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The Good, the Bad, and a New Kind of Prenup: An Analysis of the Ohio Legacy Trust Act and What Asset Protection Trusts Will Mean for Ohio

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**THE GOOD, THE BAD, AND A NEW KIND OF
PRENUP: AN ANALYSIS OF THE OHIO LEGACY
TRUST ACT AND WHAT ASSET PROTECTION
TRUSTS WILL MEAN FOR OHIO**

KEVIN R. MCKINNIS*

I.	INTRODUCTION	1106
II.	THE EVOLUTION OF DOMESTIC ASSET PROTECTION TRUSTS	
	1107	
	<i>A. The History of the Domestic Asset Protection Trust</i> .	1107
	<i>B. The Birth of the Ohio Legacy Trust Act</i>	1112
III.	WHAT OHIO LEGACY TRUSTS WILL MEAN FOR OHIO.....	1114
	<i>A. The Requirements of an Ohio Legacy Trust</i>	1114
	<i>B. Will Ohio Legacy Trusts Make Ohio Competitive In the Trust Market?</i>	1117
	<i>C. Practical Uses for an Ohio Legacy Trust</i>	1120
	1. Creditor Protection	1120
	2. Estate Planning Uses	1122
	<i>D. The Impact of Ohio Legacy Trusts</i>	1123
	1. Income Generation	1123
	2. The Negative Implications of Ohio Legacy Trusts	1125
	<i>E. Tax Implications of Ohio Legacy Trusts</i>	1126
	1. Income Tax Implications.....	1126
	2. Estate Tax Implications	1127
	<i>F. A New Kind of Prenuptial Agreement</i>	1130
	<i>G. The Ethical Responsibilities of Attorneys and Ohio Legacy Trusts</i>	1131
IV.	WILL OHIO LEGACY TRUST ACTUALLY WORK TO PROTECT A SETTLOR’S ASSETS?	1134
	<i>A. The Full Faith and Credit Clause</i>	1134
	1. Arguments Creditors Attempt to Use to Pierce an Asset Protection Trust.....	1136

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B. <i>Contracts Clause</i>	1137
1. Creditor Contract Clause Arguments	1138
C. <i>Supremacy Clause and the Bankruptcy Code</i>	1139
V. CONCLUSION	1140

I. INTRODUCTION

If there were a way in Ohio to protect your assets from future creditors, judgments, or divorce, would you not want to know about it? Ohio House Bill 479¹ contains a provision, the Ohio Legacy Trust Act, which will afford individuals the opportunity to protect their assets without going outside the country or state. This article explores various aspects of the Ohio Legacy Trust Act and what it will mean to Ohio.

It is human nature to want to protect what one has worked hard to earn or accomplish. It is this very nature that entices individuals to search for creative methods by which to protect one's assets, whether from high tax rates or creditors. As laws continually change, individuals strive to protect their assets in the most effective and secure manner possible. As a result, the protection of one's assets has evolved from the use of offshore Asset Protection Trusts (APTs) to the use of domestic APTs (DAPT).²

The Ohio Legacy Trust Act is an attempt to modernize Ohio's wealth management laws to make Ohio competitive with other states in the wealth management and trust market. Ohio's proposed trust legislation was modeled after the "successful plans used in other states,"³ such as Alaska, Delaware, and Nevada.⁴

This Note explores the impact that the Ohio Legacy Trust Act could have on Ohio. Section II explores the evolution of the APT. Section III explains the requirements to establish an Ohio Legacy Trust and compares the requirements to those of other states. Additionally, this Section will explore the potential uses of an Ohio Legacy Trust, the income and estate tax consequences, as well as its use as a substitute for a standard prenuptial agreement. The ethical responsibilities attorneys have regarding the use of Legacy Trusts are also explained. The final portion of

¹ On June 13, 2012, the Ohio House of Representatives voted by a margin of 86 to 0 in favor of House Bill 479. Bill 479 was approved by the Ohio Senate and signed into law as of December 20, 2012. Bill 479 is set to come into effect March 27, 2013. *Ohio House Bill 479*, LEGISCAN, <http://legiscan.com/OH/votes/HB479/2011>.

