FEATURE: ESTATE PLANNING & TAXATION

By **Jonathan D. Blattmachr**, **Matthew D. Blattmachr** & **Jonathan G. Blattmachr**

Avoiding the Adverse Effects of *Huber*

How to best protect assets using a self-settled trust

A recent U.S. Bankruptcy Court decision, *In re Huber*,[1] held that an Alaska self-settled trust essentially was invalid with respect to claims of the settlor's (grantor's) creditors in bankruptcy. The case doesn't appear to break new ground and, in some ways, seems flawed. However, it's important to review the decision to help determine how best to protect assets using a self-settled trust. In any case, the ruling doesn't seem to thwart using a self-settled trust to keep assets from being included in the gross estate of the settlor for federal estate tax purposes.

Case Facts

The debtor in this bankruptcy proceeding was a lifelong Washington state resident, as were his descendants. He had been in the real estate business in that state for decades. At the time the debtor transferred his assets into the trust (drafted by a lawyer in Washington), in September 2008, for the benefit of himself (thereby making it a self-settled trust) and his descendants (and step descendants), there was threatened litigation against the debtor. Specifically, the foreclosure of several properties for which the debtor had guaranteed the bank loans was becoming increasingly certain. The examiner (appointed by the court to gather facts) indicated in his report filed with the court that the debtor was or had to be aware of the "gathering storm clouds." In addition to the threat of a collapsing housing market, a review of court files after the establishment of the trust reflected that several loans in existence in August 2008 were fragile, at best.

Moreover, the debtor's partner, who was indebted to the debtor, threatened to set up his own self-settled spendthrift trust. The debtor, through his counsel, made it clear to the partner that the setting up of such a trust would be fraudulent as to him, as he considered himself a creditor of his partner.

The court stated that there was only one asset of the trust held in Alaska, which was a certificate of deposit (CD) for $10,000 transferred there by the debtor. All other assets were located in Washington. However, as discussed later, that statement about the location of the assets may not be accurate.

The record before the court indicated that Alaska USA Trust Company (which is an institution separate from and not associated with Alaska Trust Company) did nothing to become involved with the preservation and/or protection of the assets of the trust and was acting merely as a straw man.

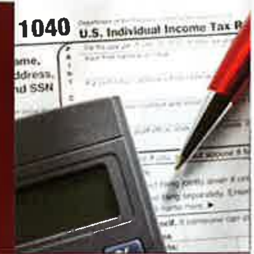
Issues Before Court

There were three issues before the court essentially related to whether the assets of the trust were part of the debtor's bankruptcy estate and, therefore, distributable to his creditors:

1. Whether the trust, which was governed by Alaska law and administered there, should be invalidated on the ground that it was self-settled and, therefore, void under Washington law as against the existing or subsequent creditors of the debtor who was the trust settlor.

2. Whether the trustee in bankruptcy could avoid (that

From far left: **Jonathan D. Blattmachr** is an associate in the Business Reorganization department at Schulte, Roth & Zabel LLP in New York. **Matthew D. Blattmachr** is a trust officer at the Alaska Trust Company in Anchorage, Alaska. **Jonathan G. Blattmachr** is a retired member of Milbank, Tweed, Hadley & McCloy LLP in New York



is, make part of the bankruptcy estate for distribution to the debtor's creditors) the transfers the debtor made to the trusts pursuant to Section 548(e)(1) of the Bankruptcy Code (the Code). That section permits the trustee in bankruptcy to avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition in bankruptcy, if, among other conditions, the debtor made the transfer to the self-settled trust with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.

3. Whether the trustee in bankruptcy could, pursuant to Section 544(b)(1) of the Code, avoid fraudulent transfers under state law because the transfers to the trust were made: (1) by the debtor with actual intent to hinder, delay or defraud a creditor; or (2) without receiving a reasonably equivalent value in exchange for the transfer or obligation while the debtor was insolvent.

Court Holdings

The court granted summary judgment in favor of the trustee in bankruptcy and against the debtor on all three issues.

1. Application of Washington law to invalidate the Alaska spendthrift trust. Although the court ruled that the debtor created the trust with an actual intent to hinder, delay or defraud creditors, it didn't state that such a finding was essential in holding that the trust was void with respect to the debtor's creditors under Washington law or its decision to apply Washington law, rather than Alaska law.

