Planning under the New Asset Protection Law of Virginia
By Roger McClure

I. Trust Terms

A. Grantor, Settlor, Trustee, Trust Corpus, Beneficiaries.

A trust normally consists of a grantor, trustee, trust corpus and the beneficiaries.

*The **grantor** is the person or entity that creates the trust. The Virginia code often refers the term **"settlor"** rather than grantor to refer to the person who creates the trust. Since the new QSSST statute refers to "settlor", that terms is used most of the time in this outline except where referring to a grantor trust under the Federal IRC.

*The **trustee** is the person or entity that has fiduciary responsibility for (1) trust administration (2) investment and management of trust assets and (3) decisions regarding and making of trust distributions.

*The **beneficiaries** of the persons or entities who are eligible under the terms of the trust to receive trust distributions.

*The **trust corpus or assets** refers to the assets. There is trust income, which is the income received from trust assets or from other sources. The assets of the trust constitute the principal.

*A trust can be an explicit trust where there is a trust document.

*A trust may be an implied trust created without anything in writing where assets are placed in trust with a person for the benefit of another person.

***Trust protector.** In recent years, it has become more common to create the office of a trust protector. A trust protector is a fiduciary who usually has the power to remove and appoint new trustees and to make administrative changes to irrevocable trusts.

***Self-settled trust** refers to a trust that the settlor has created and the settlor has retained certain benefits, such as access to income or principal for needs of the settlor.

B. Revocable.

A revocable trust is where the grantor has the power to revoke the trust. Also, the power to revoke make be given to the trustee, beneficiary or a trust protector.

In the typical “living trust”, created to achieve the goals of the settlor, such as the avoidance of probate, the settlor usually has the power to revoke and amend at any time the terms of the trust while the settlor is living and competent. During the lifetime of the trust, if the trust contains terms that define it as a “grantor trust” under the US Internal Revenue Code (IRC), then normally all of the income of the trust is taxable to the grantor. Upon the death of the grantor, the trust usually becomes irrevocable and stays in existence for a time period described in the trust. The new QSSST law has a detailed definition of when a trust is not revocable.

C. Irrevocable

An irrevocable trust usually refers to a trust that the settlor cannot revoke or amend after the settlor executes the trust. The settlor may retain other powers such as the power to appoint additional beneficiaries. An irrevocable trust can be a grantor trust under the US IRC if the trust document contains certain powers that designate it as a grantor trust under Section 671 through 678 of the IRC. These are commonly referred to as “defective trusts”. An irrevocable trust may or may not be part of the taxable estate of the grantor depending upon the terms of the trust. A common type of irrevocable trust used in estate planning is an irrevocable life insurance trust used to own a life insurance contract, usually insuring the life of the grantor. Other types of irrevocable trusts are qualified personal residence trusts and charitable remainder trusts.

D. Spendthrift Trust

A “spendthrift” trust is a trust with a clause in it that prevents the free spending person from raiding the trust assets for unwise expenditures or seeking to pledge his interests in a trust for a loan. The image is that of a young English nobleman in a Jane Austin novel wasting his monthly income on partying and frivolous matters. The idea is to prevent such wasteful spending.

Virginia recognizes spendthrift trusts:

> § 55-545.02. Spendthrift provision.
>
> A. A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest.
>
> B. A term of a trust providing that the interest of a beneficiary is held subject to a "spendthrift trust," or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest.
>
> C. A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this article, a creditor or assignee of the beneficiary may not reach the interest or a

distribution by the trustee before its receipt by the beneficiary.

If a trust is a spendthrift trust under Section 55-545.02, then a creditor of the beneficiary is not able to obtain the trust assets to satisfy a judgment against the beneficiary, except where an exception applies.

E. Asset Protection Trusts; Qualified Self-Settled Spendthrift Trusts

An Asset Protection Trust (APT), referred to in the new Virginia statute as a Qualified Self-Settled Spendthrift Trust (QSSST), is an irrevocable trust self-settled trust created by a settlor where the settlor may retain beneficial interests which are not subject to seizure by a Court order to satisfy a creditor of the settlor. In the recent law creating a Virginia Qualified Self-Settled Spendthrift Trust (QSSST), Virginia joins about 12 other states which have such provisions. APTs are common in offshore Caribbean countries and the Cook Islands as a means of enticing persons to establish trust arrangements in those jurisdictions. These APTs are usually self-settled spendthrift trusts that qualify for an APT as a means of protecting assets. In this outline, APTs are referred to as QSSSTs, the term used in the Virginia statue. Domestic APT is the term often used by commentators when referring to APTs created under state law.