² Many different types of trusts exist, with each type containing a specific benefit or ability. The basic definition of a trust, according to Black's Law Dictionary, is: "The right, enforceable solely in equity, to the beneficial enjoyment of property to which another person holds the legal title; a property interest held by one person (the *trustee*) at the request of another (the *settlor*) for the benefit of a third party (the *beneficiary*)." BLACK'S LAW DICTIONARY 1647 (9th ed. 2009).

³ *Reps. Hagan and Blessing Announce Passage of Legislation Enacting Ohio Legacy Trust Act*, OHIO HOUSE GOP REPS. BLOG SPOT (June 15, 2012), <http://ohiohousegop.blogspot.com/2012/06/rep-hagan-and-blessing-announce.html>.

⁴ William J. McGraw, *Report of the Estate Planning, Trust and Probate Law Section*, OHIO BAR ASS'N, https://www.ohiobar.org/General%20Resources/pubs/councilfiles/Report_of_the_Estate_Planning_Trust_and_Probate_Law_Section_11_10.pdf (last visited Nov. 28, 2012).

Section III examines the impact Legacy Trusts will have on Ohio creditors, as well as the benefits and negative implications they could have on Ohio. Section IV examines whether APTs actually work and analyzes the arguments that creditors commonly use to attempt to defeat them.

II. THE EVOLUTION OF DOMESTIC ASSET PROTECTION TRUSTS

A. *The History of the Domestic Asset Protection Trust*

Domestic asset protection trusts evolved from the use of offshore APTs. Originally, offshore asset protection trusts, in places such as the Cook Islands,⁵ were used to protect a settlor's⁶ assets from current or future creditors.⁷ At the time, United States law and public policy were against allowing an individual to shield his assets from creditors.⁸ As public policy changed in the United States, domestic asset protection legislation was considered.⁹ However, the very aspect that makes these offshore APTs unreachable by creditors in the United States, namely being under the jurisdiction of another country, is also what has led settlors to move away from offshore trusts.¹⁰ Also, within the past five years, the Internal Revenue Service (I.R.S.) has aggressively pursued individuals for tax evasion who were suspected of using offshore bank accounts as tax shelters.¹¹ These investigations have led to

⁵ Timothy Lee, *Alaska on the Asset Protection Trust Map: Not Far Enough for a Regulatory Advantage, But Too Far for Convenience?*, 29 ALASKA L. REV. 149, 153 (2012).

⁶ A settlor is defined as “[a] person who makes a settlement of property; esp., one who sets up a trust.—Also termed creator; donor; trustor; grantor; founder.” BLACK’S LAW DICTIONARY 1497 (9th ed. 2009).

⁷ Amy Lynn Wagenfield, *Law for Sale: Alaska and Delaware Compete for the Asset Protection Trust Market and the Wealth that Follows*, 32 VAND. J. TRANSNAT’L L. 831, 833 (1999).

⁸ *Id.* at 833, 847.

⁹ *See generally* Lee, *supra* note 5, at 155-160.

¹⁰ Individuals began to move away from offshore trusts because of the concern that they would have no legal recourse against the country of the trust situs due to the lack of jurisdiction by U.S. courts. With the ever-changing political environment of governments, settlors worried these countries could fall into political or economic turmoil and their money would be lost. *See generally* Ritchie W. Taylor, Note and Comment, *Domestic Asset Protection Trusts: The “Estate Planning Tool of the Decade”*, 13 BYU J. PUB. L. 163, 167 (1998); Lee, *supra* note 5, at 154.

¹¹ Carolyn Michelle Najera, Note and Comment, *Combating Offshore Tax Evasion: Why the United States Should Be Able to Prevent American Tax Evaders From Using Swiss Bank Accounts to Hide Their Assets*, 17 SW. J. INT’L L. 205, 208 (2011).

In 2007, the United States began its tax investigation of UBS when Bradley Birkenfeld, a former UBS banker, blew the whistle to American authorities. Birkenfeld exposed the world of offshore tax shelters that some American taxpayers had been keeping from the IRS for years. Birkenfeld voluntarily told federal investigators that he and other UBS bankers had helped American clients avoid paying taxes on assets hidden in offshore accounts. In November 2008, a federal grand jury indicted Birkenfeld for conspiring to assist thousands of U.S. taxpayers in evading U.S. taxes.