The question of whether the interest in the trust forms part of the bankrupt estate (and is distributable to the debtor's creditors) is expressly dealt with in Section 541(c)(2), which provides:

> A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

The court didn't mention or discuss that section. Although the court relies on the *Restatement (Second) of Conflict of Laws* (*Restatement (Second)*), it doesn't discuss Section 273 of the *Restatement (Second)*. That section simply states, without exception, limitation or reference to any public policy, that:

> Whether the interest of a beneficiary of [an inter-vivos] trust of movables is assignable by him and can be reached by his creditors is determined ... by the local law of the state, if any, in which the settlor has manifested an intention that the trust is to be administered, and otherwise by the local law of the state to which the administration of the trust is most substantially related.

It seems that when the trust recites what state law governs, that recital is controlling.

It seems that when the trust recites what state law governs, that recital is controlling, and the spendthrift provision, if enforceable under that law, will prevail.

The court in *Huber*, like the bankruptcy courts in *In re Portnoy*,[2] on which the *Huber* court relied, and *In re Brooks*,[3] both involving non-U.S. self-settled trusts, unraveled the trust and exposed its assets to the debtor's creditors by finding the trust invalid. Strangely, none of the jurisdictions involved in those cases (Connecticut, New York and Washington) state that a spendthrift trust is invalid. Rather, they essentially say such trusts are void

with respect to creditors. Perhaps, in the courts' view, it amounts to the same thing, but that isn't discussed. In fact, there's a statute in New York that makes a settlor's express declaration of controlling law conclusive. The New York courts have acknowledged that the statute is intended to encourage residents of other states to create New York trusts.[4]

In any case, the *Huber* court cited to and relied on the reasoning in *Portnoy*. Although the *Huber* court didn't mention it, *Brooks* is similar to *Portnoy*. In those earlier cases, the court applied the law of the forum to invalidate foreign (non-U.S.) self-settled trusts. The *Portnoy* and *Brooks* courts focused on the validity of the trust, rather than the enforceability of its spendthrift provision.[5] Those courts made their analysis under *Restatement (Second)* Section 270, which provides that an inter vivos trust of interests in movables is valid if valid under the local law of the state designated by the settlor to govern the validity of the trust, provided that the application of its law doesn't violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in Section 6 of the *Restatement (Second)*. The courts didn't make any analysis under Section 273 of the *Restatement (Second)*, only under Section 270.

> *Huber* provides no real analysis of the principles in Section 6 and doesn't really explain why it concluded that Washington had the most significant relationship as to the matter at issue.

Similarly, the court in *Huber* proceeded under an analysis pursuant to Section 270. *Huber* provides no real analysis of the principles in Section 6 and doesn't really explain why it concluded that Washington had the most significant relationship as to the matter at issue (which seems to be whether the Alaska or Washington rules on self-settled trusts apply). Rather, it seems that the court decided that the contacts with Alaska were so minimal and the contacts with Washington were so substantial that Washington state law should apply. It didn't explain how these contacts bear on the determination of whether Washington had the most significant relationship to the matter at issue. The court discussed and concluded that the policy of Washington against self-settled trusts represents strong public policy. But the discussion seems incomplete. For example, the court doesn't mention that Washington permits some protection for individual retirement accounts, a type of self-settled trust or the equivalent.[6]

The apparent reasoning of *Huber* might, for example, mean that perpetual trusts created in a state permitting them (for example, Delaware) by a resident of another state where perpetual trusts aren't permitted (for example, Texas) might be declared invalid, at least when there are similarly minimal contacts with the state whose law is stated to govern the validity of the trust and more substantial contacts with the state of the grantor's residence. In fact, the policy in Texas against perpetual trusts is contained in its state constitution.[7] That would suggest its policy against perpetual trusts is so strong that it might mean that a Texan, based on similar factual contacts to those in *Huber*, couldn't create a perpetual trust under the law of another state. Some planners might find it difficult to think that no Texan could create a perpetual trust elsewhere.

2. Application of Section 548(e) to the trust. As mentioned above, Section 548(e)(1) of the Code permits the trustee in bankruptcy to avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition in bankruptcy, if, among other conditions, the debtor made the transfer to the self-settled trust with actual intent to hinder, delay or defraud any current or future creditor.