II. Creditor Access to Trust Assets

A. Revocable Trusts

In general, a creditor of a debtor will have the same rights under a trust agreement as the debtor has under the trust. If a person has the right to revoke a trust, then a creditor, after obtaining a judgment against the debtor, as part of the enforcement of the judgment, will request that the court order the debtor to revoke the trust and turn over the assets in the trust in satisfaction of the judgment. Usually, a revocable trust only delays a creditor and does not protect the settlor from creditor seizure of trust assets. This is true even if the trust has a spendthrift provision in the trust document.

It is my experience that most non-lawyers think that their revocable trust made for estate planning purposes protects their assets in the trust. My clients will think this even where I have told them explicitly that their revocable trust does not protect them from their creditors.

Section 55-545.05 sets forth this rule:

> § 55-545.05. Creditor's claim against settlor.
>
> A. Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:

1. During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor's creditors.

B. Irrevocable Trusts and Creditors; Unqualified Self- Settled Spendthrift Trust

A self-settled spendthrift trust refers to where the settlor creates an irrevocable trust with spendthrift provisions in the trust document and also names the settlor as a beneficiary of the trust. The public policy in the past has been that a settlor cannot create a trust to avoid the **present and future** creditors of the settlor. For trust assets that do not meet the requirements of the QSSST statute, this rule that a creditor can reach the assets of an unqualified self-settled spendthrift trust remains in effect.

This is codified in Section 64.2-747 (effective October 1, 2012 after recodification) which stated prior to the amendment effective July 1, 2012:

> § 55-545.05. (former Code Section prior to recodification) Creditor's claim against settlor.
>
> A. Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:
> …
> 2. With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor's interest in the portion of the trust attributable to that settlor's contribution.

C. Qualified Self-Settled Spendthrift Trust (QSSST)

A qualified self-settled spendthrift trust (QSSST) is a trust that meets the qualifications set forth under new Sections 64.2-745.1 and 64.745.2.

For assets transferred to a QSSST, those assets are protected against future creditors and against present creditors after five years. This is accomplished by an amendment to the Section 64.2-747 (old Section 55-545.05 prior to recodification) which states that irrevocable trusts that qualify under Sections 64.2-745.1 and 64.745.2 are no longer subject to creditor invasion:

> § 64.2-747 Creditor's claim against settlor.
>
> A. Whether or not the terms of a trust contain a spendthrift provision, the following rules apply:
> ….

> 2. With respect to an irrevocable trust, ***except to the extent otherwise provided in §§ 64.2-745.1 and 64.2-745.2,*** a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor's benefit….***(emphasis added)***

An example:

Fred Loses. Fred set up a self-settled irrevocable spendthrift trust in 1995 which he thought would protect his assets, prior to the new law. Fred has an auto accident in 2012 and is sued for $2,000,000 and his insurance policy has a limit of $250,000. Under the prior rule, Fred's judgment creditor from the auto accident is able to reach all of the assets he transferred to the irrevocable trust to satisfy the judgment.

Sarah Wins. Sarah sets up a QSSST on Trust on July 1, 2012 and transfers $1,000,000 to it. The APT meets all of the qualifications under the new QSSST law. On September 1, 2012, she has an auto accident and ends up with a judgment for $2,000,000 against her. Even with the judgment, Sarah is not bankrupt. Since Sarah's liability from the auto accident occurred after she transferred the $1,000,000 to her QSSST, all of her assets in her QSSST are not subject to the claims of the auto accident creditor.

A large caution here is the impact of the bankruptcy laws, as discussed below.

D. Trusts for Beneficiaries Other than the Grantor

The self-settled trust doctrine of Section 64.2-747 applies to the amount that may be distributed for the settlor's benefit. Section 64.2-747 does not allow a creditor to reach the beneficial interests of beneficiaries who are not settlors (grantors). Section 64.2-747 does provide for the payment of the debts of a settlor of a revocable trust upon the death of settlor.

