

The Missouri Asset Protection Trust

Missouri has now joined the ranks of Alaska and a select few other states that allow a settlor of an irrevocable trust to shield his or her assets from creditors, even though the settlor is a permissible beneficiary of the irrevocable trust, and arguably even if the settlor serves as trustee of the trust.

This is welcome news for Missouri residents concerned with potential malpractice claims, for retired residents desiring to protect their retirement savings, and for creditor-conscious residents generally.

INTRODUCTION

I. Signed into law by the governor on July 9, 2004, the new Missouri Uniform Trust Code ("MUTC") is anything but uniform when analyzed from the standpoint of the ability of a individual to shield his or her assets from creditors through the use of an irrevocable trust. H.B. 1511 rejects the holdings of the courts in various decisions of the last decade and clarifies that an individual ("the settlor") may establish a Missouri trust (a Missouri Asset Protection Trust, or "MAP Trust," for short), remain on as a one of a class of permissible beneficiaries (and apparently also as the trustee), and in the process protect all of the trust assets, both income and principal, from his or her creditors. Although the full scope of the MAP Trust legislation includes a few ambiguities, the law is now at least clear enough to proclaim that Missouri has joined the ranks of Alaska and a select few other states that allow a settlor of an irrevocable trust to shield his or her assets from creditors, even though the settlor is a permissible beneficiary of the irrevocable trust. This is welcome news for Missouri residents concerned with potential malpractice claims, for retired residents desiring to shield their retirement savings against a possible creditor attack, and for creditor-conscious residents generally.



James G. Blase¹

II. PRIOR LAW

Prior to the passage of H.B. 1511, the precise extent of the MAP Trust was less than clear, as explained in a ALI-ABA national satellite presentation on *Asset Protection Planning* in the fall of 2002:

Asset protection trusts have a relatively short history, particularly in the United States. Although Missouri amended its spendthrift trust statute in 1986 in a way that permits the creation of trusts that might offer asset protection, the wording of the statute and the virtual absence of information about the intent of the statute caused many to wonder if the Missouri statute would ultimately prove to be an effective asset

protection trust statute. Thus, it was the 1997 adoption of asset protection statutes by Delaware and Alaska that generated great interest in domestic asset protection trusts. In 1999, Nevada and Rhode Island enacted asset protection trust legislation that seemed intended to have an effect similar to the Alaska and Delaware legislation.²

On the other hand, The Missouri Bar Probate & Trust Law Committee ("the committee"), which prepared the proposed legislation that led to H.B. 1511, felt that the intent of the prior Missouri legislation § 456.080.3, RSMo, was clear. The committee chose to further clarify the intent in its commentary accompanying its proposed legislation:

Under UTC [Uniform Trust Code] section 5-505(a) a settlor cannot protect assets from creditors by the use of [a] spendthrift provision in a trust. . . . Under the UTC approach, the creditors of a settlor of an irrevocable trust can reach "the maximum amount that can be distributed to or for the settlor's benefit." This is not in accord with the [sic] Missouri's present exception to that rule. . . . R.S.Mo. Section 456.080.3 provides that a spendthrift provision *does* protect a settlor's retained interest in an irrevocable trust *to the extent that the settlor is one of a class of beneficiaries entitled to*

¹ Mr. Blase practices primarily in the area of estate planning in St. Louis County. He is a frequent author and lecturer on estate planning topics. He is a 1981 graduate of Notre Dame Law School and a 1982 graduate of the New York University Graduate Program in taxation.

² ASSET PROTECTION PLANNING 84 (ALI-ABA, 2002).

*trust income or principal in the trustee's discretion.*³

The committee recognized that there were recent court decisions implying that the provisions of then § 456.080.3 did not protect a settlor's interest in a spendthrift trust that falls within the statutory exception. "To the extent that those cases hold that section 456.080.3 does not protect a settlor's interests in a trust that fits within the statutory protection, those cases are incorrect and ignore the plain language of the statute."⁴

III. THE NEW STATUTES

As alluded to above, the MUTC departs from the UTC's position that a settlor may not establish a trust for his or her own benefit, and avoid creditors. Two separate sections of the MUTC are arguably employed to achieve this goal.

Section 456.5-504.1 provides as follows:

1. Except as otherwise provided in section 456.5-503, whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if:
 - (1) the discretion is expressed in the form of a standard of distribution; or
 - (2) the trustee has abused the discretion.

