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Each member of the International Wealth and Asset Planning Group at Greenspoon Marder LLP sincerely hopes that you and your loved ones have remained, and will continue to remain, safe and healthy in these unprecedented times.

In this letter, we first briefly discuss how potential litigation may arise during this emotionally-charged period. We then provide some excerpts from a letter we shared with clients earlier this year.

POTENTIAL LITIGATION DURING TIMES OF CRISIS

During times of crisis, emotions run high. Individuals are concerned with the health and well-being of their families, friends and loved ones. Decisions during stressful times tend to be more impulsive as opposed to giving careful thought before acting. As clients of the International Wealth and Asset Planning Group, you already know that our recommended asset protection strategies are implemented with a view toward the future. That is, we place great value protecting one's assets at a time when the creditor seas are calm as opposed to waiting until it is too late.

During this highly-charged time, individuals may become more litigious for a litany of reasons (e.g., fear, anger, desperation, etc.) As a result, an increased amount of creditor threats tend to rise during this period. If a client becomes subject to a creditor threat, or if one becomes reasonably anticipated, the client should alert his trust counsel as soon as possible so they can review and advise accordingly. Similarly, if a client wishes to discuss their current estate planning documents to see if they presently align with their goals, again they should contact their legal counsel.

The bottom line is that while the "new normal" continues to affect our daily lives, we will get through these trying times together. All of us here at Greenspoon Marder LLP's International Wealth and Asset Planning Group remain committed to being available to address your legal needs. Stay safe and be well.

EXCERPTS FROM 2020 ANNUAL CLIENT LETTER

The year 2020 has definitely provided us with some 20/20 hindsight after absorbing all the 2019 activity of case law and new statutory developments. We wanted to share with you some excerpts of our client letter that was sent earlier this year.

ANNUAL REVIEWS AND REMINDERS

1. Transaction Review. The manner in which assets are owned, and how beneficiary designations (such as on IRA accounts, life insurance, etc.) are set up, may determine the degree of an integrated estate plan's (IEP's) success. A trust that is a component of an IEP should be properly funded to minimize or avoid the probate process and maximize protection so that the IEP works in the manner in which it was intended. For this reason, it would be a good idea to review your personal holdings and for us to discuss together whether it is time to transfer additional assets into the planning structure you created. Accordingly, below is a helpful summary list of to-do reviews:

- Review the purchase of any real estate, stocks, bonds or other investments during this past year. Real estate in particular is more prone to attachment since the state law where the real estate is located, coupled with the fact that real estate cannot be moved, can be used to a creditor's advantage. Consideration should therefore be given to having an integrated estate planning trust (IEPT) own a holding company LLC (to serve as a clearinghouse for operation accounts) that in turn owns several LLCs, one of which owns the real estate along with some personal property and income producing assets (e.g., a state chartered bank account in a state with protective laws such as Delaware). This better allows the laws designated in the IEPT to control versus the laws of the state where the real estate is located.

  Furthermore, equity stripping measures can be taken to make the real estate a less attractive target.

  The LLC can also better isolate any liability that may be associated with the real estate.

- Review refinancing of any real estate. If real property was temporarily removed from the trust or underlying entity during a refinance, then verifying that such property was transferred back into the trust (if allowed under the loan documents) once the refinance was complete is advisable; however, if the property was not transferred back into the trust (or better yet, an underlying LLC), then a deed should now be prepared to place the real estate back into the trust or LLC.

  - It is also worth noting here that it is preferable from a protection standpoint to avoid such temporary removals of real property from an IEP. Therefore, before taking such action, it is recommended that the trustees first talk this through with legal counsel.

  - It should be further noted that if the real estate is income producing, it can be imperative that the income so produced be deposited in the real estate owner's own separate account (and not in another entity's, nor in your own personally accessible account for that matter).

- Avoid having access to any lines of credit that involve IEP assets.

- <u>Review transfers of property</u>. Any transfer documentation to an IEP should be reviewed prior to execution to determine whether the character of the asset is separate, community, marital, or some other type of property, so that unintentional commingling or change of character of assets does not occur upon transfer.

2. <u>State Law Nuances</u>. It is always recommended that any assets that are being transferred first be confirmed by "local" counsel as not having to meet any particular state law requirements that may pertain to transfer taxes, franchise taxes, margin taxes, valuation reassessments, and other possible unintended consequences. For example, if the IEPT or an underlying entity owns or will own California real estate, the provisions should be revisited sooner versus later. In fact, if you have transferred or intend to transfer such assets to the IEPT, the trustees or you should check the definition of "Trust Period" or "Trust Term" under the IEPT to confirm whether the IEPT's term is going to expire in the next year or two. If so, we should be contacted well in advance of the expiration of the term.

California's Proposition 13 provides in relevant part (subject to a number of exceptions) that transfers involving California real estate result in an adjustment to the value of the real estate for property tax purposes. To qualify for one of the exceptions when making such a transfer, the trust must contain certain language. As such, we strongly urge that California counsel be consulted so that any needed language is analyzed with regard to other goals of an IEP.