The court stated that in determining whether the debtor made the transfer with such intent, it could consider "badges of fraud,"[8] which are "circumstances so commonly associated with fraudulent transfers that their presence gives rise to an inference of intent," such

as: (1) actual or threatened litigation against the debtor, (2) a purported transfer of all or substantially all of the debtor's property, (3) insolvency or other unmanageable indebtedness on the part of the debtor, (4) a special relationship between the debtor and the transferee, and, after the transfer, (5) retention by the debtor of the property involved in the putative transfer.

The court found that: (1) when the debtor transferred his assets into the trust, there was threatened litigation against him; (2) the debtor transferred all or substantially all of his property into the trust; and (3) there was significant indebtedness on the debtor's part when he transferred his assets into the trust. The court stated that the debtor didn't dispute that there was a special relationship, as he was both the grantor and beneficiary of the trust. The court additionally found that the debtor effectively retained the property transferred into the trust, such as the occupancy of a home and monthly distributions. Hence, the court found sufficient badges of fraud were present to conclude that the debtor had an actual intent to hinder, delay or defraud his creditors; therefore, Section 548(e) applied and the trust assets were part of the bankruptcy estate and available for distribution to the debtor's creditors.

3. Application of Section 544 to transfers to the trust: As discussed above, the court in *Huber* stated that under Section 544(b)(1), fraudulent transfers could be avoided under state law and the Uniform Fraudulent Transfer Act (UFTA) because the debtor made the transfers to the trust with actual intent to hinder, delay or defraud a creditor or without receiving a reasonably equivalent value in exchange for the transfer or obligation when the debtor was insolvent. Based on that premise and the findings the court made in its analysis of Section 548(e), it's not surprising the court reached the same conclusion with respect to Section 544, although it considered some additional badges of fraud.

HERITAGE
THE WORLD'S THIRD LARGEST AUCTION HOUSE

GLOBAL AUCTIONS, PRIVATE SALES AND APPRAISAL SERVICES FOR ESTATES, TAXES & INSURANCE

- Market Leader in Rare Coins & Collectibles–with 35 sale categories including fine & decorative art and jewelry
- USPAP Compliant Appraisal Services Department
- Always full and timely payments
- Clear and concise settlement statements–automated online tracking and reporting
- Dallas headquarters, with offices and auctions in New York and California

Request a sale proposal or appraisal from Heritage Auctions to make the most informed decision and exceed your fiduciary responsibilities.

Trusts & Estates Department
214-409-1632 | Estates@HA.com

Rembrandt Peale's iconic 1856 portrait of U.S. President George Washington–created in the artist's lifelong quest to paint the most recognizable image of the "Father of the United States"–realized a new world record for a porthole portrait by the artist when it sold for $662,500 to lead Heritage Auctions' two-day, $4.5+ million American Art events on May 10-11, 2013.

Email your contact information to Estates@HA.com and we'll mail you up to 10 free copies of *The Collector's Handbook* (value $15 each) which you can give as a benefit to your clients with collections.

Annual Sales Exceed $800 Million | 750,000+ Online Bidder-Members
3500 Maple Avenue | Dallas, Texas 75219 | 800-872-6467 | HA.com
DALLAS | NEW YORK | BEVERLY HILLS | SAN FRANCISCO | PARIS | GENEVA

TX & NY Auctioneer license: Samuel Foose 11727 & 0952360. Heritage Auction Galleries CA Bond #RSB2004175; CA Auctioneer Bond: Carolyn Mani #RSB2005661. Buyer's Premium 12%-25%. See HA.com for details. HERITAGE Reg. U.S. Pat & TM Off.

THE WORLD'S THIRD LARGEST AUCTION HOUSE
HERITAGE HA.com
AUCTIONS
HA.com/Facebook HA.com/Twitter
28465

The court, however, didn't discuss the fact that, unlike Washington, Alaska hasn't adopted the UFTA, but has retained the Uniform Fraudulent Conveyance Act (UFCA). Although the result might have been the same under the UFCA, it's surprising the court seems to assume, without analysis, that the Washington state transfer act should apply.