Other statues may allow some creditors to attach interests of beneficiaries other than a settlor. Section 64.2-745 allows the State to petition a court to invade a non-self-settled spendthrift trust for reimbursement for certain public assistance payments to the beneficiary. Also, the augmented estate provisions allow the Court to invade an irrevocable trust for satisfaction of an elective share of a surviving spouse. Section 64.2-305.

III. Requirements for a Qualified Self-Settled Spendthrift Trust (QSSST)

All Requirements Must Be Met. A reading of Sections 64.2-745.1 and 64.2-745.2 provides the following requirements for a QSSST. This is not a factor test. All of these requirements must be met. If one is missing, it is not a QSSST. If one requirement is not met, it may be a self-settled spendthrift trust that is still subject to the present and future creditors of the grantor.

1. Irrevocable. The trust must be irrevocable. Section 64.2-745.2 provides a very liberal definition of what is revocable and not revocable for the purposes of this statute. Such provisions may not be thought of as typical in an irrevocable trust and are discussed in more detail below.

2. Inter Vivos Trust. The settlor must create the QSSST "…during the settlor's lifetime." A QSSST cannot be created at death. However, usually a QSSST is not necessary when someone is dead because the beneficiaries will no longer be the settlor and subject to the self-settled trust doctrine. Does a settlor have to be a natural person? The QSSST provisions are part of the Virginia Uniform Trust Code and therefore subject to the definitions in Section 55-541.03. Under Section 64.2-701, a settlor is a person and a person includes an individual, corporation, partnership, trust, LLC or any other legal entity. There is no definition of "lifetime" that I have located in the UTC. Corporations are referred to having a perpetual existence. LLCs in Virginia can have perpetual existence as can trusts. Until this issue is resolved, it will be best for a natural person to be the settlor.

3. At Least Another Beneficiary. There has to be "… at least one beneficiary other than the settlor…" Definition of QSSST under Section 64.2-745.2 (A). The UTC defines a beneficiary as a ***person*** who has a present or future interest in a trust or a power of appointment other than as a trustee. Certainly other family members can be beneficiaries. Does a corporation controlled by the grantor constitute another beneficiary? In other parts of the QSSST statute, the statute sets forth that a corporation where the settlor owns more than 30% of the voting stock is not an independent qualified trustee, but contains no such limitation in the definition of beneficiary. If the settlor has an income interest, there must be another person with an income interest. If the settlor has an interest in principal, there must be another "beneficiary" who has an interest in principal. Usually, this will be another family member. For a qualified personal residence trust, this could a spouse or a dependent. Treas. Reg. 25.2702-5 9 (b).

4. Distribution Standards. The definition of what is permissible for the trust to be classified as revocable provides certain safe harbors. These safe harbor definitions as to distribution standards will be useful for tax planning purposes and for defeating a claim that the QSSST was part of an intent to hinder, delay or defraud creditors. If it is a discretionary distribution trust, then it would be advisable to limit distributions to principal or income in the sole discretion of an independent qualified trustee based upon "ascertainable standards" or under a 5 and 5 power. Under the tax code, ascertainable standards are limited to health, education, maintenance and support. This takes some interpretation to come to this conclusion. Section 64.2-745.2 (A) requires that to be exempt from the usual creditor access to a self-settled trust, the interest of the beneficiary must be a "qualified interest". The definition of a "qualified interest" is that the settlor is only entitled to "…receive distributions of income, principal, or both in the sole discretion of an independent qualified trustee." Section 64.2-745.2 provides that a trust is deemed to be irrevocable if "... the settlor's right to receive income or principal [is] pursuant to an ascertainable standard" or a maximum distribution per year of 5% of principal. For tax reasons, you will usually want distributions restricted to ascertainable standards and not in excess of 5% a year so that the assets in the QSSST are not part of the taxable estate of the settlor. See the discussion below on this point. The use of standards that are not ascertainable run the risk of the trust being deemed revocable and not qualifying as a QSSST or giving the trustee so much discretion that the trust may deemed a device to hinder, delay or defraud creditors. If distributions or the use of the trust assets are set up to satisfy tax requirements of special entities, then the applicable distribution standards will be those as required by a Qualified Personal Residence Trust, a Charitable Remainder Trust or a qualified annuity trust.