With regard to any IEP that owns any real estate in any state, more evidence is mounting that exhibits court bias in allowing a creditor to access the real estate. This continues to suggest revisiting (in our recommended annual meetings) ways to avoid such result-oriented rulings. For example, having the real estate transferred to a more iron-clad nest-egg sister trust can make a substantial difference in the availability of protections. Equity stripping, as mentioned above, can be another added effective safeguard maneuver.

Please check with us prior to making any transfers, in case there may be special considerations, including but not limited to the ones noted above.

3. <u>Upkeep of Entities</u>. Confirming that any needed annual LLC or partnership registration renewals have been filed is also a good agenda item to check off each year, since our office (even if we are serving as the registered agent/office) may not be notified by the registration officials as to when renewals are due or are about to expire. It would be overwhelming for us to attempt to monitor such renewal notices for all clients, so it is important that you do so each year.

In a similar vein, you should check the partnership agreement and operating agreement for each respective partnership and/or LLC you have created to see if the term of such agreement will be ending within the next year or two. If so, certain action will be needed to extend the entity term in order to prevent such entity from terminating prematurely.

4. <u>IEP Level Bank Accounts</u>. Every IEP should maintain its own bank accounts to (i) hold sufficient funds to pay for its own expenses, such as trustee fees, maintenance of properties, legal fees, etc., or (ii) deposit income (e.g., rent from a real estate tenant). For example, if an LLC owns real estate to which you should be paying rent, the LLC should have an account for purposes of collecting rent and paying real estate related expenses or other obligations the property owner may have under the terms of a lease. If you have no lease in place that addresses having the entity pay certain expenses, then such documentation should be quickly created to memorialize the financial terms of the occupancy rights of the parties. The reasoning behind this is that such documentation better withstands the continued scrutiny that is evident in some case law. We are suggesting a new form of lease that should replace any outdated lease agreements that you may currently have in place.

5. **<u>Stretch IRAs and Retirement Plans</u>.** New legislation (as discussed in further detail under the "Federal Law Developments" section provided below has now curtailed the ability to defer income taxes for certain beneficiaries beyond ten years after the participant's death, notwithstanding the provisions that may be contained in an existing IEPT. Consequently, given how new this law is, we will continue to consider ways to best address the impact of this new law as we get answers to a number of unanswered questions that are continuing to surface in the legal community with respect to this law. That being said, you should contact us in the meantime to address your particular situation if the IEPT (or any "stretch" trusts) will be a recipient of any significant taxable retirement fund proceeds. For example, in light of a maximum ten-year rule, some strategies are being discussed such as having an IRA name a charitable remainder trust that can still defer taxation of the IRA beyond the otherwise applicable ten-year term.

6. **<u>Avoid Mixing Hot Assets and Cool Assets and Conducting a Periodic Asset Review</u>.** Over the course of time, the makeup of assets held in a planning structure will change. Sometimes the change is from, say, cash to a mix of cash and real estate. Sometimes an airplane or yacht is acquired. When these situations come to our attention, clients almost always see the advantages in our advice that the low risk/no risk assets (referred to as the "cool" assets; for example, cash) be segregated from the high risk assets (referred to as the "hot" assets; for example, real estate, airplane, etc.). The reason for this is that despite the value of certain assets, they can also carry risk. For example, even a limited partner interest that could be subjected to a capital call could become a hot asset. Consequently, the main goal is to keep a liability that may emanate from a hot asset isolated and separate from the cool assets.

Periodically it is a good idea to review the IEP structure to see what assets are being held, the manner in which such assets are being held, and to consider making adjustments as appropriate. An updated financial statement or summary should also be prepared as you confirm that the IEP structure owns what you think it owns. You should further confirm that the annual tax returns accurately reflect what is owned under the IEP.

7. **<u>Being a Responsible Trustee</u>.** It should go without saying that the role of a trustee is an important position that should not be taken lightly. What many don't realize, however, is that how the trustee position is carried out can also be an important factor in whether the trust will or will not be respected, whether by a court one day in litigation or otherwise.

That is, a trustee should not simply rubber-stamp requests. It can also be helpful if the trustee is not related or subordinate to you. When carrying out trustee duties and when responding to requests, questions should be asked and independent judgment should be exercised by the trustee. For example, when a distribution to a settlor is being considered, any standards' restriction that appears in the IEPT should be given the trustee's close attention.

Consequently, the trust should not be treated as the settlor's back pocketbook. Namely, assets of the trust should not pass in and out, back and forth between the settlor and the trust.

It is also strongly suggested that a bank account for the trust be maintained. Other financial accounts for the trust may be established as well. The settlor in his or her capacity as settlor should not be a signatory on the account, but the settlor will likely have to report the account to the Department of Treasury annually if that account is a foreign account.

8. **<u>Being a Responsible Settlor</u>.** There are certain things the settlor should do so as to assist with the IEPT being respected if and when it is challenged one day, or otherwise. For example:

a. The settlor should not describe or reference or represent the trust (or planning structure) as his or her own, whether on financial statements or otherwise.

b. The settlor should not speak or think in terms of "my trust" and "my assets."

c. The settlor should not sign on behalf of the trustee.

d. The settlor should bear in mind that his or her solvency must be maintained, both in terms of assets less liabilities, and in terms of liquidity to pay debts as they come due.