Apparently, to create a genuine issue of fact to avoid summary judgment, the debtor contended that he created the trust for estate-planning purposes. The court, however, stated that such a contention didn't directly address or deny the evidence submitted by the trustee establishing that the debtor wanted to protect his assets in light of his increasingly bleak financial situation. The court found that the debtor's desire to provide for his children and grandchildren through estate planning by protecting the assets that they would otherwise stand to inherit, isn't mutually exclusive with the desire to shield his assets from creditors; therefore, estate planning alone didn't create an issue of fact as to the debtor's intent. It's not clear how estate planning would have been aided by the trust. For example, because the debtor retained the use of the trust assets, presumably its assets would be included in his gross estate under Internal Revenue Code Section 2036(a)(1). Perhaps the debtor was contending that protecting the assets from his creditors would mean they would be available to his descendants when he died.

In any event, a key question is: How can you create a self-settled trust that will be respected by the U. S. Bankruptcy Court?

SPOT LIGHT

Whole Lotta Woman

"Woman in Front of a Window" (18.5 in. by 14 in.) by Fernando Botero, sold for $195,750 at Christie's recent Latin American Art Sale on May 30, 2013 in New York. Botero's unique style, known as "Boterismo," features exaggerated and disproportionate volumetry, accompanied by fine details of scathing criticism, irony and humor.

How to Start the Trust

A trust is regarded as "self-settled" (that is, created by the trust's settlor for his own benefit) essentially to the extent that a trustee must or may make distributions to the settlor. For example, Comment f to Section 60 of the *Restatement (Third) of Trusts* provides that creditors of the settlor may attach the maximum interest the settlor retained in the trust or that the trustee could transfer to the settlor.

Allow distributions for the settlor only by the exercise of a non-fiduciary power. If the only way the settlor could receive property is by the exercise of a power held in a non-fiduciary capacity, attachment by the settlor's creditors shouldn't apply because, as indicated, a trust is regarded as self-settled to the extent that the settlor has retained an interest in the trust (for example, entitlement to income) or may receive distributions in the exercise of a trustee's discretion. For example, suppose a property owner creates a trust for her son and grants him a lifetime special power of appointment (POA), under which he may appoint the property in the trust to anyone (other than himself, his estate or creditors or the creditors of his estate) at any time. Unless there's a deal that he would exercise the

POA in his mother's favor, the mere possibility that the son might exercise the POA at some time in her favor wouldn't seem to make it subject to the claims of his mother's creditors, because it's a self-settled trust.

Permit the POA to be exercised only with non-adverse party consent. It seems further that the son's POA could be made exercisable only with the consent of a non-adverse person. (That is, someone who doesn't have a substantial adverse financial interest in the exercise of the power.)[9] It might be best not to make this a non-adverse trustee, to thwart a claim that requiring a trustee's consent essentially makes the trust self-settled. It also seems that a non-beneficiary could hold the POA.

Indeed, Alaska law provides that, unless the instrument specifies otherwise, a trust protector isn't a fiduciary and isn't deemed to be acting in a fiduciary capacity.[10] So, it seems that the settlor could name a trust protector to act in a non-fiduciary capacity, who could have the power to add the settlor to the class of beneficiaries. Unless the protector did so, the trust wouldn't appear to be self-settled.

In fact, it seems a trust protector, acting in a non-fiduciary capacity, as is the case in Alaska, could direct the distribution of assets to the settlor. In other words, the trust protector would hold the special POA. It might be better "cosmetically," however, not to call the person who holds the POA and who's not a beneficiary a "trust protector." Perhaps, simply calling that person the sole member of the distribution committee or POA committee might be preferable.[11] In any case, the trust agreement should specify that the power holder isn't holding the power and needn't exercise the power under a fiduciary capacity.

Exercise the power to a different trust someone else creates for the settlor. Another step, which may provide even more protection, would be for someone other than the settlor of the Alaska trust to create a new trust for the settlor and, at least modestly, fund it. If the settlor of the first trust didn't, directly or indirectly, provide the assets with which the new trust is funded, the new trust shouldn't be considered self-settled. The person who holds the POA of the first trust could exercise it in favor of the new trust. As long as there was no prearrangement, the new trust shouldn't be considered self-settled, even though assets of the first trust wind up in the new trust. Allowing a significant amount of time to pass before the new trust is created and the power exercised should go far in sustaining that result. Also, it would be preferable if the trustee of the old trust wasn't the trustee of the new trust (from which distributions could be made to the settlor).