5. At Least One Qualified Independent Trustee in Virginia. Under the new law, there is a difference in definitions between a qualified trustee and an independent qualified trustee. A qualified trustee is defined as (i) a natural person who resides in Virginia or is a licensed trust company in Virginia and who (ii) arranges for or maintains custody of some or all of trust property in Virginia, (iii) prepares or arranges for the preparation of the Virginia tax return **OR** (iv) participates in the administration of the trust. In other states with APTs, the practice is for the qualified trustee to meet all of the requirements under (i), (ii), (iii) and (iv). The trustee is not qualified if distributions of principal or income are subject to a trust distribution director who would not qualify as a qualified trustee. In order for it to be a qualified interest, the trustee must be a qualified independent trustee. The statute defines a qualified independent trustee by providing a list of persons who are not independent, such as family members or employees. The independent qualified trustee must also be a qualified trustee. The likely candidates for an independent qualified trustee will be those persons or entities who would be treated as independent under definitions of the QSSST and the IRC. These would be CPAs or trust companies. There can be multiple trustees, but only the qualified independent trustee may make trust distributions. There are provisions in the new QSSST statute as to selecting successor trustees if not set forth in the trust agreement.

6. Some Virginia Property. To be a qualified trustee, the qualified trustee has to have custody within Virginia of some or all of the property. In other APT states, custody of property has been defined to include membership interests in LLCs or partnerships or beneficial interests in trusts formed in the same state as the APT.

7. Virginia law. Virginia trust law must apply.

8. Spendthrift Trust. The trust instrument must "…include a spendthrift provision, as defined, in Section 64.2-743, that restrains both voluntary and involuntary transfer of the settlor's qualified interest."

Section 64.2-743 has minimal requirements and appears to state that it is sufficient to only have a statement that the interest of a beneficiary is held subject to a spendthrift trust. See above 1 D.

9. No Veto. The settlor cannot have the right to disapprove of distributions from the trust. The settlor cannot be able to instruct the trustee not to make distributions while the settlor is going through a divorce, is in financial trouble or has had a judgment entered against the settlor. Once the money comes out of the trust to the bank account of the settlor, the creditor of the settlor can obtain a court order to seize the funds in the bank account of the settlor. In such instances, the QSSST should empower the trustee to make payments directly to people or institutions that provide services or goods to the settlor.

IV. Definition of a Revocable Trust under the QSSST.

One of the most significant portions of this statute is the broad definition of what is not a revocable trust found under Section 64.2-745.2 (D). To qualify as a QSSST, the trust must be irrevocable. There are provisions in this statute that you would normally think would make the trust revocable, but this statute says they are not revocable. A trust is ***not revocable*** under any of the following circumstances:

1. Limited Power of Appointment. The settlor may retain a power of appointment that is effective on the death of the settlor over the assets in the QSSST, as long as the settlor cannot appoint the property to the settlor's estate or the creditors of the settlor's estate. It will be common that the client will want the assets in the QSSST not to be part of the client's estate. Therefore, the client would not want the power to appoint the assets to the estate of client or the creditors of the client because this would be deemed a general power of appointment and would result in the inclusion of all of the assets in the QSSST in the estate of the client. Use of this limited power could result in the inclusion of the trust assets in the estate of the settlor or an incomplete gift. Treas. Reg. Section 25.2511-2(b).

2. Qualified Interest. Even though the settlor retains an interest that is a qualified interest as defined under the statute, the trust is not deemed to be a revocable trust. This clarifies that such a qualified interest will not subject the trust to creditors of the settlor because it is a revocable trust. If the settlor's interest is not a qualified interest (trustee is not an independent qualified trustee) and assets are distributable according to standards that are not ascertainable, then the trust might be deemed revocable.

3. Ascertainable Standards. If the settlor has a right to receive income or principal subject to ascertainable standards, then the trust is not revocable.

4. Charitable Remainder Trust. It is not revocable if the settlor may receive income or principal from a charitable remainder unitrust or a charitable remainder annuity trust as defined under Section 664(d) of the IRC. The settlor may also have a right to release such interests. This is important enhancement to the use of Charitable Remainder Trusts (CRTs). Prior to this statute, the tax requirement of a CRT to pay out income to the settlor of the trust meant that the CRT was not a good vehicle for asset protection. The creditor could seize the income or attach the income interest of the settlor of the CRT. Now, clients can establish CRTs, obtain income and estate tax benefits, assist their favorite charities and have a source of income that is free from attachment. A major issue for QSSSTs is the possible set aside of a valid Virginia QSSST law under the federal bankruptcy code upon the showing of an intent to delay, hinder or defraud creditors. The use of CRT shows charitable intent and would be a strong counter to any attempt to set aside the CRT under state or federal bankruptcy fraudulent transfer laws. If you are setting up a CRT in the future, except in unusual circumstances, you may want to set up the CRT so as to qualify as a QSSST.