9. **Protector Powers.** If there is a protector serving in connection with the IEPT, attention should be given as to whether the protector needs to reflect in writing that the protector is waiving or asserting any veto powers over a trustee's actions.

10. **Review and Update Language in Older Planning Structures.** All existing IEPTs should be reviewed and updated as appropriate. Not only should changes in planning goals be reflected, but newer and updated language that has been developed should be considered as well, along with any and all recent tax law changes that may have impacted the provisions of the IEPT.

The newly designed trust (or restatement of an existing trust) would provide numerous options that can be applied based on what will bring about the most tax-efficient results. In essence, the trust would need to be crafted as an irrevocable trust, and yet have the capacity to be modified (or even terminated) without court involvement as appropriate in light of virtually any change in family or financial dynamics, goals, or laws. This might include provisions that allow: (i) for a step up in tax basis (that can eliminate capital gains); (ii) income and gains to be taxed at a lower tax rate and/or avoid state income tax; (iii) trust assets to be "poured-over" from one trust to a new trust that better addresses current goals; (iv) a trusted "fiduciary" to change beneficiaries, change the applicable law to a more favorable jurisdiction, or to amend the trust to make sure the initial goals will be carried out; and (v) other provisions that add flexibility to the IEP.

This could also be a window of opportunity to forever remove over $11.58 million (or twice that amount for married couples) from any gift, estate and generation-skipping transfer tax system. Also, using the existing IEPT in conjunction with a new more modern IEPT design would provide a unique opportunity to move partnership and LLC interests out of your taxable estate permanently while taking advantage of the "discounting" of the valuation of taxable gifts to trusts.

11. **Any Change in Settlor, Trustee or Protector.** When a domestic trustee or third-party domestic protector of a domestic "offshore" trust dies or resigns, the trust may remain a domestic trust for U.S. tax purposes *only if* a new trustee or protector, who is a U.S. person, is appointed within 12 months of the trustee's or protector's death or resignation. If a new trustee or protector is not appointed within the 12-month period, then generally the trust will retroactively be classified as a "foreign" trust for U.S. tax purposes, resulting in additional tax filing requirements and exposure to fines and penalties for non-compliance. There is also a potential income tax issue should a trust's settlor die while the trust is classified as a foreign trust for U.S. income tax purposes. *Accordingly, please notify our office as soon as possible upon the death or resignation of either a trustee and/or protector, so that we may assist you with any needed timely and proper appointment of a successor.*

This 12-month period is permitted only in the event of an "inadvertent" change, which includes death or resignation. Conversely, in the event a domestic trustee or a domestic protector is **removed** (which would not be classified as an "inadvertent" change), then such 12-month grace period will not apply. In that case, the trust will automatically be classified as a foreign trust for federal income tax purposes as of

the date of the removal. Therefore, if the desire is to keep the trust domestic, we recommend that a successor domestic trustee or domestic protector be effectively appointed prior to or at the same time that the then-serving domestic trustee or protector, as the case may be, was removed.

On a broader scale, if the residency of a settlor, trustee, or protector will change, please contact us right away so that we can determine if this could cause an otherwise "domestic" offshore trust to become a foreign trust with significant new IRS filing requirements that carry hefty penalties if missed.

If by chance the IEPT was designed as a grantor trust that is also a completed gift trust, and is a foreign trust, and the settlor passes away, there can be income tax consequences at that time unless the IEPT is amended in advance to maintain its grantor trust status (under IRC Section 678).

14. Trusts that Hold United Kingdom ("UK") Assets. If an IEP holds UK assets, the UK may be able to assess a "tax" on such assets. Also, if the IEP owns such UK assets that have incurred a "relevant UK tax liability" (i.e., the IEP has incurred UK liability for income tax, capital gains tax, inheritance tax, stamp duty land tax, wealth tax, or stamp duty reserve tax) and other certain conditions are met, the IEPT may have to register and report certain specified information in the UK on the trustee(s), settlor(s), beneficiaries (including persons named on a letter of wishes), and assets of the trust. It should be noted that any such information that is reported will be held in a UK government register and will consequently be available to taxation authorities and other law enforcement officials. If you believe such reporting may apply to you, please contact our office and we can explore this further.

SELECT GOOD IDEAS AND REFRESHERS

1. Convert Partnerships to LLCs. With an aging client base, we are experiencing a number of estates in which a probate estate is needed to be opened in order to assign a deceased general partner's interest in a partnership to the successors. This time and procedural delay can be problematic (such as when the partnership is involved in litigation and needs the successor general partner to immediately step into the role of acting for the partnership). For this reason, we are recommending converting partnerships to LLCs so that a successor manager of the LLC can step into action without the need for any probate filings. If this is of interest to you, please let us know.