Permit only acquisitions of property for the settlor's temporary use. A trust may not only provide for distributions of property to be made to its beneficiaries, but also may permit the trust to acquire assets for the use of the beneficiaries. For example, it's not uncommon for a trust to acquire homes, recreational property or art and to allow those assets to be used by one or more of the beneficiaries. If the trust permits that use and only allows it to be temporary (that is, the trustee can terminate the use by direction or by selling the asset), it seems that a creditor of the settlor can't acquire something of significant value. As mentioned above, under the *Restatement (Third) of Trusts*, creditors of the settlor of a self-settled trust can only attach the assets to the extent the trustee could distribute them to the settlor. That's because, under a temporary "use of assets" structure just discussed, the trustee can't distribute the assets to the settlor and may make them available for the settlor's use only temporarily.

> Having only a trustee in the state where the trust will be settled should help it "smell" more like it's actually situated there.

In many cases, use of property is a significant benefit (for example, providing a home). So, any trust of which the settlor is or may become a beneficiary might expressly state that, at least with respect to the settlor, the trustee may not make any distribution to the settlor and may only permit the settlor to temporarily use assets.

Similarly, the trust might provide that the trustee may loan property or cash to the settlor at the applicable federal rate (AFR), determined under IRC Section 1274(d), with accruing interest only and for a short term (for

example, not longer than three years) specified by the trustee. Even though it's not certain that the safe harbor AFR interest rules of IRC Section 7872 apply to loans from trusts, this possibility of a loan may not be attachable by a creditor of the settlor. Perhaps, the trust should state that a loan can be made to the settlor only if it's repayable on demand by the trustee.

As long as the trust is a grantor trust (that is, one the income of which is attributable directly to the grantor, pursuant to IRC Section 671), there should be no income tax effect either from the use of assets by the settlor or a loan to him from the trust.[12]

The fact that the transfer could be challenged as fraudulent at any time doesn't render the gift incomplete.

Permit the power to be exercised only if the settlor isn't married. A further step, at least for a happily married individual, is to create a trust for his spouse that allows the POA for the benefit of the settlor to be exercised only if the grantor of the trust isn't married to and living with another. For many, whether the trust benefits the spouse or the settlor won't matter. "Spouse" for this purpose could be defined as the person to whom the settlor is married and living with at the time in question.[13] If the couple separates or the spouse dies, then and only then could the special POA held by a non-fiduciary be exercised in favor of the settlor.

Use decanting to grant the special POA. About 20 jurisdictions (including Alaska) allow a trustee to pay the trust assets to another trust (called "an act of decanting"), including to grant one or more beneficiaries a special POA.[14] So, the original trust might not grant anyone a POA. Yet, at an appropriate time, the trustee could decant and grant one or more of the beneficiaries a special POA, which the beneficiary could exercise to provide benefits to the settlor (such as adding the settlor to the class of beneficiaries of the trust or appointing property to another trust someone else has created for the settlor). As a practical matter, it might be preferable if the original trustee resigned and a new person, who was unaware of the trust's existence, was appointed as the successor trustee. Only the successor would exercise the decanting power. That would reduce the risk of establishing any prearrangement to benefit the settlor.

Adverse tax effect by the exercise of the special POA? The Internal Revenue Service has indicated that a beneficiary who exercises a special POA to add someone to the class of discretionary beneficiaries could be treated as making a gift, although the IRS has refused to say how such a gift would be valued.[15] (Discretionary beneficiaries are those to whom the trustee may, but isn't required, to make distributions.) It seems that, if the beneficiary who holds the special POA is only eligible for and not entitled to any distribution, the value of any gift deemed made by the exercise of the power should be nil. ("The value of the gift is a question of fact… .")[16]

In any case, if a beneficiary holds the POA and the trustee may make distributions in favor of him only pursuant to an ascertainable standard relating to health, education, maintenance and support, the exercise of the POA by the beneficiary in favor of another shouldn't be a gift.