5. 5 & 5 power. Section 2041(b)(2) of the IRC deems that a person's right to receive $5,000 or 5% of the corpus of the principal of the trust per year is not a right that includes the trust corpus in the estate of the beneficiary of the five and five power. Paralleling this section, the new QSSST can provide the settlor an annual distribution of a maximum percentage, not to exceed 5%, of the trust assets and the trust is still a QSSST. This provides substantial flexibility for distributions beyond ascertainable standards.

6. Power to Remove a Trustee. The settlor has the right to remove a trustee and to appoint a new trustee. If the settlor does not like the distributions the settlor is getting, can the settlor remove the trustee and appoint someone else that will invest in assets that provided more income to the settlor? This a common provision in CRTs and such a provision does not include the trust corpus of the CRT in the estate of the settlor. My concern here is that in the case of a trust that is not a CRT that a power to remove a trustee may include the trust assets in the taxable estate of the settlor. If non-charitable cases, in most cases, I will probably use a trust protector to remove trustees and not give the settlor this power.

7. Qualified Personal Residence Trust. The use of the settlor of a personal residence under a qualified personal residence trust under IRS Section 2702 (c) does not make the trust revocable. Without this provision, the use of a qualified personal residence may not qualify under the ascertainable standards or as a 5 and 5 power. It is my experience that the Delaware APT statute cannot be successfully used to protect a personal residence outside of Delaware. The use of QSSSTs to protect personal residences is one of the most useful aspects of this statute as discussed below. Every estate plan should consider using a QSSST for the personal residence.

8. Annuity. The settlor can receive a qualified annuity under Section 2702.

9. Estate Expenses. A qualified trustee can have the power to pay, after death of the settlor, the debts of the settlor, costs for administering the estate of the settlor and any “estate inheritance taxes” on the settlor’s estate. What is the meaning of “estate inheritance taxes”? Does this include federal estate taxes? The UTC does not define what is an inheritance tax. Section 64.2-701. Section 58.1-901 is the definition section of the Virginia Estate tax and does not contain a definition of estate or inheritance taxes, other than a reference to taxable estate of decedent under federal law. Section 58.1-935 states that the terms in that Article are defined under Chapter 13 of subchapter B of the IRC, but the Article appears to only cover recapture of tax regarding special use valuations. Some commentators refer to the estate tax as an inheritance tax and others state that an inheritance tax is not the same as an estate tax. Given this uncertainty, it may be best not to provide a power to pay federal estate taxes. In many cases, QSSSTs will be used to provide a backup source of funds for the settlor and the main intent of the QSSST will be mainly to provide benefits for persons other than the settlor. Where so used, usually the settlor will want to make a completed gift so that the assets are no longer part of the taxable estate of the settlor. In many instances, you will not want to include a power to pay debts or taxes of a deceased settlor because that would include the QSSST assets in the taxable estate of the settlor. It should be noted that a “qualified trustee” does not have to be independent trustee and therefore the power to pay debts and estate inheritance taxes could be given to the surviving spouse, child or sibling.

10. Income Taxes. The trust is still irrevocable even if the trust can pay the income taxes directly or indirectly of the settlor on taxable income distributed to settlor. Because distributions are to be made in the discretion of an independent qualified trustee, the QSSST will be a complex trust under the IRC. Under a complex trust, if income is not distributed, then the trust pays the tax on the undistributed income. If the trust distributes income to a beneficiary, the beneficiary will be liable for the tax on the taxable income received from the trust. This may or may not be a provision that you would want to include in the QSSST. The QSSST could pay expenses of the settlor directly to the tax authorities on such income distributed for the benefit of the settlor. Therefore, even tax payments do not go through the bank account of the settlor and can be made in avoidance of a judgment. However, such a provision will include all of the assets in the taxable estate of the settlor. Rev. Rul. 2004-64, 2004-2 C.B. 7.