2. SLATs, SPATs and PLATs. Some of the tools being recommended for those who prefer totally domestic trust structures include spousal lifetime access trusts (SLATs), special power of appointment trusts (SPATs) and partner lifetime access trusts (PLATs) that capture and lock in the huge current gift tax exemption of $11,580,000 (per individual). If such a trust is completed using the appropriate applicable/governing law, such trust can provide superior gift/estate tax savings as well as asset protection. The "lifetime access" or power of appointment aspects of such trusts further provide you eligibility to regain ownership of the trust assets under certain prescribed circumstances (as set forth in the trust document). We build in safeguards here to better insure that such trusts are not "self-settled" trusts (or similar devices), such as building in certain "seasoning" periods that the trusts endure before certain powers are able to be exercised.

In any event, these trusts can also include provisions that allow you to replace trust assets that have a low tax basis with your personal assets that have a high tax basis (including cash or borrowed funds) so that the low basis assets get a step up in basis (i.e., a fair market value adjustment) under the estate tax laws to allow your family members who outlive you to then sell those assets income tax free.

Further desirable features can be built into these trusts, such as a trustee's authority to loan you trust funds at any time that you have the financial wherewithal to borrow such funds.

3. Free-Basing Trusts. To what we have heard referred to as "free-basing" trusts, if you do not live in a community property state (which allows a full adjustment to the tax basis at the death of the first of two spouses to die, thereby allowing the surviving spouse to sell any or all of their collective assets income tax free), you can nevertheless achieve similar basis adjustments (also known as double "step up in basis"). One approach to achieve this is for you to grant your spouse a restricted general power of appointment to direct that assets that are owned by you to be distributed to a recipient trust that (subject to 3.a. immediately below) benefits you and your descendants. Such power to appoint can be made contingent on prior consent from a non-trustee beneficiary.

a. You may be restricted from being a beneficiary of such recipient trust until an additional step occurs, such as an exercise of a limited power of appointment held by the descendant(s) or a limited power of amendment held by a non-fiduciary protector who was selected by a trustee.

b. Such assets are likely protected from creditors under all fifty states, not just the nineteen domestic asset protection trust law states.

c. All assets (your and your spouse's) can get the step up in basis at the time of the earlier spouse's death.

Another free-basing technique is to annually swap assets with any intentionally defective irrevocable trust that you may have created so that you receive low-basis assets in exchange for high tax basis assets. This can eliminate post-death capital gain taxes without incurring any added gift or estate tax.

4. State Estate Taxes. In addition to the federal estate tax of 40%, some states levy an additional estate or inheritance tax. Entering into 2020, there are twelve states and the District of Columbia that have a state-level estate tax, and six that impose inheritance taxes. Maryland is the only state to have both. Consequently, if you die as a domiciliary of one of these states, you should have specially drafted provisions in your estate planning documents that ensure that you have minimized such tax to the extent it is avoidable under the laws of that state, while staying in line with your estate planning goals. Namely, the twelve states that impose a state estate tax are: Connecticut, Hawaii, Illinois, Maine, Maryland, Massachusetts, Minnesota, New York, Oregon, Rhode Island, Vermont, and Washington. While Washington State's 20% rate has been the highest estate tax rate in the nation, Hawaii has now also increased its top rate to 20% effective January 1, 2020. Eight states and the District of Columbia are next with a top rate of 16%. With regard to state estate tax exemption rates, Massachusetts is notably the lowest with an exemption level of $1 million, and the District of Columbia is noted as having the highest exemption level at $5.68 million.

5. Second-Tier Asset Protection. Some have the misperception that if they have an asset protection trust in place, this also protects the assets of the businesses owned by the trust from the business's own creditors. This is not the case however. Therefore, a second tier of protection should be layered in separately. While there are a number of ways to do this, one such method is to have the business itself create its own asset protection trust.

6. Respect the Separateness of Trust and Entity Structures. It is also important to always remember that only authorized parties (as delineated under such entity's governing documents) can execute documents on behalf of a respective entity. For example, if a home owned by a trust or LLC is being refinanced, the trustee (as opposed to a settlor) or the manager should be the one entering into the loan documents.

DEVELOPMENTS

1. Federal Law Developments: The applicable exemption amount is the amount a taxpayer can give away during life or at death and not incur any gift or estate tax. The applicable exemption amount may also include the unused applicable exemption amount of your last deceased spouse (provided that "portability" is elected by filing a Form 706 (*Federal Estate Tax Return*), and the deceased spouse was a U.S. citizen or resident). For this purpose, the 2020 exemption amount is $11,580,000. To the extent the applicable exemption amount is not used up during life by lifetime gifts, what is left will apply to transfers at death. If lifetime gifts or death-time transfers exceed the applicable exemption amount (or the unused portion thereof), any applicable tax is calculated at a 40% tax rate with respect to the excess amount. Notwithstanding the foregoing, if a husband and wife "gift-split," this exemption figure can be doubled to $23,160,000. This tax law is set to sunset in 2025 so that on January 1, 2026, the exemption amounts will return to the pre-2018 exemption levels (i.e., $5,000,000 basic exclusion amount per person, plus additional amounts to account for adjustments for inflation).

