THE NEW UNIFORM VOIDABLE TRANSACTIONS ACT: GOOD FOR THE CREDITORS' BAR, BUT BAD FOR THE ESTATE PLANNING BAR?

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When not attending Miami (*nee* Florida) Marlins home games, George is any one or more of reading anything and everything regarding the entertainment industry or is keeping current and/or binge-watching television programming that skews way below his supposed demographic. George's 2016 personal highlights began on January 21 when he was fortunate to see "Hamilton" at the Richard Rogers Theater in New York, and then on April 4, he was in attendance at NRG Stadium in Houston, Texas, to watch his law school alma mater, Villanova University, win the 2016 NCAA Men's College Basketball national championship.

On January 15, 2014, George was presenter at the 48th Annual Heckerling Institute on Estate Planning in Orlando, Florida, speaking on a panel discussion titled, "Living and Working with the Uniform Principal and Income Act," focusing on the tax effects on the power to adjust trust principal to income, the power to convert an income trust to a unitrust, comparing the various unitrust statues and focusing on potential litigation facing fiduciaries in this area.

On the topic of same-sex estate planning, George has lectured at various conferences and estate planning councils throughout the United States and has published numerous articles in publications such as Steve Leimberg's LISI Estate Planning Newsletters, Trusts & Estates Magazine and the Florida Bar Journal. George has also been quoted by several publications and websites.

On the topic of the Uniform Voidable Transactions Act and its potential negative effect on estate planning, George has published several articles and has lectured in cities across the nation such as San Diego, Las Vegas, Portland (Or.) and New York, presented webinars to groups in South Dakota and Alaska, and has presented on the topic in October 2016 at the 42nd Annual Notre Dame Tax and Estate Planning Institute in South Bend, Indiana.

George's other lectures have included topics such as Portability, Decanting, Trustee Selection and Duties, the Principal and Income Act, Current Developments in Estate Planning and Taxation, Representing a Client with Potential Capacity Issues, Whether a Supplemental 706 is Required, Inter-Vivos QTIP Planning and Prenuptial Agreements for the Estate Planner and the Advantages and Disadvantages of Domestic Asset Protection Trusts.

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TABLE OF CONTENTS

I. Introduction 1
(a) 1
(b) Effect of the UVTA 1
(c) Purpose of the Outline 1
II. Status of the UVTA 1
(a) Adopted States. 1
(b) Pending Legislation States 1
III. Changes to UFTA – Minimal Effect or Major Impact, and What About the Comments? 2
(a) 2
(b) 2
(c) Impact of the Comments 2
IV. 5 Areas of Impact on Estate Planners 6
(a) 6
(b) Affected areas 6
(1) Asset Substitution 6
(2) Entity Formation 6
(3) Entity Conversion 6
(4) Domestic Asset Protection Trusts 6
(5) Homestead law 6
V. Issue #1: Asset Substitution 6
(a) Introduction to Section 4 6
(b) Paragraph 3 to Comment 8 and Intent 7
(c) Cases Interpreting Asset Substitution or Lack Thereof 7
(d) Example 1 8
VI. Issue #2: Entity Formation 9
(a) Paragraph 6 to Comment 8 9
(b) Example 2 10
(c) LLC Formation and No Anticipation of Liability 11
(d) Voidable At Any Cost 11
(e) State Law and Voidability 12
VII. Issue #3: Entity Conversion 13
(a) Introduction 13
(b) Paragraph 4 to Comment 8 - The fourth paragraph of Comment 8 (“Paragraph 4”) addresses entity conversion: 13
(c) Example 4 14

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VIII. Issue #4: Attempts to Curtail DAPTs 15
(a) Introduction 15
(b) Attack on DAPTs 15
(c) UVTA Analysis and DAPTs – Sections 4 and 10 16
(d) Wither the Self-Settled Spendthrift Trust Doctrine? 18
(e) Arguments Against Strict Interpretation of the Comments 18
(f) Are All DAPTs "Evil"? What About the Inter-Vivos QTIP Trust? 22
(g) Unintended Effect of Anti-DAPT Provisions – Potential Death Knell for ING Trusts? 24
(h) Section 10 and Full Faith & Credit – What is the Effect a DAPT State? 26
(i) 31
IX. Issue #5: Homestead 31
(a) Introduction 31
(b) 32
(c) Example 6 32
(d) This fact situation played out further could have some very inequitable results. 33
(e) Fraudulent Transfer or Fraudulent Conversion? 33
(f) How the Non-Homestead State Can Change the Laws of the Homestead State 33
X. What to Do About the UVTA? 34
(a) Prevent Passage. 34
(b) Preventing Passage Isn't Possible – Then What? 34
XI. Conclusion 41
(a) 41
(b) 41
(c) Summary of Estate Planning Issues 41
(1) Asset Substitution 41
(2) Entity Formation and Conversion 41
(3) DAPTs 41
(4) Homestead 42

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The New Uniform Voidable Transactions Act:
Good for the Creditors' Bar, But Bad for the Estate Planning Bar?[1]

I. Introduction

(a) Adopted by the National Conference of Commissioners on Uniform State Laws at its annual conference in Seattle, Washington during July 2014, the Uniform Voidable Transactions Act (the "UVTA") invites states to replace the better-known Uniform Fraudulent Transfers Act (the "UFTA").

(b) Effect of the UVTA

(1) Much about the updated UVTA is admirable – it will better tighten the laws to prevent debtors from intentionally avoiding their legitimate debts.

(2) However, the UVTA will not only impact the corrupt debtor, but it will also have the collateral effect of adversely affecting the individual who engages in certain sound and legitimate estate planning techniques.

(3) In other words, the UVTA appears to not only capture the "bad guy," but it may also catch the "good guy" in its net.

(c) Purpose of the Outline. The purpose of this outline is to:

(1) Educate the estate planning bar as to the traps and pitfalls of the UVTA in a way that is neither pro-debtor or pro-creditor.

(2) To make estate planners aware of the dangers it poses to some standard estate planning techniques.

(3) To hopefully facilitate means by which the UVTA can be passed while also eliminating the estate planning concerns.

II. Status of the UVTA

(a) As of July 1, 2017, the UVTA has been adopted in 15 states – Arkansas, California, Georgia, Idaho, Indiana, Iowa, Kentucky, Michigan, Minnesota, New Mexico, North Carolina, North Dakota, New Mexico, Utah, Vermont and Washington.[2]

(b) Arkansas, Indiana, Michigan, Utah, Vermont and Washington all introduced and passed the legislation in 2017.

(c) Legislation was introduced in the following states in 2017 and the UVTA is either still pending, was rejected, or the legislative session ended without completing the adoption process:

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[1] The basis for this Outline are the authors' LISI Asset Protection Newsletter #316 (March 14, 2016), LISI Asset Protection Newsletter #317 (March 15, 2016) (together, the "Explanation Articles") and LISI Asset Protection Newsletter #320 (April 18, 2016). The authors' biographies are at the end of this Outline.

[2] *See* UNIFORM LAW COMMISSION, Enactment Status Map & Legislative Tracking, *available at* http://www.uniformlaws.org/Act.aspx?title=Voidable%20Transactions%20Act%20Amendments%20%282014% 29%20-%20Formerly%20Fraudulent%20Transfer%20Act.

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(1) Alabama, as SB 252 (passed in Senate; went to the House, where Judiciary modified with one amendment but was not passed by the close of the session);

(2) Florida, as HB 1159 and SB 1566 (withdrawn prior the end of the legislative session);

(3) Massachusetts, as HB 46 (dormant with no action);

(4) New Jersey, as AB 3742 (as of June 6, reported out of Assembly Judiciary Comm. with Amendments, presented for 2nd Reading);

(5) New York, as AB 1853 and SB 6180 (passed Assembly on 6/15/17, and thereafter delivered to Senate where it was referred to the Rules Committee; no further action at the close of the legislative session a week later);

(6) Pennsylvania, as SB 629 (as of June 21, 2017, the bill was receiving second consideration within the Senate and remained there as the legislative session ended);

(7) Rhode Island, as HB 6123 and SB 838 (as of May 25, 2017, the Senate version was ordered by the Judiciary Committee to be held for further study; the same result occurred in the House on April 14, 2017); and

(8) South Carolina, as HB 3167 and SB 136 (remained dormant in Committee since 1/10/17).

III. Changes to UFTA – Minimal Effect or Major Impact, and What About the Comments?

(a) According to Prof. Kenneth C. Kettering, the Uniform Law Commission's Reporter for the UVTA, from his "white paper" article on the UVTA (the "White Paper"): [3]

(1) The renaming should not be taken to imply that the UVTA is a new and different act, or that the amendments make major changes to the substance of the UFTA.

(2) Nothing could be further from the truth - the UVTA is not a new act; it is the UFTA, renamed and lightly amended."

(b) While there may be few actual changes within the uniform law, the true impact is felt within the official Comments to the UVTA (the "Comments").

(1) As Professor Kettering further states, "The Drafting Committee's mandate narrowly limited its authority to revise the act, but the committee had a free hand to revise and refresh the official comments as it thought best. Changes to the statute naturally were accompanied by new and revised comments."[4]

(2) It is on these Comments where estate planners should focus their attention.

(c) Impact of the Comments

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[3] Kenneth C. Kettering, *The Uniform Voidable Transactions Act; or, the 2014 Amendments to the Uniform Fraudulent Transfer Act*, 70 THE BUSINESS LAWYER 778 (Summer 2015) at 779.

[4] Id. at 794.

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(1) Primer on Legislative Interpretation

(A) The key to interpreting any statute is to determine the statute's legislative intent.

(B) With the Internal Revenue Code,[5] there are distinct levels by which a statute is interpreted:

(i) The Department of Treasury issues regulations explaining the meaning behind a statute that often provides examples of such meaning.

(ii) The Internal Revenue Service (the "Service") will issue rulings by applying the statute and regulations to a specific set of facts.

(iii) Whenever there is a question as to what was truly meant by the passage of a particular statutory provision, there is always the "legislative history," found in the Congressional Record, for this is Congress's official statement as to why such provision was passed.

(C) The interpretation of state statutes works in the same manner, except that often, there is no regulatory or administrative analysis.

(i) To understand the meaning of a statute, the initial research begins with the statute's legislative history.

(ii) Often this legislative history is scarce or non-existent, leading the researcher to a dead end.

(iii) However, if the researcher is lucky, the particular statute may be based on a model or uniform act.

(iv) If this is the case, it is likely that the Uniform Law Commission would have released the applicable Uniform Law Committee's[6] official Comments to the uniform provision, which explain and enhance the meaning of a particular statute.

(2) Comments are a Primary Source for Interpretation

(A) Why is this relevant?

(i) For many statutes based on uniform law, the Uniform Law's Comments become a primary source for interpretation, especially when the law is unclear.

(ii) Judges will look to Uniform Law comments for clarification, which aid them in rendering a decision.

(iii) Thus, if such Uniform Law comments are biased, there is the potential that they could be applied blindly.

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[5] All references to "Code" or the "Internal Revenue Code" shall be to the Internal Revenue Code of 1986, as amended.

[6] For all purposes of this Outline, any reference to a Uniform Law Committee shall be to the "Committee."

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(B) Comments reflect the applicable Uniform Law Committee's intended application of the entire law; as verification of this, consider the following from the White Paper: "The Drafting Committee's mandate narrowly limited its authority to revise the act, but the committee had a free hand to revise and refresh the official comments **as it thought best**. Changes to the statute naturally were accompanied by new and revised comments."[7] (Emphasis added.)

(C) A conclusion from the aforementioned quote is that any Comments drafted by the Committee were clearly the intentions of the Committee as to how it intended a particular provision to be interpreted.

(D) Are the Comments really "all that" or is this just over-dramatization? Do Courts really rely on the Comments to shape the law?

(i) Consider that for many statutes based on uniform law, the Comments become a primary source for interpretation.

(ii) If the UVTA is subject for review and approval in a particular state, most likely the state's official interpretation of what a particular provision means will revert back to the Comments.

(E) Courts DO use the Comments. Consider the following cases in which Uniform Law Comments have been of primary significance in judicial interpretation of a statute based on a Uniform Law:

(i) In In re Nocita, 914 S.W.2d 358 (Mo. 1996), the Missouri Supreme Court stated that "When construing uniform and model acts enacted by the General Assembly, **we must assume** it did so with the intention of adopting the accompanying interpretations placed thereon by the drafters of the model or uniform act … Generally, comments accompanying a uniform code when adopted have great weight in construing the code." (Emphasis added.) In re Nocita at 359.

