

# ASSET PROTECTION (FOR THE RICH AND NOT) IN IOWA

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## I. INTRODUCTION

In 2001, Congress and the President enacted a slow and partial death to the federal estate tax.<sup>1</sup> On April 13, 2005, the House of Representatives voted 272 to 162 to finish the job by making the estate tax repeal permanent after 2010.<sup>2</sup> The Republican-controlled Senate came within three votes of a complete repeal.<sup>3</sup> With Democrats controlling the House and Senate following the 2006 election, a subsequent vote on the repeal of the estate tax is unlikely. Although the estate tax will likely continue, fewer individuals have the need or the desire to engage in estate tax planning.<sup>4</sup>

Alternatively, with an increasing number of lawsuits being filed, it is no wonder that many individuals may perceive a growing threat to their wealth from creditors rather than taxes.<sup>5</sup> Even federal bankruptcy laws will not protect individuals from creditors as a result of recent revisions made to the bankruptcy laws by Congress and signed by the President on

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1. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 511(a), 115 Stat. 38, 70.

2. H.R. 8, 109th Cong.; 151 CONG. REC. H1942 (daily ed. Apr. 13, 2005) (tally of House vote) (1st Sess. 2005).

3. 152 CONG. REC. S5628 (daily ed. June 8, 2006).

4. See Edmund L. Andrews, *Death Tax? Double Tax? For Most, It's No Tax*, N.Y. TIMES, Aug. 14, 2005, at BU4 (presenting statistics on the small number of estates actually affected by the estate tax).

5. See *A Rising Tide of Torts*, 71 N.Y. ST. B.J., Apr. 1999, at 40, 47.

April 20, 2005.<sup>6</sup>

Several states have revised their trust laws in recent years to allow individuals to protect their assets from claims of creditors. Some states are doing so by relaxing the rule against perpetuities.<sup>7</sup> Others have enacted laws allowing a grantor to create trusts in which the grantor is a beneficiary,

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6. Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005, Pub. L. No. 109-8, 119 Stat. 23. BAPCPA will require thousands of debtors to enter Chapter 13 and work out a plan to repay their creditors who before would have qualified for discharge under Chapter 7. *Id.* § 102. BAPCPA applies a means test: those with income above the state's median income who can pay at least \$6,000 over five years— \$100 per month— would be forced into Chapter 13, in which a judge would order a repayment plan. *Id.* Debtors who earn less than the median income in the state in which they live will remain in Chapter 7. *Id.*

Additionally, BAPCPA gives top priority to a spouse's claims for child support and restricts the homestead exemption in states to \$125,000 if the debtor in bankruptcy bought the residence less than three years and four months before filing. *Id.* §§ 312, 322. Florida, Iowa, Kansas, South Dakota, and Texas have unlimited homestead exemptions that allow debtors to file for bankruptcy and keep their homes sheltered from creditors. *See* FLA. CONST. art. 10, § 4; IOWA CODE § 561.16 (2007); KAN. STAT. ANN. § 60-2301 (2005); S.D. CODIFIED LAWS § 43-31-1 (Supp. 2007); TEX. PROP. CODE ANN. § 41.001 (Supp. 2006). BAPCPA has also limited pre-petition asset planning by adopting new § 522(o). 11 U.S.C. § 522(o) (West Supp. 2007). Section 522(o) reduces the value of a debtor's homestead for purposes of a state homestead exemption to the extent of any addition to the value of the homestead on account of a disposition of nonexempt property made by the debtor ("with the intent to hinder, delay, or defraud a creditor") during the ten years prior to the bankruptcy filing. *Id.* This would seem to apply to any extraordinary mortgage payment made shortly before the petition date.

7. Sixteen states and the District of Columbia have eliminated the rule against perpetuities. ALASKA STAT. §§ 34.27.051, 34.27.100 (2006); ARIZ. REV. STAT. ANN. § 14-2901(A) (2005); DEL. CODE ANN. tit. 25, § 503 (Supp. 2007); D.C. CODE § 19-904(a)(10) (Supp. 2007); IDAHO CODE ANN. § 55-111 (2007); 765 ILL. COMP. STAT. ANN. 305/4(a)(8), 305/3(a-5) (West 2001); ME. REV. STAT. ANN. tit. 33, § 101-A (Supp. 2006); MO. ANN. STAT. § 456.025 (West 2007); NEB. REV. STAT. § 76-2005(9) (2004); N.H. REV. STAT. ANN. § 564:24 (2006); N.J. STAT. ANN. §§ 46:2F-9 to 46:2F-11 (West 2003); OHIO REV. CODE ANN. § 2131.09(B) (West 2002); 20 PA. CONS. STAT. ANN. § 6107.1(b)(1) (West Supp. 2007); R.I. GEN. LAWS § 34-11-38 (Supp. 2006); S.D. CODIFIED LAWS §§ 43-5-1, 43-5-8 (2004); VA. CODE ANN. § 55-13.3(C) (2003); WIS. STAT. § 700.16(1)(a) (2001).

Six states permit exceptionally long term trusts. COLO. REV. STAT. § 15-11-1102.5 (2006) (1,000 years); FLA. STAT. ANN. § 689.225 (West Supp. 2007) (360 years); NEV. REV. STAT. § 111.1031 (2005) (365 years); UTAH CODE ANN. § 75-2-1203 (Supp. 2007) (1,000 years); WASH. REV. CODE ANN. § 11.98.130 (West 2006) (150 years); WYO. STAT. ANN. § 34-1-139 (2007) (1,000 years). Iowa follows a modified common law rule against perpetuities whereby the period of the rule is measured by actual events rather than possible events. IOWA CODE § 558.68.

but the assets are exempt from the grantor's creditors. This specialized type of trust is known as a self-settled, spendthrift trust.<sup>8</sup> As a result, billions of dollars are flowing into trusts established for asset protection purposes.<sup>9</sup>

This Article will discuss basic asset protection techniques in Iowa utilizing trusts, disclaimers, limited liability companies, and limited partnerships. It will also discuss the current status of retirement plans, including IRAs, as asset protection devices. Finally, this Article will address the issue of when protection of assets may amount to a fraudulent transfer of assets and expose clients and attorneys to liability.

## II. CONVERSION OF NONEXEMPT ASSETS TO EXEMPT ASSETS

Exempt property is statutorily defined and cannot be claimed by unsecured creditors for the unpaid debts of debtors.<sup>10</sup> Examples of exempt property in Iowa include clothing, household furnishings, and homesteads.<sup>11</sup> Very little Iowa case law exists regarding the conversion of nonexempt property to exempt property in order to avoid the claims of creditors.<sup>12</sup> The Iowa Supreme Court's 1929 decision in *American Savings Bank of Marengo v. Willenbrock* addressed a dispute involving a judgment creditor seeking collection of a debtor's exempt property.<sup>13</sup> The court, citing cases from the Eighth and Ninth Circuits, expressed what it believed to be the general rule: a debtor's conversion of her assets from nonexempt to exempt does not of itself vest the creditor with the right to seek collection from the exempt asset for payment of the debtor's debts.<sup>14</sup>

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8. See discussion *infra* Part II.A.

9. Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356, 359 (2005).

10. In the case of an individual debtor, Iowa law provides a list of certain property interests that are exempt from the claims of a debtor's creditors. IOWA CODE § 627.6. In addition to the general exemptions, Iowa law exempts a debtor's homestead with some limitations, not the least of which is BAPCPA. See *supra* note 6; IOWA CODE § 561.16 ("The homestead of every person is exempt from judicial sale where there is no special declaration of statute to the contrary.").

11. IOWA CODE § 627.6.

12. *In re Krantz*, 97 B.R. 514, 521 (Bankr. N.D. Iowa 1989) ("The issue facing the Court today has rarely, if ever, been directly addressed by the Iowa Supreme Court.").

13. *Am. Sav. Bank of Marengo v. Willenbrock*, 228 N.W. 295, 297 (Iowa 1929).

14. *Id.* at 299–300 (citing *In re Wilson*, 123 F. 20, 22 (9th Cir. 1903); *First Nat'l Bank v. Glass*, 79 F. 706, 707 (8th Cir. 1897)). Iowa exemption statutes are interpreted

Further, the *Willenbrock* court suggested that such a conversion cannot be considered fraud.<sup>15</sup>

There are, however, a few statutory exceptions to the general rule as pronounced in *Willenbrock*. The homestead of a debtor may be subject to the debtor's debts existing prior to the purchase of the homestead; however, the creditor must have first exhausted all of the debtor's other non-exempt property.<sup>16</sup> In addition, any debt incurred "for work done or material furnished exclusively for the improvement of the homestead" may attach to the debtor's homestead.<sup>17</sup>

Most of the cases examining Iowa's exemption statutes, however, are not from Iowa courts. Rather, most of the Iowa case law in this area comes from federal bankruptcy courts. The Bankruptcy Code allows a debtor who has filed a petition in bankruptcy to choose between the list of exempt property allowed by the Bankruptcy Code or the exemption laws of the debtor's domicile.<sup>18</sup> If a debtor chooses the state law exemptions, the scope of the claim is determined pursuant to state law, which is interpreted liberally to the benefit of the debtor.<sup>19</sup> The bankruptcy court frequently cites the *Willenbrock* case as its interpretation of Iowa's law on the conversion of nonexempt property to exempt property.<sup>20</sup> In acknowledging that Iowa's law allows for the conversion of non-exempt property into exempt property in order to defeat the claims of creditors, the bankruptcy court has placed certain limits on debtors.<sup>21</sup> When "extrinsic evidence of fraud" is proven with respect to such conversion, the bankruptcy court will deny the debtor's discharge and apply the proceeds of the exempt property to the claims of the debtor's creditors.<sup>22</sup> The courts have had difficulty

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liberally in order to effectuate the purpose of the statute. *Willenbrock*, 228 N.W. at 299.

15. *Id.* ("Nor can the use of property that is not exempt from execution to procure a homestead be held to be a fraud upon the creditors of an insolvent debtor, because that which the law expressly sanctions and permits cannot be a legal fraud.").

16. IOWA CODE § 561.21(1); *In re Allen*, 301 B.R. 55, 61 (Bankr. S.D. Iowa 2003). Iowa Code § 561.20, however, allows a debtor to transfer his exemption rights in an old homestead to a new homestead "to the extent of the value of the old." *In re White*, 293 B.R. 1, 5 (Bankr. N.D. Iowa 2003).

17. IOWA CODE § 561.21(3).

18. 11 U.S.C. § 522(b) & (d) (2000).

19. *In re McCabe*, 280 B.R. 841, 844 (Bankr. N.D. Iowa 2002).

20. *Id.*; *In re Krantz*, 97 B.R. 514, 521 (Bankr. N.D. Iowa 1989).

21. *Norwest Bank Neb., N.A. v. Tveten*, 848 F.2d 871, 873-74 (8th Cir. 1988).

22. *Id.* at 874.

defining “extrinsic fraud” and it is often a fact-driven test.<sup>23</sup> The Eighth Circuit, in *Panuska v. Johnson*, described extrinsic fraud as “further conduct intentionally designed to materially mislead or deceive creditors about the debtor’s position; conveyances for less than fair value; or, the continued retention, benefit or use of property allegedly conveyed together with evidence that the conveyance was for inadequate consideration.”<sup>24</sup> When an exemption statute is unlimited in amount, a debtor’s conversion of a significant amount of non-exempt assets to exempt assets on the eve of bankruptcy filing will constitute extrinsic evidence of fraud.<sup>25</sup>

In *Norwest Bank Nebraska, N.A. v. Tveten*, a debtor’s conversion of \$700,000 of nonexempt property into exempt life insurance contracts immediately before filing his bankruptcy petition was considered extrinsic evidence of fraud.<sup>26</sup> The court noted that most exemption statutes comport with the federal policy of providing debtors with a “fresh start.”<sup>27</sup> However, the state law exemption for life insurance contracts, which was unlimited in amount, allows the potential for unlimited abuse.<sup>28</sup> Allowing the debtor to retain \$700,000 of converted exempt insurance contracts “would constitute a perversion of the purposes of the Bankruptcy Code.”<sup>29</sup>

In *In re Krantz*, a debtor converted over \$500,000 of cash and other non-exempt assets to exempt life insurance more than a year before filing for bankruptcy.<sup>30</sup> Despite the lengthy time period, the bankruptcy court held the amount of exempt life insurance would amount to “manifest injustice” if it were allowed to pass through bankruptcy to the debtor.<sup>31</sup> The court made note of the testimony of the debtor who indicated he “converted the non-exempt property into exemptible life insurance so that the Federal Land Bank could not reach the property.”<sup>32</sup>

In *Jensen v. Dietz*, the debtor, ninety years old and living in an assisted living facility, liquidated his bank account and purchased a newly

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23. *In re Krantz*, 97 B.R. at 521–22.

24. *Panuska v. Johnson (In re Johnson)*, 880 F.2d 78, 82 (8th Cir. 1989).

25. *Tveten*, 848 F.2d at 874.

26. *Norwest Bank Nebraska, N.A. v. Tveten*, 848 F.2d 871, 872–73, 876–77 (8th Cir. 1988).

27. *Id.* at 875.

28. *Id.* at 876.

29. *Id.* (quoting *In re Reed*, 700 F.2d 986, 992 (5th Cir. 1983)).

30. *In re Krantz*, 97 B.R. 514, 524 (Bankr. N.D. Iowa 1989).

31. *Id.* at 528.

32. *Id.*

built house.<sup>33</sup> The house carried property taxes of \$2,000, which was greater than the debtor's \$600 of disposable income from social security.<sup>34</sup> The Eighth Circuit determined that a debtor's investment in exempt assets that is unwise, uneconomical, or unusual from the debtor's perspective satisfied the extrinsic fraud requirement.<sup>35</sup> Unfortunately, the court's unenlightening explanation of fraudulent intent provides very little guidance:

It is one thing to convert non-exempt assets into exempt property for the express purpose of holding it as a homestead and thereby putting the property beyond the reach of creditors. However, it is quite another thing to acquire title to a house for no other reason than to defraud creditors.<sup>36</sup>

“Absent extrinsic evidence of fraud, mere conversion of non-exempt property to exempt property is not fraudulent as to creditors even if the motivation behind the conversion is to place those assets beyond the reach of creditors.”<sup>37</sup> Such transfers of non-exempt property into exempt property in Iowa have included: \$22,000 to purchase a 1876 Winchester rifle shortly before filing bankruptcy,<sup>38</sup> \$53,600 worth of exemptions and life insurance,<sup>39</sup> and a transfer of approximately \$55,000 into the debtor's homestead.<sup>40</sup>

In a recent bankruptcy court case applying Iowa exemption law, the debtor, Lawrence McCabe, made it known that his purchase of a Browning Belgium shotgun, valued at \$10,320, was based on his attorney's recommendation.<sup>41</sup> When McCabe purchased the shotgun he knew it would be claimed exempt.<sup>42</sup> He testified that he “probably would not” have purchased the shotgun if it had not been an exemptible item.<sup>43</sup>

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33. Jensen v. Dietz (*In re Sholdan*), 217 F.3d 1006, 1010 (8th Cir. 2000).

34. *Id.*

35. *Id.* at 1010–11.

36. *Id.* at 1011 (citing Kangas v. Robie, 264 F. 92, 93–94 (8th Cir. 1920)).

37. Norwest Bank Neb., N.A. v. Tveten, 848 F.2d 871, 874 (8th Cir. 1988).

38. *In re Eichelberger*, No. L-89-00013W (Bankr. N.D. Iowa Sept. 29, 1989), available at <http://www.ianb.uscourts.gov> (search “Opinions” for “Eichelberger” selecting all judges and years).

39. Samore v. Breuer (*In re Breuer*), 68 B.R. 48, 49 (Bankr. N.D. Iowa 1985).

40. Fed. Land Bank of Omaha v. Ellingson (*In re Ellingson*), 63 B.R. 271, 279 (Bankr. N.D. Iowa 1986).

41. *In re McCabe*, 280 B.R. 841, 844 (Bankr. N.D. Iowa 2002).

42. *Id.*

43. *Id.*

Furthermore, McCabe asserted that if financial circumstances required, he would potentially sell the shotgun.<sup>44</sup> The court concluded that although it is clear that “[t]he gun merely serves as an alternative form of cash for as long as Debtor elects to keep it . . . the purchase of a shotgun, even a very expensive one, does not violate [the exemption].”<sup>45</sup>

In short, the bankruptcy court gives a great deal of deference to the debtor. Absent extrinsic evidence of fraud, mere conversion of non-exempt property to exempt property is not fraudulent as to creditors even if the motivation behind the conversion is to place those assets beyond the reach of creditors. The court in *In re Eichelberger*, provides a colorful description that seems to encompass the sentiment of the bankruptcy courts: “Debtor . . . may very well be ‘thumbing his nose’ at his creditors by spending \$10,000 on a Christmas vacation, \$6,090 for dog obedience school, and \$22,000 for a rifle. However, such a callous attitude toward his creditors does not, in and of itself, constitute extrinsic evidence of fraud.”<sup>46</sup> However, when a pig becomes a hog, it goes to slaughter.<sup>47</sup> Thus, when a debtor attempts to convert non-exempt assets on or about the eve of filing a bankruptcy petition, the conversion of assets can be considered fraudulent.<sup>48</sup>

### III. TRUSTS

#### A. Spendthrift Trusts

##### 1. Protection of Trust Assets from Beneficiaries’ Creditors

Clearly, in the context of trusts, the heart of asset protection planning is the spendthrift provision. Without it, beneficiaries would be entitled to assign, transfer, or sell their beneficial interests in the trust and their creditors could levy or foreclose on such interest.<sup>49</sup> A spendthrift is a

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44. *Id.*

45. *Id.* at 846.

46. *In re Eichelberger*, No. L-89-00013W (Bankr. N.D. Iowa Sept. 29, 1989), available at <http://www.ianb.uscourts.gov> (search “Opinions” for “Eichelberger” selecting all judges and years).

47. *In re Krantz*, 97 B.R. 514, 525 (Bankr. N.D. Iowa 1989) (citing *In re Zouhar*, 10 B.R. 154, 157 (Bankr. D.N.M. 1981)).

48. See *In re Zouhar*, 10 B.R. at 156 (the conversion of \$130,00 by the debtor was considered to be fraudulent).

49. See RESTATEMENT (THIRD) OF TRUSTS § 51 cmt. a (2003). However, the assignee has only what the beneficiary had; thus, if the trust were a pure discretionary



person “who spends lavishly and wastefully.”<sup>50</sup> A spendthrift trust, which is designed to protect the spendthrift from his own wasteful spending, is “[a] trust that prohibits the beneficiary’s interest from being assigned and also prevents a creditor from attaching that interest [or] a trust by the terms of which a valid restraint is imposed on the voluntary or involuntary transfer of the beneficiary’s interest.”<sup>51</sup>

English common law historically did not recognize a spendthrift trust’s authority to protect trust assets from a beneficiary’s creditors. The United States Supreme Court broke from English common law in 1875 by authorizing the use of spendthrift trusts.<sup>52</sup> The theoretical basis underlying the acceptance of spendthrift trust provisions in the United States is based on the idea that an individual should be able to transfer property subject to certain limiting conditions upon which the property will be available to the beneficiary.<sup>53</sup> In this regard, the maxim “*cujus est dare, ejus est disponere*,” or “whose it is to give, his it is to dispose” is frequently cited in connection with references to the validity of spendthrift trust restrictions.<sup>54</sup>

Since the Supreme Court’s decision in 1875, every state has adopted or enacted some form of a spendthrift trust provision, although the provisions are not uniform among the states.<sup>55</sup> In Iowa, the spendthrift trust was first cited in the 1907 Iowa Supreme Court case of *Olsen v. Youngerman*.<sup>56</sup> Spendthrift trusts are currently authorized under Iowa Code section 633A.2301.<sup>57</sup>

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trust, the assignee would only be entitled to distributions from the trust that the trustee decides she wants to make. *Id.* § 60 cmt. b.

50. BLACK’S LAW DICTIONARY 1436 (8th ed. 2004).

51. *Id.* at 1552.