a. Annual Exclusion—Non-U.S. Spouse: Gifts between U.S. spouses can be made to an unlimited extent, without any gift or estate tax consequences. However, if the recipient is not a U.S. person, then a $157,000 annual exclusion applies during 2020.

b. Gift Tax Annual Exclusion: This exclusion is the amount a person can give away to any number of individual recipients each year without any resulting gift tax consequences. In 2020, the gift tax annual exclusion continues to be $15,000 (or $30,000 with "gift-splitting" by spouses).

c. Generation-Skipping Transfer Tax Exemption: This exemption is the amount that can pass free of the 40% generation-skipping transfer tax over one's lifetime. Without this exemption, transfers to a grandchild or more remote individual (or a trust whose beneficiaries are comprised of only such persons) would be subject to this tax. During 2020, the exemption amount is $11,580,000 per donor/decedent. Unlike the estate tax exclusion amount, however, the generation-skipping transfer tax exemption cannot be used by a surviving spouse, unless special language is added to your estate planning documents. Please contact us if you would like to confirm whether your estate planning documents include such language or whether a modification is otherwise needed to have it included.

d. Foreign Gift Reporting Threshold: A gift from a foreign person must be reported if it exceeds a certain value. During 2020, the threshold amount remains at $100,000 for aggregate gifts made during the year from a foreign donor. The Form 3520 with respect to any purported gifts made (in the aggregate) via a transfer from a foreign partnership or foreign corporation, however, has raised its threshold for reporting purposes in 2020 to $16,649.

e. Foreign Earned-Income Exclusion: During 2020, the first $107,600 in income earned abroad by an individual is excluded from taxable income for U.S. income tax purposes (up from $105,900 during 2019).

f. Stretch IRAs and Retirement Plans Under the SECURE Act: On December 20, 2019, the "Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019" was signed into law, and may impact an IEPT as it relates, in part, to the loss of the "Stretch" provision on inherited IRAs and retirement plans for many beneficiaries. That is, under the SECURE Act, the full balance of such inherited IRA or retirement plan must

be distributed within 10 years, beginning the first year following the year of death of the plan owner. Apart from requiring that the full balance of the inherited IRA or retirement plan be withdrawn by December 31 in the 10th year following the death of the plan owner, the SECURE Act does not otherwise provide timing for such withdrawals. Even so, this new law provides a few exceptions for those who inherit an IRA or retirement plan from a plan owner that dies in 2020 or later. (Further, inherited government and labor union retirement plans do not apply this provision until 2022.)

Of notable importance are the following exceptions from the new maximum 10-year distribution requirement:

- Surviving spouses named as the sole beneficiary will not be affected by the SECURE Act, and consequently, such spouse may continue to roll over the inherited IRA or retirement plan amount into their own IRA and treat it as their own.

- Retirement plans that have been annuitized and are paying a life annuity benefit upon inheritance are excepted.

- Beneficiaries that are less than 10-years younger than the deceased plan owner are excepted (i.e., siblings).

- Beneficiaries who are under the legal age of majority are excepted; however, such exception only applies to children of the deceased plan owner and would therefore not apply to grandchildren. Even so, once the qualifying minor beneficiary reaches legal age of majority, the 10-year rule will then apply.

- Beneficiaries who are permanently disabled or chronically ill are also excepted.

2. **Select State Statutory Developments**:

a. **Domestic Asset Protection Trust ("DAPT") laws**: Two new states enacted DAPT laws, thereby increasing the total number of states that have legislation allowing the creation of such trusts from 17 to 19. More specifically, Indiana enacted its DAPT statute effective July 1, 2019; and Connecticut enacted its DAPT statute effective January 1, 2020.

b. **Private Non-Charitable Foundation laws**: In other state statutory developments, the "Wyoming Statutory Foundation Act" was passed on July 1, 2019, making Wyoming the second state to enact a private non-charitable foundation statute (thereby authorizing the statutory foundation as a new business entity), following New Hampshire, which was the first state to similarly enact such a statute back in 2017. Foundations have been available offshore for years, but now the U.S. is following suit with these first two states. There are some similarities to a trust (e.g., instead of you funding a trust as the "settlor," you can fund a foundation as the "founder"). Although beyond the scope of this letter, a foundation can offer certain advantages over a trust due to reasons that include: (i) the foundation is managed by a foundation manager instead of a trustee, which means the manager is not as restricted by fiduciary obligations that apply to trustees; and (ii) the foundation is the legal owner of the assets placed into the foundation as opposed to beneficiaries having equitable ownership of the assets.

3. Recent Developments in Case Law:

a. **In Re Cyr (Rodriguez v. Cyr)[1] (*Third Party Created Trust May be a Self-Settled Trust and Included in Bankruptcy*)**: In the case of In re Cyr, debtor husband filed for Chapter 7 bankruptcy arguing that the assets of a third party settled trust were off limits to the Bankruptcy Trustee under Texas trust law because the trust was a spendthrift trust and the debtor was merely a beneficiary as opposed to a settlor such that it would be a self-settled trust. The Bankruptcy Court rejected this argument noting that the third party trust could indeed be a self-settled trust to the extent that the debtor (and the marital community) contributed assets to the trust, such that (despite the trust's spendthrift provision) the debtor's interest in the trust was includible in the bankruptcy estate. Accordingly, the Bankruptcy Court held that "while spendthrift trusts are enforceable under Texas law, to the extent a beneficiary also contributes property to such trust, the assets contributed by the beneficiary-settlor are deemed 'self-settled' and subject to the claims of creditors."