(ii) In Yale University v. Blumenthal, 624 A.2d 1304, 225 Conn. 32 (Conn. 1993), the Connecticut Supreme Court stated that "A court can properly consider the official comments as well as the published comments of the drafters **as a source for determining the meaning of an ambiguous provision** [of a uniform act]." (Emphasis added). Yale University at 1304, 38.

(iii) In Coker v. Abell-Howe Company et. al., 491 N.W.2d 143 (Iowa 1992), the Iowa Supreme Court stated that "The official comments to the Uniform Act have **some persuasive influence** in determining what our legislature intended by the language in our comparative fault act." (Emphasis added.) Coker at 148.

(iv) In Jeld-Wen, Inc. v. Pacificorp et. al., 245 P.3d 685, 240 Or.App. 124 (Ore. Ct. App. 2010) the Oregon Court of Appeals stated that "Commentary to a uniform law adopted in Oregon **serves as legislative history**." (Emphasis added.) Jeld-Wen, Inc. at 687, 129.

(v) In Havens v. Portfolio Investment Exchange Inc., 983 F.Supp.2d 1007 (N.D. Ind. 2013), the Northern District of Indiana, South Bend Division stated that "Indiana law is quite clear that model or **uniform commentary is persuasive** when construing an ambiguous statute." (Emphasis added.) Havens at 1011.

[7] White Paper at 779.

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(vi) In In re Menashe, 301 B.R. 757 (S.D. Fla. 2003), the U.S. Bankruptcy Court in the Southern District of Florida stated that "[w]hile the official comments to the Uniform Commercial Code are not controlling as an absolute expression of legislative intent, **they are a 'valuable aid'** in the construction of code provisions."[8] (Emphasis added.)

(3) Wait …Is the Law Really Unchanged?

(A) Proponents of the UVTA have argued to the authors that nothing within the Comments changes the existing law.[9]

(B) If this is the case, then it must be asked whether the addition of several pages of new Comments to §4[10] (in particular, the voluminous Comment 8 ("Comment 8")) fits within the definition of "lightly amended."

(C) If no changes are made within existing law, then it must be asked as to why there was the need to adopt so many new comments? If the Comments merely reflect the existing law, there would apparently have been no need to have modified them as extensively as finally drafted, as the concepts would already have been understood to have been the current law.

(D) Maybe the Comments Are Trying To Shape Future Law?

(i) Consider that in some of the analysis set forth below, such as with asset substitution, there is no law directly on point or even inferred.

(ii) If there is no new law, then the proponent seeking to invalidate the transaction will ultimately look to the Comments for the meaning behind the statute.

(iii) Many of the new Comments set forth certain conclusions without supplying the legal history or reasoning for reaching such conclusions.

(iv) Instead of letting the law evolve judicially based on prior precedents, the new Comments will ultimately give the particular court a "push" to a conclusion based on the Committee's viewpoint and not necessarily that of existing applicable state law.

(4) Conclusion – Comments Definitely Attempt to Add to the Law

(A) It is reasonable to conclude, therefore, that many of the changes and additions to the Comments appear to be the Committee's attempt to put forth authoritative analysis in an effort to block certain asset transfer techniques that debtors will use to avoid creditors.

(B) While this is admirable, since wronged parties should have the law on their side, the problem is that in attempting to bolster the existing law, the Committee added the Comments to give their intended meanings behind a particular statute, and in doing so, however, the Committee may

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[8] In re Menashe, Footnote 8, *citing* Warren v. SouthTrust Bank, 221 B.R. 843, 847 n. 2 (Bankr. N.D. Ala.1998), and further stating that "noting numerous cases citing the official comments to the Uniform Commercial Code by the Court of Appeals for the Eleventh Circuit and by the courts of other jurisdictions) (citations omitted)."

[9] The authors are members of a subcommittee within the Asset Protection Committee of the Florida Bar's Real Property, Probate & Trust Law Section ("RPPTL"), and have engaged in discussions with the Florida Bar's Business Law Section as to the adoption of the UVTA in Florida. The authors expressly state that the positions in this Outline are their own personal viewpoints and are not, and nor should there be any implication to the contrary, the position of the Florida Bar or RPPTL.

[10] Unless specifically stated otherwise, all section references in this Outline shall be to sections in the UVTA.

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have made the Comments too broad so as to capture more transactions under the law than necessary – in other words, they are throwing the baby out with the bathwater.

(C) Thus, based on these cases and many others that were located but not cited here, if the UVTA is subject for review and approval in a particular state, most likely the state's official interpretation of what a particular provision means will revert back to the Comments.

(D) This conclusion could not have been lost on the Committee, so it has to be concluded that the Committee drafted the Comments with an eye to swaying judicial interpretation of a particular state statute adopted from the UVTA, and to say otherwise appears to be unrealistic, and arguably borders being disingenuous.

(E) Therefore, careful consideration must be given to the impact on all situations and not just a few advocated by the creditors' bar.

IV. 5 Areas of Impact on Estate Planners

(a) After a careful study of the UVTA, the authors have identified five positions taken by the Comments (one of which is linked to a specific statutory change) that will adversely affect the estate planning bar.

(b) The affected areas are:

(1) Asset Substitution

(2) Entity Formation

(3) Entity Conversion

(4) Domestic Asset Protection Trusts

(5) Homestead law

V. Issue #1: Asset Substitution

(a) Introduction to Section 4

(1) Section 4(a)(1) states as follows:

> "SECTION 4. TRANSFER OR OBLIGATION VOIDABLE AS TO PRESENT OR FUTURE CREDITOR.
>
> (a) A transfer made or obligation incurred by a debtor is voidable as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
> (1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or"

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(2) It is important to emphasize that §4 applies to *any* creditor, regardless of whether the creditor is an existing or *future* creditor.

(b) Paragraph 3 to Comment 8 and Intent

(1) The third paragraph to Comment 8 begins as follows:

> A transaction that does not place an asset entirely beyond the reach of creditors may nevertheless "hinder, delay or defraud" creditors if it makes the asset more difficult for creditors to reach. Simple exchange by a debtor of an asset for a less liquid asset, or disposition of liquid assets while retaining illiquid assets, may be voidable for that reason.

(2) This appears to be a simple and generic statement, but note that in this expression of the statute, one word appears to be missing: "intent."

(A) If such a simple exchange occurs, is the Committee stating that "intent" is *de facto* present?

(B) Further, the effect of the last part of the second sentence -- "may be voidable for that reason" – must be considered. By its specific inclusion, it appears as if the Committee is stating that such an exchange *is* voidable unless proven otherwise. If this is not the Committee's message, then why include that sentence?

(3) The effect of this inclusion is that, despite the burden of proof standard enacted as part of §4(c), it would appear that the initial burden of proof falls upon the debtor instead of the creditor.

(4) In other words, if a substitution occurs, and a subsequent creditor issue arises, the Committee is implying that the substitution is voidable unless proven otherwise by the debtor.

(5) What exactly is "intent"?

(A) Black's Law Dictionary defines "intent" as, "[p]urpose; formulated design; a resolve to do or forbear a particular act; aim; determination."[11]

(B) Section §4(b) lists the so-called "badges of fraud" which are to be applied in determining actual intent, but this list is specifically non-exclusive.

(C) Thus, "intent" is an open-ended concept subject to great interpretation, so it could be argued that the "intent" behind this provision in Comment 8 is to make a sweeping generalized statement as to asset exchanges so that *any* exchange of an asset reachable by a past, present or future creditor for an asset that is less reachable is a voidable transaction.

(c) Cases Interpreting Asset Substitution or Lack Thereof

[11] Black's Free Online Legal Dictionary 2nd Ed. http://thelawdictionary.org/intent/

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(1) Assume for the moment that the earlier stated position, *i.e.*, that the Comments do not add to current law and express the state of current law, is accurate. If so, then there should be a case or ruling stating this conclusion.

(2) Taking the author's home state of Florida by example, a review of Florida law failed to find one case or ruling on point. Therefore, the status of current Florida law is that there are no cases on this issue; thus, there is *no current law on this point.*

(3) As a follow up, a cursory review of California law, which has adopted the UVTA, likewise did not locate in any cases on point.

(4) Therefore, should a case surface in Florida (if it adopts the UVTA) or California (which has already adopted the UVTA), would not the Comment actually be used as evidence of the Committee's *intended* law, which is, in effect, the creation of new law?

(5) From the creditor bar perspective, this would appear to be a welcome addition. However, how would this be interpreted from an estate planning context?

(d) Example 1

In Fall 2012, Dean, a resident of Boise, Idaho, has significant assets and fears that, if no new legislation is enacted by January 1, 2013, his $5,000,000 applicable exclusion amount ("AEA") would revert to the pre-2002 threshold of $1,000,000. Dean visits his attorney, Stu, who recommends that Dean create an irrevocable trust for the benefit of his wife and/or children and into which Dean would gift assets equal in value to his remaining AEA.

Dean also wishes to use this plan in connection with more elaborate estate planning, so Stu drafts the trust so that it is a "grantor trust" for income tax purposes, *i.e.*, an intentionally defective grantor trust ("IDGT"), and then discusses with Dean that he should not only gift assets into the IDGT, but could also sell assets in exchange for a promissory note which would have the effect of "freezing" the value of the sold assets in Dean's estate. Further, Stu recommends that the assets to be gifted/sold should be closely-held limited partnership or limited liability company interests that may be eligible for certain valuation discounts. In order to achieve grantor trust status, the IDGT includes a unilateral power retained by Dean so that at any time, Dean can transfer assets into the IDGT in exchange for assets of equal value (*i.e.*, the "substitution power" under §675(4)(C) of the Code).

In December 2012, Dean gifts $5,000,000 of limited liability company interests in SandersonYao, LLC, a Delaware limited liability company (the "LLC"), and sells another $5,000,000 of interests, to the IDGT.

In January 2016, Dean, who is now 78 years old and his health is failing, reviews his financial status and realizes that the LLC has increased in value by 400% since the end of 2012. As a result, the membership interests owned by the IDGT are now considered "low basis" assets. At this time, Dean's net worth consists of $45,000,000 of cash and liquid assets, so it is recommended that Dean "swap" $40,000,000 in liquid assets into the IDGT in exchange for the LLC interests owned by the IDGT. After the swap, Dean's net worth consists of $5,000,000 in liquid assets and $40,000,000 of LLC membership interests. Upon Dean's death, the LLC interests in his estate would receive a step-up in

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cost basis under §1014 of the Code, thereby eliminating any unrealized capital gain due to its increase in value.

In January 2018, Dean, due to his failing health and medication, is involved in a horrific automobile accident with Claire where judgments are rendered in favor of Claire in excess of Dean's personal liability coverage by $10,000,000. Claire is able to attach Dean's $5,000,000 in liquid assets, but, as to Dean's LLC interests, since the LLC is a Delaware limited liability company, 6 Del. C. §18-703 limits her recovery to a charging order against further distributions.

(1) Preliminary Analysis

(A) Under this scenario, is it clear that Dean actually intended to hinder, delay or defraud the future creditors (*i.e.*, Claire) by engaging in the substitution of assets from the IDGT? Based on the facts as presented, the answer is "no."

(B) However, since Idaho has adopted the UVTA, by applying the above-cited provisions from Comment 8, can Claire move to void the prior asset substitution? Possibly.

(C) If nothing else, the burden would appear to now shift to Dean to demonstrate that he had no actual intent to hinder, delay or defraud a future creditor.

(2) Variation

(A) What if, as part of the discussion in January 2016 regarding substituting assets, Dean's financial advisor, Todd, happens to mention in passing that Dean's receipt of the LLC interests protects him against future creditors as a result of Delaware's charging order protection.

(B) Even though it is evident that Dean engaged in the substitution for tax purposes, can Todd's comment be used to illustrate intent as to Dean's future creditors?

(C) The proper question would not be as to whether Todd's comment can be used against Dean, but *should* it be able to be used against Dean?

(i) Logically, the answer should be "no."

(ii) If the creditor were in existence at the time of the swap or if Dean had an outstanding claim or judgment against him, such a transaction could easily be framed as an attempt to hinder, delay or defraud such creditor.

(iii) However, when creditor issues are not the driving force behind a transaction, legislative explanations should not be drafted so as to shift the burden to the debtor.

