second) of Trusts* (*Restatement Second*), Section 187 comment j and Section 122, as well as cases in 14 states and in two countries other than the United States.

26. *Lahti v. Comm'r*, 6 T.C. 7 (1946). The gift argument is based on two old cases. In *Lahti*, the Internal Revenue Service attempted to assert a second gift tax to the settlor when one trust transferred assets to a newly created trust. The petitioner's spouse was a discretionary beneficiary under the first trust and, pursuant to a divorce settlement, received an income interest of up to $1,000 a year withdrawal right. This 1946 case had little analysis, other than to note that the distribution standard was sufficient to allow the 1934 trust to create the 1942 trust and that parties were adverse because of the divorce. It didn't address any estate inclusion issue as to the settlor being involved in the modification of the trust.

27. *See*, *e.g*., *Pack v. Osborn*, 117 Ohio St.3d 14, par. 18 (2008) (noting that "a trust that allows the trustee the uncontrolled discretion to distribute income and principal as the trustee determines, without a support standard, is a pure discretionary trust[,]" that "[n]o court can compel a trustee of a pure discretionary trust to exercise the trustee's discretion to distribute income or principal, unless the trustee acts in bad faith, dishonestly, or with an improper motive[,]" and that "pure discretionary trusts are now legislatively recognized and sanctioned" pursuant to the Ohio Trust Code's (OTC) wholly discretionary trust provisions) (brackets added, internal cites omitted).

28. OTC Chapter 5801. Compare Ohio's Legacy Trust Act. OTC Section 5816.13 states:

No beneficiary or other person shall be considered to have a property interest in any property of a legacy trust to the extent that the distribution of that property is subject to the discretion of one or more qualified trustees or advisors, either acting alone or in conjunction with any other person, including any person authorized to veto any distributions from the legacy trust.

29. Safe harbors under Treasury Regulations Section 26.2601(b)(4).

30. The Uniform Trust Decanting Act was approved by the National Conference of Commissioners on Uniform State Laws (Uniform Law Commission) at its annual conference in Williamsburg, Va. (July 10-16, 2015).

31. Only two states have specific special purpose entities (SPE) statutes—New Hampshire and South Dakota. Delaware and Wyoming call the entities they permit "trust protector companies," but these entities aren't recognized by statute. Alaska and Nevada recognize SPEs indirectly. Also, the OTC allows any "person" the "power to direct the modification or termination of the trust," OTC Section 5808.08(C), and, once again, "person" is broadly defined to include limited liability companies (LLCs), etc. *See* OTC Section 5801.01(N). *See*

OTC Section 5816.11; “person” is defined to include LLCs, corporations, etc. *See* OTC Sections 5816.02(O) and 5801.01(N).

32. As of Jan. 1, 2020, 34 states and the District of Columbia have adopted some form of the UTC (Illinois became the 34th on Jan. 1, 2020). *See www.uniformlaws.org/committees/community-home?CommunityKey=193ff839 -7955-4846-8f3c-ce74ac23938d* . *See also* “Virtual Representation Statutes Chart” (Revised Oct. 1, 2018), *www.actec.org/assets/1/6/Bart-Virtual-Representation-Statutes-Chart.pdf* .

33. S.D. Codified Laws Section 55-2-13; Charles E. Rounds, Jr. and Charles E. Rounds, III, Loring and Rounds: A Trustee’s Handbook Section 6.1 (2015) at Section 9.9.25 (2015), Sample Trust Provision Notice: “I hereby direct that the Trustee is not required to provide the notice set forth in SDCL Section 55-2-13 to qualified beneficiaries.”

34. Alaska Stat. Section 13.36.080(b) allows for beneficiary waiver of notice but limits the settlor to exempt the trustee from the notice requirements during the life of the settlor or until the settlor’s incapacity, whichever is shorter; Del. Code Ann. Tit. 12 Section 3303 allows for the waiver of beneficiary notice but restricts it to a period of time and doesn’t expressly allow for the trust advisor or trust protector to modify notice to beneficiaries; Nev. Rev. Stat. Section 163.004, effective 2015, restricts waiver of notice to a period of time and doesn’t expressly allow for the trust advisor or trust protector to modify notice to beneficiaries; North Dakota Cent. Code 59-14-03 enacted legislation in 2017 that makes an exception for cases in which the qualified beneficiary is unknown because an individual holds a power to change such qualified beneficiary; New Hampshire RSA 564- B:1-105; RSA 564-B:8-813(d) is silent on timing, but no specific provision regarding whether advisors can withhold after death/disability (as compared to South Dakota, which so provides). *See* Al W. King III, “Should You Keep a Trust Quiet (Silent) From Beneficiaries?” *Trusts & Estates* (April 2015).

35. *See* “Privacy and Trust Planning: The South Dakota Advantage, Quiet Trust," *www.macpas.com/privacy-and-trust-planning-the-south-dakotaadvantage* . It states, in part:

Most wealthy families want the option of deciding whether to reveal to a child or grandchild that they have a beneficial interest in a trust. However, most states require trustees to inform a beneficiary of his or her beneficial interest in a trust at the age of eighteen (18). . . . Referred to as a Quiet Trust, settlors of trusts in the above-mentioned states have control over what information is revealed to a beneficiary and when it is revealed, if at all. South Dakota . . . the most comprehensive and flexible quiet trust statute in the nation, granting the settlor, trust protector, and the investment/distribution advisor the power to expand, restrict, eliminate, or modify the rights of the beneficiaries to discover information about a trust.

36. *See* Greg Omer, Larry Katzenstein and Jason Thein, “Private Trust Companies Authorized Under New Missouri Law” (2017), *www.thompsoncoburn.com/insights/blogs/bank-check/post/2017-07-28/private-family-trust-compa-nies-authorized-under-new-missouri-law* .

37. 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’ve 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, “Risks and Opportunities for Private Trust Companies and Family Offices from State and Federal (Non-Tax) Legislative Developments and Proposals, Fiduciary Income Tax Committee,” ABA Section

on Taxation 2010 ABA Mid-Year Meeting (Jan. 21-23, 2010). Ohio has PFTC legislation. *See* OTC Section 1111.01 et seq. Licensed PFTCs could always serve as "qualified trustees" of Ohio asset protection trusts (APTs). Pursuant to recent changes to Ohio APT law, unlicensed Ohio PFTCs can now also serve as qualified trustees, provided they conduct certain minimum activities in Ohio. *See* new OTC Section 5816.02(S)(1)(b)(ii).

38. *Ibid.*

39. Daniel G. Worthington and Mark Merric, "Which Situs is Best in 2012?" *Trusts & Estates* (January 2012).

40. *Restatement (Second) of Trusts*, Section 155(1) and comment (1)b.

41. *Ibid.*

42. 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.

43. Under common law, the strong majority rule was that a discretionary interest couldn't be attached at common law. Please note that the *Restatement (Third) of Trusts* 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.

44. Worthington, et al., *supra* note 12.

45. *Campbell v. Comm'r*, T.C. Memo. 2019-4.

46. A trust isn't a legal entity. It's not formed by organizing under the laws of a state.

47. *Miller v. Kresser*, 34 So.3d 172 (Dist Ct. 2019).

48. *Loving Savior Church v. U.S.*, 728 F.2d 1085 (8th Cir. 1984).

49. *Dean v. U.S.*, 987 F. Supp. 1160 (W.D. Mo. 1997).