Given the decision in this case, and others that were similarly held in and out of Bankruptcy Court, it is important that you contact our office before anyone other than a/the Settlor makes a contribution to the IEPT.

b. **Levitan v. Rosen[2] (*Can a Beneficiary's "Discretionary" Interest in a Trust be Included as Marital Property in a Subsequent Divorce Proceeding?*)**: Whether trust assets will be protected in a subsequent divorce proceeding involving the beneficiary has historically turned on whether such beneficiary's interest in the trust is a mere expectancy or a present, enforceable right. Although case law has varied greatly depending on the terms provided in a particular trust instrument, the Massachusetts Supreme Court has held in the past that interests in discretionary trusts (i.e., where an unrelated, disinterested independent Trustee has absolute discretion to make distributions) would not be included in the marital estate because such interests were too speculative because there was no guarantee that the beneficiary would ever receive a distribution from the trust.

In the Levitan case, however, the Massachusetts Appeals Court issued a decision in direct conflict with past case law by holding that all the assets of a discretionary trust share for the benefit of the wife (approximating $1.6 million in value) in a divorce proceeding were includible in the marital estate regardless of the fact that there was an unrelated, disinterested independent Trustee serving that had complete discretion to make distributions to the wife as beneficiary. In reaching this decision the Court considered several factors, including in relevant part: (i) that the wife was the only current beneficiary of the discretionary trust (with 5 remainder beneficiaries); (ii) that the wife as beneficiary had the right to withdraw 5% of the trust property each year (which she had a history of exercising); (iii) the wife was currently occupying a trust-owned house, rent free (which was valued at $645,000); and (iv) the settlor/parent's primary intent. It should be noted here that trusts can be drafted and administered in ways to better avoid these bad facts. We would be happy to discuss what options are available in your specific case.

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[1] 2019 WL 1495137 (W.D.Tex., April 1, 2019).
[2] 124 N.E.3d 148 (Mass. App. Ct. 2019).

The Court further held that the trust assets attributed to the wife in the divorce could not be assigned to the divorcing husband because the trust had a "spendthrift provision" that prohibited distributions from the trust to a beneficiary's creditors and other third parties (which would effectively include divorcing spouses). Accordingly, while the spendthrift provision ultimately protected distribution of the trust assets to the divorcing husband, the wife was still attributed assets in the divorce that she may never actually receive, and as a result, the divorcing husband essentially received a larger share of the joint marital assets than he would have otherwise been entitled.

For these reasons, the Levitan case serves as a warning that purely discretionary trusts that are established by a parent for the benefit of a child beneficiary that may later go through a divorce will not automatically be excluded from marital property in that divorce action. Further, the Levitan decision also highlights the importance of keeping trusts updated to reflect the most recent case law developments in order to prevent your testamentary intent from being frustrated in a beneficiary's later unforeseeable divorce proceeding.

c. **North Carolina Department of Revenue v. The Kimberley Rice Kaestner 1992 Family Trust[3] (*Supreme Court Limits States' Ability to Tax Trusts Based on Beneficiary Residency*)**: On June 21, 2019, the Supreme Court of the United States held in the Kaestner case that states cannot tax a trust's income when the only connection to that state is the residency of a beneficiary when certain specific criteria are met: (i) the resident beneficiary did not receive any income from the trust in the year in question; (ii) the resident beneficiary had no right to demand trust income or control, possess, or enjoy the trust assets in the year in question; and (iii) the resident beneficiary had no right to ever demand or receive distributions from the trust (i.e., distributions from the trust are fully discretionary at all times with regards to the resident beneficiary). Consequently, the holding in Kaestner is quite narrow and will not reach many existing trusts, but is important nonetheless because it provides a blueprint for how to avoid taxation when a state attempts to tax trusts based solely on the residency of a beneficiary.

The Supreme Court held that it was unconstitutional for North Carolina to tax a New York trust based on these facts and taking into account the specific criteria laid out above. Due to the narrowness of this ruling, however, the ruling may not be as impactful as the estate planning community hoped. For example, it is still an open question how the trust would be taxed in a year that a distribution is made or if the beneficiary had withdrawal rights or would receive mandatory distributions at any time during the trust's existence. However, the ruling does provide a roadmap for designing a trust that minimizes state tax law implications if a beneficiary of the trust does live in a state that taxes trusts based on beneficiary residence. Consequently, while there are many open issues that still need to be addressed in the wake of Kaestner, this is an important first step in limiting a state's ability to tax a trust based solely upon the residency of a beneficiary of the trust.

d. **In the Matter of Cleopatra Cameron Gift Trust[4] (*Out-of-State Creditor Confronted by South Dakota Supreme Court Notwithstanding Full Faith & Credit Clause Argument*)**: The Cleopatra case involved a debtor that divorced her husband

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[3] 18-457 (June 21, 2019).