Naming Trustees

Other steps also should be taken on the basis of *Huber*. For example, having only a trustee in the state where the trust will be settled should help make it "smell" more like a trust that's actually situated there. If the settlor wants someone else to manage the assets, he could form a partnership, give the general (controlling) partnership interest to a trust located, perhaps, in the same state, but one from which the settlor can never receive a distribution and would have the trustee be the person whom the settlor wishes to manage the assets (which would now be in the partnership). The limited partnership units would be transferred to the trust of which the settlor is or could possibly become a beneficiary.

It also seems appropriate not to name someone to be the trust protector who resides in the same state as the settlor if the settlor doesn't live in a state that provides creditor protection for self-settled trusts. That would seem to reduce the jurisdiction of the settlor's state over

the trust. In fact, the settlor might consider moving to a state that provides asset protection for self-settled trusts prior to the filing of a petition in bankruptcy.

Situating the Assets

The *Huber* court contended that the only asset the trust held that was in Alaska was a $10,000 CD, and all other assets were in Washington. Based on general principles, the court may be wrong, as it seems the other assets were shares of stock or interests in a limited liability company, both of which are intangibles. The law generally provides that an intangible is deemed located where its owner resides.[17] In *Huber*, there were three trustees, only one of whom was in Alaska, and the court found that the Alaska trustee did nothing to preserve the trust and was a mere "straw man." So, perhaps, on a head counting basis, the court decided even the intangibles were located where the two non-Alaska trustees resided. In any event, having only a trustee or trustees in the state where the trust will be formed and administered should help to overcome the type of contention the *Huber* court made.

To go even further, the settlor could fund the trust with a sufficiently large enough CD that the trust could use its cash to buy assets from the settlor (and without income tax, in accordance with Revenue Ruling 85-13). Since the court conceded the CD is an Alaska-sited asset, buying intangibles from the settlor using the Alaska CD would seem to keep the trust assets Alaskan.

Local Attorney

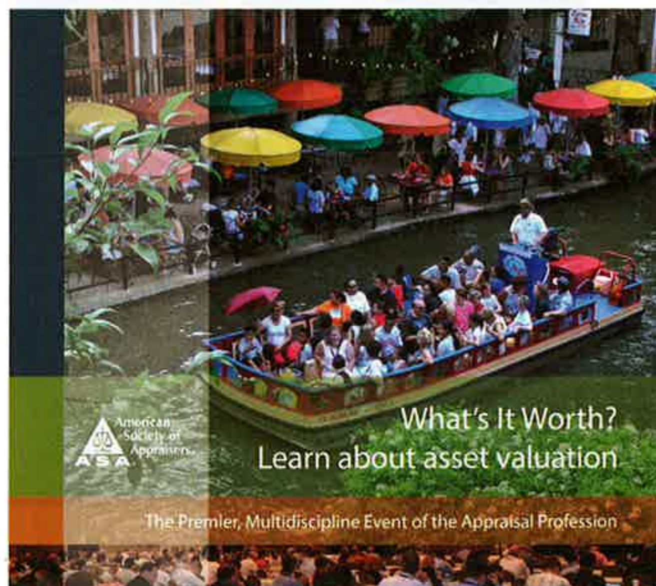
Huber lists as one of the Washington contacts the fact that the lawyer who drafted the Alaska trust was in Washington. Hence, a lawyer in the jurisdiction whose law is to govern the trust should be engaged to participate in the preparation of, or at least to review, the trust document.

Location of Beneficiaries

It also might be possible to make other trusts created under the law of the state where the self-settled trust is located the initial beneficiaries of the trust. These "beneficiary" trusts might be for individual residents (for example, descendants of the settlor) of other states. It's common for one trust to be the beneficiary of another trust.[18] Although a court might look through the beneficiary trusts to find that the ultimate individual beneficiaries aren't residents of the state where the self-settled trust was formed, having trusts formed in the same jurisdiction as the initial beneficiaries may also help to strengthen the contacts with that jurisdiction. As long as all of the trusts are grantor trusts for income tax purposes, no additional income tax reporting would be required.[19]

Estate Tax Exclusion

The tax law is consistent with respect to self-settled trusts: If the assets in the trust are subject to the claims of the settlor's creditors under the law that governs the trust, then it's included in the settlor's estate and isn't considered a completed gift. However, if it's not so subject, it won't be included merely because it's self-settled, as long as the settlor isn't entitled to the income of the trust and may not control the beneficial enjoyment of the trust property. In any case, the transfer will constitute a completed gift (and



Join us in San Antonio!