As a part of his plea bargain, Birkenfeld provided U.S. authorities with inside information regarding UBS strategies. Due to this inside information, the U.S. Department of Justice is

UBS¹² and the Swiss Bank turning over the names of clients who have offshore accounts in response to so-called John Doe summonses.¹³

Individuals are also migrating from establishing foreign trusts because of the increasing cost of establishing these trusts and the increasing costs of foreign trust tax compliance.¹⁴ These foreign trust compliances are merely informational returns, but significant penalties will result for inadvertent failures to timely file, even if a reasonable excuse exists for the late filing.¹⁵ In comparison, a trust that is classified as being domestic carries significantly fewer tax related risks and, also, the penalties are smaller when they are imposed.¹⁶ Also, individuals are more comfortable with the notion of being able to drive to their neighborhood trustee's office instead of having to fly to another country to discuss trust matters with the trustee.¹⁷

With the ever-changing laws and political atmosphere of offshore trust friendly countries, settlors continued to look for a domestic solution which would provide them with some degree of asset protection.¹⁸ The I.R.S. estimated that, as of 2012, five trillion dollars were still held in offshore tax havens.¹⁹ As settlors became uneasy with offshore trusts, they began to look for alternative ways to safeguard their assets. States like Ohio hope to offer such an alternative and encourage some of these settlors to move their offshore trusts into domestic APTs within their state.

now accusing UBS of helping wealthy Americans hide billions of dollars from the IRS by using Swiss bank accounts to conceal their identity. As of 2008, UBS has been accused of allegedly helping wealthy Americans evade twenty billion dollars in taxes.

As a result of this controversy, UBS has admitted to advising U.S. citizens on the best ways to hide their assets from the IRS.

On November 18, 2009, the Swiss government agreed to release the criteria that it used to select the 4,450 holder names that UBS provided to the IRS in August 2009. The Swiss Justice Department also agreed to hand over the names of American clients of UBS with accounts holding more than 1 million Swiss francs (USD \$986,200) where there was a reasonable suspicion of tax fraud. *Id.*

¹² UBS and Swiss Bank Corporation merged in 1998, thus the abbreviation UBS (United Bank of Switzerland) is no longer representative of the company. John Tagliabue, *International Business; 2 of the Big 3 Swiss Banks to Join to Seek Global Heft*, N.Y. TIMES (Dec. 9, 1997), <http://www.nytimes.com/1997/12/09/business/international-business-2-of-the-big-3-swiss-banks-to-join-to-seek-global-heft.html>.

¹³ Najera, *supra* note 11, at 208.

¹⁴ E-mail from John E. Sullivan III, Esq., Estate Planning Expert and Asset Prot. Specialist, to author (June 12, 2013, 15:01 EST) (on file with author).

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ Lee, *supra* note 5, at 153.

¹⁹ *Id.* at 154 n.34 (citing Abusive Offshore Tax Avoidance Scheme—Talking Points, IRS updated Jan. 31, 2012). *Contra* James T. Lorenzetti, *The Offshore Trust: A Contemporary Asset Protection Scheme*, 102 COM. L. J. 138, 140 (1997) (“In 1994, it was estimated that there was approximately \$1 trillion held in offshore asset protection trusts. This statistic is contrary to the legislative testimony in which it is stated that six trillion dollars is estimated to be in offshore tax havens.”).

Domestic APTs were first created in the United States in 1997.²⁰ With the passage of the Ohio Asset Modernization Act, Bill 479,²¹ Ohio has become the thirteenth state to offer APTs.²² Most states that adopt APT legislation have modeled their statutes after the Alaska Trust Act, but these statutes still vary from state to state in the degree of asset protection they offer.

Alaska was the first state to pass legislation allowing the creation of APTs and hoped it would encourage financial institutions to relocate and headquarter in Alaska.²³ Other states, such as South Dakota, had recently eliminated their rule against perpetuities²⁴ in an effort to enter the trust market.²⁵ Prior to this time, no

²⁰ Lee, *supra* note 5, at 154.

²¹ House Bill 479 is referred to as the Ohio Asset Management Modernization Act (OAMMA) [hereinafter Ohio Asset Modernization Act], and the Ohio Legacy Trust Act is a proposed section in the bill.

²² At the current rate, a new state adopts domestic asset protection trust legislation every 1.25 years. *Ohio Asset Management Modernization Act: Testimony on H.B. 479 Before the Ohio H. R. Judiciary Comm.*, 2012 Leg. 129th Sess. 17 (Apr. 24, 2012) [hereinafter *Testimony on H.B. 479*] (testimony of John E. Sullivan III, Sullivan & Sullivan, Ltd.).