VI. __Issue #2: Entity Formation__

(a) Paragraph 6 to Comment 8

(1) The sixth paragraph to Comment 8 ("Paragraph 6") addresses entity formation:

> Thus, for example, suppose that entrepreneurs organize a business as a limited liability company, contributing assets to

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> capitalize it, in the ordinary situation in which none of the owners has particular reason to anticipate personal liability or financial distress and no other unusual facts are present. Assume that the LLC statute has the creditor-thwarting feature of precluding execution upon equity interests in the LLC and providing only for charging orders against such interests. Notwithstanding that feature, the owners' transfers of assets to capitalize the LLC is not voidable under § 4(a)(1) *as in force in the same state*. The legislature in that state, having created the LLC vehicle having that feature, must have expected it to be used in such ordinary circumstances. By contrast, if owners of an existing business were to reorganize it as an LLC under such a statute *when the clouds of personal liability or financial distress have gathered over some of them, and with the intention of gaining the benefit of that creditor-thwarting feature, the transfer effecting the reorganization should be voidable under § 4(a)(1),* at least absent a clear indication that the legislature truly intended the LLC form, with its creditor thwarting feature, to be available even in such circumstances.
>
> (Emphasis added.)

(2) On its face, Paragraph 6 appears innocuous. The problem is that like many statements in the Comments, there is no guidance as to what the particular choice of words indicate.

(A) What exactly is meant by an "ordinary situation" in the context of "none of the owners has particular reason to anticipate personal liability or financial distress"?

(B) What "reasons" should a person be anticipating?

(C) How broadly should "financial distress" be analyzed by potential partners, shareholders and members?

(b) Example 2

> In 2013, Steve, Chevy and Martin form a multiple member LLC in Nevada for the operation of their Mariachi business, having no reasonable or foreseeable creditors amongst them. Each of Steve, Chevy and Martin has no particular reason to anticipate personal liability or financial distress. If, in 2015, Chevy is personally sued by Lorne for refusing to perform at a particular venue, Chevy's lawsuit would arguably not subject him to liability as described in Paragraph 6.

(1) "Ordinary Situation"

(A) What happens if the Mariachi business is scrapped for an inherently dangerous business such as transportation of radioactive chemicals that the LLC will use at its California plant to make missiles that will be sold to various countries and suppose that in 2014, one of the LLC's fleet of cargo transporters crashes, spilling chemicals all throughout the western part of Nevada. Could a creditor argue that Steve, Chevy and Martin had reason to believe that they someday could be subject to personal liability just for operating a business centering on this activity?

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(B) Under this scenario, Paragraph 6 raises the question as to whether this entity formation is an "unordinary situation."

(C) Note that the phrase "ordinary situation" is used only once in the UVTA. Does Paragraph 6 mean that under the UVTA, any time a business involves some form of danger it runs the risk of a *per se* violation of the UVTA?

(2) Radioactive chemical transportation might be too far-fetched of an example, so what if the activity was more common, such as a business created for oil exploration in the U.S. utilizing fracking? Suppose that in February 2016, Steve, Martin and Chevy learned that the Florida Legislature was considering allowing firms to engage in fracking within Florida. Despite all financial and media coverage that oil prices are falling and other countries are not ceasing oil production, the trio nevertheless decide to enter into their endeavor.

(A) If, as predicted by many financial commentators, oil prices remain the same and the business fails, should Steve, Martin and Chevy have foreseen financial duress from this particular business venture?

(B) If the trio had done a minimum of financial homework prior to engaging in the venture, it would appear so. Is that enough to subject this scenario to Paragraph 6?

(c) LLC Formation and No Anticipation of Liability

(1) Forming an LLC where owners do not have a particular reason to anticipate personal liability or financial distress should not be a voidable transaction.

(2) However, it could be voidable if the owner is financially distressed, unless the particular state legislature intended otherwise. In this context, what does "financially distressed" mean?

(3) Variation of Example 2

What if prior to forming the LLC, Steve married Diane, a spendthrift, and signed a guarantee on a loan for Diane's California business in 2012. Steve probably had an inclination that, based on her spending and prior financial history, Diane might default on her loan, even if Diane's business started out with a perfect financial forecast. Diane's business fails and in 2014, creditors call the loan signed by Steve.

Should Steve have anticipated that he may be under financial distress just by signing the loan for spendthrift Diane? Probably not; however, that argument might, at a minimum, give a creditors' rights attorney some thought under Paragraph 6 to attempt to invalidate Steve's interest in the LLC in order to attach Steve's contribution.

(d) Voidable At Any Cost

(1) To what degree, though, does Paragraph 6 allow "attachment"? Should the size of the particular member/debtor's ownership interest effect the result?

(2) Consider the last sentence in Paragraph 6: "If owners of an existing business were to organize it as an LLC under such a statute when the clouds of personal liability or financial distress have gathered over *some of them* with the intention of gaining the benefit of that creditor-thwarting feature, *the transfer effecting the reorganization should be voidable under §4(a)(1)…*"

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(3) Note that Paragraph 6 refers to "some of them" but also states the "transfer effecting the reorganization." It would appear that the Committee is stating that if *any* member involved in the LLC, regardless of ownership interest, has the intent to avoid creditors, then the *entire* transaction – formation or conversion – is voidable.

(4) Example 3

> Worried about their job security in a tough job market, yet having the financial assets to start an investment company, Greg, David, Rick, Steve, Byron, Eric, George, Derek, Billy and Jason would like to form a multiple member LLC in Nevada. While Greg, Rick, Steve, Byron, Eric, George, Derek, Billy and Jason would hold a combined total of 99% of the membership interests, David, for many reasons, would hold just a 1% membership interest. Unbeknownst to the other members, David may have a creditor issue based on a dispute with his current employer.
>
> Can the phrase within Paragraph 6 that "the transfer effecting the reorganization be voidable" be interpreted so as to void the entire LLC's charging order protection and/or the entity formation?

(e) State Law and Voidability

(1) What is the effect of forming a business in Nevada if a claim is brought by a creditor against a member and both the claimant and the member are California residents?

(2) Note that immediately following Paragraph 6, the seventh paragraph of Comment 8 ("Paragraph 7"), which is more focused on domestic asset protection trusts ("DAPTs") provides that:

> Because the laws of different jurisdictions differ in their tolerance of particular creditor thwarting devices, choice of law considerations may be important in interpreting § 4(a)(1) as in force in a given jurisdiction. For example, as noted in Comment 2, the language of § 4(a)(1) historically has been interpreted to render voidable a transfer to a self-settled spendthrift trust. Suppose that jurisdiction X, in which this Act is in force, also has in force a statute permitting an individual to establish a self-settled spendthrift trust and transfer assets thereto, subject to stated conditions. If an individual Debtor whose principal residence is in X establishes such a trust and transfers assets thereto, then under § 10 of this Act the voidable transfer law of X applies to that transfer. That transfer cannot be considered voidable in itself under § 4(a)(1) as in force in X, for the legislature of X, having authorized the establishment of such trusts, must have expected them to be used. (Other facts might still render the transfer voidable under X's enactment of § 4(a)(1).) By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has no legislation validating such trusts, and if Debtor establishes such a trust under the law of X and transfers assets to it, then the result would be different. Under § 10 of this Act, the voidable transfer law of Y would apply to the transfer. If Y follows the historical

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interpretation referred to in Comment 2, the transfer would be voidable under § 4(a)(1) as in force in Y.

(3) Contrast Paragraph 7 with the Paragraph 6 language referring to "in the same state."

(A) Should it be presumed that Paragraph 7 also applies to entity formation?

(B) If David from Example 3 is a California domiciliary, and if he and his other 9 co-members form the LLC in Nevada, is the formation *per se* voidable as a choice of law under Paragraph 7 because California does not have charging order protection?

(C) Although Paragraph 7 is intended to thwart DAPTs, the Comments to §4 are not specific. Therefore, could this provision also be applied to entities?

(D) After all, there certainly does not seem to be any language in the Comments limiting specific paragraphs to particular topics or transactions.

(E) Moreover, could a creditor take this argument a step further and assert that just forming the entity was a voidable transaction because the purpose is to hinder, delay or defraud a creditor, albeit an unknown creditor?

VII. __Issue #3: Entity Conversion__

(a) Introduction

(1) An entity may modify its initial choice of legal entity for several tax and non-tax reasons.

(2) An entity "conversion" can be initiated in order for an entity to lawfully change forms or to keep the same form and change jurisdictions.

(3) For example, members of an LLC in state X may decide that the laws of state Y provide lower tax rates for LLC members. Likewise, shareholders in an S corporation in State X may decide that forming an LLC in State Y provides its members lower tax rates. Additionally, members of an LLC in state Y may decide that in light of the laws of state Z, a pro-business state with a history and body of old case law, converting to an entity in state Z makes sense in case its business ever became subject to any litigation. Finally, partners in a general partnership formed in State X may decide that the conversion to a limited partnership in State Y may be more tax advantageous for all involved.

(4) Of course, in addition to the above-stated reasons, the particular form of entity in each example may also lend itself to stronger creditor protection for the owner of the entity interest.

(5) The point is there are numerous reasons, other than avoiding creditors, as to why an entity may convert from one form or jurisdiction to another form or jurisdiction.

(b) Paragraph 4 to Comment 8 - The fourth paragraph of Comment 8 ("Paragraph 4") addresses entity conversion:

> Under the same principle, §4(a)(1) would render voidable an attempt by the owners of a corporation to convert it to a different legal form (*e.g.,* limited liability company or partnership) with intent to hinder the

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owners' creditors, as may be the case if an owner's interest in the alternative organization would be subject only to a charging order, and not to execution (which would typically be available against stock in a corporation). See, *e.g., Firmani v. Firmani,* 752 A.2d 854, 857 (N.J. Super. Ct. App. Div. 2000); *cf. Interpool Ltd. v. Patterson,* 890 F. Supp. 259, 266-68 (S.D.N.Y. 1995) (similar, but relying on a "good faith" requirement of the former Uniform Fraudulent Conveyance Act rather than that act's equivalent of § 4(a)(1)). If such a conversion is done with intent to hinder creditors, it contravenes § 4(a)(1) regardless of whether it is effected by conveyance of the corporation's assets to a new entity or by conversion of the corporation to the alternative form. In both cases the owner begins with the stock of the corporation and ends with an ownership interest in the alternative organization, a property right with different attributes.

(c) Example 4

Suppose Brian and his sons, Chris and David, are California residents and own their auto parts business as a California S Corporation. Unlike closely-held entities such as family limited partnerships or limited liability companies, corporate stock is not afforded charging order protection. In 2009, Brian, the majority stockholder in the entity, decides to recapitalize the S Corporation so that he can begin a plan to transfer control in his company to the next generation. The result is that by 2013, Chris and David each hold 48.5% of the outstanding shares while Brian owns the remaining 1%. For a variety of reasons, one of which is the charging order protection, Chris and David vote to convert to a Delaware LLC in 2014 while Brian votes against it. Because a majority of the ownership consents, the entity is converted. Later, in 2016, Rob successfully sues Brian and obtains a judgment.

(1) Issues

(A) Should Rob, who is now a personal creditor of Brian, be able to void the conversion as an attempt to hinder him even if Brian had no knowledge at the time of conversion in 2014 that he would be sued?

(B) Does this eliminate the charging order protection afforded to Chris and David as to any subsequent claim for attachment of the interest?

(C) Would Brian's status be sufficient to overturn the entire recapitalization?

(2) It appears this example could turn out in either party's favor based on Paragraph 4.

(A) On the one hand, one of the reasons that Chris and David wanted to convert was completely unrelated to creditor protection.

(B) On the other hand, if it could be proven that Chris or David had knowledge of Brian's predicament, this would appear to be sufficient cause under Paragraph 4 to void the entire conversion.

(C) Even if neither Chris nor David had knowledge, can the generality of the Comments allow the entire conversion to be deemed voidable even though Brian had only a 1% interest?

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VIII. Issue #4: Attempts to Curtail DAPTs

(a) Introduction

(1) A "Domestic Asset Protection Trust," or "DAPT," is another name for a "self-settled spendthrift trust."

(2) A DAPT is an irrevocable trust created by a settlor whereby the trustee has full discretion to pay trust income or principal back to, among others, the settlor, and the settlor's creditors are prohibited from attaching judgments against the trust assets.

(3) Starting with Alaska in 1997, there are now 15 states as of January 1, 2016 that have enacted full DAPT legislation.[12]

(b) Attack on DAPTs

(1) Unlike the above techniques, the Committee is not shy about its intentions – through the Comments, the Committee desires to eradicate DAPTs.