52. *Nichols v. Eaton*, 91 U.S. 716, 730 (1875).

53. *Id.*; see also *Roorda v. Roorda*, 300 N.W. 294, 297 (Iowa 1941) (“[I]t is well settled in this jurisdiction that a testator has the right to dispose of his estate as he desires.”).

54. *In re Quinn*, 299 B.R. 450, 457 (Bankr. W.D. Mich. 2003).

55. See GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 222 (2d ed. 1992) (containing a summary of all the states’ laws on spendthrift trust provisions).

56. *Olsen v. Youngerman*, 113 N.W. 938, 939 (Iowa 1907). The *Olsen* case had nothing to do with the merits of the spendthrift provision in the trust. *Id.* at 938–41. No creditors were involved and no assignment or transfer of a beneficial interest was addressed. *Id.* at 939. The issue in *Olsen* was whether the trust could be terminated because it did not serve a material purpose. *Id.* at 939–40. The Iowa Supreme Court simply made an observation that the trust was a spendthrift trust and moved on with its analysis about the other issues of the case. *Id.* at 939.

57. IOWA CODE § 633A.2301 (2007).

There is no particular form required for a spendthrift trust provision; however, the Iowa Code requires that in order for a trust to be a spendthrift trust, it must reference a “spendthrift trust or words of similar import.”<sup>58</sup> A spendthrift provision can be as simple as the following: “the interest of the beneficiary . . . shall not be seized by creditors or said beneficiary or by anyone, by attachment, garnishment, execution or otherwise.”<sup>59</sup>

If a drafter prefers to use a few more words, the following could be used:

No beneficiary shall have the right, power, or authority to assign, transfer, dispose of, pledge, hypothecate, anticipate, encumber, or in any other manner alienate, impair, or create a charge upon the income, principal, or any other benefit devolving from all or any portion of any trust created hereunder to which such beneficiary may be entitled. Likewise, income or principal distributable or which may become distributable to a beneficiary, or any other benefit devolving on a beneficiary with respect to any trust hereunder shall not be subject to seizure, lien, levy, attachment, bankruptcy, transfer, assignment, garnishment, or any other legal process whatsoever, nor shall any such interest in income or principal or any other benefit hereunder be subject to interference or control by any creditor of any beneficiary, nor subject to any claim for alimony or for the support of a spouse pursuant to a decree of separate maintenance or separation agreement, until distribution is actually made to such beneficiary; and, to the extent permitted by applicable law, the trust funds administered hereunder, until actually paid over and distributed to one or more beneficiaries, as herein provided, shall be held by the fiduciaries free and clear of all manner of anticipation or voluntary or involuntary alienation.

## 2. *Exceptions to Spendthrift Trust Protection*

The public policy in favor of spendthrift trusts— whose it is to give, his it is to dispose— competes head-to-head with public policies that favor payment of child (and other dependent) support and providing necessary services and supplies to beneficiaries.<sup>60</sup> Thus, a spendthrift trust provision

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58. *Id.*

59. *See* Emmet County Bd. of Supervisors v. Ridout, 692 N.W.2d 821, 824 (Iowa 2005) (holding such language sufficient to create a spendthrift clause).

60. *See* Nichols v. Eaton, 91 U.S. 716 (1875); *see also supra* text accompanying notes 42–50.

may not protect the trust assets from the beneficiaries' creditors in every instance.

a. *Restatement of the Law.* The *Restatement (Third) of Trusts* sets forth two situations in which a creditor of a beneficiary can attack the trust assets:

The interest of a beneficiary in a valid spendthrift trust can be reached in satisfaction of an enforceable claim against the beneficiary for:

(a) support of a child, spouse, or former spouse;

or

(b) services or supplies provided for necessities or for the protection of the beneficiary's interest in the trust.<sup>61</sup>

The public policy behind allowing the piercing of spendthrift trusts for a beneficiary's child support and alimony obligation is that beneficiaries should not enjoy the beneficial interests in a trust while neglecting to support their dependents.<sup>62</sup> The public policy behind the provision of services and supplies to beneficiaries is rooted in the belief that a beneficiary would be unjustly enriched if the creditors providing necessary supplies and services were prevented from reaching the beneficial interest.<sup>63</sup> Also, there may be a danger that beneficiaries of modest means would find the spendthrift restraint an obstacle to obtaining services essential to the protection or enforcement of their intended rights under the trust.<sup>64</sup>

b. *Tort Creditor Exceptions.* In some jurisdictions, the exceptions to spendthrift protection have expanded to include tort creditors of beneficiaries.<sup>65</sup> In 1997, the Mississippi Supreme Court, in *Sligh v. First National Bank of Holmes County*, ruled that the public policy interests of a beneficiary's tort creditor outweighed the public policy interests of enforcing spendthrift trust provisions.<sup>66</sup> The facts of *Sligh* were worthy of

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61. RESTATEMENT (THIRD) OF TRUSTS § 59 (2003).

62. *Id.* § 59 cmt. b.

63. *Id.* § 59 cmt. d.

64. *Id.* § 59 cmt. c.

65. Louisiana and Oklahoma have statutes that enable a beneficiary's tort creditor to pierce the spendthrift trust liability shield. LA. REV. STAT. ANN. § 9:2005 (2005); OKLA. STAT. ANN. tit. 60, § 175.25 (West 1994 & Supp. 2007).

66. *Sligh v. First Nat'l Bank of Holmes County*, 704 So. 2d 1020, 1027 (Miss. 1997).

public policy considerations. On January 30, 1993, William B. Sligh was seriously injured in a car accident with a drunk, uninsured motorist, Gene Lorange.<sup>67</sup> Lorange had no assets but was a beneficiary of a trust set up by his deceased mother.<sup>68</sup> The trial court heard evidence that Lorange's mother knew he was an alcoholic who regularly drove while drunk, had been involved in numerous car accidents, and had been arrested and convicted on numerous prior occasions for drunk driving.<sup>69</sup>

The trial court also heard evidence that Lorange's mother established the trust as part of an intentional plan "to enable her son to continue to lead his intemperate, debauched, wanton and depraved lifestyle while at the same time shielding his beneficial interest in the trusts from the claims of his involuntary tort creditors."<sup>70</sup> The trial court ruled in favor of the beneficiary.<sup>71</sup> The Mississippi Supreme Court, in a split decision, overturned the lower court and held that as a matter of public policy, a beneficiary's interest in a spendthrift trust is not immune from claims arising out of a beneficiary's intentional or gross negligence.<sup>72</sup>

Although the Mississippi Supreme Court may have been heavy-hearted, the Mississippi legislature obviously was not. Within six months of the *Sligh* ruling, the Mississippi legislature passed the Family Trust Preservation Act of 1998, effectively overruling the Mississippi Supreme Court's holding in *Sligh*.<sup>73</sup>

c. *Federal Tax Liens.* A general federal tax lien attaches to all property and rights to property, both real and personal, tangible and intangible, belonging to a taxpayer.<sup>74</sup> Property includes anything that is subject to ownership, capable of transfer, and subject to jurisdiction and process by a court.<sup>75</sup> State law determines whether a property interest

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67. *Id.* at 1022.

68. *Id.*

69. *Id.* at 1023.

70. *Id.*

71. *Id.*

72. *Id.* at 1029.

73. MISS. CODE ANN. §§ 91-9-501 to -511 (1999).

74. I.R.C. § 6321 (2000).

75. *Citizen's State Bank of Barstow, Tex. v. Vidal*, 114 F.2d 380, 382-83 (10th Cir. 1940). Some courts hold that transferability is not an essential element of a property interest. *In re Orr*, 180 F.3d 656, 663 (5th Cir. 1999) ("[W]e know of no controlling authority which compels the conclusion that transferability is a necessary incident of 'property and rights to property.'").

exists; however, once a property interest has been identified, federal law determines whether the tax lien has validly attached.<sup>76</sup>

State law exemptions from creditors, such as the homestead exemption, do not affect the federal tax lien.<sup>77</sup> Thus, the distinction between a state's exemption and a state's determination of a property right can get a little muddled. Spendthrift trust provisions generally prohibit the assignment or encumbrance of a beneficiary's interest and thus are more like an exemption than a property right.<sup>78</sup> Most federal courts will not immunize trust assets from a federal tax lien just because the trust instrument contains a spendthrift provision.<sup>79</sup>

Most federal courts will, however, provide protection from federal tax liens to trust provisions that provide purely discretionary distribution powers to the trustee.<sup>80</sup> In such a case, the beneficiary has no basis to compel the trustee to make a distribution and therefore no property right exists to which a federal tax lien can attach.<sup>81</sup> When a seemingly discretionary trust instrument has any indicia of "support" included within it, the federal courts have held that a beneficiary has a "property interest" to which a federal tax lien attaches.<sup>82</sup> Frequently, such a distinction rests on the grantor's choice of one of two words in the trust's dispositive provisions— *shall* or *may*.

In *United States v. Delano*, the federal district court compared a trust

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76. See *Drye v. United States*, 528 U.S. 49, 52 (1999); *United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 722–23 (1985); *United States v. Durham Lumber Co.*, 363 U.S. 522, 525 (1960); *Aquilino v. United States*, 363 U.S. 509, 512–14 (1960).

77. See *United States v. Rodgers*, 461 U.S. 677, 690, 692 (1983) (ruling a state law exemption applicable to a spouse's homestead interest does not prevent attachment of a federal tax lien).

78. *First Nw. Trust Co. v. IRS*, 622 F.2d 387, 391 (8th Cir. 1980) (describing the spendthrift provision in a trust instrument as an exemption determined under South Dakota state law); *United States v. Rye*, 550 F.2d 682, 685 (1st Cir. 1977) (stating that a spendthrift trust provision is "merely a state-created exemption . . . and not an aspect of a substantive right"); see also I.R.S. Chief Couns. Adv. Mem. 200036045 (May 16, 2000) (stating that spendthrift provisions are state-created exemptions).

79. See *In re Orr*, 180 F.3d at 663 ("The wishes of the creator of a spendthrift trust cannot overcome the government's need to collect tax and a spendthrift trust beneficiary's duty to pay tax."); *First Nw. Trust Co.*, 622 F.2d at 390 (stating income from a spendthrift trust is not immune from federal tax liens).

80. See I.R.S. Chief Couns. Adv. Mem. 200036045 (May 16, 2000).

81. *Id.*

82. See, e.g., *In re Orr*, 180 F.3d at 664 (stating that the debtor's rights in future income constituted a property interest).

dispositive provision using the term “shall”<sup>83</sup> with the term “may”<sup>84</sup> and held that the former created a property right subject to attachment by a federal tax lien but the latter did not.<sup>85</sup> Other courts that have reviewed dispositive provisions using the word “may” have concluded the beneficiary has no property right to which a federal tax lien can attach.<sup>86</sup>

d. *Self-Settled Trusts*. Until 1997, if a settlor wanted the ability to receive any benefits from his self-settled trust while at the same time protecting the trust assets from creditors, the settlor had to create an off-shore, foreign jurisdiction trust.<sup>87</sup> The foreign jurisdiction selected for an off-shore trust must have a recognition of the “trust” concept and be hostile to attacking creditors.<sup>88</sup> Typically, a foreign jurisdiction will require a higher burden of proof for a creditor to make a fraudulent transfer claim.<sup>89</sup> Discovery rules may be pro-debtor.<sup>90</sup> The statute of limitations applicable to the creditor in foreign jurisdictions may be considerably shorter than in the United States.<sup>91</sup>

Furthermore, the remoteness of a foreign jurisdiction can create significant hurdles for a potential creditor to overcome. A creditor’s attorney will likely know nothing about the foreign jurisdiction’s laws and

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83. United States v. Delano, 182 F. Supp. 2d 1020, 1022 (D. Colo. 2001) (“During my son’s lifetime, my trustee shall pay to or apply for the benefit of my son so much of the income or principal, or both, as my trustee in its sole and absolute discretion shall deem necessary or advisable for his maintenance, health, education, comfort and welfare. My trustee may, but need not, consider all funds known to my trustee to be available to him. Any undistributed income may be added to principal from time to time in the discretion of my trustee.”).

84. *Id.* at 1023 (“[T]he trustees *may* pay or apply for the benefit of the [beneficiaries] . . . in their uncontrolled discretion . . .” (quoting *In re Marriage of Jones*, 812 P.2d 1152, 1156 (Colo. 1991))).

85. *Id.*

86. *E.g., In re Wilson*, 140 B.R. 400, 405 (Bankr. N.D. Tex. 1992) (stating the court cannot compel the trustee to make a distribution to the beneficiary absent fraud, misconduct, or clear abuse of discretion).

87. See Elena Marty-Nelson, *Offshore Asset Protection Trusts: Having Your Cake and Eating It Too*, 47 RUTGERS L. REV. 11, 11–14 (1994) (explaining the rationale behind and protection afforded by the off-shore trust).

88. See *id.* at 59–60.

89. See William C. Smith, *Offshore Trust Busting*, A.B.A. J., Nov. 1999, at 32 (stating the applicable standard of proof is beyond a reasonable doubt).

90. Cf. Barry S. Engel, *Foreign Situs Trusts: An Overview of Various Uses and Applications*, 61 N.Y.U. INST. ON FED. TAX’N § 22.02(4)(c)(vi) (discussing a creditor’s considerations before pursuing assets located in a foreign jurisdiction).

91. Eric Henzy, *Offshore and “Other” Shore Asset Protection Trusts*, 32 VAND. J. TRANSNAT’L L. 739, 741 (1999); Marty-Nelson, *supra* note 87, at 61.

procedures. Additionally, the cost to litigate at a foreign location can be excessive.

In addition to favorable laws to debtors, a foreign jurisdiction should have a stable economy and government before being considered by a debtor. Commentators have identified the following countries as possible sites for asset protection trusts: Anguilla, Antigua, Bahamas, Barbados, Belize, Bermuda, Cayman Islands, Cook Islands, Cyprus, Gibraltar, Marshall Islands, Nevis, Niue, Seychelles, Turks, Caicos, Liechtenstein, Channel Islands (Jersey and Guernsey).<sup>92</sup> Some jurisdictions have developed an entire economy catering to the demand of United States residents establishing asset protection trusts in their countries.<sup>93</sup>

Some of the risks involved in establishing a foreign jurisdiction asset protection trust are as follows: the high costs associated with establishing and maintaining a foreign jurisdiction trust, the trust assets are subject to the uncertain laws of a foreign jurisdiction, and the foreign trustee in possession of the trust assets may not always be trustworthy.<sup>94</sup> More importantly, foreign jurisdiction asset protection trusts may simply not work, as many trust grantors have gone to jail.<sup>95</sup>

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92. HOWARD D. ROSEN & GIDEON ROTHSCHILD, *TAX MANAGEMENT PORTFOLIO, ASSET PROTECTION PLANNING*, NO. 810, A-97 to A-101 (2d ed. 2002); David Brownbill, *The Role of Offshore Jurisdictions in the Development of the International Trust*, 32 VAND. J. TRANSNAT'L L. 953 (1999); Frederick J. Tansil, *A Jurisdictional Comparison of Potential Situses for Asset Protection Trusts*, J. ASSET PROTECTION, Jan.-Feb. 2000, at 9, 9.

93. Alan Cowell & Edmund L. Andrews, *Undercurrents at a Safe Harbor: Isle of Man (and Corporations) Is an Enclave of Intrigue*, N.Y. TIMES, Sept. 24, 1999, at C1 ("About 37 percent of the island's economy is based on financial services, much of that on behalf of foreigners. With a population of 72,000, the island's corporate registry boasts 42,000 companies . . .").

94. See *Beaubien v. Cambridge Consol. Ltd.*, 652 So. 2d 936, 937 (Fla. Dist. Ct. App. 1995) (at least \$100,000 of \$500,000 in a Cayman Islands trust was missing and beneficiaries were unable to acquire accounting from trustee).

95. See, e.g., *FTC v. Affordable Media, LLC*, 179 F.3d 1228, 1238-39, 1243 (9th Cir. 1999) (affirming lower court's order that grantors be incarcerated for failure to repatriate assets held by them in a Cook Islands trust); *Eulich v. United States*, No. Civ.A.3:99CV1842-L, 2004 WL 1844821, at \*1, \*6 (N.D. Tex. Aug. 18, 2004) (concerning Bahamian trust); *SEC v. Bilzerian*, 131 F. Supp. 2d 10, 18 (D.D.C. 2001) (discussing a Cook Island Trust, the court stated that "[g]iven Bilzerian's facially deficient accounting, the only remedy is to incarcerate Bilzerian until he provides the information covered by the Court's order or, at a minimum, until he demonstrates a credible and good faith effort to do so."); *Goldberg v. Lawrence (In re Lawrence)*, 227 B.R. 907, 917-18 (Bankr. S.D. Fla. 1998) (proceedings landed Lawrence, the debtor, in jail for contempt for failing to repatriate a Mauritian trust).

Today, settlors can create a domestic self-settled spendthrift trust without the same risks of a foreign jurisdiction asset protection trust. In 1997, Alaska enacted the first legislation allowing self-settled spendthrift trusts.<sup>96</sup> The states of Delaware,<sup>97</sup> Nevada,<sup>98</sup> Utah,<sup>99</sup> and Rhode Island<sup>100</sup> soon followed. Four other states—Oklahoma,<sup>101</sup> South Dakota,<sup>102</sup> Wyoming,<sup>103</sup> and Tennessee<sup>104</sup>—have since passed legislation to allow self-settled spendthrift trusts. Two other states have some aspect of a self-settled trust provision.<sup>105</sup> Each of these state statutes permits the creation

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96. See ALASKA STAT. § 34.40.110 (2006).

97. See DEL. CODE ANN. tit. 12, §§ 3570–3576 (2001); see also Richard W. Nenno, *Delaware Law Offers Asset Protection and Estate Planning Benefits*, 26 EST. PLAN. 3 (1999).

98. See NEV. REV. STAT. §§ 166.010–166.170 (2005).

99. See UTAH CODE ANN. § 25-6-14(1)(a)(ii) (Supp. 2007).

100. See R.I. GEN. LAWS § 18-9.2-2(9) (2003).

101. Family Wealth Preservation Trust Act, OKLA. STAT. ANN. tit. 31, §§ 10–18 (West Supp. 2007). The Oklahoma statutes require that the trust be subject to Oklahoma income tax and that a majority of the trust assets be Oklahoma assets. *Id.* § 11(5)(d), (e). The assets may be securities issued by Oklahoma-based companies; bonds or obligations issued by Oklahoma, its governmental agencies, counties, municipalities, school districts, or certain public trusts; or other Oklahoma property designated therein. *Id.* § 11(2). Furthermore, the protections from a grantor's creditors extend only to \$1 million. *Id.* § 12.

102. South Dakota's legislation was enacted on March 2, 2005, and made effective July 1, 2005, and is virtually identical to the Delaware Act. 2005 S.D. Sess. Laws 594 (codified at S.D. CODIFIED LAWS § 55-16-1 to -16 (Supp. 2007)).

103. Wyoming's legislation was enacted on February 28, 2007, and made effective July 1, 2007. Wyoming Qualified Spendthrift Trust Legislation, 2007 Wyo. Sess. Laws 368 (codified at WYO. STAT. ANN. §§ 4-10-505, 4-10-510 to -523 (2007)).

104. Tennessee's legislation was enacted on May 10, 2007, and made effective July 1, 2007. 2007 Tenn. Pub. Acts ch. 144.

105. Colorado and Missouri may provide for self-settled spendthrift trusts in limited circumstances. Colorado law provides that “[a]ll deeds of gift, all conveyances, and all transfers or assignments, verbal or written, of goods, chattels, or things in action, or real property, made in trust for the use of the person making the same shall be void as against the creditors existing of such person.” COLO. REV. STAT. § 38-10-111 (2006). At least one court has interpreted this Colorado statute to mean that a Colorado self-settled spendthrift trust will be held effective as to future creditors but not to existing creditors. *In re Baum*, 22 F.3d 1014, 1017 (10th Cir. 1994). However, the Colorado Supreme Court has questioned the statute's validity. *In re Cohen*, 8 P.3d 429, 433 (Colo. 1999). Missouri law provides that a spendthrift trust will shield the assets from the claims of creditors unless: (1) “[t]he settlor was the sole beneficiary of either the income or principal of the trust,” (2) the settlor “retained the power to amend the trust,” or (3) “[t]he settlor was one of a class of beneficiaries and retained a right to receive a specific portion of the income or principal of the trust that was



of an irrevocable trust, the assets of which are protected from most of the settlor's creditors, and permits the settlor to: (1) be a permissive or discretionary beneficiary of the trust, (2) retain a lifetime veto power over trust distributions, and (3) retain a testamentary special power of appointment over the trust corpus. The Delaware statute goes one step further to allow the settlor to retain the income of the trust for life.<sup>106</sup> Attached as an Appendix is a comparative summary of the interests or powers that can be retained by a settlor in each of the jurisdictions.