The other states which have asset protection trust legislation are: Alaska: ALASKA STAT. ANN. §§ 34.40.010, 34.40.110 (West 2012); Delaware: Qualified Dispositions in Trust Act, DEL. CODE ANN. tit. 12 § 3570 (West 2012); Hawaii: Permitted Transfers in Trust Act, HAW. REV. STAT. § 554G-1 (West 2012); Missouri: MO. ANN. STAT. § 456.5-505.3 (West 2012); Nevada: Spendthrift Trust Act of Nevada, NEV. REV. STAT. ANN. § 166.010 (West 2012); New Hampshire: Qualified Disposition in Trust Act, N.H. REV. STAT. ANN. § 564-D (2012); Oklahoma: OKLA. STAT. ANN. tit. 31, § 10 (West 2012); Rhode Island: Qualified Disposition in Trust Act, R.I. GEN. LAWS ANN. § 18-9.2-1 (West 2012); South Dakota: Qualified Disposition Act, S.D. CODIFIED LAWS § 55-16-1 (2012); Tennessee: TENN. CODE ANN. §§ 66-1-202, 35-15-505 (West 2012); Utah: UTAH CODE ANN. § 25-6-14 (West 2012) (dealing with restricting transfers of trust interests); Wyoming: WYO. STAT. ANN. § 4-10-510 (West 2012). The number of states that have adopted asset protection trusts is debatable, with some sources citing that 13 states as of 2010 had adopted domestic asset protection legislation, while other sources have stated that only 12 states as of 2011 have adopted such legislation. See David M. Grant & Jeremy K. Cooper, *Nevada Laws Provide Top Trust Situs*, 18 NEV. LAW. 20, 23 (2010).

²³ Lee, *supra* note 5, at 154 (citing H.B. 101).

²⁴

The rule against perpetuities was intended to prevent people from tying up property[,] both real and personal[,] for generation after generation. In feudal England, the practice was to put land in trust in perpetuity, with succeeding generations living off the land without actually owning it. The catalyst for this practice was the avoidance of certain taxes which were being levied upon the transfer of land upon the death of the owner. Perpetual trusts avoided the tax, but many people argue that the practice had the [harmful] effect of concentrating large amounts of wealth among a few members of society.

The rule against perpetuities, then, was designed to ensure that some person would actually own the land within a reasonable period of time after the death of the transferor. To accomplish this result, the rule stated that no interest in property would be valid unless it could be shown that the interest would vest . . . no later than 21 years [after] creation of the interest.

state allowed settlors of a trust to shield their assets from creditors by assigning the assets to a self-settled trust.²⁶ Before 1997, the Alaska legislature vetoed legislation authorizing the creation of domestic APTs²⁷ because of the fear that they would be used to escape child support payments.²⁸ The 1997 Alaska Trust Act, which was ultimately passed by the legislature, was amended to meet these concerns.²⁹

At the time that Alaska was considering adopting this legislation, it was argued that domestic APTs would create a moral hazard in society by protecting individuals' assets from future creditors.³⁰ The rationale behind this argument was that if an individual will not be held financially accountable for his or her actions, there is no incentive for the individual to refrain from reckless or negligent behavior.³¹ It was also argued that APTs would only be vehicles of the wealthy, due to the costs associated with establishing and managing an APT.³² However, there appears to be little evidence that these concerns have come to fruition in the fifteen years since Alaska first passed domestic APT legislation.

Michael P. Pancheri, *Understanding the Rule Against Perpetuities*, THE LIVING TRUST NETWORK, <http://livingtrustnetwork.com/estate-planning-center/last-will-and-testament/what-the-experts-say/understanding-the-rule-against-perpetuities.html> (last visited Nov. 4, 2012).

²⁵ Lee, *supra* note 5, at 160.

²⁶ *Id.* at 154 n.35 (citing David G. Shaftel, *Domestic Asset Protection Trusts: Key Issues and Answers*, Shaftel Law Offices).

²⁷ Also referred to as self-settled trusts, but from this point forward will only be referred to as domestic asset protection trusts.

²⁸ Lee, *supra* note 5, at 157.