(2) In the White Paper, Prof. Kettering states,

> The avoidance laws of some jurisdictions are substantially debased by comparison with the UVTA. That is notably so in "asset havens" that have eviscerated, or completely expunged, their avoidance laws, commonly as part of a package of local laws that facilitate the local formation of so-called "asset-protection trusts" by persons seeking to shield their assets from their creditors…Section 10 reflects the committee's conclusion, which was to include no escape hatch in the statutory text. It addresses asset tourism through a comment stating that a debtor's "principal residence," "place of business," or "chief executive office" should be determined on the basis of genuine and sustained activity, not on the basis of artificial manipulations.[13]

(3) The perception is that DAPTs are a technique only used by the "shady" debtor as a means of avoiding his or her debts, but only a handful of cases are reported on DAPTs, and such cases fit within this description (note that such cases are considered to be "bad facts" cases – while structuring a "proper" DAPT is beyond the scope of this outline, no cases have been decided regarding a "proper" DAPT).

(4) For this reason, any additional teeth given to debtor/creditor law to allow the wronged party to recover the debtor's assets should be viewed as a positive.

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[12] ALASKA STAT. §34.40.110; 12 DEL. C. §§3536(c)(1), 3570-3576; HAW. REV. STAT. §§554G-1-554G-12; MISS. CODE §§91-9-701 et seq.; R.S. MO. §456.5-505(3); NEV. REV. STAT. §§166.010-166.180; N.H. REV. STAT. ANN. §§564-B:5-505(c), 564-D:1-564-D:18; OHIO REV. CODE ANN. §§ 5816.01-5816.14; OKLA. STAT. TIT. 31, §§10-18; R.I. GEN. LAWS §§18-9.2-1-18-9.2-7; S.D. CODIFIED LAWS §§55-1-36, 55-16-1-55-16-17, 55-3-39, 55-3-41, 55-3-47; TENN. CODE ANN. §§35-16-101-35-16-112; UTAH CODE ANN. §25-6-14; VA. CODE ANN. §§64.2-745.1, 64.2-745.2, 64.2-747(A)(2); WYO. STAT. ANN. §§4-10-103, 4-10-506(b), 4-10-510-4-10-523.

[13] Kettering at 800-1.

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(5) Is it possible, though, that the Committee went "too far" in its attack on DAPTs and disregarded the application as to non-creditor evasive uses for DAPTs?

(c) UVTA Analysis and DAPTs - §4 and new §10.

(1) Section 4

(A) As stated above, §4 concerns creditors who purport to "hinder, delay and defraud" a debtor and also lists the so-called "badges of fraud."

(B) Not much substantively has changed with respect to actual language of §4, so on its face, §4 appears to remain the same; where the changes actually occur as to DAPTs is within the Comments.

(C) The first three sentences of the first paragraph to new Comment 2 ("Comment 2") state the following:

> 2. Section 4, unlike § 5, protects creditors of a debtor whose claims arise after as well as before the debtor made or incurred the challenged transfer or obligation. Similarly, there is no requirement in § 4(a)(1) that the intent referred to be directed at a creditor existing or identified at the time of transfer or incurrence. *For example, promptly after the invention in Pennsylvania of the spendthrift trust, the assets and beneficial interest of which are immune from attachment by the beneficiary's creditors, courts held that a debtor's establishment of a spendthrift trust for the debtor's own benefit is a voidable transfer under the Statute of 13 Elizabeth, without regard to whether the transaction is directed at an existing or identified creditor*. Mackason's Appeal, 42 Pa. 330, 338-39 (1862); see also, e.g., Ghormley v. Smith, 139 Pa. 584, 591-94 (1891); Patrick v. Smith, 2 Pa. Super. 113, 119 (1896).
>
> (Emphasis added.)

(D) The real teeth are found in the last three sentences of Paragraph 7, which are repeated as follows:

> By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has no legislation validating such trusts, and if Debtor establishes such a trust under the law of X and transfers assets to it, then the result would be different. Under § 10 of this Act, the voidable transfer law of Y would apply to the transfer. If Y follows the historical interpretation referred to in Comment 2, the transfer would be voidable under § 4(a)(1) as in force in Y.

(2) Section 10

(A) Note that Comment 8 invokes the governing law provision of §10, which provides for a definitive determination of governing law.

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(B) Section 10 provides that:

SECTION 10. GOVERNING LAW.

(a) In this section, the following rules determine a debtor's location:

(1) A debtor who is an individual is located at the individual's principal residence.

(2) A debtor that is an organization and has only one place of business is located at its place of business.

(3) A debtor that is an organization and has more than one place of business is located at its chief executive office.

(b) *A claim for relief in the nature of a claim for relief under this [Act] is governed by the local law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred.*

(Emphasis added.)

(3) Applying the Comments to the DAPTs

(A) Applying the logic from the Comments, the Committee claims that the language of §4(a)(1) historically has been interpreted to render voidable a transfer to a DAPT.

(B) Other than ancient Pennsylvania cases, however, the Committee provides no further support for this conclusion.

(C) The gap in the reasoning is that historically, there was the question as to which law governs – the law of the settlor/debtor's domicile state (the "Domicile State") or the law of the DAPT state (the "DAPT State").

(i) Even if a court in the Domicile State deemed the transfer to the DAPT to be fraudulent or voidable, the DAPT proponent could look to the DAPT State for protection under its laws.

(ii) The DAPT State would then argue that DAPTs are valid in such state and would therefore not afford "Full Faith & Credit" to any judgment from the Domicile State.

(iii) Through the Comments and §10, the Committee seeks to fix the governing law to remove this doubt and force the issue as to DAPTs.

(4) Effect of §10 to DAPT analysis.

(A) If the Committee had its way, all 50 states and the District of Columbia would adopt the UVTA, meaning that each of the 50 states and the District of Columbia would have §10 as part of its law (after all, that is the goal of any Uniform Law).

(B) If the DAPT State adopts §10, it would be agreeing that the law of the Domicile State would apply to the transfer, and would therefore have a difficult time not affording Full Faith & Credit to the Domicile State's judgment.

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(C) By applying the above-cited provisions within Comments 2 and 8, the purpose for the transfer would most likely be disregarded as such Comments would deem that *any* transfer to a DAPT as voidable.

(d) Wither the Self-Settled Spendthrift Trust Doctrine?

(1) Comment 2 seemingly tries to adopt a global "voidable per se" approach to DAPTs, but ignores the fact that in many states, transfers to DAPTs may actually be subject to the "self-settled trust doctrine."

(2) The "self-settled trust doctrine" is a separate rule which provides that a spendthrift restraint on alienation is not valid with respect to any interest retained by the settlor. Thus, in a jurisdiction that follows this doctrine, if a settlor transfers property to a spendthrift trust and retains a right to trust income for life (but not principal), only the income is subject to attachment (but not the principal).

(3) An attempt to universally characterize all transfers to self-settled trusts, *i.e.*, DAPTs, as *per se* voidable in order to render all trust assets available to the settlor's creditors undermines the principles of the self-settled trust doctrine and is an improper application of the law.

(e) Arguments Against Strict Interpretation of the Comments

(1) Unless and until all 50 states and the District of Columbia adopt the UVTA and §10, DAPT proponents still have the ability to uphold the DAPT.[14]

(2) Which Law Applies – Voidable Transactions Law or Conflicts of Law

(A) To begin to analyze this issue, the first question is which body of law (as opposed to which particular state law) is applied – the voidable transactions law or the law regarding conflicts.

(B) The analysis can be viewed this way – if a transfer into a DAPT is deemed to be voidable, must the DAPT state recognize that decision, or is the analysis really not a voidable transactions analysis but rather whether the DAPT state determines for itself under a conflict of laws analysis as to whether its laws should govern the transaction.

(C) While this seems like it should be the same analysis, it really is not. Consider that both sets of laws – voidable transfers and self-settled trusts – have their respective origins in different *centuries*: the fraudulent-transfer rules originated with the Statute of 13 Elizabeth (1570), and the rule against self-settled trusts began with the even earlier Statute of 3 Henry VII (1487).

(3) Existing Law Limited Only to Pennsylvania?

(A) Recall that Comment 2 states that the language of §4(a)(1) historically has been interpreted to render voidable a transfer to a self-settled spendthrift trust.

[14] Gratitude is given to Mr. Richard W. Nenno of Wilmington Trust Company, Wilmington, Delaware, for his help in formulating this part of the analysis, which was included in the materials of Peter W. Bowie, Sandra K. Woodruff and George D. Karibjanian for their presentation entitled, *The Nature And Effectiveness Of Domestic Asset Protection Trusts*, as presented at the 2015 ANNUAL MEETING OF THE CALIFORNIA TAX BAR AND CALIFORNIA TAX POLICY CONFERENCE, November 5, 2015 at La Jolla, California, and THE STATE BAR OF CALIFORNIA TAXATION SECTION'S 24TH ANNUAL ESTATE & GIFT TAX CONFERENCE, February 25, 2016 at San Francisco, California.

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(B) The only legal precedent cited for this conclusion within the Comments are three ancient Pennsylvania cases which, assuming that these cases state what the Committee says that they state, means that Pennsylvania deems such transfers to be "*per se* voidable."

(C) Unless a state has determined, either by judicial decision by the highest court in the state or by specific statutory law, that transfers to self-settled trusts are "*per se* voidable," then it would appear that the statements in Comments 2 and 8 about DAPTs should only apply as to Pennsylvania.

(D) If so, then unless similar precedent can be found by the highest court of a particular state or within the statutory framework of such state's UVTA, the conclusion that all such transfers are voidable is debatable.

(E) This conclusion then stands for the proposition that the DAPT State would not be required to afford Full, Faith & Credit to the Domicile State's judgment.

(F) If no Full, Faith & Credit, then what happens in the court of the DAPT State? This leads to an analysis of the Conflicts of Laws.

(4) Conflicts of Laws and the Gap in Reasoning

(A) The governing law of a trust is the subject of §273 Restatement (Second) of Conflict of Laws (1971) (the "Conflicts Restatement"). Subsection (b) provides as follows:

> § 273 Restraints on Alienation of Beneficiaries' Interests.
> Whether the interest of a beneficiary of a trust of movables is assignable by him and can be reached by his creditors is determined …
> (b) in the case of an inter vivos trust, 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.
>
> Comment c to this section provides, in pertinent part, as follows:
> *c.* *Inter vivos trusts.* In the case of an inter vivos trust, if the settlor has manifested an intention that the trust is to be administered in a particular state, such as by naming as trustee a trust company of that state, the applicable law is the local law of that state.

(B) Pursuant to this section, so long as there are sufficient contacts to a particular state, the settlor of a trust can designate that the laws of that state should govern the trust.

(C) Can, however, the settlor's state of residence argue against this conclusion? This is the subject of §270(a) of the Conflicts Restatement, which provides as follows:

§ 270 Validity of Trust of Movables Created Inter Vivos

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An inter vivos trust of interests in movables is valid if valid,

(a) under the local law of the state designated by the settlor to govern the validity of the trust, provided that this state has a substantial relation to the trust and that the application of its law *does not 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 § 6 …

(Emphasis added.)

(i) Comment a to §270 of the Conflicts Restatement provides, in part, that "It is desirable that a trust should be treated as a unit and, to this end, that the trust as to all of the movables included therein, no matter where they happen to be at the time of the creation of the trust, should be governed by a single law."

(ii) Further insight from Comment b – the "Public Policy" position

(I) Comment b provides, in part, that

> A state has a substantial relation to a trust when it is the state, if any, which the settlor designated as that in which the trust is to be administered, or that of the place of business or domicile of the trustee at the time of the creation of the trust, or that of the location of the trust assets at that time, or that of the domicil[15] of the settlor, at that time, or that of the domicile of the beneficiaries. There may be other contacts or groupings of contacts which will likewise suffice.

(II) Comment b also provides insight on the "public policy" provision:

> [the designated law] will not be applied if this would violate a strong public policy of the state with which as to the matter in issue the trust has its most significant relationship. Thus, where the settlor creates a revocable trust in a state other than that of his domicil, in order to avoid the application of the local law of his domicil giving his surviving spouse a forced share of his estate, it may be held that the local law of his domicil is applicable, even though he has designated as controlling the local law of the state in which the trust is created and administered.

[15] Yes, this is how "domicile" is spelled within Comment b. Each author had to be careful not to "add" the term to his respective spell-check's dictionary.

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(iii) Based on the foregoing, is creating a DAPT in a DAPT state a violation of the public policy of the settlor's domicile state if the domiciliary state does not have a DAPT statute? The answer is not clear unless there is a specific affirmation as to the particular public policy.

(iv) Consider that a violation of public policy can take all types of forms, but the easiest application of public policy is an express statement that a transfer violates the public policy of the state. Consider Ohio Revised Code §3101.01(c)(3), as in effect prior to Obergefell et. al. v. Hodges et. al.:[16]

> (3) The recognition or extension by the state of the specific statutory benefits of a legal marriage to nonmarital relationships between persons of the same sex or different sexes is *against the strong public policy of this state*…" (Emphasis added.)