Because self-settled spendthrift trust legislation is relatively new, there have been few cases that have tested the various provisions. There are areas of possible attack that are based in the United States Constitution. Thus, if a creditor can obtain in personam jurisdiction in Iowa over the trustee of an asset protection trust resulting in a judgment in Iowa,<sup>107</sup> the Full Faith and Credit Clause may require an Alaska court to enforce the Iowa judgment against the trust assets. In personam jurisdiction in Iowa would not be out of the question for a trustee such as Wells Fargo. The Due Process Clause may restrict a state's ability to apply its own laws to disputes between "outsiders."<sup>108</sup> Therefore, the Due Process Clause may prevent the application of Alaska trust law to a dispute between an Iowa settlor and an Iowa creditor.

The *Restatement (Second) of Conflict of Laws* states that a settlor or testator can designate which state's law shall govern the validity of the trust provided that the designated 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."<sup>109</sup> In most cases, a domestic asset protection trust instrument will designate the laws of one of the aforementioned states to

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determinable solely [by] the trust instrument." MO. REV. STAT. § 456.5-505(3)(2) (2007). Thus, if a settlor does not fall into one of those categories, the trust should be protected from the claims of future creditors.

106. See DEL. CODE ANN. tit. 12, § 3570(10)(b)(3) (2001). For an example of a form for a Delaware self-settled asset protection trust, see Richard W. Nenno, *Planning with Domestic Asset-Protection Trusts: Part II*, 40 REAL PROP. PROB. & TR. J. 477, App. D (2005).

107. The basis for such a judgment could be a fraudulent conveyance. See Henry J. Lischer, Jr., *Professional Responsibility Issues Associated with Asset Protection Trusts*, 39 REAL PROP. PROB. & TR. J. 561, 571-76 (2004).

108. See *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 818 (1985) ("We think that the Supreme Court of Kansas erred in deciding on the basis . . . that the application of its laws to all claims [of nonresidents] would be constitutional.").

109. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 270(a) (1971); see also *Nat'l Shawmut Bank of Boston v. Cumming*, 91 N.E.2d 337, 341 (Mass. 1950).

control the validity of the trust. The trust instrument will also generally provide that: (1) at least one of the trustees must be domiciled in such state, (2) at least some of the trust assets be deposited in such state, and (3) at least some of the administration of the trust be performed in such state. These factors may lead a court to the conclusion that the designated state has a “substantial relation to the trust” as stated in the Restatement, but the state with the most significant relationship to the trust may be some other state.<sup>110</sup> If the state with the most significant relationship to a trust is Iowa and if the terms of the trust instrument violate a strong public policy of Iowa, then the trust instrument’s designated choice of law may not apply. The unanswered question is whether a court would rule that an Iowa settlor’s avoidance of creditors by using a self-settled spendthrift trust is a violation of strong public policy in Iowa.

The Supremacy Clause may be useful to attack a self-settled spendthrift trust in another jurisdiction.<sup>111</sup> If a debtor is insolvent, a creditor can force the debtor into bankruptcy under the United States Bankruptcy Code.<sup>112</sup> However, § 541(c)(2) of the Bankruptcy Code provides that “[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law” is also enforceable under the Bankruptcy Code.<sup>113</sup> A creditor would have to convince the bankruptcy court that Alaska, Nevada, or another state’s asset protection trust code did not apply or was not “applicable nonbankruptcy law.” Perhaps a creditor could make a successful argument by stating that, at the time § 541(c)(2) was adopted by Congress, there was no self-settled spendthrift trust legislation in any of the states.

The real concern to debtors, however, is that Congress could amend the Bankruptcy Code to eliminate any protection it may give to debtors of self-settled spendthrift trusts. In fact, BAPCPA, signed into law on April 20, 2005, has done just that.<sup>114</sup> BAPCPA added a new subsection to § 548 of the Bankruptcy Code that gives the bankruptcy trustee authority to avoid a transfer of an interest of the debtor in property made within ten years of the petition date if:

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110. See *Buchholz v. Cook (In re Cook)*, 263 B.R. 249, 255 (Bankr. N.D. Iowa 2001) (holding that the state with the most significant relationship to the trust was Nebraska (rather than Iowa) because the settlor lived there, the parties had discussions about the trust there, and the funds were transferred into trust there).

111. U.S. CONST. art. VI, cl. 2.

112. See 11 U.S.C. § 303(h) (West Supp. 2007).

113. *Id.* § 541(c)(2) (2000).

114. See Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified in scattered sections of 11 U.S.C.).

- (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.<sup>115</sup>

The new subsection was enacted specifically to address the new laws passed by several states that allow debtors to more easily shield their assets from their creditors.<sup>116</sup> The exceptionally long look-back period— ten years— may have the effect of lessening the appeal of self-settled trusts to avoid current creditors. Note, however, that subparagraph (D) requires that the bankruptcy trustee show that the transfer was made to avoid a particular claim.<sup>117</sup> Thus, an individual's establishment of a self-settled trust in a state allowing self-settled trusts as a general asset protection measure and without any particular claim in mind, should not allow the bankruptcy trustee to pull the trust assets into the bankruptcy estate.<sup>118</sup>

*e. Other Exceptions.* In situations when the sole trustee is also the sole beneficiary, spendthrift trust protection may not be available because separation does not exist between the legal and equitable interests in the trust corpus.<sup>119</sup> Spendthrift trust protection may not apply when a trustee's discretion to make payments to a beneficiary merely relates to the time and manner of payment and not to payment or nonpayment.<sup>120</sup> For example, consider the following language in a testator's will: "All moneys remaining in my estate shall be kept in trust by my trustee for my son until such time

115. *Id.* § 1402(4), 119 Stat. at 214 (codified at 11 U.S.C. § 548(e)(1)).

116. 151 CONG. REC. S2427–28 (daily ed. Mar. 10, 2005); *see also* David Shafteel & David H. Bundy, *Impact of New Bankruptcy Provision on Domestic Asset Protection Trusts*, 32 EST. PLAN., Mar. 10, 2005, at 28, 28–29.

117. 11 U.S.C. § 548(e)(1)(D).

118. One court, in interpreting "actual intent" language has explained it to mean the following: "If the debtor has a particular creditor or series of creditors in mind and is trying to remove his assets from their reach, this would be grounds to deny the discharge. If the debtor is merely looking to his future wellbeing, the discharge will be granted." *Oberst v. Oberst (In re Oberst)*, 91 B.R. 97, 101 (Bankr. C.D. Cal. 1988).

119. 2 AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, *THE LAW OF TRUSTS* § 99 (4th ed. 1987).

120. BOGERT & BOGERT, *supra* note 55, § 228, at 521 & n.4.

as my trustee decides to distribute it to him.”<sup>121</sup> Such language provides a vested interest in the son and discretion to the trustee that relates only to the time and manner of payment.<sup>122</sup> Contrast such provision with one in which a trustee may provide for the support of the settlor’s son until the son reaches the age of thirty.<sup>123</sup> A material purpose of protecting the trust property until the beneficiary reaches age thirty exists<sup>124</sup> and would thus preclude the beneficiary’s creditors from attaching the trust assets.

### 3. Iowa’s Adopted Exceptions to the Spendthrift Trust

Iowa, like Mississippi,<sup>125</sup> has been more on the hard-hearted side when addressing exceptions to spendthrift trust provisions.<sup>126</sup>

a. *Child Support and Alimony.* Iowa courts have clearly refused to adopt the public policy of supporting spouses and dependents over the protection of trust beneficiaries. In *Roorda v. Roorda*, a father who was

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121. See *In re Nicholson’s Estate*, 50 A.2d 283, 283 (Pa. 1946) (involving a will with a similar provision).

122. See *id.* at 285 (“[T]he words of the will . . . disclose testator’s clear intention to limit the trustee’s discretion solely to the time or method of making payment.”).

123. RESTATEMENT (THIRD) OF TRUSTS § 65 cmt. d, illus. 5 (2003).

124. *Id.*

125. See *supra* note 59 and accompanying text.

126. In 2004, the Iowa legislature amended the Iowa Trust Code affecting spendthrift protection in Iowa trusts. 2004 Iowa Acts 27, 29–30 (codified in IOWA CODE § 633A.2301 (2007)). Amended § 633A.2301 distinguishes, in a more specific manner than its predecessor, the differences between a discretionary trust and a support trust and the consequences thereof. The amended section also likely eliminates the “discretionary support trust” concept fashioned by the Iowa Court of Appeals in *Strojek ex rel. Mills v. Hardin County Board of Supervisors*, 602 N.W.2d 566, 570–71 (Iowa Ct. App. 1999), discussed *infra* in the text accompanying notes 141–49. The language of the section was changed as follows:

A creditor or assignee of a beneficiary of a spendthrift trust ~~shall~~ may not compel a distribution that is subject to the trustee’s discretion ~~if any of the following apply~~ despite the fact that:

a. The distribution is expressed in the form of a standard of distribution.

b. The trustee has abused its discretion.

2005 Iowa Acts ch. 38, § 38 (codified at IOWA CODE § 633A.2301(4) (2007)).

delinquent on child support payments was successfully sued by the mother of his children for payment of child support.<sup>127</sup> The father had no assets but was a beneficiary of a spendthrift trust that the mother attempted to attach for payment of the child support.<sup>128</sup> The Iowa Supreme Court noted that the trust was specifically established by the parents of the father to defeat the claims of the mother for child support.<sup>129</sup> The court honored their wishes by holding the trust assets exempt from the mother's claim for child support.<sup>130</sup>

The Iowa Supreme Court reaffirmed the *Roorda* holding in *In re Marriage of Meredith* by stating "the rule in Iowa is that trust funds in a spendthrift trust cannot be taken for child support or alimony."<sup>131</sup> However, the court did note that income from a spendthrift or discretionary trust can be considered by a court "in the over-all scheme of property division in a dissolution of marriage action."<sup>132</sup>

b. *Necessities for Beneficiary.* The Iowa Courts have adopted a narrow exception for necessities. In *In re Estate of Dodge*, the Iowa Supreme Court was presented with a trust that required the trustee to make distributions for the maintenance of the beneficiary and permitted the trustee to invade the corpus of the trust to achieve that end.<sup>133</sup> The court labeled the trust as a "support" trust in contrast to a true "discretionary" trust.<sup>134</sup> A support trust exists when the grantor directs or mandates the trustee to make payments to the beneficiary for the beneficiary's support.<sup>135</sup> A discretionary trust exists when the grantor gives the trustee complete and unfettered discretion in determining if any of the trust's income or corpus should be distributed to the beneficiary.<sup>136</sup> A beneficiary's creditor cannot compel a trustee of a discretionary trust to

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127. *Roorda v. Roorda*, 300 N.W. 294, 294–95 (Iowa 1941).

128. *Id.* at 295.

129. *Id.* at 296.

130. *Id.* at 297.

131. *In re Marriage of Meredith*, 394 N.W.2d 336, 339 (Iowa 1986).

132. *Id.*

133. *Murphy v. Scott (In re Estate of Dodge)*, 281 N.W.2d 447, 451 (Iowa 1979).

134. *Id.*

135. *Id.*; *Torgerson v. Barkema (In re Barkema Trust)*, 690 N.W.2d 50, 54 (Iowa 2004) (quoting GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 229 at 540 (rev. 2d ed. 1992)).

136. *Strojek ex rel. Mills v. Hardin County Bd. of Supervisors*, 602 N.W.2d 566, 569 (Iowa Ct. App. 1999).

make payments.<sup>137</sup>

Conversely, a beneficiary can compel a trustee of a support trust to make payments, according to the *Dodge* court.<sup>138</sup> The amount that a beneficiary can require the trustee to pay is limited in two ways: (1) the claim is for necessary goods or services, not officiously rendered, which the settlor intended to be provided the beneficiary by trust funds; and (2) the withholding of payment for the goods and services is not properly within the discretion granted the trustee by the instrument . . .<sup>139</sup>

The *Dodge* court held that the trustee of the support trust at issue therein was required to reimburse the sister of the trust beneficiary for over \$40,000 that the sister incurred in providing support for the trust beneficiary.<sup>140</sup>

The Iowa Court of Appeals later clarified the second part of the *Dodge* test and added an entirely new category of trusts called “discretionary support” trusts in *Strojek v. Hardin County Board of Supervisors*.<sup>141</sup> The court was presented with the following dispositive provision of a trust:

“My trustee *shall*, from time to time, pay to or apply for the benefit of my daughter, Marie Helen Strojek, such sums from the income and principal as my trustee in the exercise of her *sole discretion* deems necessary or advisable, to provide for her proper care, support, maintenance and education.”<sup>142</sup>

The court noted that not all trust dispositive provisions can fit neatly in the category of either a support trust or a discretionary trust.<sup>143</sup> It therefore devised a new category of trust called the “discretionary support” trust, which the court says is created when a grantor, like that in *Strojek*, “combines explicit discretionary language ‘with language that, in itself,

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137. *Id.* (citing RESTATEMENT (SECOND) OF TRUSTS § 155(1) (1959)).

138. *In re Estate of Dodge*, 281 N.W.2d at 451.

139. *Id.*; see also *Emmet County Bd. of Supervisors v. Ridout*, 692 N.W.2d 821, 827 (Iowa 2005).

140. *In re Estate of Dodge*, 281 N.W.2d at 449, 452.

141. *Strojek ex rel. Mills v. Hardin County Bd. of Supervisors*, 602 N.W.2d 566, 571 (Iowa Ct. App. 1999); see also *McKinnon v. McCabe (In re Trust of McCabe)*, No. 01-1972, 2002 WL 31757533 (Iowa Ct. App. Dec. 11, 2002) (involving a demand by a beneficiary for payment by the trustee of her nursing home costs).

142. *Strojek*, 602 N.W.2d at 568 (emphasis added).

143. *Id.* at 569 (citing numerous contradictory rulings regarding seemingly similar dispositive provisions).

would be deemed to create a pure support trust.”<sup>144</sup>

According to *Strojek*, “[t]he effect of a discretionary support trust is to establish the minimal distributions a trustee must make in order to comport with the settlor’s intent of providing basic support, while retaining broad discretionary powers in the trustee.”<sup>145</sup> In other words, a trustee can be compelled by a beneficiary “to pay at least the minimum amount which in the opinion of a reasonable [person] would be necessary” to meet a support standard.<sup>146</sup> It also means that a beneficiary’s interest can be reached by the beneficiary’s creditor (but only for support or services the creditor provided to the beneficiary meeting the *Dodge* standard<sup>147</sup>) and by the Internal Revenue Service.<sup>148</sup>

Iowa Code section 633A.2301 was amended during 2004 and now more specifically defines the situations that would provide for a pure discretionary trust and a support trust.<sup>149</sup> Section 633A.2301, as amended, along with section 633A.4702, likely overrules *Strojek* and its discretionary support trust concept.

c. *Federal Tax Liens*. Federal courts look to state property rights in determining whether a federal tax lien attaches to a beneficiary’s interest in a trust.<sup>150</sup> Generally, if a beneficiary has a right to compel a trustee to

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144. *Id.* at 570 (quoting Evelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 IOWA L. REV. 273, 279 n.26 (1983)). The Iowa legislature may have eviscerated the court’s discretionary support trust concept in 2004 when it amended Iowa Code § 633.2301 and enacted Iowa Code § 633.4702 (2005). 2004 Iowa Acts ch. 1015, § 30 (codified at IOWA CODE § 633A.4702 (2007)). Section 633A.4702 purports to shift all interpretive close calls in favor of a discretionary trust status. The new law reads as follows:

In the absence of clear and convincing evidence to the contrary, language in a governing instrument granting a trustee discretion to make or withhold a distribution shall prevail over any language in the governing instrument indicating that the beneficiary may have a legally enforceable right to distributions or indicating a standard for payments or distributions.

IOWA CODE § 633A.4702.

145. *Strojek*, 602 N.W.2d at 570.

146. *Id.* (quoting 3 AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, *THE LAW OF TRUSTS* § 187, at 15 (4th ed. 1988)).

147. *Murphy v. Scott (In re Estate of Dodge)*, 281 N.W.2d 447, 451 (Iowa 1979).

148. *See infra* Part III.A.3.c.

149. *See supra* notes 126 & 144; *see also* IOWA CODE § 633A.2301.

150. *See supra* Part III.A.2.c.

make a distribution of trust income or assets, then the beneficiary has a property right in such income or assets to which the federal tax lien can attach.<sup>151</sup> Iowa courts allow beneficiaries of two kinds of trusts to compel a trustee to make a trust distribution: (1) support trusts and (2) discretionary support trusts.<sup>152</sup> The two types of trusts were defined and distinguished by the Iowa Court of Appeals in the *Strojek* case.<sup>153</sup> Both types of trusts allow a beneficiary to compel the trustee to make distributions<sup>154</sup> and thus constitute a property right for the beneficiary to which a federal tax lien can attach.<sup>155</sup>

However, as mentioned earlier, Iowa Code section 633A.2301, as amended, likely overrules *Strojek* and its discretionary support trust concept.<sup>156</sup> What remains unclear, however, is whether Iowa Code section 633A.2301 would be viewed as an exemption or a property right. If the section is viewed by a federal court as an exemption, then *Strojek* would continue to control whether a taxpayer-beneficiary has a property interest to which a federal tax lien could attach. If section 633A.2301 is considered to be a definition of a property right rather than an exemption, then it would control.

In practice, if the intent of a client is to create a pure discretionary trust and not a support trust, then the word “shall” should not be used in the same context of any discretionary powers given to the trustee. One should consider the following discretionary dispositive provision:

Until my son attains the age of forty (40) years, my Trustee may pay (or not pay) to him such amounts of the income or principal of the Trust assets as my Trustee deems appropriate for his maintenance in health and reasonable comfort or education.

Also, the client may consider giving a sprinkle power to the trustee to inhibit a court’s consideration in piercing a trust’s liability shield in favor of one beneficiary; for example,

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151. *In re Orr*, 180 F.3d 656, 664 (5th Cir. 1999); *First Nw. Trust Co. v. IRS*, 622 F.2d 387, 393 (8th Cir. 1980); *see also* I.R.S. Chief Couns. Adv. Memo 200036045 (May 16, 2000).

152. *Strojek ex rel. Mills v. Hardin County Bd. of Supervisors*, 602 N.W.2d 566, 568–69, 570 (Iowa Ct. App. 1999).

153. *Id.*

154. *Id.* at 570.

155. *In re Orr*, 180 F.3d at 664; *First Nw. Trust Co.*, 622 F.2d at 392–93.

156. *See supra* notes 144–49 and accompanying text.



Until my son attains the age of forty (40) years, my Trustee may pay (or not pay) to him or any of his descendants such amounts of the income or principal of the Trust assets as my Trustee deems appropriate for his and their maintenance in health and reasonable comfort or education.

Another alternative is extending the trust term to the maximum period allowed by the Rule Against Perpetuities in order to continue protection from the beneficiaries' creditors.<sup>157</sup>

d. *Self-Settled Trusts.* Iowa courts have historically not allowed spendthrift protection for self-settled trusts.<sup>158</sup> The Iowa Trust Code is also clear on the issue, stating "If a settlor is a beneficiary of a trust created by the settlor, a transferee or creditor of the settlor may reach the maximum amount that the trustee could pay to or for the settlor's benefit."<sup>159</sup>

Several years ago, the Ninth Circuit decided a case that characterized a beneficiary's short-lived right to withdraw a contribution from a trust as a present interest for federal gift tax purposes.<sup>160</sup> This case created a new type of trust known as the Crummey Trust because of the limited right of withdrawal that is given to the beneficiaries.<sup>161</sup> Several cases have held that a beneficiary has created a self-settled trust when the beneficiary himself allows property to remain in trust that the beneficiary is otherwise entitled to receive outright.<sup>162</sup> The question then arises whether the Crummey Trust is a self-settled trust that creditors of the beneficiary can attach.