[4] 2019 S.D. 35 (June 26, 2019).

in 2009, who depended on her for his support and the support of their children. The debtor's primary means of support, however, was a California trust that was set up by her father for her benefit. A California court ordered the trustee to pay the debtor's support obligations. The trustee complied with this order until such time the trust assets were decanted to a South Dakota trust and in 2017, the California order was no longer given deference under the full faith and credit clause of the U.S. Constitution. The recognition of a California judgment does not mean South Dakota would need to enforce such judgment as self-executing against the trust.

In reaching its decision, the South Dakota Supreme Court upheld the Circuit Court's decision to not enforce the support obligation finding that South Dakota doesn't provide for exception creditors to the spendthrift clause and therefore, the Court would not give full faith and credit to the California judgment. Caution should be taken, however, that if such a decanting takes place too close in time to the actual divorce action, the non-beneficiary spouse may try to argue that the decanting is either a voidable transaction designed to avoid a creditor, or is in contravention of public policy considerations.[5] Further, even though the decision didn't directly involve a Domestic Asset Protection Trust ("DAPT"), the Cleopatra case does suggest that a DAPT created in South Dakota (and quite possibly in other states that have DAPT statutes) by a non-resident of a DAPT state is more likely to stand up in an enforcement proceeding brought under the law of the non-DAPT state of residence.

e. **John F. Campbell v. Commissioner[6] (*Tax Court Rules that Nevis Offshore Asset Protection Trust Assets are not Available to the Taxpayer for Purposes of Paying the IRS*)**:

In the recent Tax Court ruling under Campbell, the facts of the case involved a federal tax deficiency that was assessed by the Internal Revenue Service ("IRS") against the grantor of an asset protection trust that was created under the laws of Nevis well before the tax years related to the assessment of the tax deficiency. The IRS rejected the grantor's offer in compromise (which is a process in which the IRS may agree to collect a lesser sum if the taxpayer has too few assets at their disposal). The IRS claimed that the trust assets were available to the grantor to pay the deficiency in full. The grantor subsequently appealed this decision. Ultimately, the Tax Court held that the IRS abused its discretion in requiring that the trust assets be considered in calculating the amount that the IRS could accept under the offer in compromise. Favorable facts in the case include: (i) the grantor was still solvent following the transfer of the trust assets (that is, the grantor was noted as having transferred only $5 million of his $25 million overall net worth); and (ii) the grantor didn't have sufficient control of the trust assets even though the trust instrument did in fact allow the grantor to request (but not mandate) that the trust protector remove the trustee.

[5] It should be noted, however, that in the Cleopatra case, the South Dakota Supreme Court rejected the public policy claim made by the debtor's ex-husband who cited the Domestic Asset Protection Trust ("DAPT") statute that requires spousal notice of transfers of marital property into a DAPT. However, it was noted that separate property transferred into a DAPT under South Dakota law does not require spousal notice. It should also be noted that although the decanting did not occur until after the divorce action was filed, the trust went through a number of trustee changes, and perhaps that made the decanting appear to be more of an effort to find an acceptable trustee as opposed to being simply an effort to find a jurisdiction that could skirt the support obligations.
[6] T.C. Memo 2019-4 (Docket No. 5644-12L, filed February 4, 2019).

Even so, it is interesting to note the IRS' argument that the grantor had maintained sufficient control over the trust and therefore had access to the trust assets because the grantor had appointed the trust protector, and because the trust indirectly invested in some of the grantor's business ventures. The Tax Court nevertheless responded with the view that the trustee, in its sole discretion, directed trust assets to be so invested and that the grantor could not and did not control this decision, even though the grantor proposed some of the trust investments.

f. **In Re Rensin**[7] (***Cook Islands Trust Holding Annuities for Benefit of Grantor-Debtor Protected from Creditors***): Rensin is a Bankruptcy Court case that involved a debtor that filed for personal bankruptcy almost sixteen years after creating a Cook Islands Trust in which he was the settlor and beneficiary. At the time of creating the trust, the debtor had no creditor issues and funded the trust with monies he received from the sale of a business, totaling $9 million. A few years after creating the trust, the debtor was sued by the Federal Trade Commission ("FTC"), which claimed that the debtor's wholly-owned company and its subsidiary defrauded customers by taking $14 million in payments but never delivering products. The FTC won a $13.4 million judgment against the debtor's wholly-owned company, but initially, the debtor was not personally named in the judgment.

In the two year time frame that occurred thereafter, the wholly-owned company declared bankruptcy and judgment was entered against it, but this time debtor was included personally for $609,000. Simultaneously, the Cook Islands trust that was previously created by the debtor was amended to give the debtor a power of appointment to direct the Cook Islands trustee to distribute assets to any member of an appointed class of beneficiaries. However, the Cook Islands trustee retained the power to remove beneficiaries from this appointed class.