V. Present and Future Creditors

A. Future Creditors.

Future creditors will not have to right to execute a judgment against the assets in the QSSST, except where the future creditor can prove that the settlor's transfer was made with the intent to delay, hinder or defraud creditors. The mere setting up of the QSSST and transferring assets to it is deemed by this statute not to be proof of an intent to delay, hinder or defraud creditors. However, a QSSST can be set aside under Sections 55-80 and 55-81 for other reasons, such that the transfer to the QSSST rendered the settlor insolvent. This refers to Virginia's fraudulent transfer statutes. Section 55-82.1 authorizes the court to award attorney fees to the creditor who proves a fraudulent transfer.

B. Attached Financial Statement.

It will be advisable to attach to the QSSST a signed and notarized under oath financial statement of the settlor showing that the transfer of the settlor of the assets to the QSSST will not render the settlor insolvent. Future creditors will not have an easy path to set aside properly documented QSSSTs.

C. Present Creditors.

The access of present creditors is only for five years from the date of the transfer of the assets to the QSSST. A collection action initiated five years after the transfer to the QSSST by a creditor of the settlor at the time of transfer will be barred. Also, a key provision is that the QSSST follows a first out, last in allocation system. That is, distributions are allocated first to the most recent distribution. An example:

Sally's Trust. In 2012, Sally sets up a Virginia QSSST for her and her granddaughter Sandra. In 2012, Sally transfers $1,000,000 to the trust. In 2015, Sally transfers another $500,000 to the trust. In 2018, a creditor obtains a judgment against Sally for $2,000,000 for a debt that Sally owed in 2012 when she set up the QSSST. Even with the $2,000,000 judgment, Sally is not bankrupt. Since the creditor's judgment was entered more than five years after Sally's transfer of the $1,000,000 in 2012, the creditor cannot execute the judgment against the $1,000,000 Sally transferred in 2012 to the QSSST. The creditor requests that the Court distribute to the creditor the $500,000 transferred in 2015, a transfer made less than five years from the judgment in 2018. However, the trustee of the QSSST has distributed $500,000 from the QSSST to Sally and Sandra prior to the judgment of the creditor. Because the $500,000 distribution is deemed to have been made from the latest transfer in 2015 (Section 64.2-745.1 F. 3.), there are no funds in the QSSST that are subject to execution of the creditor's judgment.

VI. State Fraudulent Transfer Statures.

A court may set aside the asset protection of a QSSST in the event of a transfer by the settlor with the intent to delay, hinder or defraud creditors for the purposes of Section 55-80 and 55-81. See *Fox Rest Associates v. Little, Record No. 100434 (September 16, 2011)*. Those sections do not provide a further definition of these terms, except that Section 55-80 extends transfers to include a gift, conveyance, assignment, transfer or incursion upon a property, real or personal. Section 50-80 does not undue a sale to a purchaser for valuable consideration who had no knowledge of the fraudulent intent of the transferor. Such transfer could include not only transfers to a QSSST, but also to a LLC, partnership or corporation.

A recent Virginia Supreme Court case sets forth some useful guidelines as to what is an intent to delay, hinder or defraud creditors under Virginia law. *Fox Rest Associates v. Little, Record No. 100434 (September 16, 2011)*. The issue was whether the creditor had presented a prima facie case that the debtor had made a fraudulent transfer under Sections 55-80 and 55-81. The Court did not find fraudulent intent for all of the transfers made. The Virginia Supreme Court ruled that the creditor did present a prima facie case for certain transfers. The Court noted that in a suit to set aside a fraudulent conveyance proof of the fraudulent intent must be "clear, cogent and convincing" and that because of the difficulty of establishing actual intent, evidences of fraud may be and must be circumstantial. *In re: Porter, 37 B.R. 56, 63 (E.D.Va 1984)*.

In *Fox Rest Associates*, the Court notes that Virginia courts have relied upon the following badges of fraud:

(1) Retention of an interest in the transferred property by the transferor. This will be the case in all QSSSTs. Presumably, the provision of the QSSST statute that the mere execution and transfer of assets to the QSSST may make this factor not applicable in certain cases.

(2) Transfer between family members for allegedly antecedent debt. This may not be factor in most QSSSTs.

(3) Pursuit of the transferor or threat of litigation by his creditors at the time of the transfer. The time to set up a QSSST is when the settlor is not in financial trouble. It is common practice in asset protection planning to have the settlor execute a statement regarding the debts of the settlor and any existing or anticipated claims.