2013 Joint International Appraisers & Advanced Business Valuation Conferences

October 13-16 | San Antonio, Texas | Marriott Rivercenter

Educational Sessions ★ Exhibits ★ Networking

Register today at www.appraisers.org meetings/2013ASAConference

may be subject to gift tax when made).

Any transfer during lifetime, even if not to a self-settled or any other trust, may remain subject to the claims of the creditors of the settlor as a fraudulent one. In other words, property given outright (not in trust) to someone else may be subject to the transferor's creditors, if they can establish the gift was a fraudulent transfer. Although states impose a statute of limitations against such a claim, usually the state provides additional time if the transfer was "secret." For example, under Florida Stat. 726.110, a creditor of a transferor may challenge as fraudulent an asset transfer to avoid pre-existing creditors for one year after the creditor became aware of or reasonably could have discovered the transfer, under certain conditions. Under the Florida law, certain creditors may challenge a transfer, no matter how ancient, for a period of one year after the creditor's actual or constructive discovery of the transfer.

SPOT LIGHT

Heads Up

"Mujeres con Fruta" (36 in. by 34 in.) by Alfredo Ramos Martínez, sold for $1,107,750 at Christie's recent Latin American Art Sale in New York on May 29, 2013. Considered by many to be the "Father of Mexican Modernism," Ramos Martínez is best known for his serene and empathetic paintings of traditional Mexican people and scenes.

However, the fact that the transfer could be challenged as fraudulent at any time doesn't render the gift incomplete. The IRS has developed a logical rule, set forth in Rev. Rul. 76-103, 1976-1 CB 293: If the self-settled trust is created and administered under the law of a state where the creditors of the settlor can attach the trust assets, the gift to the trust is incomplete; however, if and when the trust is moved to a state where the settlor's creditors can no longer attach the trust assets, the transfer will be completed for gift tax purposes. A similar rule seems to apply for estate tax inclusion purposes.[20]

In *Estate of German v. United States*, for example, Estelle German, a Florida domiciliary, created a trust under Maryland law. Estelle wasn't a trustee, but her son, who lived in Maryland, was. The trustees were authorized, in their discretion, to distribute income and corpus of the trust to Estelle, although only with the consent of an adverse party (that is, another beneficiary). In holding that the trust wasn't included in her gross estate, the court stated:

> [T]he narrow issue to be decided herein is as to the extent of decedent's creditors' rights with respect to the trust income and assets under Maryland law. *** Defendant [IRS] has not established that under Maryland law creditors of the settlor could have reached the trust income or principal of her discretionary trusts up to the time of her death.[21]

The court, therefore, held that the trust assets weren't in Estelle's gross estate for federal estate tax purposes. It's possible that a creditor might have obtained jurisdiction over the trust and/or Estelle in some state other than Maryland and successfully attached the trust assets, but that possibility wasn't sufficient to cause the trust to be included in her gross estate.

The test the IRS has developed and that the courts seem to follow is that there will be estate tax inclusion, but no completed gift, when the:

> grantor [can] ... effectively enjoy the trust income by *relegating* [his or her] creditors to the trust for settlement of their claims.[22]

Hence, the mere possibility of attachment, without the settlor's direct ability to relegate his creditors to the trust, is insufficient to render the gift incomplete and the trust included in his estate.

Although *Huber* continues to follow the lead of *Portnoy* and *Brooks,* which allow some creditors to attach the trust assets in some cases if the settlor winds up in bankruptcy court, that possibility is insufficient to change the long-standing rule on gift completion and estate tax inclusion with respect to self-settled trusts.

Self-Settled Trusts Live On

Although the bankruptcy court struck down a transfer to an Alaska self-settled trust, its finding that the transfer was intended to hinder, delay or defraud creditors means it should have been struck down, regardless of the trust situs.

Even though the court found that the Washington self-settled trust law should apply, rather than that of Alaska, the fact that the court didn't adopt a blanket rule that no one from a state that doesn't protect any self-settled trust can get asset protection for such a trust created under the law of another jurisdiction means that self-settled trusts may still provide asset protection when properly created.