The referenced exception under § 456.5-503 provides that:

[e]ven if a trust contains a spendthrift provision, a beneficiary's child, spouse, or former spouse who has a judgment against the beneficiary for support or maintenance, or a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust, may obtain from a court an order attaching present or future trust income.⁵

The second statute, § 456.5-505.3, for

the trust part merely restates former § 456.080.3:

3. With respect to an irrevocable trust with a spendthrift provision, a spendthrift provision will prevent the settlor's creditors from satisfying claims from the trust assets except:

- (1) Where the conveyance of assets to the trust was fraudulent as to creditors pursuant to the provisions of Chapter 428, RSMo; or
- (2) To the extent of the settlor's beneficial interest in the trust assets, if *at the time the trust became irrevocable*:

(a) The settlor was the sole beneficiary of either the income or principal of the trust *or retained the power to amend the trust*; or

(b) The settlor was one of a class of beneficiaries and retained a right to receive a specific portion of the income or principal of the trust that was determinable solely from the provisions of the trust instrument. (Emphasis added).

The emphasized language is the only existing statutory language that was significantly altered by the committee, and is no doubt intended to make clear that the MAP Trust protections are intended to apply only to irrevocable trusts, the terms of which may not be amended by the settlor. The statute also retains the obvious rule that a MAP Trust will not be effective against the settlor's existing creditors.

According to the committee:

The incorporation and reenactment of these statutory provisions giving settlor's [sic] a limited protection from creditors by virtue of a spendthrift clause in Section 456.5-505.3 is intended to overrule any holding that would render that portion of the statute meaningless. . . . MUTC section

456.5-505 altered the UTC provisions to incorporate Missouri's exception for protection of a settlor's retained discretionary interest as one of a class of beneficiaries that is currently contained in R.S.Mo. 456.080.3.⁶

Although the new statutes did not take effect until January 1, 2005, once effective the new statutes applied retroactively to all trusts created before January 1, 2005.⁷ It is thus possible to have a trust that was established prior to 2005 fall within all of the statutory protections of the new law beginning January 1, 2005, provided all of the new statutory requirements are satisfied.

It is now clear that a MAP Trust will afford a settlor establishing and funding the same full creditor protection, provided there is adherence to the following trust drafting guidelines:

1. The trust must be irrevocable and incapable of being amended by the settlor;

2. Subject to the following discussion, the settlor may not be the sole beneficiary of either the income or principal of the trust;

3. Subject to the following discussion, the trust must contain a spendthrift clause applicable to the settlor's interest in the trust; and

4. The settlor may not retain a right to receive a specific portion of the income or principal of the trust pursuant to the trust instrument; in other words, any interest of the settlor in the trust must be a discretionary interest only.

Although the settlor may not amend the terms of the MAP Trust, the MUTC provides that, unless the settlor expressly overrides the statute:

If a settlor's marriage is dissolved or annulled, any beneficial terms of a trust in favor of the settlor's former spouse or any fiduciary [e.g., trustee] appointment of the settlor's former

³ 2004 MISSOURI TRUST AND ESTATE LEGISLATION 93 (recommended to The Missouri Bar Board of Governors by the Probate & Trust Law Committee of The Missouri Bar (2003) (emphasis added).

⁴ *Id.* at 94.

⁵ *Id.* at 85-86. The committee report provides that the exception for a judgment creditor who has provided services for the protection of a beneficiary's interest in the trust (including, presumably, an attorney who has represented a beneficiary in a suit involving the trust), "allows a beneficiary of modest means to overcome an obstacle preventing the beneficiary's obtaining services essential to the protection or enforcement of the beneficiary's rights under the trust." *Id.* at 86-87.

⁶ *Id.* at 94.

⁷ Sections 456.11-1104-1106, RSMo Supp. 2004.

spouse is revoked on the date the marriage is dissolved or annulled, whether or not the terms of the trust refer to marital status. The terms of the trust shall be given effect as if the former spouse had died immediately before the date the dissolution or annulment became final.⁸

IV. REMAINING ISSUES

Although the new MAP Trust legislation provides welcome relief to Missouri estate planning attorneys who have struggled in the past to understand the precise scope of the prior law, there remain a few aspects of the new law that merit further discussion.

A. May the settlor serve as trustee of the MAP Trust?

The new Missouri MAP Trust statutes are silent on the issue of whether the settlor may serve as trustee of the MAP Trust and maintain the same level of creditor protection afforded a settlor of a MAP Trust who does not serve as trustee. The issue is whether this silence means a settlor may serve or may not serve as trustee of a MAP Trust.