(v) It can therefore be argued that, absent some statute or case expressly stating that transfers to a self-settled spendthrift trust created in another state violates the public policy of the domiciliary state, no such public policy exists.

(vi) Further, if one state prohibits an act (the creditor protection of self-settled trusts) and another state allows such an act, is it a public policy violation if a resident of the prohibiting state irrevocably contracts in the state that allows such an act? Doesn't this type of argument pit §270 of the Conflicts Restatement (which has a public policy component) against §273 of the Conflicts Restatement (which has no public policy component)?

(D) §270 vs. §273

(i) Consider the approach taken in what is considered to be the preeminent DAPT case, In Re Huber.[17]

(ii) The Washington Supreme Court's opinion contains an extensive discussion of §270 of the Conflicts Restatement but failed to reference §273 of the Conflicts Restatement, which speaks to the attachability of a creditor's interest in the trust.[18]

(iii) If the Huber decision is correct and that §270 of the Conflicts Restatement controls, this would mean that a trust must first pass through §270 of the Conflicts Restatement before §273 of the Conflicts Restatement can be applied.

(iv) If that is the case, then why even have §273 of the Conflicts Restatement? After all, if the determination is between a non-DAPT state and a DAPT state, and if, under §270 of the Conflicts Restatement the law is determined to be the Domicile State, then §273 of the Conflicts Restatement is unnecessary to determine the impact of the attachability by creditors.

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[16] 576 U.S. ___, (June 26, 2015).

[17] 493 B.R. 798 (Bankr. W.D. Wash., May 17, 2013)

[18] For further analysis of this particular issue, see Jonathan D. Blattmachr and Jonathan G. Blattmachr, *In re Huber: Alaska Self-Settled Trust Held Subject to Claims of Creditors of Grantor-Beneficiary*, LEIMBERG ASSET PROTECTION PLANNING NEWSLETTER #225 (May 22, 2013) at http://www.leimbergservices.com.

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(v) Likewise, if §270 of the Conflicts Restatement concludes that the DAPT State controls, then the laws of the DAPT State would deem the settlor's interest unattachable, so, again, §273 of the Conflicts Restatement is unnecessary.

(vi) The fact that §273 of the Conflicts Restatement is still part of the Conflicts Restatement is an indication that there has to be some independent significance and applicability to it.

(E) Consider the alternative approach, such that §270 of the Conflicts Restatement and §273 of the Conflicts Restatement can be applied independently of the other. After all, both sections speak as to the validity of the settlor's selection of state law.

(i) Under this theory, if §273 of the Conflicts Restatement is argued, no public policy need be discussed and a decision could be made without even considering §270 of the Conflicts Restatement.

(ii) This approach would appear to be more logical in that it gives credence to §273 of the Conflicts Restatement.

(F) The Second Approach and Turning the Argument Around

(i) Therefore, if this second, alternative approach is applied, then the DAPT proponent can use the UVTA proponents' Comments argument against themselves.

(ii) The UVTA proponents argue that the Comments do not add to current law.

(iii) If this is the case, then Comments 2 and 8 are free to be disregarded and, in doing so, states are then free to apply the alternative argument and follow §273 of the Conflicts Restatement, which would allow the law of the DAPT state to apply.

(iv) If the DAPT state law is applied and if the DAPT state had not adopted §10, then §10 never enters into the debate.

(f) Are All DAPTs "Evil"? What About the Inter-Vivos QTIP Trust?

(1) Introduction

(A) As many practitioners believe that DAPTs are, at best, in the "gray" area of asset protection planning, isn't it a good thing that the UVTA seeks to eradicate DAPTs? Perhaps, but what about the legitimate use of DAPTs – much like including a spendthrift clause in a testamentary trust, could it not be argued that DAPTs simply afford a family protection against itself?

(B) Further, what about a non-specific creditor purpose for a DAPT – even though a DAPT is includible in the settlor's gross estate for estate tax purposes, are there any estate tax motivated reasons for creating a DAPT?

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(C) Surprisingly, there is one such technique – the use of the Inter-Vivos QTIP Trust.[19]

(2) Typical Set-Up of the Inter-Vivos QTIP

(A) In a typical plan, one spouse creates an inter-vivos trust for the benefit of his/her spouse, and elects qualified terminable interest property ("QTIP") treatment in order to defer the transfer tax consequences (the "Inter-Vivos QTIP").

(B) Why would this occur? The ideal situation for use of the Inter-Vivos QTIP is when a spouse has little or no assets, so that the Inter-Vivos QTIP trust not only allows the use of the donee spouse's applicable exclusion amount, but also can utilize the donee spouse's exemption from the generation-skipping transfer tax (the "GST") (which, unlike any unused applicable exclusion amount, is not subject to the portability rules of §2010(c) of the Code).

(C) An element of the Inter-Vivos QTIP plan is that if the donee spouse predeceases the donor spouse, the trust can provide that a portion or all can be subsequently held in further trust for the donor spouse (the "Back-End Trust").

(D) Back-End Trust and Gross Estate Inclusion

(i) The question is whether the donor spouse's retained interest in the Back-End Trust causes the lifetime QTIP to fail to qualify as a gift or disqualify the interest in the donee spouse for the gift tax QTIP election under either §§2036 or 2038 of the Code?

(ii) While it would appear to be the case, the answer is actually "no" – pursuant to §2523(f)(1) of the Code, no part of the QTIP property is treated as having been transferred to anyone other than the one spouse.

(iii) This enables the gift tax marital deduction to be available upon establishing the Inter-Vivos QTIP trust, even if the donor spouse could benefit from the trust if the donor spouse survives the donee spouse.

(iv) Correspondingly, inclusion of the QTIP property under §2044 of the Code in the donee spouse's estate means that for estate and GST tax purposes, the QTIP property is treated as property passing from the donee spouse.

(v) Based on this statutory construction, Treas. Reg. §25.2523(f)-1(f), Exs. 10 and 11 conclude that a donor spouse's interest in the Back-End Trust will not be a retained interest pursuant to §§2036 or 2038 of the Code.

(E) What About §2041?

(i) These examples, however, focus only on §§2036 or 2038 of the Code.

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[19] This section is derived from Richard S. Franklin, *Creative Estate Planning Strategies For Using Lifetime QTIP Trusts*, as presented at the 50TH ANNUAL HECKERLING INSTITUTE ON ESTATE PLANNING, January 14, 2016. Extreme gratitude is given to Mr. Franklin for his knowledge on this issue and also as he allowed one of the authors, George D. Karibjanian, to present these materials at the 41ST ANNUAL NOTRE DAME TAX & ESTATE PLANNING INSTITUTE, South Bend, Indiana on September 18, 2015.

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(ii) Technically speaking, the Back-End Trust for the settlor was created under a trust created by the settlor; therefore, isn't this actually a self-settled trust?

(iii) If the settlor lives in a non-DAPT jurisdiction, isn't there the possibility that, since this is a self-settled trust, the settlor's creditors could reach the trust assets, and, if so, does such an event trigger gross estate inclusion under §2041 of the Code?

(iv) While certain states such as Florida have legislation to prevent such creditor attachment,[20] if the settlor's domiciliary state does not have such a statute, creditor attachment and a gross estate includibility argument remain a possibility.

(3) Solution – Establishment in a DAPT Jurisdiction

(A) To avoid any argument concerning the applicability of §2041 of the Code, the settlor of the Inter-Vivos QTIP trust could provide that the Back-End Trust for his/her benefit should be established in a DAPT jurisdiction.[21]

(B) Thus, a non-specific creditor avoidance reason exists for establishing a DAPT which clearly the Committee did not consider when adding the new, anti-DAPT Comments to §4.

(g) Unintended Effect of Anti-DAPT Provisions – Potential Death Knell for ING Trusts?

(1) In most states that impose a state income tax, an aggressive technique was created that would seemingly allow certain income to avoid the imposition of the state's income tax – the "ING Trust."[22]

(2) Summary of ING Trusts

(A) An ING Trust is an irrevocable, non-grantor trust (*i.e.*, a trust which is not a "grantor trust" under Subchapter J of the Code which would cause the income earned thereon to be taxed directly to the trust's settlor) established in a state that does not impose state income taxes.

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[20] *See, for example,* FLA. STAT. §736.505(3):

"(3) Subject to the provisions of s. 726.105, for purposes of this section, the assets in:

(a) A trust described in s. 2523(e) of the Internal Revenue Code of 1986, as amended, or a trust for which the election described in s. 2523(f) of the Internal Revenue Code of 1986, as amended, has been made; and

(b) Another trust, to the extent that the assets in the other trust are attributable to a trust described in paragraph (a), shall, after the death of the settlor's spouse, be deemed to have been contributed by the settlor's spouse and not by the settlor."

[21] *See* Jonathan G. Blattmachr, Mitchell M. Gans and Diana S.C. Zeydel, "*Supercharged Credit Shelter Trust*SM, 21 Prob. & Prop. 52 (July/Aug. 2007); Jonathan G. Blattmachr, Mitchell M. Gans and Diana S.C. Zeydel, "*Supercharged Credit Shelter Trust*SM *versus Portability*, 28 PROB. & PROP. 10 (March/April 2014). *See also Portability – The Game Changer*, ABA-RPTE, INCOME AND TRANSFER TAX GROUP, ESTATE AND GIFT TAX COMMITTEE PROJECT (distributed at 47th Heckerling Inst., Jan 2013 and available on Committee's webpage); Richard S. Franklin and Lester B. Law, *Portability's Role in the Evolution Away from Traditional By-Pass Trusts to Grantor Trusts*, Vol. 37, No. 2 BLOOMBERG BNA, TAX MANAGEMENT'S ESTATES, GIFTS AND TRUSTS JOURNAL (March-April 2012).

[22] For further reading on ING Trusts, *see* George D. Karibjanian and Hannah W. Mensch, *State Income Tax Planning for the Non-Resident Floridian: The ING Trust*, 90 FLA. BAR J. No. 2 at 58 (February 2016).

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(B) Because the trust has two goals - (i) to return income back to the settlor of the trust, and (ii) if the income is not needed, to protect the assets for the eventual passage to the next generation, the ING Trust is established in a DAPT state that does not impose a state income tax, such as Delaware, Nevada or South Dakota.

(C) By purposefully structuring the trust as a non-grantor trust, the trust becomes its own taxpayer.

(3) ING Trust Example - Example 5

Johnnie is a Massachusetts resident, and Massachusetts is a state that imposes a state income tax. Johnnie decides to create an irrevocable trust in South Dakota, which is a DAPT state that does not impose a state income tax. The trust provides, in part, that income or principal may be paid back to Johnnie at the trustee's discretion. Johnnie names Marcia, a South Dakota resident, to be the trustee. During the initial taxable year (Year 1), the trust earns $100,000 of income that would have been taxable to Johnnie for Massachusetts state income tax purposes if Johnnie had retained the assets. Marcia does not effect any trust distributions during Year 1. Because the income is earned within a non-grantor trust, the trust is the taxpayer, so Marcia, as the trustee, is responsible to pay from the trust assets any Federal and state income taxes on the earnings. While Marcia has the trust pay the Federal income taxes, because the trust is a taxpayer in South Dakota, no state income tax is payable.

During Year 2, the investments are such that the trust has no DNI. Also during Year 2, Marcia effects a $100,000 distribution to Johnnie. Because there is no DNI, Johnnie is not subject to either Federal or Massachusetts income tax on the distribution. Therefore, with a one year deferral, the income earned in Year 1 is in Johnnie's hands and yet avoids Massachusetts state income taxation.

(4) Essential Element of the ING Trust – the DAPT State

(A) Over the past 10 years, the Service has blessed the complexities of the ING Trust and held that such trusts are not grantor trusts.[23]

(B) At the heart of the ING Trust have is the non-income tax and asset protection afforded by certain DAPT states.

(C) Certain states, such as California and New York, have modified their state statutes to thwart the ING Trust technique.

(i) California, for example, imposes a "throwback" rule concept so that if income from an ING Trust is, at any time, distributed back to a California resident, such income will be subject to California income tax regardless of the trust's DNI in the taxable year of distribution.[24]

[23] *See, for example,* Private Letter Rulings 201550005, 201550006, 201550007, 201550008, 201550009, 201550010, 201550011 and 201550012 (December 15, 2015); and Private Letter Rulings 201410001, 201410002, 201410003, 201410004, 201410005, 201410006, 201410007, 201410008, 201410009 and 201410010 (March 7, 2014).