Perhaps, the greatest protection is to create a trust that's not self-settled but for the benefit of other family members, granting someone in a non-fiduciary capacity the power to add others (including the settlor) to the class of beneficiaries or to pay it over to another trust someone else has created for the settlor. In addition, based on the apparent analysis of the *Huber* court, having only trustees in the self-settled jurisdiction whose law will govern the trust, a lawyer in that jurisdiction participate in the drafting or review of the trust agreement and significant assets situated there should substantially increase the chances of the trust providing asset protection.

In any event, an Alaska self-settled trust may still be used, as it was in Private Letter Ruling 200944002, to avoid inclusion of the trust assets in the settlor's gross estate for federal estate tax purposes.

Endnotes

1. *In re Huber*, 201 B.R. 685 (Bankr. W.D. Wash. May 17, 2013).
2. *In re Portnoy*, 201 B.R. 685, 701 (Bankr. S.D.N.Y. 1996).
3. *In re Brooks*, 217 B.R. 98 (Bankr. D. Conn. 1998).
4. This is discussed in detail in Gideon Rothschild, Daniel S. Rubin and Jonathan G. Blattmachr, "Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch?" 9 *Journal of Bank. L. & Prac.* (Nov./Dec. 1999).
5. *Ibid.*
6. *See* Wash. Rev. Code Section 6.13.030.
7. *See* Texas Bill of Rights, Article 1, Section 26.
8. Because intent to defraud is difficult to prove, courts rely on "badges of fraud." Thus, certain indicia of fraud may lead to the conclusion that the debtor had fraudulent intent. The most common of these badges, now found in the Uniform Fraudulent Conveyance Act and in Bankruptcy Code Section 548, is to assume fraudulent intent when an "insolvent debtor makes a transfer and gets nothing or very little in return." *Kupetz v. Wolf,* 845 F.2d 842, 846 (9th Cir. 1988).
9. Treasury Regulations Section 25.2511-2(e).
10. Alaska Stat. 13.36.370(d).
11. In several private letter rulings, the power of appointment was stated in the trust to be held by a group called the "Distribution Committee" or "Power of Appointment Committee." *See, e.g.,* PLR 200715005 (Jan. 3, 2007), PLR 200731019 (May 1, 2007), PLR 200729025 (April 10, 2007) and PLR 201310002 (Nov. 7, 2012).
12. *See* Revenue Ruling 85-13, 1985-1 CB 184.
13. *Cf. Estate of Tully, Sr. v. United States,* 528 F.2d 1401 (Fed. Cir. 1976) and Rev. Rul. 80-255, 1980-2 CB 273.
14. *See, e.g.,* Alas. Stat. 13.36.157; New York EPTL 10-6.6.
15. *Cf.* PLR 200243026 (July 24, 2002) (not precedent).
16. *Ibid. Cf.* Rev. Rul. 75-550, 1975-2 CB 357 ("In this case, the trustee's discretionary power to invade corpus of the residuary trust for the benefit of B and the children can occur only if such diversion is necessary for their 'comfort, support, hospital or medical expenses.' Thus, the power of invasion is impliedly limited by a definite standard . . . In addition, as of the date of transferor A's death, the likelihood of any invasion of the trust corpus on behalf of the children was not so remote as to be negligible. Accordingly, B's life estate in the residuary trust was capable of valuation ...").
17. *See, for example,* the discussion in E.C. Schwab and William P. LaPiana, "The Income Taxation of New York Resident Trusts," 68 *N.Y.S. B.J.* 30 (March/April 1996).
18. *See, e.g.,* Treas. Regs. Section 1.643(c)-1 (first sentence) ("An heir, legatee, or devisee *(including an estate or trust)* is a beneficiary"). (Emphasis added.)
19. *See* Jonathan G. Blattmachr and Bridget J. Crawford, "Grantor Trusts and Income Tax Reporting Requirements: A Primer," *Probate Practice Reporter,* Vol. 13, No. 5 (May 2001).
20. *See, e.g.,* Rev. Rul 2004-64, 2004-2 C.B. 7.
21. *Estate of German v. U.S.,* 7 Ct. Cl. 641 (1985).
22. Rev. Rul. 76-103. (Emphasis added.)