Iowa cases have held that a Crummey Trust is not a self-settled trust from the perspective of a beneficiary. There are two Iowa cases that speak primarily to whether a creditor of a trust beneficiary with a right of withdrawal can garnish trust assets in payment of the beneficiary's debts. The first is *Ober v. Seegmiller*, in which a creditor of a father who had a right to demand certain payments from his sons was unsuccessful in

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157. For Iowa's Rule Against Perpetuities, see IOWA CODE § 558.68 (2007). Iowa has adopted the "wait and see" method of determining the relevant time period within which the interest must vest. *Id.*

158. *Phillips v. Roe (In re Estate of Nagel)*, 580 N.W.2d 810 (Iowa 1998).

159. IOWA CODE § 633A.2303(1); *see also* RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. f (2003).

160. *Crummey v. Comm'r*, 397 F.2d 82 (9th Cir. 1968).

161. *See id.*

162. *See, e.g., Hartsfield v. Lescher*, 721 F. Supp. 1052 (E.D. Ark. 1989); *Barash v. Morris (In re Morris)*, 151 B.R. 900 (C.D. Ill. 1993).

garnishing the father's sons.<sup>163</sup> The father never exercised his right to demand payment from his sons, and the court said that until he did, the sons were not indebted to their father.<sup>164</sup> Without an amount owed to the father, the creditors had nothing to garnish.<sup>165</sup> Nor could the creditor compel the father to exercise his right to demand payments from his sons because the father's right to demand payment was personal to him and not subject to levy.<sup>166</sup>

The second case, *Darling v. Dodge*, involved a daughter who had the right, upon her election, to receive the corpus from a sizable trust fund.<sup>167</sup> She never exercised her election, and when her creditors tried to garnish the trust assets, the court said there was nothing they could garnish.<sup>168</sup> There was nothing "due" to the beneficiary from the trust unless and until she exercised her election, and no one, including creditors, had the right to compel her to make that election.<sup>169</sup> A related case, *Ober v. Dodge*,<sup>170</sup> affirmed the holding in *Darling*.<sup>171</sup>

The Iowa Trust Code likely overrules the holdings of the *Ober v. Dodge* and *Darling* cases. Iowa Code section 633A.3105 states that property of a trust is chargeable to the creditors of a "presently exercisable" general power of appointment holder.<sup>172</sup> Thus, to the extent that a Crummey-type right of withdrawal is the same as a general power of appointment (they are very similar, although not identical),<sup>173</sup> then Iowa Code section 633A.3105 overrules these cases, but only during the withdrawal period.<sup>174</sup> When a beneficiary's right of withdrawal period passes, section 633A.3105 is no longer determinative, and the *Ober* and *Darling* cases could be expected to provide residual protection to the beneficiaries. The *Restatement (Third) of Trusts* states likewise.<sup>175</sup>

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163. *Ober v. Seegmiller*, 160 N.W. 21, 23–24 (Iowa 1916).

164. *Id.* at 23.

165. *Id.*

166. *Id.*

167. *Darling v. Dodge*, 206 N.W. 266 (Iowa 1925).

168. *Id.* at 268.

169. *Id.*

170. *Ober v. Dodge*, 231 N.W. 444, 447 (Iowa 1930).

171. BOGERT & BOGERT, *supra* note 120, § 228, n.20 at 533–34 (stating that the *Ober v. Dodge* and *Darling* cases "seem erroneously decided").

172. IOWA CODE § 633A.3105 (2007).

173. *See supra* notes 161–62 and accompanying text.

174. *See* IOWA CODE § 633A.3105.

175. RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. g (2003) (stating a beneficiary's prior failure to exercise a lapsed general power of appointment for his or

### B. Beneficiary as Trustee

Iowa Code section 633A.3105 may subject a beneficiary's interest to the claims of creditors if the beneficiary is also a trustee with discretionary authority to distribute the income or corpus of a trust. Section 633A.3105 refers only to a presently exercisable general power of appointment and provides that the creditors of such a holder may attach assets of a trust that are subject to the power.<sup>176</sup>

The Iowa Code does not define the term "general power of appointment."<sup>177</sup> The Iowa Supreme Court has defined general power of appointment as a donee's right to appoint property "wholly in favor of the donee" or "the estate of the donee."<sup>178</sup> Internal Revenue Code § 2041 defines a general power of appointment to mean a power that is exercisable in favor of the donee, his estate, his creditors, or the creditors of his estate, "but it is usually sufficient that the donee can appoint the property to himself."<sup>179</sup> The *Restatement (Third) of Trusts* distinguishes between a power of appointment and a trustee's discretionary authority to distribute assets to herself in that the latter is subject to a fiduciary obligation to the other beneficiaries whereas a power of appointment is not.<sup>180</sup> Iowa's disclaimer statute, which was passed in 2004, states that a power of appointment held by a fiduciary may disclaim such power in full or in part.<sup>181</sup> Comments to the Uniform Disclaimer of Property Interests Act, which make up the substance of the 2004 Iowa disclaimer legislation, indicate that a fiduciary power of appointment includes situations in which the trustee of a discretionary trust has the authority to distribute income or corpus to himself or others.<sup>182</sup>

Regardless of whether a substantive difference exists between a beneficiary-trustee's discretionary authority and a general power of

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her own benefit does not cause the beneficiary to be treated as a settlor for purposes of later piercing the trust's liability shield).

176. IOWA CODE § 633A.3105.

177. The Iowa Code provision covering the power of appointment ironically does not define the term "power of appointment," although it purports to govern how and when such powers are released or disclaimed. *Id.* § 559.2.

178. *In re Estate of Spencer*, 232 N.W.2d 491, 495–96 (Iowa 1975) (quoting RESTATEMENT OF PROP. § 320, at 1828 (1940)).

179. BOGERT & BOGERT, *supra* note 55, § 233, at 50–51.

180. RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. a (2003).

181. IOWA CODE §§ 633E.5, 633E.11; *see also infra* note 238–43 and accompanying text.

182. UNIF. DISCLAIMER OF PROP. INTERESTS ACT § 11, cmt. (1999).

appointment, the *Restatement (Third) of Trusts* and the courts in jurisdictions surrounding Iowa treat the two situations in a similar manner: creditors of a trustee who has discretionary authority to distribute income or corpus to himself and creditors of a beneficiary holding a general power of appointment can attach all the income or assets of the trust subject to such discretion or power.<sup>183</sup> However, the position set forth in the *Restatement (Third) of Trusts*, with respect to a creditor's ability to attach trust assets that are subject to general power of appointment, does not apply in all jurisdictions.<sup>184</sup>

Many marital trusts are established with one of the spouses named as trustee, giving the trustee discretionary authority to distribute income and corpus to the other spouse. Sometimes the discretionary authority is limited by an ascertainable standard; sometimes it is not. Iowa Code section 633A.3105 may subject the trust's assets to the claims of the spouse's creditors, whereas prior to the enactment of section 633A.3105, case law was clear that the trust's assets would not be subject to the claims of the spouse's creditors.<sup>185</sup>

The best choice as trustee, from an asset protection perspective, is not a beneficiary. If this is not possible, it is important that the beneficiary-trustee has discretion to sprinkle the trust assets over a large class of beneficiaries in addition to himself and that the remainder be distributed to someone other than the trustee. A court considering piercing the spendthrift trust liability shield on behalf of a debtor beneficiary would first be required to consider the interests of the other beneficiaries. Another

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183. RESTATEMENT (THIRD) OF TRUSTS § 58 cmt. b (2003) (stating that a spendthrift restraint will not prevent the beneficiary's creditors from reaching property that is subject to the beneficiary's general power of appointment); *id.* § 60 cmt. g (stating that creditors can reach the amount that the trustee-beneficiary can take); *see also* Johnson v. McCoy (*In re McCoy*), 274 B.R. 751, 764–66 (Bankr. N.D. Ill. 2002) (holding that all assets of the trust that the beneficiary-trustee could pay to himself are included in his bankruptcy estate, notwithstanding that the trustee's discretion was limited by an ascertainable standard and that there were other beneficiaries of the trust).

184. *See* BOGERT & BOGERT, *supra* note 55, § 233, at 52 (“Under common law rules, property subject to a donee's *general* power of appointment not created by the donee is available to his creditors, during his lifetime or at his death *only* if the power is exercised.”) (second emphasis added); *see also* Univ. Nat'l Bank v. Rhoadarmer, 827 P.2d 561, 564 (Colo. Ct. App. 1991) (stating general power of appointment is available to creditors of power holder *only* if the power is exercised) (citations omitted).

185. Ober v. Seegmiller, 160 N.W. 21 (Iowa 1916); *see also* Darling v. Dodge, 206 N.W. 266 (Iowa 1925) (stating a creditor cannot compel a general power of appointment holder to exercise such power); *see also infra* Part III.D.1.

planning mechanism to consider is limiting the beneficiary-trustee's discretionary power by an ascertainable standard or by requiring that the beneficiary-trustee's power to make distributions to himself be consented to by one or more other beneficiaries whose economic interests in the trust are adverse to the trustee.

### C. *Special Needs Trusts*

The needs of an adult disabled child require special attention. Many planners use a special needs trust to provide for such children as well as allowing the child to qualify for government assistance such as Medicaid. A special needs trust should be a pure discretionary trust with a spendthrift provision.

The Iowa Court of Appeals and the Iowa Supreme Court have recently issued opinions on the effect of trusts on governmental benefits eligibility and recovery.<sup>186</sup> A third case on this topic was addressed by the Iowa Supreme Court on February 25, 2005, but the court disposed of the matter on a statute of limitations issue rather than on substantive grounds.<sup>187</sup>

In *Strojek*, the issue before the court was whether Marie Strojek, a sixty-three-year-old mentally handicapped individual, was ineligible for mental health services through Hardin County because of a trust established for her benefit by her deceased father.<sup>188</sup> The trust dispositive provision was as follows:

My trustee *shall*, from time to time, pay to or apply for the benefit of my daughter, Marie Helen Strojek, such sums from the income and principal as my trustee in the exercise of her sole discretion deems necessary or advisable, to provide for her proper care, support, maintenance and education.<sup>189</sup>

The court analyzed the facts of the case as if Hardin County was just an ordinary creditor providing support to the beneficiary, Marie Strojek.<sup>190</sup> Once the court determined that the trust language was a form of a support

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186. *In re Barkema Trust*, 690 N.W.2d 50 (Iowa 2004); *Strojek ex rel. Mills v. Hardin County Bd. of Supervisors*, 602 N.W.2d 566 (Iowa Ct. App. 1999).

187. *Emmet County Bd. of Supervisors v. Ridout*, 692 N.W.2d 821 (Iowa 2005).

188. *Strojek*, 602 N.W.2d at 568.

189. *Id.*

190. *See id.* at 571.

trust, it applied the rationale of *In re Dodge* to hold that the trust assets should be considered for purposes of determining Marie Strojek's eligibility for Hardin County benefits.<sup>191</sup>

In *In re Barkema Trust*, the Iowa Supreme Court was presented with the issue of whether the Department of Human Services had a valid claim for recovery of Medicaid benefits from a trustee of a trust for the benefit of the settlor's daughter, Lois.<sup>192</sup> The trust dispositive provision was as follows: "If possible, only the income from said share *shall* be used for Lois, however, if necessary for her proper support and maintenance, then the corpus of said trust may be invaded to the extent said trustees deem necessary."<sup>193</sup> Unfortunately, the settlor of the trust did not provide who should take the remainder of the trust after Lois's death.<sup>194</sup> Lois spent several years in a nursing home paid for by Medicaid before passing away on April 14, 2003.<sup>195</sup>

The Iowa Supreme Court held that under the Iowa Code, the Department of Human Services had the authority to seek recovery from any "*interest in trust*" that Lois may have had immediately before her death.<sup>196</sup> The court reasoned that Lois had an interest in trust only if she had a "legal ability to obtain [assets from the trust]."<sup>197</sup> The court applied the rationale of *Strojek* and concluded that the dispositive provision of the trust provided enough of a "support" standard to allow Lois to compel the

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191. *Id.* at 568–69 (citing *In re Dodge*, 281 N.W.2d 447, 450 (Iowa 1979)). *Dodge* says that a spendthrift trust provision is invalid against a creditor of a beneficiary providing necessary goods or services to the beneficiary, provided that: (1) the claim is for necessary goods or services, not officiously rendered, which the settlor intended to be provided the beneficiary by trust funds; and (2) the withholding of payment for the goods and services is not properly within the discretion granted the trustee by the instrument, before a creditor's claim may be enforced against the trustee of a support trust subject to a spendthrift clause. *In re Dodge*, 281 N.W.2d at 451.

192. *In re Barkema Trust*, 690 N.W.2d 50, 52–53 (Iowa 2004).

193. *Id.* at 52 (emphasis added).

194. *Id.*

195. *Id.* Apparently, the Department of Human Services never questioned whether the trust was an available resource to Lois for Medicaid eligibility purposes. *Id.* at 52–53.

196. *Id.* at 55 (citing IOWA CODE § 249A.5(2)(c) (2007)); *see also In re Estate of Steffes*, 697 N.W.2d 128 No. 5-014/04-0601 (Iowa Ct. App. March 31, 2005) (holding that a self-settled trust for a Medicaid applicant was an available resource to the applicant to be counted for purposes of determining eligibility).

197. *In re Barkema Trust*, 690 N.W.2d at 55 ("In order for an asset to be considered an actually available resource, an applicant must have a legal ability to obtain it.") (citing *Hecker v. Stark County Soc. Serv. Bd.*, 527 N.W.2d 226, 237 (N.D. 1994)).

trustee to invade the corpus for the trust and make distributions to her for her support; therefore, she had an “interest in trust.”<sup>198</sup> Note, however, that the new Iowa Code section 633A.2301 would label the provision as purely discretionary because it contains a “standard.”<sup>199</sup>

If the settlor in the *Strojek* and *Barkema* cases used a pure discretionary dispositive provision rather than a “discretionary support” provision, the courts likely would have ruled in favor of the trustee and beneficiary and not the government claimants.<sup>200</sup> The settlor’s use of the word “shall” in the dispositive provision may have been the deciding fatal factor. Based on the analysis in the *Strojek* and *Barkema* cases, a pure discretionary provision such as the following should be sufficient to protect the trust assets from government claimants in Iowa: “Until my son attains the age of forty (40) years, my Trustee may pay (or not pay) to him such amounts of the income or principal of the Trust assets as my Trustee deems appropriate for his maintenance in health and reasonable comfort or education.”

Adding a sprinkle power and alternate beneficiaries would also help to insulate a special needs trust from the claims of government claimants.<sup>201</sup> Consider the following as an alternative to the trust provision in *Barkema*:

A share created for my daughter, Lois, shall be administered as a separate trust by my Trustee to be known as the Lois Special Needs Trust and shall remain in trust during Lois’s lifetime. The income and principal of the Lois Special Needs Trust, including any property received from elsewhere, may (or may not) be used by the Trustee in the Trustee’s absolute discretion to provide for the comfort and well-being of Lois. Any income not distributed shall be added to the principal. The express purpose of this trust is to provide extra and supplemental care and education in addition to and over and above the benefits Lois otherwise receives as a result of her handicap or disability from any local, state or federal government, or from private and/or

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198. *Id.* at 54.

199. *See supra* note 126 and accompanying text; *see also* IOWA CODE § 633A.2301.

200. An important part of the Iowa Supreme Court’s analysis in *Barkema* was its conclusion that Lois had the “legal ability to compel the trustee to invade the corpus of the trust and make distributions to her for her support.” *In re Barkema Trust*, 690 N.W.2d at 56. In a pure discretionary trust, “a creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal.” *Strojek ex rel. Mills v. Hardin County Bd. of Supervisors*, 602 N.W.2d 566, 569 (Iowa Ct. App. 1999) (quoting RESTATEMENT (SECOND) OF TRUSTS § 155(1) (1959)).

201. *See supra* Part III.C.

charitable agencies, any of which provides services or benefits to persons with handicaps or disabilities. It is my express purpose for this trust only to supplement other benefits received by Lois and if my Trustee decides to utilize the trust income and principal for Lois's benefit, my Trustee shall use such discretionary expenditures to improve the quality of Lois's life and to enhance her happiness. Examples of such discretionary expenditures include, but are not limited to, expenditures for participation in vocational and recreational trips, expenses for a traveling companion if requested or necessary, entertainment expenses and transportation costs. The Lois Special Needs Trust created herein is not intended to be a supplemental needs trust described in Chapter 634A of the Iowa Code.

Accordingly, if in the sole opinion of my Trustee a distribution permitted by this section would not achieve its full economic benefit as intended due to physical, emotional, legal or any other reason, my Trustee is empowered to withhold such distributions, or portions thereof, until such time as my Trustee determines that the intended benefit would be accomplished by the distribution.

In addition to these discretionary expenditures for Lois, income and principal may also be expended for the health, care, support, maintenance, and education of my other children or descendants of a deceased child, in the Trustee's discretion. My Trustee shall have complete and absolute discretion to distribute all, any portion, or none of this trust to my other children and descendants of a deceased child if the Trustee believes the purposes for which this trust was created are no longer capable of attainment, or if the funds in this trust are being used in lieu of any other funds available to Lois, or if the trust principal is in excess of the amount that my Trustee reasonably believes necessary to assist Lois for the expected term of her life. If such distributions are made to another child or children, or descendants of a deceased child, I request that my more fortunate children and descendants provide the love and assistance to Lois that I would have provided had I survived. Upon the death of Lois, the Trustee shall distribute the remainder of this trust to my descendants, per stirpes, subject to the condition that if a trust or share is then being administered by my Trustee for a descendant of mine that such distribution shall be added to such descendant's trust or share.

Iowa Code Chapter 634A (2007) applies to what it terms



“supplemental needs trusts for persons with disabilities.”<sup>202</sup> Section 634A.2(4) suggests that such trusts may be unenforceable in certain cases<sup>203</sup> and section 634A.2(5) indicates that the trust assets may be considered “available” to the beneficiary for medical assistance or other government benefits.<sup>204</sup> Thus, an individual who wants to establish a trust for a beneficiary with special needs should never refer to such a trust as a “supplemental needs trust” in the trust instrument. Further, a drafter should include a specific disclaimer in the trust’s dispositive provision to be absolutely certain a court will not interpret such dispositive provision as being a supplemental needs trust under Chapter 634A.

#### D. *Avoiding Creditors by Disclaiming*

Consider the following hypothetical: An unmarried mother of three children suddenly and unexpectedly dies, leaving a \$1,000,000 estate. The mother’s will leaves her entire estate to her descendants, per stirpes. One of the three children has substantial debt in which he is in default. His creditors have acquired a judgment against him and are ready to levy on his minimal assets. What can the debtor son do to protect his share of his inheritance that he will soon receive from his mother’s estate?

The answer is that he may not be able to do anything if his objective is to keep the inheritance for himself and protect it from his creditors. However, if he would rather have his children or siblings receive the inheritance instead of his creditors, he should consider disclaiming his interest in the inheritance. The Iowa Supreme Court clearly stated in the 1999 case *In re Estate of Kirk* that Iowa’s disclaimer statute may be used to thwart creditors.<sup>205</sup>

In *Kirk*, a Medicaid recipient who lived in a nursing home passed away three months after her husband.<sup>206</sup> Her husband devised to her \$30,000 of his assets that had not yet been distributed to her at the time of her death.<sup>207</sup> The Iowa Department of Human Services made a claim against the assets of the wife’s estate for repayment of up to \$41,000 of Medicaid payments for her nursing home costs.<sup>208</sup> The executor of the

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202. IOWA CODE § 634A (2007).