[24] *See* CAL. REV. & TAX. CODE §§17731, 17742, 17743, 17744 and 17745; CAL. CODE REGS. TIT. 18, §17742(b); and Cal. FTB TAM No. 2006-2 (2/17/06).

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(ii) New York took a much more drastic step, wherein any trust that contains the elements of an ING Trust will be treated, for New York state income tax purposes, as a grantor trust.[25]

(5) In a state that has a separate state income tax, has no legislation like California and New York as to ING Trusts and then adopts the UVTA, query whether the state has unintentionally solved the ING Trust problem?

(A) Return to Example 5, except suppose that, at the time of the creation of the ING Trust, Massachusetts had adopted the UVTA.

(B) In Year 1, Massachusetts would have received its state income tax on the $100,000 of earnings had the trust assets remained with Johnnie and not been transferred to the trust.

(C) The transfer to the ING Trust resulted in Massachusetts not receiving its tax dollars – is, therefore, the Commonwealth of Massachusetts deemed to be a creditor as to those tax dollars?

(D) Our first instinct is that "no," they are not because that is speculative at best; however, consider that the ING Trust is a DAPT, and, as described above, Comments 2 and 8, by invoking §10, deem transfers to DAPTs to be voidable, can Massachusetts argue voidability and therefore present a claim for its tax dollars because, as a result of the voidability, those assets were technically in Johnnie's possession?

(E) This is an interesting argument and one which could possibly play out in the courts.

(h) Section 10 and Full Faith & Credit – What is the Effect a DAPT State?

(1) Introduction

(A) Suppose that a non-DAPT state enacts the UVTA, and a resident of such state creates a DAPT. After the creation of the DAPT, the settlor partakes in a transaction that leads to an action against her and eventually the creditor obtains a judgment in the non-DAPT state. The creditor now wants to attach the judgment to the DAPT and force a distribution.

(B) Notwithstanding the arguments set forth above, *i.e.*, the Self-Settled Spendthrift Trust doctrine and §273 of the Conflicts Restatement, is §10 the "smoking gun" needed by the creditor to force the DAPT state to honor the judgment with Full Faith & Credit and require the satisfaction from the DAPT?

(2) Full Faith & Credit – A Primer

(A) Article IV, § 1 of the United States Constitution provides that "Full Faith and Credit ["FFC"] shall be given in each State to the public Acts, Records, and judicial proceedings of every other State. And the Congress may by general laws prescribe the manner in which such acts, records, and proceedings shall be proved, and the effect thereof."

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[25] N.Y. TAX LAW §612, effective as of June 1, 2014. Note that within the income tax laws, most states acknowledge that a grantor trust for Federal income tax purposes is a grantor trust for said state's income tax purposes.

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(B) Over time, Congress has enacted several laws to assure the operation of the FFC Clause, such as the Parental Kidnapping Prevention Act, the Child Support Orders Act of 1994 and the Safe Homes for Women Act of 1994.[26]

(i) The broad language of the FFC Clause contains no exceptions to its requirements; however, the Supreme Court has never considered the requirements of the FFC Clause to be absolute as instead, the clause has been interpreted to impose certain minimum requirements.[27]

(ii) The Supreme Court has crafted an exception to FFC in that the requirement of FFC do not extend to those acts, records, or proceedings, which, if recognized, who would violate the public policy of the state (the "Public Policy Exception").[28]

(iii) The public policy rationale prevents states from being forced to recognize those acts of other states which are fundamentally at odds with the views of the resident state – "…in the case of statutes, the extra-state effect of which Congress has not prescribed, as it may under the constitutional provision, we think the conclusion is unavoidable that the full faith and credit clause does not require one state to substitute for its own statute, applicable to persons and events within it, the conflicting statute of another state, even though that statute is of controlling force in the courts of the state of its enactment with respect to the same persons and events."[29]

(C) The Public Policy Exception is limited - while the Supreme Court has recognized the Public Policy Exception to FFC as it applies to a forum state in determining the law applicable to a controversy, it has also specified that judgments are not subject to the Public Policy Exception.[30]

(3) Does §10 Create a "Back Door" Public Policy Statement Against DAPTs?

(A) Section 10 is a surreptitious way for an unwitting state to adopt a public policy against DAPT planning by its residents.

(B) Adoption of § 10 also brings with it the Comments, which, as stated above, are likely to be applied to the analysis, and the Comments are crystal clear that transfers from a resident in a Non-DAPT state to a DAPT located in a DAPT state are voidable.

(C) Thus, § 10 has the effect of being a "Trojan Horse" as to a back-door public policy argument in that §10, when combined with the Comments, can be read to state that, in a state that

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[26] Heather Hamilton, *The Defense of Marriage Act: A Critical Analysis of its Constitutionality Under the Full Faith and Credit Clause*, 47 DEPAUL L. REV. 943 (Summer 1998) at 947-8.

[27] Id. at 954-5, *citing* Wells v. Simonds Abrasive Company, 345 U.S. 514 (1953), in which the Court noted that "[t]he Full Faith and Credit Clause does not compel a state to adopt any particular set of rules of conflict of laws; it merely sets certain minimum requirements which each state must observe when asked to apply the law of a sister state."

[28] Id. at 957, *citing* Pacific Ins. Co. v. Industrial Accident Comm'n, 306 U.S. 493 (1939)

[29] Pacific Ins. Co. at 502.

[30] Kevin Oates, *Public Policy and the Recognition of Same-Sex Marriage*, 12 NEVADA LAWYER 32, at 33, *citing* (in footnote 16) Baker v. General Motors Corp., 522 U.S. 222 (1998), stating that "The Full Faith and Credit Clause does not compel a state to substitute the statutes of other states for its own statutes dealing with a subject matter concerning which it is competent to legislate (*citing* Pacific Employers Ins. Co. v. Industrial Accident Comm'n, 306 U.S. 493, 501 (1939)). Regarding judgments, however, the full faith and credit obligation is exacting. A final judgment in one State, if rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment, qualifies for recognition throughout the land."

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adopts §10 but does not have a DAPT law, all transfers from a domiciliary of that state to a DAPT are voidable, which can be interpreted as a public policy stand against DAPTs.

(D) This is, in many states, a departure from current law (*i.e.,* the self-settled spendthrift trust doctrine) and the trend in the law.

(4) UVTA notwithstanding, the DAPT State Law should still govern whether judgments can be satisfied.[31]

(A) A DAPT state may regulate the method by which other states' judgments are enforced within its borders - as noted by the United States Supreme Court in Baker, "Full faith and credit, however, does not mean that States must adopt the practices of other States regarding the time, manner, and mechanisms for enforcing judgments. Enforcement measures do not travel with the sister state judgment as preclusive effects do; such measures remain subject to the even-handed control of forum law."[32]

(B) The Full Faith and Credit Clause merely creates a rule of evidence that a plaintiff's out-of-state judgment is valid, whereas the rules for enforcing a judgment are established by the state in which enforcement is sought.[33]

(C) Finally, the Second Restatement of Conflict of Laws adopts a comparable view, as does case law, and the Uniform Enforcement of Foreign Judgments Act provides that a judgment from another state may be satisfied only pursuant to the procedures established by local law.[34]

(5) Query whether §10 and the affirmation of a definitive state law application force the hand of the DAPT state as to enforcement of the judgment?

(A) From the above, a state is free to limit how it is to apply FFC as to a foreign judgment seeing attachment in such state. In other words, a state cannot be bound to satisfy the judgment unless the judgment also meets that particular state's laws.

(B) In theory, that should be the end of it, in that the DAPT state law should prevail and not be forced to satisfy the judgment if such satisfaction is not clearly within its state laws; however, the UVTA may change this thinking.

(C) Applying this to Delaware law, with respect to a DAPT, the judgment also has to satisfy Delaware's attachment provisions against the assets held in the DAPT.

(D) Under 12 Del. C. §3572(a), satisfaction occurs as follows:

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[31] Paragraph (h)(4) is derived from Richard W. Nenno, *Planning and Defending Domestic Asset-Protection Trusts* (November 20, 2014) ("Nenno Defense").

[32] Nenno Defense at 123, *citing* Baker at 235; Nastro v. D'Onofrio, 822 A.2d 286, 291 (Conn. App. Ct. 2003); *see also* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 99 (1971); UNIF. ENFORCEMENT OF FOREIGN JUDGMENTS ACT § 2, 13 U.L.A. 160, et seq. (2002); 10 DEL. C. § 4782.

[33] Nenno Defense at 123, *citing* Baker at 241-42 (Scalia, J., concurring).

[34] Nenno Defense at 123, *citing* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 142 (1971); id. cmt. d.; Nastro at 291; UNIF. ENFORCEMENT OF FOREIGN JUDGMENTS ACT, 13 U.L.A. 160, et seq. (2002); id. § 2; 10 DEL. C. § 4782.

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(i) First, the transfer into the DAPT was have been fraudulent (voidable) under 6 Del. C. §1304 or §1305 (*i.e.*, the sections of the Delaware Uniform Fraudulent Transfer Act that are the equivalent of UVTA §§4 and 5); and

(ii) Second, as to a creditor whose claim arose after a transfer to the DAPT (*i.e.*, a future creditor), the transfer to the DAPT was made with the actual intent to defraud such creditor.

(E) Example: Suppose that A, a resident of State X, transfers $4,000,000 into a Delaware DAPT. A's remaining assets are $5,000,000 in securities held with her husband as tenants-by-the-entirety (and even documented as such with the financial institution) and a $3,000,000 home that qualifies as exempt under the State X's homestead laws. Two years after the creation of the DAPT, A business matter involving A goes awry and A is sued by B, who obtains a judgment in State X for $2,500,000. A only has insurance coverage of up to $1,000,000, thereby leaving a gap of $1,500,000. B seeks to enforce the balance of the judgment in Delaware as to the DAPT.

(i) UVTA Not in Effect in State X

(I) Under the above analysis, Delaware would give the judgment FFC, but it must be applied as to Delaware's laws and procedures.

(II) Under 12 Del. C. §3572(a), as set forth above, as this is a future creditor, the only way that the DAPT would be required to satisfy the judgment is if the transfer satisfies the requirements of the §1304 or §1305 of the Delaware Uniform Fraudulent Transfer Act and the transfer was made with the actual intent to defraud that particular creditor.[35]

(III) To win, the creditor must focus on the actual intent of the transfer.

(IV) In this instance, the judgment is unrelated to the transfer to the DAPT, so it would be extremely tough for the creditor to show that the transfer to the DAPT was done with the intent to defraud such creditor. Thus, summary judgment is granted to the DAPT and the attachment action is dismissed.

(ii) UVTA in Effect in State X

(I) Applying the same logic to a situation where the UVTA and its provisions come into play, A's only non-exempt assets were the $4,000,000 which she transferred to the Delaware DAPT.

(II) Under UVTA §10, via the application of the Comments, A's transfer of assets to the DAPT is voidable *per se*; the logic from the Comments would indicate that if State X wanted a different answer, it would have DAPT legislation on its books.

(III) B gets his judgment and now seeks attachment against A's Delaware DAPT, so B commences a second action – this time, it is to argue that, under §10, the transfers to the DAPT are voidable *per se*.

(IV) Applying the Comments, the particular State X court agrees and holds that the transfers to the Delaware DAPT are voidable *per se* under the laws of State X.

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[35] Other DAPT states have similar requirements. *See* S.D. CODIFIED LAWS §§55-16-9; Nev. Rev. Stat. §166.170(3).

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(V) B can now take that decision into Delaware. The fact that State X is calling the actual transfer to the DAPT voidable *per se* seems to be much closer to the language in 12 Del. C. §3572(a) that the qualified disposition was done with "actual intent" to defraud; however, does it satisfy the second prong of the second requirement, *i.e.*, is this intent as to that particular creditor?

(01) This is a difficult concept for both the creditor and the court. Theoretically, if this is a future creditor, how can this be a transfer against such creditor if such creditor is not known at the time of the transfer?

(02) The statute would conceivably be applied in a more general sense, in that was there actual intent to defeat certain future creditors by the transfer – for example, if the creditor can establish that the settlor/debtor had reason to believe that there might be some claim in the future, this could be sufficient to sway a court. For example, a surgeon transferring funds to a DAPT may be aware that she may be sued in the future based on a malpractice action that occurred in the past – such creditor would be a future creditor because the claim would arise after the transfer to the DAPT, and a court could consider the injured party to be the creditor from whom B was trying to avoid with transfers to the DAPT. Conversely, an injured party in a future automobile accident may not be a creditor against whom the settlor was intending to avoid.[36]

(03) In the fact pattern, the potential exists that B can demonstrate that A's creation of the DAPT was related to his business activities and therefore B can allege that he was in the class of creditors that A intended to avoid by the transfer to the DAPT.