The Alaska Trust statute was recently amended to clarify the settlor/trustee situation. The Alaska statute now provides that a settlor may serve as co-trustee of an Alaska Trust, *but only* “if the settlor does not have a trustee power over discretionary distributions.”⁹

Application of normal statutory construction rules to the MAP Trust statutes would typically lead to the conclusion that, because the statutes do not expressly provide that the settlor may not serve as trustee in order to achieve the MAP Trust protections, then the settlor may freely serve in such capacity. Because a trustee has fiduciary responsibilities to all of the beneficiaries of the MAP Trust, especially the current beneficiaries, this would certainly seem to be a logical conclusion. The Alaska statute, on the other hand, does not require that there be other current beneficiaries in order for the

settlor to be protected, which no doubt lowers the level of the trustee’s fiduciary responsibilities to other beneficiaries.

It is important to place some type of discretionary distribution standards in the trust document, however; otherwise it might be argued that, because there are no fiduciary standards for making encroachments on behalf of the settlor, the settlor *in effect* has a power to revoke the trust through the exercise of his or her broad discretionary powers as trustee of trust.

A settlor who prefers to be on the cautious side may nevertheless choose not to serve as trustee of the MAP Trust. Another approach might be for the settlor to serve as trustee, but retain the ability to resign as trustee in the event the Missouri law is ever judicially interpreted or legislatively clarified in an unfavorable (at least as to settlor) manner. Still a third approach would be for the settlor to not serve as trustee, but to retain the power to remove the current trustee and substitute another trustee other than the settlor.

B. Must a discretionary trust contain a spendthrift provision or have other current beneficiaries in order for the settlor to be protected?

Section 456.6-504.1 provides that, *whether or not a trust contains a spendthrift provision*, a creditor of a beneficiary may not compel a distribution that is subject to the trustee’s discretion. Section 456.5-505.3 provides that, if an irrevocable trust contains a spendthrift provision and the interest of the settlor is that of a class of beneficiaries and is only discretionary, the settlor’s creditors may not reach the trust assets. The statutory construction question that arises is: If the settlor’s interest as a discretionary beneficiary of the trust is already protected under § 456.5-504.1, then are other current beneficiaries and a spendthrift clause (i.e., requirements of § 456.5-505.3) necessary in order to protect the settlor’s discretionary interest in the MAP Trust assets?

New § 456.1-103(2), RSMo, and the MUTC define the term “beneficiary” as “a person that: (a) has a present or future beneficial interest in a trust, vested or contingent; or (b) in a capacity other than that of trustee, holds a power of appointment over trust property.” Although it would appear clear that a settlor who has a present beneficial interest in a trust fits within this definition of the term “beneficiary,” and therefore is protected under § 456.6-504.1 above, such does not appear to be the intent of the committee. New § 456.5-505.2, which is also part of the MUTC, provides that “[w]ith respect to an irrevocable trust without a spendthrift provision, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor’s benefit.” In order to give this section meaning, the term “beneficiary,” as employed in § 456.5-504.1, must be read to exclude a beneficiary who is also the settlor. If the settlor is not included within the scope of the term “beneficiary,” as that term is employed in § 456.5-504.1, then only § 456.5-505.3 can shield a trust from the claims of the settlor’s creditors, and § 456.5-504.1 should be limited as providing protection only for a beneficiary of the trust who is not also the settlor.

C. May the settlor of a MAP Trust retain a lifetime or testamentary limited power of appointment over the trust assets?

Section 456.5-505.3 subjects a trust’s assets to the claims of the settlor’s creditors if the settlor “retained the power to amend the trust,” but only “to the extent of the settlor’s beneficial interest in the trust assets.” Does a settlor’s lifetime or testamentary limited power to appoint the assets of a trust to an individual or individuals, other than the settlor, constitute a “power to amend the trust” that bestows upon the settlor a “beneficial interest in the trust assets?”

It would indeed be a strained construction of § 456.5-505.3 to answer

⁸ Section 456.1-112.1, RSMo Supp. 2004.

⁹ ALASKA STAT. § 34.40.110(f) (emphasis added).

this question in the affirmative. A limited power of appointment that is included in the trust document from the outset can hardly be regarded as a retained "power to amend the trust," as by its very nature the exercise of a limited power of appointment bestowed under a trust document does not constitute the amendment of the trust's terms. Further, even if a limited power of appointment could be construed as a power to amend the trust, what is *the settlor's* beneficial interest in the trust assets? The only beneficial interest applies to the permissible appointees under the limited power, not the settlor. Assuming the settlor's creditors can somehow compel the settlor to exercise his or her power in favor of one or more of the appointees, certainly this does not mean that the creditors would also possess the right to take the appointed property from the appointees.