203. *Id.* § 634A.2(4).

204. *Id.* § 634A.2(4).

205. *In re Estate of Kirk*, 591 N.W.2d 630, 633 (Iowa 1999).

206. *Id.* at 632.

207. *Id.*

208. *Id.*

wife's estate filed a timely disclaimer under Iowa's then-existing disclaimer statute.<sup>209</sup> The court held that beneficiaries are entitled to renounce property intended for their benefit even if the renunciation may effectively defeat claims of creditors.<sup>210</sup> It reasoned that the disclaimer of property does not amount to an assignment or conveyance of property and that such disclaimer is treated as if no transfer occurred.<sup>211</sup> The court's reasoning is important because if a disclaimer is treated as if no transfer occurred, a creditor cannot make a fraudulent transfer claim under Iowa's Uniform Fraudulent Transfers Act.<sup>212</sup>

Iowa recently passed the Uniform Disclaimer of Property Interest Act (the "Disclaimer Act").<sup>213</sup> The Disclaimer Act is significant in that it eliminated the fixed, nine-month time period in which a disclaimer had to be made under the disclaimer statute.<sup>214</sup> The nine-month time period is still important for those individuals wanting to make an effective disclaimer for federal gift and estate tax purposes and the Disclaimer Act accommodates such disclaimers.<sup>215</sup> The Disclaimer Act, however, clearly expands the horizon of possibilities of making disclaimers and thus expands the number of planning opportunities for debtors.

Like the Iowa Supreme Court's decision in *In re Estate of Kirk*,<sup>216</sup> the Disclaimer Act provides that a proper disclaimer is not a transfer, assignment, or release<sup>217</sup> and generally is effective at some retroactive date.<sup>218</sup> Generally, a disclaimer can be made at any time, provided the disclaimant has not accepted any interest in the property.<sup>219</sup> Acceptance

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209. *Id.* at 632–33 (citing IOWA CODE § 633.704 (1995)).

210. *Id.* at 633–34.

211. *Id.* at 634. The *Kirk* decision was likely overruled by legislation. *See infra* note 236–37 and accompanying text.

212. *See In re Estate of Kirk*, 591 N.W.2d at 634; *see also infra* note 383 and accompanying text.

213. IOWA CODE ch. 633E (2007).

214. IOWA CODE § 633.704 (2003) (repealed 2004). The nine-month time limit is based on Internal Revenue Code § 2518 regarding disclaimers for estate tax purposes. The nine-month time limit is important for estate tax because an estate tax return is due nine months following the death of an individual if such individual had sufficient assets to warrant the filing of an estate tax return. IOWA CODE § 450.94(2) (2005).

215. IOWA CODE § 633E.4 (2007).

216. *See supra* note 210 and accompanying text.

217. IOWA CODE § 633E.5(6) (2007).

218. *Id.* § 633E.6(1).

219. *Id.* § 633E.13(2)(a).

occurs when a beneficiary receives an income distribution from a trust.<sup>220</sup> Acceptance also occurs when a beneficiary accepts incidents of ownership, such as when a recipient of a limited partnership interest elects herself as its general partner.<sup>221</sup> However, a beneficiary who is also a fiduciary may exercise fiduciary powers to preserve or maintain disclaimed property without constituting acceptance of such property.<sup>222</sup> The exercise of a nonfiduciary general power of appointment to any extent constitutes acceptance.<sup>223</sup> Acceptance of consideration in exchange for a disclaimer will also constitute acceptance.<sup>224</sup>

An individual may make a full disclaimer of property or merely a partial interest in property.<sup>225</sup> A contingent or future interest in property may be disclaimed.<sup>226</sup> A beneficiary of a life insurance policy may disclaim part or all of the death benefits of the policy.<sup>227</sup> A trustee or personal representative can disclaim an interest on behalf of a trust or an estate provided that such disclaimer is not inconsistent with the governing instrument or another statute of the State of Iowa, or would constitute a common law breach of trust.<sup>228</sup> The “breach of trust” provision is unique to the Iowa legislation— it is not part of the Uniform Disclaimer of Property Interests Act, and it was not part of the prior disclaimer statute.<sup>229</sup>

The breach of trust provision presents several issues. Would a breach of trust apply only to trustees or would it also apply to personal representatives of estates? Does a personal representative owe a fiduciary duty to the estate beneficiaries, estate creditors, or both? If a personal

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220. Treas. Reg. § 25.2518-2(d)(4) (1986), Ex. (1). A receipt of income from the trust, however, does not preclude the beneficiary from disclaiming a remainder interest in the trust. *Id.*

221. I.R.S. Tech. Adv. Mem. 9123003 (June 7, 1991).

222. Treas. Reg. § 25.2518-2(d)(2) (1986); I.R.S. Priv. Ltr. Rul. 8922082 (June 2, 1989).

223. Treas. Reg. § 25.2518-2(d)(1) (1986).

224. *Estate of Monroe v. Comm’r*, 104 T.C. 352, 361–62 (1995) (stating a father that induced disclaimers by twenty-eight beneficiaries of an estate by promising them payments of a like amount disqualified the disclaimer by the beneficiaries).

225. IOWA CODE § 633E.5(1) (2007).

226. IOWA CODE § 633E.3.

227. UNIF. DISCLAIMER OF PROP. INTERESTS ACT § 6, cmt. at 174 (1999) (stating that if the beneficiary of a life insurance policy disclaims, she will be deemed to have predeceased the insured and either the contingent beneficiary will take or the insured’s estate).

228. IOWA CODE § 633E.5.

229. *See id.* Iowa’s previous disclaimer statute was codified at IOWA CODE § 633.704 (2003).

representative owes a fiduciary duty to creditors of an estate, then a disclaimer of estate assets may constitute a breach of fiduciary duty to those creditors.

The Iowa Supreme Court has repeatedly recognized and held that an executor or administrator is a trustee acting in a fiduciary capacity between the creditors of the estate of the deceased and the devisees, legatees, and distributees.<sup>230</sup> “As such impartial trustee it is [the executor’s] duty to collect and conserve the assets of the estate . . . for the benefit and protection of the creditors and the distributees or devisees.”<sup>231</sup> Therefore, an executor’s attempt to disclaim assets of an estate may constitute a breach of trust as it relates to creditors or beneficiaries of the estate. Such a disclaimer would be ineffective by the express provision of the Disclaimer Act.<sup>232</sup>

If the “breach of trust” exception to a disclaimer codified in the Disclaimer Act does apply to estates, then the Disclaimer Act effectively overrules *In re Estate of Kirk*.<sup>233</sup> In *Kirk*, the creditor of the estate was the Iowa Department of Human Services seeking to recoup Medicaid payments on behalf of the decedent.<sup>234</sup> The executor’s failure to seek collection of assets from the decedent’s husband’s estate would likely be a breach of trust as it applied to the Iowa Department of Human Services making the executor’s disclaimer ineffective under the Disclaimer Act.<sup>235</sup> Regardless of whether the *Kirk* case would have involved a breach of trust, the Disclaimer Act may overrule *Kirk* on other grounds. The Iowa Code was recently changed to state that a disclaimer constitutes a transfer of assets for purposes of Medicaid eligibility.<sup>236</sup> The Iowa Supreme Court in *Kirk* based its decision on its finding that no transfer was deemed to have

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230. *In re Estate of Wiese*, 257 N.W.2d 1, 3 (Iowa 1977); *Jennings v. Schmitz*, 20 N.W.2d 897, 901 (Iowa 1945); *Reichard v. Chi., B. & Q. R. Co.*, 1 N.W.2d 721, 731 (Iowa 1942); *In re Estate of Willenbrock*, 290 N.W. 502, 505 (Iowa 1940); *In re Estate of Chismore*, 189 N.W. 770, 772 (Iowa 1922); *Blackman v. Baxter*, 100 N.W. 75, 76 (Iowa 1904).

231. *In re Smith’s Estate*, 36 N.W.2d 815, 826 (Iowa 1949); *see also* S. KURTZ, KURTZ ON IOWA ESTATES § 9.1 (3d ed. 1995).

232. IOWA CODE § 633E.5 (2007).

233. *In re Estate of Kirk*, 591 N.W.2d 630, 634 (Iowa 1999).

234. *Id.* at 632.

235. *Id.*

236. IOWA CODE § 633E.15 (“A disclaimer of any property, interest, or right pursuant to the provisions of this chapter constitutes a transfer of assets for the purpose of determining eligibility for medial assistance under chapter 249A in an amount equal to the value of the property, interest, or right disclaimed.”).

occurred.<sup>237</sup> So, the new statute clearly prevents a disclaiming beneficiary from disregarding the disclaimed assets from his or her application for Medicaid. Because the new statute says it applies only for purposes of Medicaid eligibility, it is not clear whether it would have allowed the Iowa Department of Human Services in *Kirk* to recoup all the Medicaid payments from the institutionalized spouse's estate or only those Medicaid payments made on her behalf after she was entitled to her husband's inheritance. If the latter interpretation is correct, then the Iowa Department of Human Services would have only recouped three months worth of payments.

### 1. *Powers of Appointment*

A person holding a general or special power of appointment may disclaim that power.<sup>238</sup> Nonfiduciary special and general power holders can disclaim if they have not yet exercised the power, but general power of appointment holders cannot disclaim if they have already exercised it, even if the power was exercised only once for the benefit of someone else.

A fiduciary power of appointment is a little different than a nonfiduciary power of appointment. A fiduciary power of appointment is a power of appointment held by a trustee, personal representative, or power of attorney.<sup>239</sup> It can exist in the form of a trustee's discretionary authority to make distributions of income or principal to herself as well as other beneficiaries.<sup>240</sup> A general or special power held in a fiduciary capacity can be disclaimed at any time even if the power has already been exercised by the fiduciary for her own benefit.<sup>241</sup> The disclaimer of a fiduciary general power of appointment could be extremely beneficial to a trustee of a discretionary trust who is also a beneficiary. Under the Disclaimer Act, the trustee could disclaim only the power to make distributions to herself. In addition, unless the trust instrument or the disclaimer provided otherwise, the trustee's disclaimer will only be effective while she was trustee.<sup>242</sup> Thus, upon the resignation of the trustee and appointment of a successor, the successor trustee would again be vested with the power to make discretionary distributions to the resigning trustee.<sup>243</sup>

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237. See *supra* note 210–12 and accompanying text.

238. IOWA CODE § 633E.9.

239. *Id.* § 633E.2(4).

240. UNIF. DISCLAIMER OF PROP. INTERESTS ACT, § 11, cmt. (1999).

241. *Id.* § 11.

242. IOWA CODE § 633E.11.

243. UNIF. DISCLAIMER OF PROP. INTERESTS ACT, § 11, cmt. (1999).

## 2. *Effect of Disclaimer on Federal Tax Liens*

A disclaimer, even though effective against most creditors, is not effective against a federal tax lien.<sup>244</sup> In *Drye v. United States*, the Supreme Court held that a beneficiary's interest in an estate in Arkansas vests upon death of the decedent, which gives the beneficiary a property interest to which a federal tax lien can attach.<sup>245</sup> The IRS, in enforcing its claim, is entitled to ignore the taxpayer-beneficiary's attempted disclaimer because the disclaimer is nothing more than a legal fiction, much like a homestead exemption.<sup>246</sup> Iowa law, like Arkansas, provides that a beneficiary's interest in estate property vests upon death of the decedent.<sup>247</sup> Therefore, a tax-debtor who is a beneficiary of an estate likely will not be entitled to disclaim an inheritance through an estate to avoid federal tax liabilities. This exception for federal tax liens applies only to federal tax liens and not tax liens in favor of a state or other locality.

### E. *Terminating the Irrevocable Trust*

The Iowa Trust Code provides two methods by which an irrevocable trust can be terminated: One in which the settlor is still living and one in which the settlor is deceased.

Iowa Code section 633A.2202(1) allows for the modification or termination of an irrevocable trust with "the consent of the settlor and *all* of the beneficiaries."<sup>248</sup> For cases in which a beneficiary is not yet born or otherwise unavailable, the code allows the consent of a person who may bind the beneficiary (such as a conservator or a parent of a minor) to act on behalf of the beneficiary.<sup>249</sup> Once terminated, the trustee distributes the trust property as agreed by the beneficiaries and the settlor.<sup>250</sup> If the settlor and all the beneficiaries agree to terminate the trust but do not agree on how the trust assets should be distributed, the court will order a distribution of its own design.<sup>251</sup> In certain cases, the beneficiaries may be deemed to have made a taxable gift to the settlor by consenting to the

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244. *Drye v. United States*, 528 U.S. 49, 59–61 (1999).

245. *Id.* at 61.

246. *Id.* at 60–61.

247. IOWA CODE § 633.350.

248. *Id.* § 633A.2202(1) (emphasis added).

249. *Id.* § 633A.6304. A parent may also represent and bind his minor child. *Id.* § 633A.6303.

250. *Id.* § 633A.2202(2).

251. *Id.*

distribution to the settlor.<sup>252</sup>

For situations in which the settlor is deceased, the trust can only be modified or terminated by court order upon a showing that the continuance of the trust is not necessary to carry out a material purpose *and* that all the beneficiaries consent to the modification or termination.<sup>253</sup> If the court approves a modification or termination, the court orders the distribution of the trust property in accordance with the probable intention of the settlor.<sup>254</sup> Again, persons with the ability to bind a beneficiary are able to consent on behalf of those beneficiaries.<sup>255</sup> A repeal of the federal estate tax could perhaps be the basis of a termination of a credit shelter trust if the primary purpose for creation of the trust was to avoid federal estate taxes.

Another less formal method of effecting an irrevocable trust termination is to grant an individual named in the trust instrument with a special power of appointment who would have the authority to transfer the trust assets back to the settlor.<sup>256</sup> Obviously, the settlor should be cautious in choosing this person because he would have independent discretion as to when the trust corpus is distributed and to whom it is distributed.

An example of a special power of appointment is as follows:

During Trustor's lifetime, my wife may appoint the entire principal and accumulated income of the trust as provided in this Article. The power may be exercised at any time during her lifetime by a written instrument delivered to the Trustee. My wife may appoint the principal of the trust to any persons or entities other than herself, her estate, her creditors, or the creditors of her estate, in such amounts and proportions, and for such estates and interests, on such terms and conditions, either outright or in trust, as she may elect. However, this limited power of appointment may not be exercised in a manner which would serve to discharge my wife's legal obligations, or would otherwise inure to her pecuniary benefit. In the event my wife is unable to exercise this special power of appointment because of death

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252. *See id.*; Treas. Reg. § 25.2511-1 (as amended in 1997).

253. IOWA CODE § 633A.2203(1).

254. *Id.* § 633A.2203(2).

255. *Id.* § 633A.2203(3).

256. A person has a special power of appointment if "(a) it can be exercised only in favor of persons, not including the donee, who constitute a group not unreasonably large, and (b) the donor does not manifest an intent to create or reserve the power primarily for the benefit of the donee." *In re Estate of Spencer*, 232 N.W.2d 491, 496 (Iowa 1975) (quoting RESTATEMENT OF PROP. § 320, at 1828 (1940)).

or disability, John Doe shall have the right to exercise such special power of appointment under the same terms and conditions.

The choice of a spouse to be the special power holder should not cause the trust assets to be taxable in her estate or in the settlor's estate for federal estate tax purposes.<sup>257</sup>

#### F. *The Low Budget Asset Protection Trust*

Off-shore asset protection trusts can be expensive and risky. Domestic asset protection trusts are expensive and uncertain. There are, however, more traditional and inexpensive methods to provide asset protection and retain some control over trust assets by use of statutory terminations and special powers of appointment.

##### 1. *Protection from Settlor's Creditors*

Iowa Code section 633A.2303(1) draws a line for asset protection for self-settled trusts in Iowa.<sup>258</sup> It states: "If a settlor is a beneficiary of a trust created by the settlor, a transferee or creditor of the settlor may reach the maximum amount that the trustee could pay to or for the settlor's benefit."<sup>259</sup>

A settlor who desired to protect assets from her creditors could merely establish an irrevocable trust and then rely upon the willingness of the beneficiaries to later consent to a termination of the trust and distribution back to the settlor. Absent factors such as a fraudulent transfer and a deemed taxable gift by the beneficiaries to the settlor, the assets in the trust should be insulated from the claims of the settlor's creditors.<sup>260</sup> A settlor who wanted to retain some ability to access the trust assets at some later time should carefully choose the beneficiary of the trust. A beneficiary who is sympathetic or allegiant to the settlor would allow the settlor to modify or terminate the trust by implementing Iowa

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257. See *Kneeland v. Comm'r*, 34 B.T.A. 816 (1936). In *Kneeland*, the decedent established an irrevocable trust for his family, but under which his wife could revoke the trust and have the principal returned to the decedent. *Id.* at 818. The court held that the power of the decedent to influence his wife to revoke the trust did not support inclusion of the trust in the decedent's estate. *Id.* at 823.

258. IOWA CODE § 633A.2303(1) (2007).

259. *Id.*; see also RESTATEMENT (THIRD) OF TRUSTS § 60 cmt. f (2003).

260. See *In re Estate of Kirk*, 591 N.W.2d 630, 634 (Iowa 1999); see also IOWA CODE § 684.



Code section 633A.2202.<sup>261</sup> Once terminated or modified, section 633A.2205 allows the beneficiary and settlor to decide how and to whom the trust assets are to be distributed.<sup>262</sup> The fewer the beneficiaries designated in the trust instrument, the easier it will be for the settlor to acquire the requisite consent. Of course, the settlor should weigh the benefit of having fewer beneficiaries against the risk that the beneficiaries may die and trigger a distribution event. A spouse may be a good choice as beneficiary, but a transfer in trust to a relative sometimes invites unwanted scrutiny for a fraudulent transfer.<sup>263</sup>

Another method to allow the settlor to retain some control over an irrevocable trust is to designate a special power of appointment holder.<sup>264</sup> Individuals given a special power of appointment under a trust to transfer all or a portion of the trust's assets to anyone other than themselves, their creditors, or their estates could elect to use such power to transfer the trust assets back to the settlor. This leaves the door open for the settlor to receive the trust assets back at some point in the future while enabling the settlor to protect the trust assets from his creditors, provided the settlor is not considered a beneficiary.<sup>265</sup>

Although the settlor may be a beneficiary of the special power of appointment holder's exercise of power, the settlor should not be deemed a beneficiary for purposes of Iowa Code section 633A.2303.<sup>266</sup> The Iowa Trust Code defines the term "beneficiary" as "a person who has any present or future interest in the trust, vested or contingent, and also includes the owner of an interest by assignment or other transfer."<sup>267</sup> Generally, however, "[m]embers of a class of possible appointees under a

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261. IOWA CODE § 633A.2202.

262. *Id.* § 633A.2205.

263. *Benson v. Richardson*, 537 N.W.2d 748, 760 (Iowa 1995) (stating a debtor husband may not accomplish a transfer without consideration to his wife to the frustration of his creditors); *Commercial Sav. Bank of Lohrville v. McLaughlin*, 214 N.W. 542, 543 (1927) ("[B]lood relationship between the parties is not per se a badge of fraud, although it strengthens the inference that arises from the circumstances, and requires strict proof of the consideration and the fairness of the transaction."). *See also infra* text accompanying notes 383-86 (discussing fraudulent transfers).

264. *See supra* note 256 and accompanying text.

265. If a settlor is deemed a beneficiary, the settlor's creditors can attach the trust assets. *See supra* note 159, 259 and accompanying text.

266. *See supra* notes 159, 259 and accompanying text.

267. IOWA CODE § 633A.1102(2); *See also Grandquist v. Grandquist (In re Kenneth L. Grandquist Revocable Trust)*, No. 03-1688, 2005 WL 1962554, at \*2 (Iowa Ct. App. Aug. 17, 2005) (stating that the Iowa Trust Code broadly defines a beneficiary).

power of appointment are not considered beneficiaries of a nature that would entitle them to rights under the Iowa Trust Code.<sup>268</sup> Nor is a special power holder a trustee for purposes of Iowa Code section 633A.2303. A trustee is defined as “[t]he person holding property in trust.”<sup>269</sup> A special power holder does not hold trusts assets. A special power holder can only direct the trustee to distribute assets.