(VI) If B can demonstrate "actual intent" to avoid his particular claim, then the transfer fits within the exception under Delaware law and the judgment must be satisfied from the DAPT (query whether the entire trust is returned to State X, or just the judgment amount).

(i) Michigan and Utah – Protecting the State Interests or Falling for the "Long Con"?[37]

(1) Introduction

(A) Until 2017, no DAPT state had adopted the UVTA, which makes sense - with such a proliferation and growth in acceptance of DAPT legislation, and considering the negative impact of the UVTA, seemingly no DAPT state would adopt the UVTA.

(B) However, in 2017, both Michigan and Utah becoming both UVTA and DAPT states.

(C) The question becomes whether the two sets of laws are reconcilable with each other.

(2) In-State DAPTs Avoid Section 10

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[36] For an article explaining "future creditors" in connection with UFTA/UVTA §4, *see* Jay Adkisson, *The Fraudulent Transfer Laws Do Indeed Apply to Future Creditors*, FORBES.COM (April 27, 2015) (http://www.forbes.com/sites/jayadkisson/2015/04/27/the-fraudulent-transfer-laws-do-indeed-apply-to-future-creditors/3/#1a9314a82354)

[37] The following is paraphrased from, George D. Karibjanian, *Two DAPT States Adopt the UVTA*, www.wealthmanagement.com (April 11, 2017). http://www.wealthmanagement.com/estate-planning/two-dapt-states-adopt-uvta

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(A) At least as to in-state DAPTs, it would appear that the two provisions can work together.

(B) Pre-2017 Example

(i) Suppose that a Michigan resident created a DAPT in Tennessee in 2016, and thereafter, a subsequent creditor of said resident attempted to attach a judgment to the DAPT.

(ii) The respective courts would have been faced with a conflicts of law analysis - while the Michigan court would argue that the debtor's transfer was in violation of Michigan fraudulent transfer law, the Tennessee court would argue that such an analysis is irrelevant because Tennessee authorizes DAPTs, so unless the provisions of Tenn. Code. §35-16-104(a) apply (which is a transfer in violation of Tennessee's Uniform Fraudulent Transfer Act), Tennessee is not bound by what the Michigan court determines.

(C) Current Law and Exception

(i) If the above transaction occurred after March 8, 2017, by applying the Michigan Uniform Voidable Transaction Act, it may be argued that the Michigan resident's transfer to the Tennessee DAPT is per se voidable.

(ii) However, applying the first sentence of the Anti-DAPT Provision, if the debtor instead created a Michigan DAPT, the Anti-DAPT Provision would not apply because the transfer was to a DAPT within the same state (*i.e.*, Michigan).

(3) Oops…Other UVTA Problems Still Persist

(A) The problem with this analysis is that, as stated above, DAPTs are only one estate planning technique affected by the negative ramifications of the UVTA.

(B) While it may have been the intent of both the Michigan and Utah legislators that the interaction of the two laws would be an incentive for the creation of in-state DAPTs, the passage of the UVTA now opens the door to the other detrimental implications of the UVTA, *i.e.*, the issues regarding asset substitution, entity formation/conversion and state homestead laws.

(j) If even some of the above analysis is upheld, it would tend to cause more DAPT proponents to adopting Steve Oshins's "Hybrid DAPT" approach where DAPT status can theoretically be toggled on and off.[38]

IX. <u>Issue #5: Homestead</u>

(a) Introduction

(1) Certain states exempt from creditor claims "homestead" property.

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[38] *See* Steven J. Oshins, *The Hybrid Domestic Asset Protection Trust,* LEIMBERG ASSET PROTECTION PLANNING NEWSLETTER #200 (May 10, 2012) at http://www.leimbergservices.com

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(2) The degree of exemption allowed may vary greatly, with Tennessee providing for a very minimal exemption as opposed to Florida which allows for an almost unlimited exemption.[39]

(3) Certain states, such as Florida, have a strong public policy in protecting homestead property, providing that the homestead exemption trumps all other state law, including the fraudulent transfer statutes.

(4) No case exemplifies this more than the Florida Supreme Court 2001 opinion in Havoco of America, Ltd. v. Hill.[40]

(A) In Havoco, a debtor with an outstanding judgment in Tennessee switched his domicile to Florida and argued that his primary residence in Florida was afforded homestead protection from the judgment.

(B) The Florida Supreme Court ultimately agreed with the debtor, stating that Florida homestead protection is rooted in the Florida Constitution, which supersedes any statutory law to the contrary.

(b) Perhaps unintentionally, the UVTA can allow one state's law to dictate a change in the homestead laws of another state.

(1) §10(b) - as previously discussed, §10(b) states as follows:

> (b) A claim in the nature of a claim under this [Act] is governed by the local law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred.

(2) Applying §10(b), it is not outside the realm of possibility that the UVTA can have a drastic effect on the sanctity of a state's homestead laws.

(c) Example 6

Alexander retires from practice in Tennessee and decides to retire in Florida. Alexander purchases large estate in Florida that, when he subsequently establishes Florida domicile, becomes his homestead.

With that, Alexander is sued by Aaron, a patient of his in Tennessee and obtains a judgment in excess of Alexander's personal liability coverage. Aaron wants a lien on the house, claiming violation of UFTA.

Suppose, though, that both Florida and Tennessee have adopted the UVTA, so now it's clear that since the purchase of the Florida property occurred in Tennessee, Tennessee's laws determine whether the transfer is voidable.

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[39] TENN. CODE ANN. §26-2-301; Art. X, §4 FLA. CONST.

[40] Havoco of America, Ltd. v. Hill, 790 So.2d 1018 (Fla. 2001).

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In this example, a Tennessee court can determine that the purchase of the Florida residence is deemed voided. Aaron now goes to Florida to record the judgment and meets with opposition.

(1) Based on the UVTA, is there any guarantee that the Florida court will uphold Havoco, or would the Florida court say that Florida's adoption of the UVTA affects Havoco as Florida has willingly allowed another state to pass judgment on its property, and that this now becomes an exception to Havoco?

(2) Note that even if a court (possibly an appeals court) ultimately holds that Havoco overrides §10, the Florida debtor will likely expend significant attorneys' fees to prove that the result in Havoco has not been altered by the adoption of the UVTA.

(d) This fact situation played out further could have some very inequitable results.

(1) For example, two debtors could be living next to each other, with the same facts as it relates to a voidable transactions claim, except that one purchased her Florida homestead when "located" in California and the other purchased her homestead when "located" in Florida.

(2) Under §10(b), it is possible that the California courts, which would hear the first debtor's case, could arrive at a different conclusion about Florida homestead than the Florida courts, which would hear the second debtor's case.

(e) Fraudulent Transfer or Fraudulent Conversion?

(1) Does the UVTA even apply to a shift in status to homestead property? Isn't that really a fraudulent conversion which is subject to a different set of laws?

(2) Creditors' rights attorneys, as is the situation in most plaintiffs' actions, generally plead any possible avenue of relief, whether a fraudulent transfer (or voidable transaction) or its closely related "cousin," a fraudulent conversion (note that the creditor in Havoco argued both positions).

(3) This scenario plays out when, in a state such as Florida, usually a northern neighbor purchases a secondary residence in Florida for visits during the winter. Over time, what started as a secondary residence then becomes Florida homestead when the purchaser changes his/her/their domicile to Florida.

(4) Herein presents the flaw in the reasoning of the conversion argument – the conversion argument advocates that the transfer from non-exempt to exempt property is a fraudulent conversion and is not subject to the UVTA. However, under these facts, there had not been a conversion at the time of purchase because the debtor/purchaser had not then shifted his/her domicile to Florida. Thus, all that occurred was the transfer of readily reachable funds (*i.e.*, cash) for property that is not as reachable (out-of-state real property). This appears to be a transaction that, on its face, would fit squarely within the UVTA.

(f) How the Non-Homestead State Can Change the Laws of the Homestead State

(1) If both the protected homestead state (*e.g.*, Florida) and the original domiciliary state have adopted the UVTA (and with it, § 10), the initial purchase could be construed as a voidable transaction that hindered or delayed a creditor from collecting against real property located in Florida rather than the previously held cash.

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(2) The fraudulent *conversion* rules would not apply because the Florida residence would not be exempt homestead because homestead status is only afforded to Floridians, and in this example, the debtor/purchaser had not shifted his/her domicile to Florida.

(3) With the adoption of §10, there is a strong possibility that a Florida court would consider the Florida Legislature's adoption of the UVTA as a statement that Florida would allow another state to pass judgment on a transaction that occurred when the Florida residence was not constitutionally protected.

(4) If, in Example 6, the Tennessee court held that the original purchase of the Florida residence was a voidable transaction, would the Florida court necessarily be required to afford the judgment Full Faith & Credit, thereby allowing a Tennessee court to dictate an exception to Florida homestead laws? Possibly.

*X. **What to Do About the UVTA?***

(a) Prevent Passage - For states where the UVTA has not been passed, the easiest option is to block the UVTA from passing in a particular state.

(b) Preventing Passage Isn't Possible – Then What?

(1) Prevent Use of the Comments

(A) If other factions are forcing the hand of the particular state legislature whereby passage of the UVTA is inevitable, the estate planning bars should be made aware of the repercussions and press for two additions prior to passage.

(B) Addition #1 – Prevent the Comments from Acting as Statutory Interpretation

(i) As stated above, the Comments are not part of the law.

(ii) A statute preventing the use of Comments is unusual to say the least, especially since the Comments are not the law. However, as to the UVTA, a clear statutory expression of the intention is warranted to remove any doubt as to the ability of the Comments to be applied for interpretation purposes.

(iii) Wait…why globally prevent the use of all of the Comments? Aren't some of them valid?

(I) To go through and "pick and choose" which Comments are valid and which are not would be painstaking and cumbersome.

(II) In addition, to do so would not bar the possibility that future Comments could be adopted to override any individual prevention.

(01) For example, suppose that a legislature provides language to the effect that "State X prevents any of the Comments added as part of the 2014 revisions to the UFTA into the UVTA to be applied to interpret the UVTA."

(02) The Uniform Law Commission could very easily adopt the repudiated Comments as part of a later adoption process that would circumvent State X's repudiation.

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(III) Example:

(01) Suppose that State X specifically wants to ignore Paragraph 7 by stating that "It is the intention of the State X Legislature that Paragraph 7 shall not, in any manner, whether directly or indirectly, be relied upon, in interpreting this Act."

(02) If the Uniform Law Commission wished to nevertheless have Paragraph 7 available to courts in State X for use in interpreting Sections 4 and 10, the Uniform Law Commission could simply re-adopt Paragraph 7 as a new Comment, which would not be specifically referenced by State X's legislation.

(03) Thus, this "cat and mouse" game could be played by the Uniform Law Commission to secure the effectiveness of Paragraph 7.

(iv) The "Ace in the Hole" Argument Favoring Statutory Adoption – UVTA Proponents Shouldn't Care.

(I) Adkisson Commentary

(01) In his rebuttal to the Explanation Articles, Jay Adkisson, who was a representative on the Uniform Law Commission on behalf of the American Bar Association's Business Law Section, and is in favor of the passage of the UVTA, provided two very important statements as his views (and, perhaps, the views of the Commission?) as to importance of the Comments: "The Comments, in short, are no more than a law journal article on steroids. The Comments … are not law, and courts are no more bound by them than they are by any other law journal article."[41]

(02) In short, Mr. Adkisson is stating that the Comments are of no more interpretative authority than a law journal article.

(II) Kettering Commentary - In addition to the quote above, in the White Paper, Prof. Kettering further explained as to the importance of the Comments: "Still, the amendment package does include some revisions to the comments that are not linked to changes in the statutory text. ... *Such revisions are not substantive*, as states do not enact the comments and courts are not bound by them. Moreover, they speak for themselves (or at least they should)." (Emphasis added.)

(III) So, what Mr. Adkisson and Prof. Kettering are stating is that the Comments carry the legal weight of a law review article and that courts are not bound by them.

(IV) So, if the Comments are what Mr. Adkisson and Prof. Kettering infer, then the Comments are not all that important, so, therefore, there should be no objections to the formal prevention of their use for interpretative purposes.

(v) Why not repudiate the Comments altogether?

(I) A simple solution would be to provide that the particular state "repudiates and does not acquiesce" to the Comments, but this could have a negative effect.