²⁹ *Id.* at 157; *see also* 1997 Alaska Sess. Laws 6; Duncan E. Osborne & Mark E. Osborn, *Asset Protection Trust Planning*, ST041 ALI-ABA 1 (LexisNexis April 2012).

³⁰ Richard C. Ausness, *The Offshore Asset Protection Trust: A Prudential Financial Planning Device or the Last Refuge of a Scoundrel?*, 45 DUQ. L. REV. 147, 184-85 (2007); *see also* Darsi Newmann Sirknen, *Domestic Asset Protection Trusts: What's the Big Deal?*, 8 TRANSACTION: TENN. J. BUS. L. 133, 142 (2006).

³¹ Lee, *supra* note 5, at 155 n.38; *see also* Sirknen, *supra* note 30.

³² Lee, *supra* note 5, at 154. This is a viable argument, and, in the past fifteen years since the passing of the Alaska asset protection legislation, it appears to be true if the statistics from the number of Delaware trusts are any indication. In Delaware, there have been over one thousand asset protection trusts created since 1997, when Delaware passed legislation authorizing the creation of Delaware domestic asset protection trusts. It is estimated that over two billion dollars in assets are held in these trusts, which, assuming there are only one thousand trusts all with equal sums of assets, would divide out to two million dollars being held in each trust. This is a significant indication that asset protection trusts have become a vehicle of the wealthy and not commonly used by the masses. Richard W. Nenko & Jeffrey C. Wolken, *A PRACTITIONER-FRIENDLY GUIDE TO THE DELAWARE ASSET-PROTECTION TRUST 1* (2011), available at <http://www.naepc.org/journal/issue08g.pdf>. However, it could be the case that the wealthy are the only ones in need of such a trust to protect their substantial assets that exceed the amount they need for day to day living. The wealthy are often the target of frivolous lawsuits, and the use of asset protection trusts could help to protect their assets from such claims. Sirknen, *supra* note 30, at 144.

The passage of domestic APT legislation in Alaska signaled a significant change in United States trust law.³³ It was the first time in the United States that self-settled trusts³⁴ were authorized and could be used by a settlor to shield assets from a creditor.³⁵ Shortly after the passage of the Alaska Trust Act, Delaware passed the Qualified Dispositions in Trust Act,³⁶ authorizing the creation of domestic APTs in Delaware in an effort to gain a share of the six hundred and forty billion dollar trust industry.³⁷ The Qualified Dispositions in Trust Act offers similar benefits as the Alaska Trust Act, but it also provides the settlor with the ability to reserve additional powers in the trust instrument.³⁸ Unlike an Alaska APT, a Delaware APT allows a settlor to receive up to five percent of the trust's assets, as specified in the trust instrument.³⁹ This allows the settlor to retain some additional control over and to benefit from the trust and helps make Delaware APTs more appealing. Delaware is also more appealing to settlors because it is home to the largest number of U.S. corporations and, as a result, has the infrastructure to handle much larger financial assets than Alaska.⁴⁰

Nevada was the third state to pass legislation authorizing the creation of domestic APTs.⁴¹ Nevada, in an attempt to distinguish itself from Delaware and Alaska, requires that trustees of an APT ignore any judgment order seeking to raid the trust.⁴² Also, Nevada chose not to include any exceptions that would allow claims for child or spousal support or allow preexisting tort claimants to automatically have access to the APT.⁴³ Delaware, on the other hand, allows child/spousal support claims and claims from preexisting tort claimants,⁴⁴ while Alaska only allows spousal support claims in certain situations and does not have an exception for preexisting tort

³³ Lee, *supra* note 5, at 162.

³⁴ Self-settled trusts are "trust[s] in which the settlor is also the person who is to receive the benefits from the trust, [usually] set up in an attempt to protect the trust assets from creditors. In most states, such a trust will not protect trust assets from the settlor's creditors. Also termed *asset-protection trust*." BLACK'S LAW DICTIONARY 1654 (9th ed. 2009).

³⁵ Lee, *supra* note 5, at 149. See generally Adam J. Hirsch, Symposium, Trust Law in the 21st Century, Fear Not the Asset Protection Trust, 27 CARDOZO L. REV. 2685 (2006).

³⁶ Delaware passed the Delaware Qualified Dispositions in Trust Act on July 9, 1997, while Alaska passed asset protection legislation in the spring of 1997. RICHARD W. NENNO, DELAWARE TRUSTS 2011 6 (Duncan E. Osborne & Elizabeth M. Schurig eds., 2011); Lee, *supra* note 5, at 168-69.