## 2. *Federal Gift Tax Consequences*

A settlor who establishes a trust for the purpose of protecting the assets of the trust from creditors may not want the trust to qualify as a gift for federal gift tax purposes. A gift for federal gift tax purposes will either use up the settlor’s unified credit or cause the settlor to incur gift taxes. Settlers can avoid making a gift for federal gift tax purposes if they retain a power to change beneficial interests in the trust.<sup>270</sup> Thus, adding a provision allowing the settlor to add beneficiaries to a trust (other than himself, his creditors, his estate, or his dependents) should avoid the incurrence of a taxable gift for federal gift tax purposes. Likewise, the appointment of the trust property by the special power holder should not trigger a taxable gift because the power holder does not own or possess the property subject to the power.<sup>271</sup>

With certain trusts, such as Crummey Trusts,<sup>272</sup> the settlor may desire to have made a completed gift for federal gift tax purposes. When a gift upon creation is desired, the existence of a special power of appointment may negate such a gift in certain circumstances. If an agreement, understanding, or prearrangement is found to exist between the power holder and the settlor, contemporaneous with the creation of the trust, that would allow the settlor to receive the trust assets back, a few courts have held that the transfer of the settlor’s assets to the trustee may not qualify as a completed gift because the settlor has retained the power to re-vest the trust assets in his own name.<sup>273</sup> Historically, an agreement, understanding,

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268. BOGERT & BOGERT *supra* note 55, § 182, at 261. Rights of a beneficiary would include the right to compel the trustee to provide an accounting or do other acts. IOWA CODE § 633A.4502.

269. RESTATEMENT (SECOND) OF TRUSTS § 3 (1959).

270. Treas. Reg. § 25.2511-2(c) (1958); *see also* I.R.S. Priv. Ltr. Rul. 93-26-049 (July 2, 1993) (“[A] gift is incomplete if the donor reserves the power to name new beneficiaries or to change the interests of the beneficiaries as between themselves . . .”).

271. Treas. Reg. § 25.2511-2(g) (1958).

272. *See supra* notes 161–62 and accompanying text.

273. Estate of Skinner v. United States, 316 F.2d 517 (3d Cir. 1963); Estate of

or prearrangement has been difficult for the IRS to prove.<sup>274</sup> In *Herzog v. Commissioner*, a completed gift was held to have occurred upon the transfer of assets into trust by the settlor despite the fact that on the very same day the trust was created, the trustee distributed all of the trust's income back to the settlor pursuant to the trustee's special power of appointment.<sup>275</sup> The court stated: "if the grantor retains such a mere expectancy that the trustee will distribute trust assets to the grantor rather than an enforceable interest in the trust, the expectancy does not prevent the completion or reduce the value of the gift."<sup>276</sup> In *Outwin v. Commissioner*, a completed gift was deemed to occur despite the fact that the trustees were close personal friends of the settlor and the trustees had the special power to appoint all the trust property back to the settlor.<sup>277</sup>

In other cases, a transfer to a trust may be considered incomplete for gift tax purposes if, under state law, the settlor's creditors can reach the trust assets to satisfy their claims.<sup>278</sup> Under Iowa Code section 633A.2303, the settlor's creditors may attach all of the trust assets that the trustee could pay to the settlor regardless of whether the trust contains a spendthrift clause, and regardless of whether the trustee's discretion was wholly and purely discretionary.<sup>279</sup> Because the trustee would have the special power to make a distribution to the grantor, the grantor's creditors could attach the trust assets. As a result, the assets transferred into trust will not be considered a completed gift for gift tax purposes, and, in such case, the trust assets can be included in the taxable estate of the settlor

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Green v. Comm'r, 64 T.C. 1049 (1975), *acq.*, 1976-2 C.B. 1; Estate of Nicol v. Comm'r, 56 T.C. 179 (1971); Treas. Reg. § 25.2511-2(c).

274. See, e.g., *Outwin v. Comm'r*, 76 T.C. 153, 160-68 (1981), *acq.*, 1981-2 C.B. 1 (holding that an oral agreement "prior to the execution of the written agreements to (1) distribute the trust income or corpus whenever the grantors requested such funds, and (2) terminate the trusts upon their request by making liquidating distributions of all the remaining corpus" was not evidence contrary to the completion of a gift); Estate of Beckwith v. Comm'r, 55 T.C. 242, 251 (1970) (holding that the respondent did not prove that "an informal agreement or prearrangement . . . [could] be inferred . . .").

275. *Herzog v. Comm'r*, 41 B.T.A. 509 (1940), *aff'd*, 116 F.2d 591 (2d Cir. 1941).

276. Rev. Rul. 77-378, 1977-2 C.B. 347 (citing *Herzog*, 41 B.T.A. at 509).

277. *Outwin*, 76 T.C. at 168-69.

278. *Comm'r v. Vander Weele*, 254 F.2d 895, 898 (6th Cir. 1958); Estate of Paxton v. Comm'r, 86 T.C. 785, 815-16 (1986); *Outwin*, 76 T.C. at 162; Hambleton v. Comm'r, 60 T.C. 558, 562-63 (1973), *acq. in result*, 1974-2 C.B. 1; Paolozzi v. Comm'r, 23 T.C. 182, 186 (1954), *acq.*, 1962-2 C.B. 3; Rev. Rul. 76-103, 1976-1 C.B. 293; Henry J. Lischer, *Domestic Asset Protection Trusts: Pallbearers to Liability?*, 35 REAL PROP. PROB. & TR. J. 479, 564 (2000).

279. IOWA CODE § 633A.2303 (2007).

under Internal Revenue Code § 2036(a).<sup>280</sup> It makes no difference whether the special dispositive power is limited by an ascertainable standard.<sup>281</sup>

If the special power of appointment holder is not the trustee, Iowa Code section 633A.2303 would not be applicable, and the grantor's creditors would not be allowed to attach the trust assets.<sup>282</sup> Consequently, the gift to the trust would be considered a completed gift.<sup>283</sup> Thus, the special power holder should not hold trustee powers.<sup>284</sup>

#### IV. LIMITED PARTNERSHIPS AND LIMITED LIABILITY COMPANIES ("LLEs")

##### *A. Protecting the LLE Assets from Its Owners' Creditors*

Limited Partnerships and Limited Liability Companies (hereinafter referred to in the aggregate as limited liability entities or "LLEs") may be effective asset protection instruments. Provided the LLE is properly formed and operated, an LLE owner is protected from the liabilities of the LLE in much the same way a shareholder is protected from the liabilities of the corporation.<sup>285</sup> This has sometimes been called "inside-out" protection because the liabilities existing inside the LLE cannot escape to taint the LLE owners' assets.

Conversely, LLEs may have "outside-in" protection. In other words, liabilities of an LLE owner cannot seep into the LLE to taint the assets of the LLE, even if a creditor acquires more than a controlling interest in the LLE. Such a result occurs because the owner's creditor, after levying on the LLE interest, does not acquire any voting rights.<sup>286</sup> The creditor is only

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280. See *Outwin*, 76 T.C. at 168-69; Rev. Rul. 77-378, 1977-2 C.B. 347; JOSEPH M. DODGE & WM. H. FRANCIS, JR., *TAX MANAGEMENT PORTFOLIO, TRANSFERS WITH RETAINED INTERESTS AND POWERS*, at A-23, A-73 (5th ed. 1992).

281. Rev. Rul. 77-378, 1977-2 C.B. 347.

282. *Ober v. Dodge*, 231 N.W. 444, 447 (Iowa 1930) (stating creditors could not compel garnishee to elect to claim the income in the hands of the trustee); *Darling v. Dodge*, 206 N.W. 266, 267 (Iowa 1925) (holding that funds in the hands of the trustee are not subject to garnishment); *Ober v. Seegmiller*, 160 N.W. 21, 22 (Iowa 1916) (stating only a beneficiary could demand payment from garnishment).

283. Rev. Rul. 77-378, 1977-2 C.B. 347 (holding donor who parts with dominion and control over property makes a complete gift).

284. See *supra* notes 159, 259 and accompanying text.

285. IOWA CODE § 490A.603 (2007) (stating that members are not liable for the debts of the limited liability company); *id.* § 488.303 (stating limited partners are not liable for the debts of the limited partnership).

286. *Id.* § 490A.902-04 (stating that a creditor acquires the rights of an

entitled to receive distributions from the LLE when the LLE decides to make distributions.<sup>287</sup>

To further burden the creditor of an LLE owner who has levied on the owner's LLE interest, such creditor is likely to be taxed on the income of the LLE.<sup>288</sup> Of course a levying creditor on an LLE interest pays income tax on the profits of the LLE, and may have no guarantee of receiving any distributions.

The outside-in protection offered by an LLE has caused some practitioners to recommend establishing a limited liability company (LLC) and "checking the box"<sup>289</sup> to have the entity taxed as an S corporation.<sup>290</sup> The LLC offers outside-in liability protection, and the tax characteristics of an S corporation allow for more flexible FICA tax planning.<sup>291</sup>

Creditors have had some recent success in penetrating the outside-in defense of an LLE. In *In re Turner*, the bankruptcy court held that the LLC was the member's alter ego when the LLC was formed for the purpose of holding the LLC member's residence as an asset.<sup>292</sup> The court stated,

[a]n entity or series of entities may not be created with no business purpose and personal assets transferred to them with no relationship

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assignee, who is not entitled to "participate in the management affairs of the limited liability company"); *id.* § 488.702-03 (stating that a creditor acquires the rights of a transferee, who is not entitled to "participate in the management or conduct of the limited partnership's activities"). Although the assignee of an LLC or LP interest does not acquire voting rights, the assignor of the LP interest retains the voting rights; however, the assignor of the LLC interest does not retain voting rights unless specifically provided for in the operating agreement. *Cf. id.* §§ 488.702(4), 490A.902. However, the operating agreement of the LLC is allowed to provide that an assignor retains voting rights of an assigned interest until the assignee is voted in as a member by the other members. *Id.* § 490A.902 ("Except as provided in the articles of organization or an operating agreement, a member ceases to be a member upon assignment of the member's entire membership interest.").

287. *In re Stocks*, 110 B.R. 65 (Bankr. N.D. Fla. 1989); *see also In re Smith*, 17 B.R. 541 (Bankr. M.D. Ga. 1982); *In re Pischke*, 11 B.R. 913 (Bankr. E.D. Va. 1981); *Chrysler Credit Corp. v. Peterson*, 342 N.W.2d 170 (Minn. Ct. App. 1984).

288. Rev. Rul. 77-137, 1977-1 C.B. 178.

289. Treas. Reg. § 301.7701-3(a) allows entities to choose whether to be taxed as a corporation or a partnership regardless of the structure of the entity.

290. F. Owen Evans III & William J. Hyland, Jr., *The LLC Envelope*, FLA. BAR J. Dec. 2003, at 50.

291. *Id.*

292. *In re Turner*, 335 B.R. 140, 147 (Bankr. N.D. Cal. 2005).

to any business purpose, simply as a means of shielding them from creditors. Under such circumstances, the law views the entity as the alter ego of the individual debtor and will disregard it to prevent injustice.<sup>293</sup>

In *In re Ehmman*, the bankruptcy court ruled that a bankruptcy trustee may disregard the no voting rights upon assignment concept in place in Arizona for LLCs.<sup>294</sup> In *Ehmman*, the debtor obtained an interest in an LLC formed by his parents.<sup>295</sup> The court did not indicate how large the percentage interest the debtor acquired was, but it did acknowledge that the debtor's siblings were also members.<sup>296</sup>

The court observed that if the operating agreement of the LLC is nonexecutory in nature with respect to the debtor (such as when the debtor has no obligation to perform), § 541(c)(1) of the Bankruptcy Code applies.<sup>297</sup> "Code § 541(c)(1) expressly provides that an interest of the debtor becomes property of the estate notwithstanding any agreement or applicable law that would otherwise restrict or condition transfer of such interest by the debtor."<sup>298</sup> All of the limitations in the operating agreement of an LLC and all of the provisions of the state's law constitute conditions and restrictions upon the debtor-member's transfer of his interest to the bankruptcy trustee.<sup>299</sup> "Section 541(c)(1) renders those restrictions

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293. *Id.*

294. *Movitz v. Fiesta Invs. (In re Ehmman)*, 319 B.R. 200, 206 (Bankr. D. Ariz. 2005).

295. *Id.* at 202.

296. *Id.* at 204.

297. *Id.* at 205–06. 11 U.S.C. § 541(c)(1) (2000) provides:

[e]xcept as provided in paragraph (2) of this subsection, an interest of the debtor in property becomes property of the estate under subsection (a)(1), (a)(2), or (a)(5) of this section notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law—

(A) that restricts or conditions transfer of such interest by the debtor; or  
(B) that is conditioned on the insolvency or financial condition of the debtor, on the commencement of a case under this title, or on the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement, and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in the property.

298. *In re Ehmman*, 319 B.R. at 206.

299. *Id.*

inapplicable.”<sup>300</sup> This suggests that the bankruptcy trustee has all of the rights and powers of the debtor with respect to the LLC, including voting rights.<sup>301</sup>

If the operating agreement is executory with respect to the debtor (such as if the debtor has material obligations to perform), then § 365(e)(2) of the Bankruptcy Code requires that the bankruptcy trustee not interfere with the performance of such operating agreement.<sup>302</sup> In other words, the bankruptcy trustee would have to honor the terms of the operating agreement, which may provide that an assignee of a membership interest is not entitled to voting rights.<sup>303</sup>

The court concluded that the operating agreement imposed no obligations on the non-manager members and was therefore nonexecutory.<sup>304</sup> The trustee was not obligated to abide by the terms of the operating agreement or the LLC statutes of the State of Arizona.<sup>305</sup> The court reserved the issue of what types of collection remedies the bankruptcy trustee may have with respect to the LLCs assets for a later hearing.<sup>306</sup> The court suggested that the trustee may be able to compel a redemption of the debtor’s interest or to dissolve the LLC.<sup>307</sup>

In light of the developing legal theory advanced by *Ehmann*, practitioners should consider providing material obligations upon each member of the LLC.<sup>308</sup> This may be accomplished by requiring that each member covenant not to compete with the business of the LLC. Requiring members to make additional capital contributions in limited situations may also be a material obligation. Naming each of the members as managers of the LLC would also be a material obligation, although it may also subject the members to FICA taxation issues.

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300. *Id.*

301. *Id.*

302. *Id.* at 203.

303. *Id.* at 204.

304. *Id.* at 206.

305. *Id.*

306. *Id.*

307. *Id.*

308. See generally Thomas Earl Geu & Thomas E. Rutledge, *Guess Who’s Coming to Dinner?: The Bankruptcy Trustee’s Ability to Become a Member of an LLC and the Ehmann Decision*, BUS. ENTITIES, Mar.–Apr. 2005, at 32, 41 (explaining that the inclusion of fiduciary duties in the operating agreement or the offering of management opportunities are two ways to implicate executory obligations, thus avoiding significant bankruptcy trust substitution issues).

### B. Single Member LLCs

The outside-in protection may provide significant burdens to an LLE owner's creditors when there are two or more LLE owners. What about creditors of a single member LLC? There is no exception in the Iowa Limited Liability Company Act for the involuntary assignment of the interest of a single member LLC to the member's creditor.<sup>309</sup> Therefore, would the creditor, owning one hundred percent of the LLC, be required to wait for management to make distributions on the interest? Would the debtor-member still control the management of the LLC?

A Colorado bankruptcy court in *In re Albright* ruled that despite language in the Colorado Limited Liability Company Act to the contrary, the levying creditor on a one hundred percent interest of a Colorado LLC is entitled to full and complete control of the LLC, including the right to distribute all its assets.<sup>310</sup> In that case, the debtor, Ashley Albright, owned the entire interest in a Colorado LLC named Western Blue Sky, LLC.<sup>311</sup> The LLC owned real estate in Colorado.<sup>312</sup> Albright first declared bankruptcy on February 9, 2001, under Chapter Thirteen, it was then converted to Chapter Seven on July 19, 2001.<sup>313</sup> Although her entire interest in the LLC was included in her bankruptcy estate, Albright maintained that the bankruptcy trustee was only entitled to a charging order, or in other words, the right to receive distributions.<sup>314</sup> She maintained that the bankruptcy trustee was not entitled to assume management of the LLC or cause it to sell or distribute its assets.<sup>315</sup>

The bankruptcy court ruled against Albright and in favor of the bankruptcy trustee in holding that the bankruptcy trustee was entitled to manage the LLC and could cause it to sell or distribute all its assets.<sup>316</sup> Under the Colorado Limited Liability Company Act, the charging order concept is solely intended to benefit the other members of the LLC.<sup>317</sup> Because there were no other members of the LLC, the charging order provision served no purpose in this particular case.<sup>318</sup> The bankruptcy

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309. See generally IOWA CODE § 490A (2007).

310. *In re Albright*, 291 B.R. 538, 541 (Bankr. D. Colo. 2003).

311. *Id.* at 539 n.3.

312. *Id.*

313. *Id.* at 539 n.1.

314. *Id.* at 539.

315. *Id.*

316. *Id.* at 542.

317. *Id.* at 541.

318. *Id.*



court noted, however, that the result would be different if there were other non-debtor members in the LLC.<sup>319</sup>

As a result of the *Albright* decision, some have suggested that an operating agreement for a single member LLC be prepared with a springing member who would automatically come into existence at the first sign of trouble. Of course, there are many problems associated with this type of solution, not the least of which is that it would likely be viewed as a complete sham.

### C. Single Member LLC Tax Liability

The LLCs hybrid status presents unique issues for single member LLCs in the federal tax liability context. Unlike issues relating to contractual and tort liability, a single member LLC cannot look to corporate case law for guidance on tax issues if it has elected to be disregarded as an entity separate from its owner. For federal tax purposes, if a single member LLC is disregarded, its activities are treated in the same manner as those in a sole proprietorship.<sup>320</sup>

In a single member LLC, the member is responsible for the tax liabilities of the LLC. This rule has left many practitioners wondering if, because the single member is responsible for the LLCs tax obligations, the opposite is also true. That is, can the single member LLC be required to satisfy the personal tax obligations of its only member?

In a 1999 Memorandum, the IRS issued its policy regarding the ability to place a lien against the assets of a single member LLC to satisfy the tax liability of that taxpayer.<sup>321</sup> In the 1999 Memorandum, the IRS held that “[t]he mere fact that the LLC entity is disregarded for federal tax purposes does not entitle the Service to disregard the entity for purposes of collection.”<sup>322</sup> Sections 6321 and 6331 of the Internal Revenue Code authorize the IRS to create a lien against all property belonging to an individual owing taxes to the IRS.<sup>323</sup> However, because LLCs are separate entities from their members under state law, individual taxpayers do not have any property interests in the property of the LLC.<sup>324</sup> Therefore, the IRS cannot serve a levy against the property of an LLC because it does not

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319. *Id.*

320. Treas. Reg. § 301.7701-2(a) (2006).

321. I.R.S. Chief Couns. Adv. Mem. 199930013 (Apr. 18, 1999).

322. *Id.*

323. *Id.* (citing I.R.C. §§ 6321, 6331 (2000)).

324. *Id.*

belong to the taxpayer.

Despite its finding that the IRS could not reach the assets of the LLC to collect taxes owed to the IRS by the LLC members, the IRS opined that it was not without other collection options.<sup>325</sup> The IRS reasoned that if the taxpayer has a transferable distributional interest in the LLC pursuant to state statute, the IRS can place a lien on the interest.<sup>326</sup> In addition, if grounds for piercing the LLC veil exist, the IRS can collect from the LLC as the alter ego of the single member taxpayer.<sup>327</sup> For these reasons, the IRS likely welcomed the decision in *Albright*.