D. What are the consequences under a MAP Trust if the settlor is permitted to use and/or occupy real or tangible personal property owned by the trust?

What rights, if any, are bestowed upon the settlor's creditors if the settlor, as one among a class of beneficiaries, is allowed to use and/or occupy real property and tangible personal property owned by the MAP Trust? For example, should the creditors be allowed to exact a reasonable rent from the settlor for the privilege of being able to occupy the residence which is owned by the trust?

The revised Alaska Trust statute deals with this question expressly by providing that:

[P]ayment or delivery of the interest to the beneficiary does not include a beneficiary's use or occupancy of real property or tangible personal property owned by the trust if the use or occupancy is in accordance with the trustee's discretionary authority under the trust instrument.¹⁰

While under § 456.5-505.3 it does not appear that permitting the settlor to use and occupy a residence owned by the trust will cause the settlor's creditors to be able to attach the residence itself, it would also not appear to be an unreasonable construction of the statute to allow the creditor a fair market value rent should the trustee allow the settlor to occupy the property. Under such circumstances, the wisest course may be for the settlor to pay the trust rent¹¹ (assuming the settlor has sufficient unattached funds with which to pay the rent); the trustee would then not be allowing the settlor to occupy the residence under the trustee's discretionary power of distribution, and the rent payments to the trust would then become property of the trust, shielded from the settlor's creditors. The settlor's creditors could, of course, attempt to argue that the rent payments to the trust are fraudulent pursuant to Chapter 428, RSMo, since the trustee would be charging the settlor rent payments under circumstances that did not require the same.

V. TAX CONSEQUENCES OF MAP TRUSTS

Not to be overlooked in an article discussing the MAP Trust are the income, estate and gift tax consequences associated with a settlor transferring all or a portion of his or her assets to such a trust.

A. Income Tax Consequences

Under the typical MAP Trust arrangement, where the settlor is a permissible recipient of trust income and principal, the trust should be treated as a complete grantor trust (i.e., income and capital gains) as to the settlor, under § 677 of the Internal Revenue Code ("the code"), thereby eliminating the need to file a separate income tax return for the trust, and avoiding the high income tax rates Congress charges on trusts. The trust would also be treated as a complete grantor

trust under § 674 of the code, if the settlor retained a lifetime limited power of appointment over trust principal.

A problem may arise in paying the income taxes associated with the trust income. If the trustee makes a distribution to the settlor for the purpose of paying income taxes attributable to trust income at a time when the settlor is experiencing creditor problems, can the settlor's creditors attach the trust distribution? What if the trustee makes the distribution directly to the tax collection agency? Would that make a difference?

The answers in each instance would appear to favor the settlor. The exercise of the trustee's discretionary power would be only for the purpose of allowing the settlor to pay his or her income taxes. The creditor would not be able to attach the distribution, since the settlor holds the funds only as agent for the trustee for the purpose of paying the settlor's income taxes. The same reasoning should apply if the trustee pays the taxes directly to the tax collection agency.

B. Gift Tax Consequences

The general rule is that, when a settlor transfers assets to an irrevocable trust in which he or she is a permissible beneficiary of trust income and principal along with others, the transfer constitutes a taxable gift, at least in part, to the other beneficiaries of the trust, including those holding remainder interests in the trust.¹² If, on the other hand, the settlor is also the sole trustee of the trust, the gift may be incomplete until and to the extent there is an actual distribution made to or for the benefit of another beneficiary of the trust, at least as long as the other beneficiaries of the trust have no rights to income or principal.¹³ A retained lifetime limited power of appointment over the trust assets, not in the capacity as trustee, should also render the gift incomplete until and to the extent there is a transfer to one of the

¹⁰ ALASKA STAT. § 34.40.110(a).

¹¹ See the discussion below as to how to avoid adverse income tax consequences on the rent payments by structuring the trust as a grantor trust for federal income tax purposes.

¹² Treas. Reg. § 25.2511-2(b).