(4) Lack of or gross inadequacy of consideration for the transfer. In most QSSSTs, the main intent will be to make gifts to family members or charities and often there will not be full consideration. However, with a

transfer to a LLC, the client is supposed to receive back a LLC membership interest equal to what the client transferred to the LLC.

(5) Retention or possession of the property by transferor. In a QSSST for financial assets, the trustee, not the settlor will retain possession of the trust assets. With a QPRT, the settlor retains possession of the property for a limited time period. However, a QPRT is specifically deemed protected under the new QSSST law.

(6) Fraudulent incurrence of the indebtedness after the conveyance. *In re: Porter, 37 B.R. at 63*. This means there needs to be annual review of the operation of the QSSST.

As can be seen from this discussion, there should be careful planning and implementation of the QSSST to avoid a claim of a fraudulent conveyance.

VII. Federal Bankruptcy Law

A. Section 548(e) Attack on APTs

Section 548(e) was added to the Federal Bankruptcy Code in 2005 to close the self-settled spendthrift trust loophole and was directed at the five states that permitted such transfers at the time. The main purpose was to provide the bankruptcy estate representative with an extended reach back period for QSSSTs. The actual intent for a fraudulent transfer in Section 548(e)(1)(D) is identical to the standard found in Section 548(a)(A) for setting aside other fraudulent transfers and obligations. *Battley v. Mortensen, No. A09-90036-DMD, US Bankruptcy Court for the District of Alaska (May 26, 2011)*.

B. Provisions of Section 548 (e)

Section 548(e) provides:

> (e)(1) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or ***within 10*** *years* before the date of the filing of the petition, if-
>
> (A) such transfer was made to a self-settled trust or similar device;
>
> (B) such transfer was by the debtor;
>
> (C) the debtor is a beneficiary of such trust or similar device; and

> (D) the debtor made such transfer with actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted. ***(emphasis added).***

If Section 548 (e) applies to a Virginia QSSST, then a present and a future creditor of the settlor has the ability to petition the bankruptcy court to set aside the QSSST. It appears that all Virginia QSSSTs will meet the requirements of A, B and C and issue returns back the question of the intent to hinder, delay of defraud a creditor.

In *Mortensen*, the Bankruptcy Court of Alaska held the Alaska Asset Protection Trust drafted by Mortensen, a non-lawyer, could be set aside in his bankruptcy proceeding. The Court found that Mortensen had complied with the Alaska APT statute and was solvent at the time of the transfer. The *Mortensen* Court set aside the APT based upon several factors: Mortensen ran up large credit card debt after he transferred the house to the APT. The Mortensen APT explicitly stated that the purpose of the trust was the protection of the trust estate from creditors' claims. Although such language of intent could not be used under Alaska law to defeat the APT, it could be used under federal bankruptcy law. Mortensen put into the trust $80,000 in addition to the recreational residential property. The Judge did not believe Mortensen's testimony that the trust repaid the $80,000 Mortensen put into the trust. The trust was not used just to protect the future inheritance of his children because the trust made speculative stock investments. The Court looked as his continued steady decreases in income, mounting credit card debt and statements of financial strife after his divorce. See Jennifer L. Moccia, Virginia State Bar Trusts and Estates Section, Newsletter, Vol. 22, No 6., page 4.

There is substantial debate on the impact of the *Mortensen* decision. It affirms the right of the bankruptcy court to set aside a QSSST when a fraudulent intent can be shown. However, on other hand, if the settlor does not file bankruptcy or is not forced into bankruptcy by his creditors, then this federal 10 year look back does not apply. It means that QSSSTs should be only used in appropriate circumstances.

VIII. Completed Gifts and Taxable Estate

A. PLR 98377007

The Internal Revenue Service (Service) issued Private Letter Ruling 98377007 that a gift to an Alaska self-settled spendthrift trust could result in a completed gift. Usually, if a settlor retains life estate in a property or subjects it to any power over its disposition, then the assets are included in the estate of the settlor upon the death of the settlor and there is no completed gift. IRC 2036(a) (1); Treas. Reg. 25.2511-2(b). In Rev Rul. 77-378, 1972, C.H. 348, the Service held that there was a completed gift where an independent trustee had complete discretion as to distributions to the settlor and settlor could not change the disposition of trust assets upon his death. The Service did not rule on whether the assets were part of the taxable estate on the settlor.