#### V. IRAS AND QUALIFIED RETIREMENT PLANS

The United States Supreme Court, in *Patterson v. Shumate*, held that retirement plan assets in a “qualified” retirement plan under ERISA containing an anti-alienation (e.g., spendthrift) clause were entirely exempt from the claims of the creditors of the plan participants and plan sponsor.<sup>328</sup> The Court observed that qualified retirement plans gain their exemption through spendthrift clauses required under ERISA and that the Bankruptcy Code excludes from the bankruptcy estate only those spendthrift trusts that are enforceable under “applicable nonbankruptcy law.”<sup>329</sup>

The issue in *Patterson* was whether ERISA was “applicable nonbankruptcy law.”<sup>330</sup> The Court held that it was.<sup>331</sup> Qualified retirement plans include pension plans, profit sharing plans, 401(k) plans, employee stock ownership plans, and other retirement plans that meet the requirements of ERISA. Funds held in these plans are exempt from creditors regardless of whether the plan participant has the right to withdraw the funds at any time and in any amount.<sup>332</sup>

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325. *Id.*

326. *Id.*

327. *Id.*

328. *Patterson v. Shumate*, 504 U.S. 753, 760 (1992).

329. *Id.* at 757–60. Even IRAs rolled into ERISA qualified retirement plans are fully exempt under the holding of *Patterson*. *In re Holst*, 192 B.R. 194, 199–200 (Bankr. N.D. Iowa 1996).

330. *Patterson*, 504 U.S. at 755; *see also* 11 U.S.C. § 541(c)(2) (2000) (“A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.”).

331. *Patterson*, 504 U.S. at 759.

332. *See In re Holst*, 192 B.R. at 200 (finding an employee’s beneficial interest

*A. Exemption from Federal Tax Liens*

The IRS essentially takes the position that a taxpayer who has a right to elect distribution can be compelled to make such a distribution election and then pay the proceeds to the IRS as back taxes.<sup>333</sup> In a 1999 Memorandum, the IRS informed an inquiring revenue agent that the IRS can generally make an early retirement election on behalf of a taxpayer who qualifies to make such an election but chooses not to, and then levy on the assets in the plan.<sup>334</sup> The memorandum reasons that under Internal Revenue Code § 6321, a “federal tax lien attaches to a participant’s interest in an ERISA-covered plan if the participant has any vested benefit under the plan.”<sup>335</sup> The lien attaches to all present rights the taxpayer has under the plan, which may include the present right to future payment and to elect a form of distribution, although the taxpayer may not have yet exercised those rights.<sup>336</sup> The taxpayer who was the subject of the memorandum had a vested right in the plan, so the tax lien attached to his present right to elect early retirement benefits.<sup>337</sup>

The revenue agent was cautioned, however, that “[c]areful consideration must be given [when] the [IRS] seeks collection from a retirement plan that . . . requires benefits to be paid in the form of a joint and survivor annuity.”<sup>338</sup> In that case, the IRS “may only levy upon that joint and survivor annuity, and may not elect another form of benefit for collection purposes without the consent of a spouse.”<sup>339</sup> In a footnote, the memorandum mentions that the IRS’s Internal Revenue Manual “provides that the [IRS] should use discretion in levying on the income from retirement plans and that the corpus of a plan . . . should be levied upon only in flagrant cases.”<sup>340</sup>

In addition to federal tax liens, qualified retirement plans may be subject to garnishment for restitution orders under the Mandatory Victims

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under an employer profit sharing plan was excluded from employee’s estate regardless of employee’s right to withdraw).

333. I.R.S. Chief Couns. Adv. Mem. 36,041 (Sept. 10, 1999).

334. *Id.*

335. *Id.*

336. *United States v. Sawaf*, 74 F.3d 119, 122–23 (6th Cir. 1996); *Raihl v. United States (In re Raihl)*, 152 B.R. 615, 617–18 (B.A.P. 9th Cir. 1993); *Treas. Reg. § 301.6331-1* (as amended in 1994).

337. I.R.S. Chief Couns. Adv. Mem. 36,041 (Sept. 10, 1999).

338. *Id.*

339. *Id.*

340. *Id.* n.8.

Restitution Act (MVRA).<sup>341</sup> In *United States v. Novak*, the Ninth Circuit held that a defendant who pled guilty to conspiracy to transport stolen telephone equipment was liable to pay restitution of \$3,360,051.67 from his employer's retirement plans.<sup>342</sup> However, the court went on to hold that the garnishment powers under MVRA only apply to the extent that the defendant had the right under the plan to immediately demand a lump sum payment from the plan without spousal consent.<sup>343</sup> In other words, like the right of the IRS, the government has the right to "step into the defendant's shoes" to access the defendant's retirement plan assets.<sup>344</sup> Therefore, if the defendant has access to the retirement plan, the government has access to the retirement plan under MVRA. The Ninth Circuit is the only circuit court to have decided a case on the interplay between MVRA and ERISA.<sup>345</sup>

### B. IRAs and Other Non-ERISA Plans

IRAs and some SEPs, SIMPLEs, and Keogh plans are not ERISA plans,<sup>346</sup> and until recently, were not exempt from the claims of the owner's

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341. Mandatory Victims Restitution Act, 18 U.S.C. §§ 3663A–3664 (2000).

342. *United States v. Novak*, 476 F.3d 1041, 1043, 1049 (9th Cir. 2007).

343. *Id.* at 1063.

344. *Id.* (emphasis removed).

345. *Id.* at 1057.

346. Generally, the same protections afforded participants of corporate qualified retirement plans also apply to unincorporated entities under the revisions to "H.R. 10" plans (otherwise known as "Keogh" plans) enacted in 1982. I.R.C. § 401(c)(1) & (3) (2000). Since 1982, unincorporated and corporate entities have been treated similarly under ERISA and the Tax Code. Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982, PUB. L. NO. 97-248, 96 Stat. 324 (codified as amended in scattered sections of the U.S.C.).

However, an H.R. 10 plan maintained by sole proprietors for their benefit may not be exempt from levy by a judgment creditor. A general rule of law states that a person cannot shelter assets from creditors by creating a "self-settled" trust and depositing such assets into it. A sole proprietor's qualified retirement plan, if established only for his personal benefit, is essentially equivalent to a "self-settled" trust; therefore, the plan may not benefit from protection from judgment creditors. *Aronsohn & Springstead v. Weissman*, 552 A.2d 649, 650–51 (N.J. Super. Ct. App. Div. 1989).

H.R. 10 plans maintained by separate, unincorporated, legal entities—such as limited liability companies—should not be considered "self-settled" with respect to their principal owners. *Velis v. Kardanis*, 949 F.2d 78 (3d Cir. 1991). In addition, ERISA regulations indicate that a Keogh or H.R. 10 plan maintained by a partnership with one or more common law employees, in addition to the partners, is a plan that is subject to ERISA's anti-alienation and preemption provisions and is exempt from judgment creditors. See 29 U.S.C. § 1056(d) (2000) (ERISA's anti-

creditors.<sup>347</sup> This changed when the United States Supreme Court decided *Rousey v. Jacoway*.<sup>348</sup>

### 1. *Rousey v. Jacoway*

The Court in *Rousey*, decided on April 4, 2005, acknowledged that IRAs are not ERISA plans and therefore are not offered the same full exemption from bankruptcy as an ERISA plan.<sup>349</sup> Instead, the Court in *Rousey* used another exemption under the Bankruptcy Code to exempt IRAs.<sup>350</sup>

The Bankruptcy Code allows a debtor to exempt several kinds of property from the bankruptcy estate. Included among those exemptions

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alienation clause); 29 U.S.C. § 1144(a) (ERISA's preemption clause); *Mackey v. Lanier Collection Agency & Serv. Inc.*, 486 U.S. 825, 836 (1988) (stating ERISA's anti-alienation clause expressly precludes state-law enforcement of judgments against pension benefit plans); *Samore v. Graham (In re Graham)*, 726 F.2d 1268, 1273 (8th Cir. 1984) ("ERISA-required anti-alienation clauses may preempt state law and preclude the use of judgment enforcement devices . . ."); 29 C.F.R. § 2510.3-3(b) (1975) (stating Keogh plan can be an ERISA pension benefit plan).

ERISA's regulations indicate a Keogh or H.R. 10 plan that only covers owners is not an ERISA plan and may not seek the protection of ERISA's anti-alienation and preemption clauses. 29 C.F.R. § 2510.3-3. In addition, as indicated above, a sole proprietor's Keogh plan will not be protected from judgment creditors by virtue of spendthrift clauses included in the Keogh plan document because such plan is considered "self-settled." *Aronsohn & Springstead*, 552 A.2d at 650-51. Therefore, prior to the enactment of the BAPCPA, it was important that any qualified retirement plan established by partnerships or limited liability companies include a common law employee who is not otherwise an owner. *See supra* note 6 (explaining the enactment of the BAPCPA). After BAPCPA, all tax qualified retirement plans, including H.R. 10 plans, are exempt. 11 U.S.C. § 522(b)(4) (West Supp. 2007).

347. Under Department of Labor regulations and recent case law, a retirement plan with no participants other than the business owner and his spouse is not an "employee benefit plan" subject to ERISA and is not excluded from the bankruptcy estate under *Patterson. Watson v. Proctor (In re Watson)*, 161 F.3d 593, 594 (9th Cir. 1998); 29 C.F.R. § 2510.3-3(b). However, if the plan also covers one or more other employees in addition to the business owner and his spouse, then it is an ERISA plan and all the participants' plan assets (including the assets of the business owner and spouse) are protected from claims of the participants' creditors. *Yates v. Hendon*, 541 U.S. 1, 6 (2004); Op. Dep't of Labor 1999-04A (Feb. 4, 1999).

348. *Rousey v. Jacoway*, 544 U.S. 320 (2005).

349. *See id.* at 326. ERISA plans are exempt from the bankruptcy estate under 11 U.S.C. § 541(c)(2) because ERISA is "applicable nonbankruptcy law." *Velis v. Kardanis*, 949 F.2d 78, 82 (3d Cir. 1991). IRAs have no enforceable restrictions under any nonbankruptcy laws. *Id.*

350. *Rousey*, 544 U.S. at 334.

are payments “under a stock bonus, pension, profitsharing, annuity or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor . . . .”<sup>351</sup> The Court in *Rousey* held that IRAs are similar to stock bonus, pension, and profit sharing plans because the United States Tax Code provides substantial penalties for withdrawal prior to turning age fifty-nine and a half.<sup>352</sup>

Although *Rousey* clarifies that IRAs qualify for exemption, there are several distinctions between the exemption provided for ERISA qualified retirement plans described in *Patterson* and the exemption for IRAs. First, the exemption for ERISA qualified retirement plans are unlimited in amount. ERISA qualified retirement plans are treated for bankruptcy protection under the same exemption that a debtor’s beneficial interest in a spendthrift trust would be— both are fully exempt. A debtor’s interest in an IRA, alternatively, is exempt under § 522(d)(10)(E) “to the extent reasonably necessary for the support of the debtor and any dependent of the debtor . . . .”<sup>353</sup> Section 522(d)(10)(E) clearly contemplates that the exemption for IRAs is not unlimited. How much of an IRA remains exempt is a factual inquiry to be determined by future courts.<sup>354</sup>

Second, the exemption under § 522(d)(10)(E) is not applicable for debtors who choose to utilize their state’s exemption scheme instead of the federal exemption scheme. The state exemption scheme may or may not

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351. 11 U.S.C. § 522(d)(10)(E) (2000) (emphasis added).

352. *Rousey*, 544 U.S. at 327. I.R.C. § 72(t), which is applicable to IRAs, provides a ten percent penalty for withdrawal prior to age fifty-nine and a half.

353. 11 U.S.C. § 522(d)(10)(E).

354. Factors to be considered in determining whether an IRA is reasonably necessary for debtor’s support and thus exemptable under this section include:

- (1) Debtor’s present and anticipated living expenses; (2) Debtor’s present and anticipated income from all sources; (3) Age of the debtor and dependents; (4) Health of the debtor and dependents; (5) Debtor’s ability to work and earn a living; (6) Debtor’s job skills, training, and education; (7) Debtor’s other assets, including exempt assets; (8) Liquidity of other assets; (9) Debtor’s ability to save for retirement; special needs of the debtor and dependents; [and] (10) debtor’s financial obligations such as alimony or support payments.

*In re Flygstad*, 56 B.R. 884, 889–90 (Bankr. N.D. Iowa 1986). *Flygstad* was decided at a time when the Iowa exemption statute was nearly identical to 11 U.S.C. § 522(d)(10)(E). Iowa’s exemption statute, prior to 1992, exempted “[a] payment under a pension, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.” IOWA CODE § 627.6(8)(e) (1991).

include an exemption for IRAs.

Under Iowa's exemption structure, deductible IRAs and the earnings thereon are exempt to the extent: (1) that they are a rollover from an ERISA qualified retirement plan,<sup>355</sup> or (2) that contributions to the IRA by the debtor were deductible for federal income tax purposes.<sup>356</sup> Nondeductible contributions to an IRA, and the earnings thereon, are not exempt from the bankruptcy estate. Roth IRAs are exempt to the extent contributions do not exceed the amount that is allowed to be contributed to a Roth IRA, presumably as determined by federal law, not state law.<sup>357</sup>

## 2. *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*

The Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005 changed everything, and most of the changes regarding retirement plans are debtor friendly.<sup>358</sup> Regardless of whether a debtor chooses the federal exemptions or the state exemptions, BAPCPA exempts all retirement funds that are exempt from taxation in one form or another.<sup>359</sup> This includes traditional IRAs, Roth IRAs, 401(k) plans, 403(b) plans, 457 deferred compensation plans, and self-employed plans such as SEPs, SIMPLEs, and Keoghs.<sup>360</sup> All but traditional IRAs and Roth IRAs are unlimited in amount.<sup>361</sup> Most traditional IRAs and Roth IRAs are limited to \$1 million in asset value.<sup>362</sup>

Not all traditional IRAs and Roth IRAs are subject to the \$1 million cap, however. SEP and SIMPLE IRAs are not subject to the cap, nor is a rollover IRA from another tax qualified retirement plan plus any earnings thereon.<sup>363</sup> BAPCPA also allows for the \$1 million cap to be extended if the "interests of justice" so require, presumably on a case-by-case basis.<sup>364</sup>

The \$1 million cap should provide some incentive to keep IRA assets segregated from other tax qualified retirement plans. A traditional IRA

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355. IOWA CODE § 627.6(8)(f)(1)(b) (2007).

356. *Id.* § 627.6(8)(f)(4).

357. *Id.* § 627.6(8)(f)(5).

358. Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified in scattered sections of 11 U.S.C.).

359. 11 U.S.C. §§ 522(b)(3)(A) & 522(d).

360. *See id.* (enumerating sections of the Internal Revenue Code of 1986 that establish various tax-exempt retirement funds).

361. *See* I.R.C. §§ 401, 403, 414, 457, 501(a) (West Supp. 2007).

362. 11 U.S.C. § 522(n) (West Supp. 2007).

363. *Id.*

364. *Id.*

that is combined with a rollover from a 401(k) will be virtually impossible to separate, and thus the entire combined account may be considered for purposes of determining the \$1 million cap. However, there may be a way to untaint a tainted traditional IRA that exceeds \$1 million. Plans under sections 403(b) and 457 are unlimited in their exemption and both can accept rollovers from IRAs.<sup>365</sup> Therefore, if an IRA owner had access to a 403(b) plan or a 457 plan that allowed rollovers, a rollover from the IRA to one of the two types of plans would purify the IRA and qualify it for an unlimited exemption amount.

As a practical matter, the \$1 million cap should be more than sufficient for most debtors' needs. The annual limit on non-rollover IRA contributions was only \$2,000 from 1975 through 2001.<sup>366</sup> A person making the maximum contributions from 1975 through 2005 would only have contributed \$67,000 (\$69,000 if fifty or older by 2002).<sup>367</sup> Such person would have had to receive an investment return of more than fifteen percent in order to have more than a \$1 million balance today— possible, but not probable.

So where does *Rousey*<sup>368</sup> stand in light of BAPCPA? Historically, *Rousey* likely stands as being a very important case for a little over two weeks. Although BAPCPA did not change the “to the extent reasonably necessary for the support of the debtor” language of § 522(d)(10)(E) of the Bankruptcy Code to which *Rousey* subjected IRAs, there are not many conceivable situations in which the *Rousey* standard is better than the \$1 million cap offered by BAPCPA. Perhaps someday if inflation devalued the dollar to a significant degree, \$1 million may not be sufficient for the support of a debtor. But such does not appear to be the case today.

### C. Exemption of Distributions from Qualified Plans

Whether ERISA-qualified retirement plan assets retain their exempt character after they have been paid or are otherwise made available to the plan participant is not entirely clear. A wealth of cases decided by federal courts have indicated the protection afforded by ERISA and the case law decided by the United States Supreme Court ends the moment the plan administrator issues a check.<sup>369</sup> Iowa law, alternatively, may provide some

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365. See I.R.C. §§ 403(b) & 457 (West Supp. 2007).

366. *Id.* § 408(a)(1) (West Supp. 2006).

367. *Id.*

368. See *supra* text accompanying notes 349–52 (discussing *Rousey*).

369. *Velis v. Kardanis*, 949 F.2d 78, 80–83 (3d Cir. 1991); *In re Holst*, 192 B.R.



protection for distributions from retirement plans. The Iowa Code provides that “a payment or a portion of a payment under a pension, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service” is exempt from judgment creditors and an individual’s bankruptcy estate except for any extraordinary contributions made to such a plan for a one-year period prior to the filing of a bankruptcy petition.<sup>370</sup> This exemption applies to *distributions from*, rather than *contributions to*, an ERISA qualified retirement plan.<sup>371</sup>

In *In re Caslavka*, decided early in 1995, the bankruptcy court construed the Iowa Code language to include protection from creditors for funds received from a retirement plan upon retirement that are directly traceable to the retirement plan.<sup>372</sup> The court allowed an exemption in an IRA, the proceeds of which were directly traceable from a qualified ERISA retirement plan and were rolled over from the plan at a time when the debtor was already receiving periodic payments on account of age.<sup>373</sup> The court viewed the IRA of the debtor under such circumstances as a continuation of the qualified retirement plan of which he was a participant.<sup>374</sup>

The fact that the distribution from the ERISA-qualified retirement plan was to an IRA was not significant to the court’s holding.<sup>375</sup> The ruling from the *Caslavka* court came at a time when the court viewed IRAs as nothing more than tax-favored savings accounts and not exempt from bankruptcy. The IRA had nothing to do with the court’s holding; rather, the court ruled the IRA to be exempt under Iowa Code section 627.6(8)(e) because the IRA was funded from the debtor’s ERISA-qualified retirement plan at a time when the debtor was of retirement age.<sup>376</sup> The distribution could have been made to the debtor’s checking account and the court’s holding would likely have been the same.

The *Caslavka* holding has at least two shortcomings for retirees hoping to shelter distributions from ERISA-qualified retirement plans

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194, 199–200 (Bankr. N.D. Iowa 1996); *Brosamer v. Mark*, 540 N.E.2d 652, 654–55 (Ind. Ct. App. 1989).

370. IOWA CODE § 627.6(8)(e) (2007). This section was amended in 1992. See *supra* note 354 for the text of section 627.8(e) as it read prior to 1992.

371. *Id.* § 627.6(8)(e).

372. *In re Caslavka*, 179 B.R. 141, 144 (Bankr. N.D. Iowa 1995).

373. *Id.*

374. *Id.* at 146–47.