¹³ Treas. Reg. § 25.2511-2(c); compare Treas. Reg. § 25.2511-2(g) (where the settlor/trustee is not also a permissible beneficiary of the trust).

permissible appointees or other beneficiaries of the trust.¹⁴

It should thus be a relatively easy matter to avoid creating a taxable gift upon the funding of a MAP Trust, assuming the conclusions reached in the preceding section of this article relative to the ability of the settlor to serve as trustee of a MAP Trust and to retain a lifetime limited power of appointment are correct. Of course, the settlor does make a completed gift to the extent distributions are actually made by the trustee of the MAP Trust to a beneficiary other than the grantor.¹⁵

D. Estate Tax Consequences

A settlor of a properly drafted MAP Trust that does not bestow upon the settlor any rights in the income or principal of the trust, and under which the settlor does not serve as trustee and does not retain any power of appointment over the trust assets, should not have the assets of the MAP Trust included in his or her gross estate at death for federal estate tax purposes. This is the case because the settlor could not then be said to have possessed any estate tax includible "string" over the trust corpus or income. The offsetting transfer tax problem associated with a MAP Trust drafted in this fashion, of course, is the taxable gift by the settlor that will typically result, with only the settlor's lifetime \$1 million gift tax exemption available to prevent the actual imposition of gift tax.

If the settlor serves as trustee of the trust or retains a lifetime or testamentary power of appointment over the trust assets, however, the trust corpus will be includible in the settlor's gross estate under either or both of §§ 2036 and 2038 of the Internal Revenue Code. Thus, in most instances in which the MAP Trust is drafted in a manner designed to avoid a taxable gift, estate tax inclusion will result.

VI. ADDITIONAL ESTATE PLANNING OPPORTUNITY

The MAP Trust presents clients with an additional estate planning opportunity. In advising married couples whether or not to sever property held by them as tenants by the entirety, estate planning attorneys previously needed to weigh the benefits of potential estate tax savings, on the one hand, against the loss of creditor protection for the tenancy by the entirety property, on the other. For example, a couple owning \$3 million worth of tenancy by the entirety property (e.g., such as a jointly-owned home and joint brokerage account) might be advised by the estate planning attorney that severing such jointly held property into two separate \$1.5 million accounts (one for the husband and one for the wife) could eliminate all estate taxes at the couple's death. The attorney fulfilling his or her responsibilities, however, would need to also advise the couple that, by severing the tenancy by the entireties properties, a significant level of creditor protection (i.e., for the tenancy by the entireties property) would be lost under Missouri law.

The MAP Trust allows the clients the opportunity to have their cake and eat it, too. By severing the tenancy by the entireties property and then transferring the severed interests to two separate MAP Trusts (i.e., one for the husband and one for the wife), a full \$3 million worth of estate tax exemption would be achieved, but without losing the creditor protection previously only available by titling property jointly between the spouses. In fact, the MAP Trust actually *increases* the couple's level of asset protection. This is because, whereas previously a successful joint lawsuit against the couple would enable the plaintiff to reach the tenancy by the entireties property, by utilizing two separate MAP Trusts the couple would prevent a successful plaintiff suing the couple jointly from having any similar success attempting to attach the MAP

Trust assets.

VII. "CHOICE OF LAW" AND "FULL FAITH AND CREDIT" ISSUES

New § 456.1-107 of the MUTC provides that:

The meaning *and effect* of the terms of a trust are determined by: [(1) the law of the jurisdiction designated in the terms unless the designation of that jurisdiction's law is contrary to a strong public policy of the jurisdiction having the most significant relationship to the matter at issue; or [(2) in the absence of a controlling designation in the terms of the trust, the law of the jurisdiction having the most significant relationship to the matter at issue. (Emphasis added.)

The committee's comment to the UTC emphasizes that "[t]he jurisdiction selected [in a choice of law clause] need not have any other connection to the trust."¹⁶ A Missouri resident establishing a MAP Trust should feel secure that the statute will apply fully with respect to litigation occurring within the boundaries of the state.

If the Missouri settlor of the MAP Trust causes personal injury outside of Missouri's boundaries, and as a consequence a judgment is awarded against the settlor or against the settlor and the trustee of the MAP Trust (assuming the plaintiff is able to achieve personal jurisdiction over the trustee of the MAP Trust), the issue that arises is whether the out-of-state judgment is entitled to "full faith and credit" in Missouri, as against the trustee of the MAP Trust. Although the answer to this question is not yet clear, it should be emphasized that, despite the fact that the Full Faith and Credit Clause of the Constitution¹⁷ requires states to give "[f]ull faith and credit" to "acts" of sister states, the U.S. Supreme Court has recently reaffirmed its position that "the Full Faith and Credit Clause does not compel 'a state to substitute the statutes of

¹⁴ *Id.*

¹⁵ Treas. Reg. § 25.2511-2(b).