³⁷ Lee, *supra* note 5, at 169.

³⁸ *Id.* at 159.

³⁹ DEL. CODE ANN. tit. 12, § 3570(11)(b)(5) (LexisNexis 2012).

⁴⁰ Lee, *supra* note 5, at 168.

⁴¹ NEV. REV. STAT. ANN. § 166.010 (LexisNexis 2010).

⁴² *Id.* § 166.120(2).

⁴³ *Id.* § 166.090(1).

⁴⁴ DEL. CODE ANN. tit. 12, § 3573(2) (LexisNexis 2013).

claimants.⁴⁵ Since Nevada entered the domestic APT market, numerous other states⁴⁶ have attempted to modernize their wealth management laws to gain a share of the trust market, and, each year, more states propose adopting domestic APT legislation.⁴⁷

B. The Birth of the Ohio Legacy Trust Act

Ohio first attempted to make its wealth management laws more appealing by allowing settlors to opt out of the rule against perpetuities in 1999.⁴⁸ This change allowed for the establishment of multigenerational trusts or dynasty trusts.⁴⁹ Ohio decided to further modernize its wealth management laws and is the latest state to adopt domestic APT legislation.

Susan Locke of KeyBank first recommended the adoption of APT legislation in Ohio to members of the Ohio Bankers League more than ten years ago.⁵⁰ In May 2007, two committees were formed by the Ohio Bankers League (OBL) and the Ohio State Bar Association Estate Planning, Trust, and Probate Law Section to explore the possibility of adopting asset protection legislation.⁵¹ Over the course of the next two years, the OBL discussed the adoption of asset protection legislation and worked to convince commercial lenders that adopting asset protection legislation would not significantly affect their lending opportunities and real-estate portfolio risks.⁵²

The Estate Planning, Trust, and Probate Law Council (EPTPL) of the Ohio State Bar Association formed the Ohio Legacy Trust Committee in 2007.⁵³ By September 2010, the committee had gone through roughly sixteen drafts of the legislation before it was approved by EPTPL.⁵⁴ The drafted legislation was heavily influenced

⁴⁵ McGraw, *supra* note 4, at 30.

⁴⁶ Alaska, Delaware, Hawaii, Missouri, Nevada, New Hampshire, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, and Wyoming all have adopted asset protection trust legislations. Florida also has adopted significant homestead exemption legislation. *Id.* at 28.

⁴⁷ *Testimony on H.B. 479*, *supra* note 22, at testimony of John E. Sullivan III, Sullivan & Sullivan, Ltd.

⁴⁸ M. Patricia Culler & Craig F. Frederickson, *Opting-Out From the Rule Against Perpetuities in Ohio: Nine Years Later*, 18 OHIO PROB. L. J. 121, 146 (2008).

⁴⁹ *Id.* at 145. A dynasty trust is defined as “[a] generation-skipping trust funded with the amount that is permanently exempt from generation-skipping tax and designed to last more than two generations. In 2000, a settlor could contribute \$1 million to a dynasty trust. Almost half the states allow dynasty trusts, despite their potential for lasting more than 100 years.” BLACK’S LAW DICTIONARY 1650 (9th ed. 2009). Prior to OHIO REV. CODE ANN. § 2131.09(B)(1) (LexisNexis 2012), a trust was required to vest in a beneficiary within twenty-one years. Culler & Frederickson, *supra* note 48, at 145.

⁵⁰ McGraw, *supra* note 4, at 28; *see also* D. Bowen Loeffler, & John E. Sullivan III, *Ohio’s Quiet Revolution: The Ohio Asset Management Modernization Act of 2012*, 23 OHIO PROB. L. J. 118 (2013).

⁵¹ McGraw, *supra* note 4, at 49.

⁵² *Id.*

⁵³ Loeffler & Sullivan, *supra* note 50, at 118.