Thereafter the case cites to various facts, but notably finds that within the two to three year period prior to the debtor filing for bankruptcy: (i) the debtor purchased a residence in Florida and claimed homestead (and such purchase was made a month after the judgment against him and his wholly-owned company were reversed thereby increasing the $609,000 judgment to $14 million, but ultimately entered at $13.4 million less than a year before the debtor filed bankruptcy); (ii) the trust changed trustees and moved its situs from the Cook Islands (with Southpac Trust International, Inc. as trustee) to Belize (with Orion Corporate and Trust Services as trustee); (iii) debtor received approximately 14 distributions totaling $8.68 million during the FTC litigation which were used to pay settlements with creditors, legal fees, and a new business venture that ultimately was unsuccessful; (iv) debtor transferred $350,000 to his counsel who then transferred the money to the trust so the trust could purchase a deferred variable annuity issued by a Cayman Islands company, and contemporaneously, the trust used the balance of the trust assets (approximating $1.7 million) to purchase a fixed annuity from the same company so that at the conclusion of both transactions the trust only held two annuity contracts for which the debtor himself was the annuitant, and the trust was the owner and beneficiary.

The first issue the Florida Bankruptcy Court in Rensin had to consider was which law applied. The debtor claimed Belize law should apply since it was stated in the trust document and that was where the trust was located. The Court disagreed and held that

[7] 600 B.R. 870 (May 3, 2019).

Florida law should apply. In this regard, Florida law does not protect a debtor's interest in a self-settled trust, and as a result, the protections afforded to the trust under Belize law would not apply and were ignored. Next, the Court had to address whether the trust assets were includible in the debtor's bankruptcy estate thereby making the trust assets available to creditors and to administration in the bankruptcy proceeding. In this regard the Court found that the trust assets were generally not protected from creditors because the trustees had the discretion to distribute the entire trust corpus to the debtor (because it was a self-settled trust).

Next the Court turned to whether the annuity contracts (the trust's sole assets) were includible in the debtor's bankruptcy estate, and whether the annuity payments were exempted. The variable annuity that was first purchased was a deferred annuity for which payments had not yet started and was found to be includible in the bankruptcy estate because the trust could cash it out and it was not subject to exemption. The Bankruptcy Trustee requested a declaratory judgment that would require the trust to turn over the deferred annuity, but the court deferred its ruling on this issue because the trust was not a party to the action thereby giving the Bankruptcy Trustee the opportunity to join the trust as a party.

With regard to the second annuity purchased, which was a fixed annuity that had annuitized and started making payments immediately, the Court found that the annuity payments were exempted under Florida law [8] and not subject to administration of the bankruptcy case.

Lastly, it should also be noted that the Court denied the debtor's claim for homestead exemption under Florida law because such law was superseded by federal bankruptcy law which provides in relevant part that home equity is includible in a debtor's bankruptcy estate when the home is purchased within the 40-month period prior to the bankruptcy filing with the intent to defeat creditors, which the Court found to be the case here. Consequently, the Court ordered that the debtor's homestead be sold.

This is an important case for many reasons, but most notably, as we have mentioned in past letters and communications, it emphasizes the continually-changing legal landscape, including the fact that self-settled trusts (where the settlor is also the beneficiary) weakens the protection of an offshore trust.

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If you prefer not to receive any periodic updates, alerts or educational information from us by email, please let us know. If you have any questions about anything contained in this letter, please email or call. In closing, we want to sincerely thank you for allowing us to be of service and for the history that we so much appreciate having shared with you.

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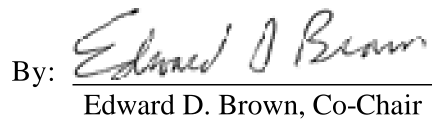
[8] It is worth noting that while Florida law exempts annuity payments from enforcement of a creditor judgment, there are limitations to this protection when fraud is involved. More specifically, this can occur when there is a "fraudulent conversion" (as provided for under Florida statute) involving converting a non-exempt asset into an exempt asset. In the Rensin case however, the opinion states that it was not the debtor who converted assets into annuities, but it was a trustee over whom the debtor had no authority to direct where trust assets would be invested. Therefore, the debtor engaged in no fraudulent conversion.

This letter is for your general information. The discussion of any asset protection and/or estate planning strategies, alternatives, and other observations herein are not intended as legal or tax advice and does not consider the asset protection goals, estate planning objectives, financial situations, or needs of individual clients. This letter is based upon information obtained from various sources that the authors believe to be reliable, but the authors make no representation or warranty with respect to the accuracy or completeness of such information. Views expressed herein are current opinions only as of the date written, and are subject to change without notice. Suggested outcomes may not be realized due to a variety of factors, including changes in law or regulations.

Very truly yours,

GREENSPOON MARDER LLP

By: 

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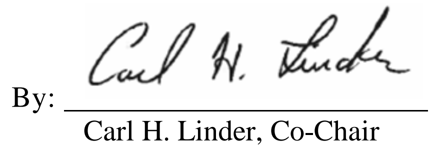
By: 

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