¹⁶ 2004 MISSOURI TRUST AND ESTATE LEGISLATION 28 (recommended to The Missouri Bar Board of Governors by the Probate & Trust Law Committee of The Missouri Bar) (2003).

¹⁷ U.S. Const. art. IV, § 1.

other states for its own statutes dealing with a subject matter concerning which it is competent to legislate."¹⁸ Taken to its logical extreme, an out-of-state court may not be required to honor Missouri's MAP legislation when it renders its judgment against the MAP Trust trustee (on fraudulent transfer or other grounds), and Missouri would then be required to honor the out-of-state judgment unless it is able to justify (to the U.S. Supreme Court) not honoring the same on public policy grounds.

VII. COMPARISON TO THE WRAP TRUST

The author first published an article on the WRAP (short for Wealth, Retirement and Asset Protection) Trust in 1997, which was the same year the Alaska Trust was enacted.¹⁹ In fact, a portion of the first WRAP Trust article was devoted to comparing and contrasting the WRAP Trust with the Alaska Trust.²⁰ This article concludes with a comparison of the WRAP Trust to the MAP Trust.

The two trust types are both irrevocable, and both are designed to shield the trust assets from claims of the settlor's creditors. One major difference between the two types of trusts lies in the manner in which the settlor accesses income and principal of the trust. The settlor may be a discretionary beneficiary of income and principal of the MAP Trust, whereas with the WRAP Trust the settlor is not permitted direct access to the trust income or principal. The settlor's access to the income and principal of the WRAP Trust is instead typically achieved through estate tax deductible loans to the settlor from the trust.

The other major difference between the two forms of creditor protection trusts concerns their estate taxation. The WRAP Trust is designed to be excluded from the settlor's gross estate for federal estate tax purposes, whereas the MAP Trust, as typically designed, will be included in the settlor's gross estate. The reader is referred to the author's 1997 article on the WRAP Trust for further information regarding its

design and intended benefits.

VIII. CONCLUSION

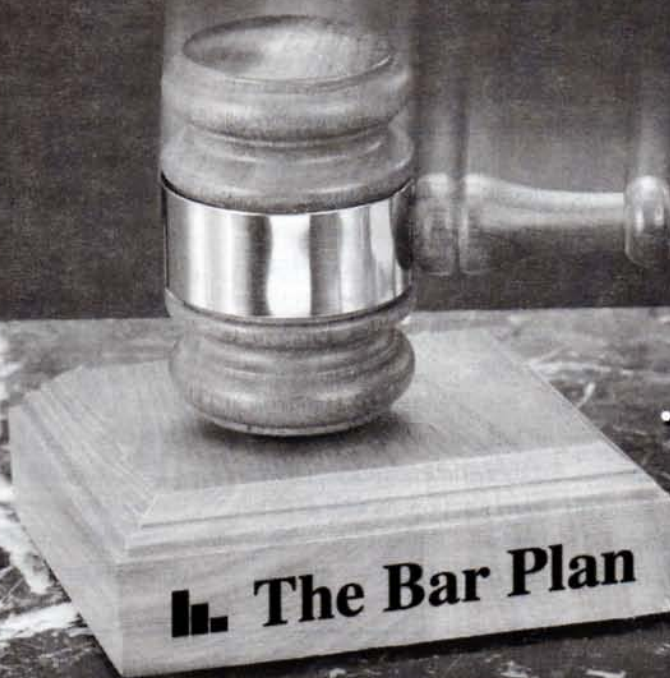
H.B. 1511 clarifies and expands existing Missouri law to afford certain self-settled trusts creditor protection similar to that already achieved in Alaska and a select few other states. The MAP Trust will present an important tool in the Missouri estate planning attorney's arsenal of tools designed to assist a client in protecting his or her assets. Although the MAP Trust must be irrevocable in order to provide creditor protection, because the settlor may be a beneficiary of the trust, and should be able to serve as trustee of the trust and/or retain a limited power of appointment over the trust assets, the MAP Trust should prove to be a popular estate planning device for the creditor conscious client.

¹⁸ *Franchise Tax Bd. of Calif. v. Hyatt*, 538 U.S. 488, 494 (2003).

¹⁹ James G. Blase, *The WRAP Trust*, J. AM. SOC. CLU & CHFC (September 1997) at 92.

²⁰ *Id.* At 96.

You protect your clients...



... We protect you!

Providing Lawyers Professional Liability Insurance since 1986.

800.843.2277
www.thebarplan.com