(II) While a state may wish to disassociate itself from the Comments, to say that it "repudiates" the Comments may have a more drastic effect in that it could be interpreted as if

[41] Jay Adkisson, *Reporter's Comments to the Uniform Voidable Transactions* Act, LISI ASSET PROTECTION NEWSLETTER #319 (April 11, 2016) (the "Adkisson Response").

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the interpretation should be the opposite of the particular comment, and in many instances, that is not the intention.

(III) Example

(01) Comment (2) to UVTA §5 references the conclusion that a transfer by an insolvent debtor for or on account of an antecedent debt to an insider when the insider had reasonable cause to believe that the debtor was insolvent is voidable.

(02) This Comment is not controversial and has nothing whatsoever to do with the estate planning concerns expressed above.

(03) If a state repudiates the Comments, does this mean that it takes the opposite view of all Comments, such that it disagrees with the conclusion in said Comment (2)? Although such an interpretation is unlikely, taken literally, if the state says that it "repudiates" the Comment, it is not out of the realm of possibility that a debtor could argue that such state's repudiation necessarily invokes the opposite conclusion to what the Comment provided.

(IV) In short, the most practical way to avoid the effect of overly-broad Comments is merely to negate their application instead of an outright repudiation.

(vi) Proposed Statutory Example:

"§15 ***Legislative Intent.***

Although this Act is adopted, in part, from the Uniform Voidable Transactions Act as released by the National Conference of Commissioners on Uniform State Laws, the official Comments to the Uniform Voidable Transactions Act, as amended from time to time, shall not, in any manner, whether directly or indirectly, be relied upon, in interpreting this Act."

(vii) Would this really happen – would a state actually repudiate the Comments? YES!!!

(I) Arkansas – TOTAL REPUDIATION. The following was added as Section 2 to the adopted version of Arkansas HB 2139:

> SECTION 2. DO NOT CODIFY. The General Assembly finds that although 24 the text of this act is in agreement with and will improve Arkansas law, the 25 2014 Official Uniform Law Commission comment no. 2 and comment no. 8 to 26 Section 4 of the uniform act, which is codified at § 4-59-204, is intended 27 to be persuasive authority but does not represent Arkansas law and should 28 not be considered when interpreting this act.

(II) Indiana – PARTIAL REPUDIATION. The following was added as Section 21 to SB 316 upon adoption:

> SECTION 21. IC 32-18-2-23 IS ADDED TO THE INDIANA CODE AS A NEW SECTION TO READ AS FOLLOWS [EFFECTIVE JULY 1, 2017]:
>
> Sec. 23. This chapter:

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(1) adopts, in part, provisions of the Uniform Voidable Transactions Act as released by the National Conference of Commissioners on Uniform State Laws; and

(2) may be cited as the Indiana Uniform Voidable Transactions Act.

However, in interpreting solely this chapter, comments released by a committee of the National Conference of Commissioners on Uniform State Laws shall not be considered as authority.

(C) Option #2 – Legislative History

(i) Adopting a new statute to disassociate from Comments is a radical concept and may not be welcomed by a state legislature.

(ii) If that is the case, then another option would be for the particular state to disassociate itself through the legislative history of the enactment of the UVTA.

(iii) The downside to such a position is that, even though they should, not every party will search for the legislative history in interpreting a statute, and, if the parties to an action fail to do so, a debtor may be faced with an action where the particular court applies the Comments.

(iv) Although, under these facts, it could easily be categorized as "buyer beware" in that the failure to check the legislative history is the fault of the attorney and the attorney should bear the blame for the result, in certain instances, statutes are enacted to prevent situations like this from arising.

(I) For example, a basic estate planning concept is, in drafting a non-revocable/testamentary trust, if the beneficiary is to be the sole Trustee, the beneficiary cannot have absolute discretion over distributions as such distribution authority could be considered to be a general power of appointment and create gross estate inclusion under §2041.

(II) If an attorney drafted a trust in this manner, the attorney could be liable for malpractice; however, Florida assists the attorney and prevents this result through Fla. Stat. §736.0814(2)(a), which provides as follows:

> "(2) Subject to subsection (3) and unless the terms of the trust expressly indicate that a rule in this subsection does not apply, a person who is a beneficiary and a trustee may not:
>
> (a) Make discretionary distributions of either principal or income to or for the benefit of that trustee, except to provide for that trustee's health, education, maintenance, or support as described under ss. 2041 and 2514 of the Internal Revenue Code;"

(v) If the particular legislature is more comfortable with the negation provisions being in the legislative history, then language nearly identical to the proposed statute above should be inserted into the particular state act's legislative history.

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(2) Create Statutory Exceptions

(A) Introduction

(i) For a state that is a "self-settled spendthrift trust" state, the adoption of Section 10, with the potential application of the Comments thereto, will have a heightened possibility of the violability of transfers to a trust or an entity in another jurisdiction that contains features that are not present under state law.

(ii) Examples of this include the charging order protection afforded to single-member LLC's ("SMLLCs") and transfers to DAPTs.

(B) Removing the Presumption of Voidability

(i) As explained above, the application of §10 and the Comments to §4 and §10 could have the effect of rendering transfers to DAPTs as "voidable *per se*." Further, as illustrated above, such a designation could lead to the effective satisfaction of a judgment from a future creditor from a DAPT.

(ii) Therefore, the first goal should be to remove the possibility of the voidable *per se* presumption as to future creditors - in doing so, there should be no modification to other provisions UVTA as a means from protecting creditors. If a creditor is to undo a transaction, let it happen in accordance with UVTA state applying its current state law and other provisions of the UVTA and then determine whether the provisions of the laws of the DAPT state allow for the satisfaction of the judgment.

(iii) By doing so, this would force the creditor to demonstrate that the action securing the judgment would also be successful if brought in the DAPT state; this would be more difficult burden and is more in the spirit of acknowledging the Self-Settled Spendthrift Trust doctrine.

(iv) Where to implement this provision? Either in §8, titled "Defenses, liability, and protection of transferee or oblige", or in §10. Some may find that positioning this statute in §8 fits better within the scheme of the UVTA in that this is a defense for the debtor and an "exception" to the general rule, and would be inserted at the end of the section.

(v) Proposed Statutory Example:

"***§9 Defenses, Liability, and Protection of Transferee or Obligee.***

…

(i) Notwithstanding the foregoing provisions of this Act:

(1) Nothing in this Act shall deem as voidable per se the transfer of an asset by a debtor residing in this state to an entity or irrevocable trust that is formed and governed under the laws of foreign jurisdiction; provided, however, that such transfer may nevertheless be deemed voidable pursuant to other provisions of this Act."

(C) Clarification that UVTA Should Not Dictate What Happens in the DAPT State

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(i) With the assurance that the mere transfer of property to a DAPT is not voidable *per se* as to a future creditor, in order to respect FFC, assurances should be given that the satisfaction of any judgment must be done in accordance with the laws of the DAPT state.

(ii) Arguably, this is done if the UVTA state adopts Proposed §8(i)(1); however, further provisions should be adopted to guarantee that if a judgment is obtained against a debtor residing in State X, and the creditor wants to attach the judgment to a DAPT (or an entity such as a SMLLC where the transfer to the other state was effected BEFORE the action leading to the judgment arose, *i.e.*, a future creditor, then the judgment has to be able to be satisfied in accordance with the claims laws of the DAPT/SMLLC state.

(iii) Further protections must be given so that any judgment is not an indication that a transfer was made in contravention of a negative-inference perceived public policy against such trusts/entities by State X.

(iv) Applying a statute based on Delaware's statute, which is one of the more accessible for creditors, would purport to protect DAPTs in states where the attachability statute is more difficult to satisfy.

(v) The statute should signify intent that the judgment not be applied to satisfy the basic test for attachability in another state unless it meets certain criteria; applying Delaware's statute, the judgment cannot be applied unless the DAPT (and SMLLC) state law allows for the attachment, or that, as to any trust or entity created before the action leading to the judgment, the transfer to the trust or entity is subject to another provision of the state's UVTA. This way, all other UVTA remedies are preserved.

(vi) Proposed Statutory Example:

"***§9 Defenses, Liability, and Protection of Transferee or Obligee.***

…

(i) Notwithstanding the foregoing provisions of this Act:

…

(2) A judgment under this Act may not be satisfied or enforced against any entity, or an interest in such entity, owned by the debtor (or a trust that is revocable by the debtor) that is organized under the laws of a foreign jurisdiction, or against any irrevocable trust created by the debtor in which the debtor has retained a beneficial interest and which is governed under the laws of a foreign jurisdiction, unless:

(i) The Claims Laws of the foreign jurisdiction governing such entity or trust, independent of the effect of the judgment under this Act, permit such judgment to be satisfied from, or enforced against, such entity, or interest in such entity, or trust; or

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(ii) (A) Such entity or trust was created before the particular transfer made, or obligation incurred, by the debtor resulting in such judgment, and

(B) The assets held by such entity or trust were transferred by the debtor to such entity or trust in violation of another provision of this Act."

(D) An effort in the proposed statutes is made to incorporate the SMLLC, as it is anticipated that the law for attachments against such entities would be very similar to that of the DAPT because, like a DAPT, the SMLLC provides unique asset protection features (in the form of charging order protection) that is not found in most states, it is noted that the UVTA does not define "entity".

(i) In order to be consistent, a definition should be provided as §8(i)(3).

(ii) Proposed Statutory Example:

"***§9 Defenses, Liability, and Protection of Transferee or Obligee.***

…

(i) Notwithstanding the foregoing provisions of this Act:

…

(3) For purposes of this subsection (i), "entity" shall be defined as provided in [citation to particular state's limited liability company act] notwithstanding the fact that such entity is organized under the laws of a foreign jurisdiction."

(E) Homestead Protection

(i) As described above, the potential exists that §10 could be applied to allow a foreign state to modify another state's homestead exemption laws.

(ii) In order to prevent this result, statutory guidance should be adopted to §10 to assure that the governing law provision should have no effect on such exemptions.

(iii) Proposed Statutory Example:

§10 Governing Law.

…

(c) The provisions of this section shall not affect the governing law for any other claims or issues between the parties arising outside of the provisions of this Act. If this section requires the application of the Claims Laws of a foreign jurisdiction, such a determination will not affect which jurisdiction's exemption laws apply, the availability of exemptions under applicable law[, or the debtor's entitlement to any protections afforded to the debtor's homestead under the [State] Constitution."

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XI. Conclusion

(a) The UVTA is intended to strengthen creditor's rights, which is admirable and should be supported by all, but in explaining the UVTA, the Committee took broad liberties with respect to existing, unchanged provisions.

(b) To say that the UVTA does not change existing law is a misnomer, especially considering that as to several estate planning techniques that involve asset protection, there is no specific existing creditor's law and, as such, precedent suggests that the Comments will be used to formulate such new law.

(c) Summary of Estate Planning Issues

(1) Asset Substitution

(A) "Asset substitution" is a common planning technique and is perhaps the most widely-used "taint" clause in irrevocable trusts to cause such trusts to be grantor trusts for income tax purposes.

(B) The ability to substitute assets of equal value into an irrevocable trust grants the settlor of a trust the ability to create dynastic trusts to preserve family wealth while also allowing him or her to manage the income tax attributes of the transferred assets.

(C) Many practitioners will likely be surprised to know that arguments exist whereby a future creditor of the client could potentially have the ability to retroactively usurp the substitution, which not only creates creditor problems for the client, but also can undo some technical tax planning.

(2) Entity Formation and Conversion

(A) Likewise, entity formation and conversion has come under scrutiny under the Comments.

(B) It can be argued that if only one partner or member has creditor issues, not only is that partner/member's entity interest at risk, but, the Comments can be interpreted to argue that the entire formation/conversion could be undone.

(C) Interestingly, the vagueness of the Comments leave open the possibility that, unless the partners/members form an limited partnership or limited liability company in their domiciliary state, some of the asset protection features of the entity may not be available to the partners/members.

(D) Practitioners in UVTA states must now pay closer attention when advising clients with respect to any limited partnership or limited liability company formation/conversion.

(3) DAPTs

(A) With respect to DAPTs, the Committee is clear in its goal to eliminate DAPTs in states that have not adopted DAPT legislation by deeming as voidable transfers from a domiciliary in a non-DAPT state to a DAPT created in a DAPT state.

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(B) While DAPT proponents still have legitimate arguments regarding the enforceability of the creditor-protection feature, the effect of §10 may force a court in a DAPT state to grant Full Faith & Credit to a judgment from the domiciliary state.

(4) Homestead - as to Homestead law, while it does not appear plausible, it is certainly possible that the UVTA may allow another state's courts to dictate exceptions to a particular state's homestead laws.

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