B. PLR 200944002

In PLR 200944002, the Service ruled that the transfer of the assets of settlor to a QSSST under the laws of the applicable state was a completed gift and the assets were not part of the taxable estate of the settlor. This letter ruling provides persuasive guidance on how to establish a QSSST where the transfers to the QSSST will be completed gifts and the assets of the QSSST will not be part of the taxable estate of the settlor.

The following are factors considered by the Service:

(1) Qualified Independent Trustee. There was a Trust Company as the trustee. Persons deemed not as independent qualified trustees under the Virginia QSSST, such as a spouse or children, were prohibited by the trust agreement to serve as a trustee.

(2) Sole discretion. The Trustee had sole and absolute discretion to make distributions for the benefit of the grantor, the grantor' spouse and the grantor's descendants.

(3) Not a Beneficiary if the Trust Terminates. The settlor could not be a beneficiary of the trust if the trust terminates and the assets are distributed to the beneficiaries.

(4) Death Distributions Not Controlled by Settlor. Settlor did not retain a power to change the distributions of trust assets upon the death of the settlor. Under the trust agreement referenced in the PLR, the assets must be distributed to separate share trusts of each descendant. If there are no descendants, then the trustee allocates the assets to qualified charities. Treas. Reg. Section 25.2511-2(b).

(5) No Power to Reacquire the Property. The settlor had no power to reacquire the property except for full consideration and after the Trustee exercises fiduciary responsibility in the transfer of such property.

(6) No Taxes paid. The Trustee may not use the income or assets of the trust to pay the income taxes of the settlor due to distributions to the settlor. In Rev. Rul. 2004-64, 2004-2 C.B. 7, the Service ruled that the power of the trustee to pay the income taxes of the settlor included the full value of trust assets into the estate of the settlor.

(7) Creditor of Settlor may not reach assets. Under the state QSSST provisions and the trust agreement, creditors of the settlor were limited in their ability to execute a judgment against settlor. Therefore, for the trust assets to be not included in the estate of the settlor, it should probably be set up as a QSSST.

IX. Comparison of LLC and a Qualified Personal Residence Trust formed as QSST.

	LLC Stocks & Bonds	LLC Residence	QSSST Stocks & Bonds	QPRT Residence
Not subject to future creditors excluding fraud	YES	?	YES	YES
Not subject to future creditors if fraud	NO	NO	NO	NO
Not subject to 10 year statue for APT's in bankruptcy	YES	YES	NO	?
Completed Gifts	YES	?	YES	YES
Not part of Estate	NO	?	YES	YES
Right of Possession	YES	?	NO	YES
Easy for Lenders	NO	NO	NO	NO

X. Qualified Personal Residence Trust as a QSSST.

Prior to the Virginia QSSST statute, there were many drawbacks as to the use of an LLC to own a personal residence as a means of asset protection for the residence. Usually, LLCs are used for non-personal use assets. The retention of a right to reside at the residence owned by an LLC probably would result in the inclusion of the property in the taxable estate of the settlor. But if QPRT regulations are complied with and the settlor lives beyond the time period, then the residence will not be part of the taxable estate of the settlor under IRC Section 2702. Also, with a QPRT, the only other funds that may be placed in the QPRT are reasonable cash needed for cash expenses. Treas. Reg. 25.2702-5 (c)(5). This also helps to prove that the trust was a legitimate estate planning tool that was not created to avoid creditors.

Example. Alice and Fred have been married for 35 years and the only children they have are children of both spouses. They are retired and own a residence in Fairfax County worth $800,000 with no debt. The other assets they have are worth $1.5 million. If the QPRT takes their assets out of their taxable estate, Alice and Fred will not have a taxable estate even if the exemptions for estate taxes returns to $1 million per person in 2013 by the use of husband and wife revocable trusts. They will not be insolvent as a result of the transfer to the QPRT which is formed as a QSSST. The QPRT trust is written to also be a QSSST. Alice and Fred attached a financial statement and a statement that they had no knowledge of pending or threatened collection actions against them. Their counsel reviews with them annually their situation. They have protected their home from all future creditors and from present creditors after five years from the date of the QPRT.

For every new estate planned for a Virginia resident on or after July 1, 2012, the client family should seriously consider forming a QPRT that is also a QSSST.