375. See *id.* at 144–47.

376. *Id.* at 147 (citing IOWA CODE § 627.6(8)(e) (1995)).

from creditors. First, the bankruptcy court emphasized that only directly traceable retirement plan proceeds received on account of age retain their exempt status.<sup>377</sup> Therefore, distributions made to a checking account in which, for example, dividend, interest, or social security income is also credited, will likely lose their exempt status. As a result, retirees may wish to establish separate checking or savings accounts specifically for depositing their retirement plan distributions. Second, the distribution must have been made from a retirement plan on account of age, which usually means retirement.<sup>378</sup> Many ERISA-qualified retirement plans provide an option for loans or for plan participants to receive a lump sum distribution upon termination of employment. In such situations, a distribution is not made on account of age and does not receive protection from creditors under Iowa law.<sup>379</sup>

When planning for bankruptcy, a debtor's first preference should be to keep as much of his retirement assets in an ERISA-qualified retirement plan because the full balance will be exempt from the debtor's bankruptcy estate under the holding of *Patterson* and BAPCPA. If a debtor has a significant IRA and has access to an ERISA-qualified retirement plan that accepts rollovers from IRAs, then the debtor should consider rolling over his IRA into the ERISA-qualified retirement plan. The amount rolled over from the IRA into the ERISA-qualified retirement plan will be fully protected.<sup>380</sup>

A debtor's second preference is to keep his retirement assets in an IRA. Non-rollover IRAs are exempt up to \$1 million.<sup>381</sup>

A debtor's third preference is to segregate the distributions from the IRA or ERISA-qualified retirement plan into a separate bank account. The funds will remain exempt from the debtor's bankruptcy estate if the debtor can show that the distribution was made on account of age, disability, illness, death, or length of service.<sup>382</sup>

## VI. FRAUDULENT TRANSFER OF ASSETS

Asset protection planning may, in some cases, be considered a fraudulent transfer. Iowa's fraudulent transfer law provides that a transfer

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377. *Id.* at 147.

378. *Id.* at 146.

379. *Id.* at 144 (citing *In re Huebner*, 986 F.2d 1222, 1225 (8th Cir. 1993)).

380. *See In re Holst*, 192 B.R. 194, 200 (Bankr. N.D. Iowa 1996).

381. 11 U.S.C. § 522(n) (West Supp. 2007).

382. IOWA CODE § 627.6(8)(e) (2007); *In re Caslavka*, 179 B.R. at 147.

is fraudulent if the debtor made the transfer “[w]ith actual intent to hinder, delay, or defraud any creditor of the debtor.”<sup>383</sup> Because the transferor’s intent would be exceedingly difficult to prove in most instances, the Iowa Code provides that, in determining the transferor’s actual intent, consideration may be given to various factors, but no single factor creates a presumption the debtor has made a fraudulent transfer.<sup>384</sup> The factors include:

- (a) Whether the transfer or obligation was to an insider.
- (b) Whether the debtor retained possession or control of the property transferred after the transfer.
- (c) Whether the transfer or obligation was disclosed or concealed.
- ....
- (e) Whether the transfer was of substantially all the debtor’s assets.
- ....
- (g) Whether the debtor removed or concealed assets.
- (h) Whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred.

....<sup>385</sup>

Each of the six factors listed above may be present in an Iowa resident’s funding of a self-settled spendthrift trust in Alaska or one of the other states allowing self-settled spendthrift trusts. There have been no Iowa court decisions involving a debtor’s creation of a self-settled spendthrift trust in a foreign jurisdiction. However, there are several reasons why an Iowa court may construe an Iowa resident’s creation of self-settled spendthrift trust in, say Alaska, as a fraudulent transfer.<sup>386</sup>

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383. IOWA CODE § 684.4(1)(a).

384. *Id.* § 684.4(2).

385. *Id.*

386. Henry J. Lischer, Jr., *Professional Responsibility Issues Associated with Asset Protection Trusts*, 39 REAL PROP. PROB. & TR. J. 561, 575–77 (2004).

The first reason is that from a public policy perspective, the self-settled spendthrift trust encourages settlors to establish trusts to avoid paying their lawful debts while allowing settlors to continue enjoying the benefit of their property. A self-settled spendthrift trust permits individuals, behind the protection of the trust, to thumb their noses at creditors. The trust also permits the settlor, or debtor, to pick and choose which unsecured creditors to pay and which to avoid. The civil enforcement mechanism for enforcing obligations is severely retarded as a result.

The second reason why Iowa courts may broadly construe the fraudulent transfer statute is that they may follow courts in other jurisdictions that have applied a substance over form analysis to self-settled spendthrift trusts schemes designed to thwart courts and creditors. Those courts have concluded that the self-settled spendthrift trust transaction is inconsistent with an orderly judicial process for resolution of claims.<sup>387</sup>

The final reason Iowa courts may broadly construe the fraudulent transfer statute relates to exempt property statutes, which are available under both state and federal law.<sup>388</sup> A self-settled spendthrift trust created in a foreign jurisdiction is contrary to the rationale of exempt property statutes because the trust is not subject to limits on the nature or amount of property that may be transferred to the trust.

Some commentators have suggested that an attorney assisting a debtor with the establishment of a domestic asset protection trust using another state's laws could result in disciplinary proceedings against the attorney.<sup>389</sup> Although no disciplinary cases sanctioning an attorney for implementing transfers to a domestic asset protection trust exist, several attorneys have been sanctioned for implementing asset transfer techniques solely designed to allow their clients to avoid creditors.<sup>390</sup>

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387. See *FTC v. Affordable Media, LLC*, 179 F.3d 1228, 1240 (9th Cir. 1999) (“[O]ff shore [self-settled spendthrift] trusts operate by means of frustrating domestic courts’ jurisdiction . . . .”); *Godberg v. Lawrence (In re Lawrence)*, 227 B.R. 907, 917 (Bankr. S.D. Fla. 1998) (refusing to apply foreign law to protect a spendthrift trust and finding that “[i]t is against public policy to permit the settler beneficiary to tie up her own property in such a way that she can still enjoy it but prevent her creditors from reaching it.” (quoting *Dzikowski v. Edmons (In re Cameron)*, 223 B.R. 20, 24 (Bankr. S.D. Fla. 1998))); *Breitenstine v. Breitenstine*, 62 P.3d 587 (Wyo. 2003) (upholding a lower court’s ruling that a transfer to a spendthrift trust was fraudulent).

388. See 11 U.S.C. § 522; IOWA CODE § 627.6.

389. Lischer, *supra* note 386, at 610–12.

390. *In re Whitebeck*, 727 N.Y.S.2d 414 (Sup. Ct. 2001); *Townsend v. State Bar of Cal.*, 197 P.2d 326 (Cal. 1948).

Outside of the context of transfers to domestic asset protection trusts, a fraudulent transfer can occur when a husband makes a transfer of assets to his wife.<sup>391</sup> A fraudulent transfer can even occur when a husband works for his wife's corporation, if the wife will benefit from such work.<sup>392</sup> The transfer of 280 acres of farmland to a LLC owned by the transferor's children has been considered fraudulent if the consideration received in exchange is less than the value of the contributed property.<sup>393</sup> As mentioned previously, the conversion of non-exempt property to exempt property can be fraudulent if done on the eve of bankruptcy and the conversion amounted to significant assets.<sup>394</sup>

## VII. CONCLUSION

With careful planning, significant assets can be shielded from creditors despite the recent amendments to the bankruptcy code.<sup>395</sup> Within reason, a debtor is entitled to convert non-exempt assets such as cash, into exempt assets such as IRAs or a homestead.<sup>396</sup>

Trusts are useful mechanisms to protect assets from the claims of a beneficiary's creditors.<sup>397</sup> Until recently, however, even trusts could not shield assets from the claims of a grantor's creditors if the grantor retains an interest in the trust.<sup>398</sup> Today, several states have passed legislation allowing a debtor to create a trust exempt from claims of creditors while retaining an interest in the trust.<sup>399</sup> Iowa is not one of those states, but an Iowa debtor may be able to create a trust under the law of one of the other states.<sup>400</sup> However, the creation of such an asset protection trust in Iowa using another state's laws is not without risk.<sup>401</sup>

Asset protection trusts can be created under Iowa's existing laws, but the trust must be irrevocable and the grantor cannot retain an interest in the trust.<sup>402</sup> The grantor should also avoid making a contribution to such a

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391. *See* *Benson v. Richardson*, 537 N.W.2d 748, 760–61 (Iowa 1995).

392. *Id.* at 761–62.

393. *See In re Schaefer*, 331 B.R. 401, 421 (N.D. Iowa 2005).

394. *See supra* note 25 and accompanying text.

395. *See supra* note 6 and accompanying text.

396. *See supra* Part II.

397. *See supra* Part III.A.1.

398. *See supra* note 87 and accompanying text.

399. *See supra* note 96–106 and accompanying text.

400. *See supra* note 107–18 and accompanying text.

401. *See supra* note 386–89 and accompanying text.

402. *See supra* Part III.F.1.

trust if it would cause the grantor to be insolvent or otherwise run afoul of Iowa's fraudulent transfer laws.<sup>403</sup> The grantor could later access the trust assets by terminating the trust, if all the beneficiaries consent, or by the action of a special power of appointment holder designated in the trust instrument.<sup>404</sup>

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403. *See supra* note 383–85 and accompanying text.

404. *See supra* Part III.F.1.

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## APPENDIX

## Summary of Domestic Asset Protection Trust Provisions

	<b>Alaska</b>	<b>Delaware</b>	<b>Nevada</b>	<b>Rhode Island</b>	<b>Utah</b>
<b>May trust be revocable?</b>	<b>No.</b> ALASKA STAT. § 34.40.110(a) (2006).	<b>No.</b> DEL. CODE ANN. tit. 12, § 3570(10)(b) (2001).	<b>No.</b> NEV. REV. STAT. § 166.040(1)(b), (2)(a) (2005).	<b>No.</b> R.I. GEN. LAWS § 18-9.2-2(9)(ii) (2003).	<b>No.</b> UTAH CODE ANN. § 25-6-14(1)(a) (Supp. 2007).
<b>Is the settlor protected from child support or alimony obligations?</b>	<b>No.</b> ALASKA STAT. § 34.40.110(b)(4)(j)(6) (2006).	<b>No.</b> DEL. CODE ANN. tit. 12, § 3573(1) (2001).	<b>Yes.</b> NEV. REV. STAT. § 166.120(2), (3) (2005).	<b>No.</b> R.I. GEN. LAWS § 18-9.2-5(a) (2003).	<b>No.</b> UTAH CODE ANN. § 25-6-14(2)(c)(v) (Supp. 2007).
<b>Can the settlor be a trustee?</b>	<b>Yes, as co-trustee.</b> ALASKA STAT. § 34.40.110(f) (2006).	<b>No.</b> DEL. CODE ANN. tit. 12, § 3570(9)(c) (2001).	<b>No reference in this statute for this provision.</b>	<b>No.</b> R.I. GEN. LAWS § 18-9.2-2(9)(ii) (2003).	<b>No reference in this statute for this provision, but individuals may generally serve as co-trustees.</b>
<b>Must the trustee be a resident or domiciled or authorized to do business in the state?</b>	<b>Yes, for IRA trusts. No reference in statute for other trusts.</b> ALASKA STAT. § 34.40.110(m)(l) (2006).	<b>Yes.</b> DEL. CODE ANN. tit. 12, § 3570(9)(a) (2001).	Yes, if the settlor is a beneficiary. NEV. REV. STAT. § 166.015(2) (2005).	<b>Yes.</b> R.I. GEN. LAWS § 18-9.2-2(8)(i) (2003).	<b>Yes.</b> UTAH CODE ANN. § 7-5-1(1)(d) (Supp. 2007).
<b>Can settlor be a discretionary distributee of income and principal?</b>	<b>Yes.</b> ALASKA STAT. §§ 34.40.110(b)(2), 34.40.110(j) (2006).	<b>Yes.</b> DEL. CODE ANN. tit. 12, § 3570(10)(b)(3), (4) (2001).	<b>Yes.</b> NEV. REV. STAT. § 166.040(1)(b), (2)(b) (2005).	<b>Yes.</b> R.I. GEN. LAWS § 18-9.2-3 (2003).	<b>Yes.</b> UTAH CODE ANN. § 25-6-14(2)(c)(iv) (Supp. 2007).
<b>Can settlor require trustee to make mandatory income or principal distributions to settlor?</b>	<b>No.</b> ALASKA STAT. § 34.40.110(b)(3) (2006).	<b>Yes as to income and five percent unitrust amount.</b> DEL. CODE ANN. tit. 12, § 3570(10)(b)(3), (5) (2001).	<b>No.</b> NEV. REV. STAT. § 166.040(1)(b) (2005).	<b>No.</b> R.I. GEN. LAWS § 18-9.2-3 (2003).	<b>No.</b> UTAH CODE ANN. § 25-6-14(2)(c)(iv), (e)(iii) (Supp. 2007).

	<b>Alaska</b>	<b>Delaware</b>	<b>Nevada</b>	<b>Rhode Island</b>	<b>Utah</b>
<b>Can settlor retain an income interest in the trust assets?</b>	<b>No.</b> ALASKA STAT. § 34.40.110 (b)(3) (2006).	<b>Yes.</b> DEL. CODE ANN. tit. 12, § 3570(10)(b)(3) (2001).	<b>No.</b> NEV. REV. STAT. § 166.040 (1)(b) (2005).	<b>No.</b> R.I. GEN. LAWS § 18-9.2-3 (2003).	<b>No.</b> UTAH CODE ANN. § 25-6-14 (2)(c)(iii) (Supp. 2007).
<b>Can settlor retain veto power over distributions?</b>	<b>Yes.</b> ALASKA STAT. § 34.40.110 (b)(2) (2006).	<b>Yes.</b> DEL. CODE ANN. tit. 12, § 3570(10)(b)(1) (2001).	<b>Yes.</b> NEV. REV. STAT. § 166.040 (2)(a) (2005).	<b>No.</b> R.I. GEN. LAWS § 18-9.2-2(9)(ii)(A) (2003).	<b>Yes.</b> UTAH CODE ANN. § 25-6-14 (2)(c), (e)(i) (Supp. 2007).
<b>Can settlor retain a testamentary special power of appointment over the trust assets?</b>	<b>Yes, but not statutorily defined.</b> ALASKA STAT. § 34.40.110(b)(2) (2006).	<b>Yes, but not statutorily defined.</b> DEL. CODE ANN. tit. 12, § 3570(10)(b)(2) (2001).	<b>Yes, but not statutorily defined.</b> NEV. REV. STAT. § 166.040 (2)(a) (2005).	<b>Yes, but not statutorily defined.</b> R.I. GEN. LAWS § 18-9.2-2(9)(ii)(B) (2003).	<b>Yes.</b> UTAH CODE ANN. § 25-6-14(2)(c),(e)(ii) (Supp. 2007).
<b>Miscellaneous:</b>	<b>Existing creditors may reach trust assets only if transfer was fraudulent.</b> ALASKA STAT. § 34.40.110 (b)(1) (2006).	<b>Limits on creditors do not apply to tort claimants.</b> DEL. CODE ANN. tit. 12, § 3573(2) (2001).	<b>If claim arose before transfer is made, creditors are required to bring an action within two years after the transfer or six months after the creditor discovers or reasonably should have discovered the transfer—the shortest statute of limitations of these states.</b> NEV. REV. STAT. § 166.170(1) (2005).	<b>Limits on creditors do not apply to a person who suffers death, personal injury, or property damage on or before transfer which tort was caused by the settlor.</b> R.I. GEN. LAWS § 18-9.2-2(5)(b) (2003).	<b>Creditors can reach trust assets if for purpose of recovery of public assistance received by settlor.</b> UTAH CODE ANN. § 25-6-14(2)(c)(vii) (Supp. 2007).



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	Oklahoma	South Dakota	Wyoming	Tennessee
<b>May trust be revocable?</b>	<b>Yes.</b> OKLA. STAT. ANN. tit. 31, § 13 (West Supp. 2007).	<b>No.</b> S.D. CODIFIED LAWS § 55-16-2(2) (Supp. 2007).	<b>No.</b> WYO. STAT. ANN. § 4-10-510 (a)(iv) (Supp. 2007).	<b>No.</b> 2007 Tenn. Pub. Acts ch. 144, § 7(B).
<b>Is the settlor protected from child support or alimony obligations?</b>	<b>No.</b> OKLA. STAT. ANN. tit. 31, § 12 (West Supp. 2007).	<b>No.</b> S.D. CODIFIED LAWS § 55-16-15 (Supp. 2007).	<b>No.</b> WYO. STAT. ANN. § 4-10-520(a)(i) (Supp. 2007).	<b>Yes.</b> TENN. CODE ANN. § 35-15-507 (2007).
<b>Can the settlor be a trustee?</b>	<b>No reference in this statute for this provision, but individuals may generally serve as co-trustees.</b>	<b>No.</b> S.D. CODIFIED LAWS § 55-16-4 (Supp. 2007).	<b>No.</b> WYO. STAT. ANN. § 4-10-103(a)(xxxv) (Supp. 2007).	<b>No.</b> 2007 Tenn. Pub. Acts ch. 144, § 2(12)(C).
<b>Must the trustee be a resident or domiciled or authorized to do business in the state?</b>	<b>Yes.</b> OKLA. STAT. ANN. tit. 31, § 11(5)(b) (West Supp. 2007).	<b>Yes.</b> S.D. CODIFIED LAWS § 55-16-3 (Supp. 2007).	<b>Yes.</b> WYO. STAT. ANN. § 4-10-103(a)(xxxv) (2007).	<b>Yes.</b> 2007 Tenn. Pub. Acts ch. 144, § 8(a).
<b>Can settlor be a discretionary distributee of income and principal?</b>	<b>No reference in this statute for this provision.</b>	<b>Yes.</b> S.D. CODIFIED LAWS § 55-16-2(2)(c),(d) (Supp. 2007).	<b>Yes.</b> WYO. STAT. ANN. § 4-10-510(a)(iv)(C),(D) (2007).	<b>Yes.</b> 2007 Tenn. Pub. Acts ch. 144, § 11(6)(A).
<b>Can settlor require trustee to make mandatory distributions of income or principal to the settlor?</b>	<b>No reference in this statute for this provision.</b>	<b>Yes as to income and five percent unitrust amount.</b> S.D. CODIFIED LAWS § 55-16-2(2)(c), (e) (Supp. 2007).	<b>Yes as to income and five percent unitrust amount.</b> WYO. STAT. ANN. § 4-10-510(a)(iv)(C),(E) (2007).	<b>Yes as to income and five percent of the initial value of the trust.</b> 2007 Tenn. Pub. Acts ch. 144, § 11(5).
<b>Can settlor retain an income interest in the trust assets?</b>	<b>No reference in this statute for this provision.</b>	<b>Yes.</b> S.D. CODIFIED LAWS § 55-16-2(2)(c) (Supp. 2007).	<b>Yes.</b> WYO. STAT. ANN. § 4-10-510(a)(iv)(C) (Supp. 2007).	<b>Yes.</b> 2007 Tenn. Pub. Acts ch. 144, § 11(3).
<b>Can settlor retain veto power over distributions?</b>	<b>No reference in this statute for this provision.</b>	<b>Yes.</b> S.D. CODIFIED LAWS § 55-16-2(2)(a) (Supp. 2007).	<b>Yes.</b> WYO. STAT. ANN. § 4-10-510(a)(iv)(A) (Supp. 2007).	<b>Yes.</b> 2007 Tenn. Pub. Acts ch. 144, § 11(1).
<b>Can settlor retain a testamentary special power of appointment over the trust assets?</b>	<b>No reference in this statute for this provision.</b>	<b>Yes.</b> S.D. CODIFIED LAWS § 55-16-2(2)(b) (Supp. 2007).	<b>Yes.</b> WYO. STAT. ANN. § 4-10-510(a)(iv)(B) (Supp. 2007).	<b>Yes.</b> 2007 Tenn. Pub. Acts ch. 144, § 11(2).

	Oklahoma	South Dakota	Wyoming	Tennessee
<b>Miscellaneous:</b>	<p><b>Trust must be subject to this state's income tax laws.</b> OKLA. STAT. ANN. tit. 31, § 11(5)(e) (West Supp. 2007).</p> <p><b>Creditor protection available for trust assets of \$1million or less.</b> OKLA. STAT. ANN. tit. 31, § 12 (West Supp. 2007).</p>	<p><b>If a creditor's claim arises concurrent with or subsequent to the transfer, creditors must bring action within four years.</b> S.D. CODIFIED LAWS § 55-16-10 (Supp. 2007).</p>	<p><b>Creditors can reach trust asset if asset is listed on application or financial statement used to obtain credit other than for the benefit of the trust.</b> WYO. STAT. ANN. § 4-10-520(a)(ii) (Supp. 2007).</p>	<p><b>Spendthrift provisions are unenforceable as to claims by the state.</b> TENN. CODE ANN. § 35-15-503 (Supp. 2006).</p>