⁵⁴ *Id.*

by legislation from other states, such as Delaware and South Dakota.⁵⁵ The Ohio State Bar Association (OSBA) review process began in October 2010, but the Legacy Trust Act encountered resistance from other bar sections, such as the litigation section.⁵⁶ As a result, the legislation was dropped by the OSBA.⁵⁷ In January 2011, five Ohio attorneys organized an informal working group, which they dubbed “Black Ops,” to attempt to get the legislation approved by the Ohio legislature.⁵⁸ It was from this group of five attorneys that the larger Asset Modernization Management Act (AMMA) emerged. After drafting of the comprehensive legislation, the group began the search for legislatures who would sponsor the bill and bring it before Ohio’s Legislative Services Commission (LSC).⁵⁹ By August 2011, then Representative Randy Gardner agreed to bring the bill to the LSC.⁶⁰ After the LSC vetting process and the bill being cleaned up, AMMA was introduced into the Ohio House of Representatives by Christina Hagan and Louis Blessing, Jr. as House Bill 479 on March 12, 2013.⁶¹

The Ohio Legacy Trust Act is modeled after the domestic asset protection legislation adopted by Alaska, Delaware, and South Dakota and provides for many of the same safeguards regarding child and spousal support.⁶² The Ohio Asset Management Modernization Act came before the House Judiciary and Ethics Committee on May 23, 2012 and was largely supported by those who testified.⁶³ On June 13, 2012, the Ohio House of Representatives voted by a margin of eighty-six to zero in favor of House Bill 479.⁶⁴ On June 19, Bill 479 was introduced into the Ohio Senate and, on December 11, passed by a margin of ninety-three to zero, after being assigned to the Senate Judiciary committee for hearings and review.⁶⁵ The Bill was acted on by the Governor of Ohio, John Kasich, on December 20, 2012 and became

⁵⁵ OHIO LEGIS. SERVICE COMM., BILL ANALYSIS AM. SUB. H.B. 479, available at <http://www.lsc.state.oh.us/analyses129/h0479-ph-129.pdf>.

⁵⁶ Loeffler & Sullivan, *supra* note 50, at 118.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ Loeffler & Sullivan, *supra* note 50, at 118.

⁶² BILL ANALYSIS AM. SUB. H.B. 479, *supra* note 55.

⁶³ See generally *Testimony on H.B. 479*, *supra* note 22. Fifteen associations and companies offered support in favor of passing Bill 479, whereas only two organizations offered testimony against it.

⁶⁴ OHIO H.R., *Unofficial Votes for H.B. 479*, H.R. 129-479 (2012), http://www.legislature.state.oh.us/votes.cfm?ID=129_HB_479.

⁶⁵ *Id.* This unanimous vote demonstrates that this bill was bipartisan legislation. The fact that the vote was unanimous suggests that both parties anticipate Legacy Trusts having a beneficial effect on Ohio and that the benefits will outweigh any negatives.

effective March 27, 2013.⁶⁶ With the adoption of the Ohio Legacy Trust Act in Bill 479, Section 5816 is added to the Ohio Revised Code (O.R.C.).⁶⁷

The Ohio Legacy Trust Act defines an Ohio Legacy Trust as a trust, evidenced by a written trust instrument, that essentially satisfies the following criteria: it has a “qualified trustee” in connection with property that is the subject of a “qualified disposition”; it incorporates Ohio laws to govern its validity, construction, and administration; it expressly states that it is irrevocable; and it has a spendthrift provision⁶⁸ applicable to a beneficiary’s interests, including a transferor’s interests in the trust property.⁶⁹

Ohio Legacy Trusts can be used for a variety of purposes including estate planning, income and estate tax planning, and business planning. The predominant purpose is to protect an individual’s assets from creditors.⁷⁰ The ability to protect a settlor’s assets from creditors generally requires that the creditor did not exist prior to the funding of the Legacy Trust.⁷¹ If the trust is funded prior to the creditor’s existence, the creditor is denied access to the trust for payment.⁷² However, if the assets are assigned to the trust for the sole purpose of defrauding that specific creditor who is challenging the disposition, then the disposition can be voided, if the creditor is successful and the creditor obtains access to the trust, as will be discussed in Section III.⁷³

III. WHAT OHIO LEGACY TRUSTS WILL MEAN FOR OHIO

A. The Requirements of an Ohio Legacy Trust

The creation of an Ohio Legacy Trust requires that strict criteria be followed in the writing of the trust instrument and is similar to the requirements to establish an APT in Alaska or Delaware.⁷⁴ An Ohio Legacy Trust requires that the trust

⁶⁶ *Id.*

⁶⁷ H.R. 479, 129th Gen. Assemb., Reg. Sess. (Ohio 2012) (proposed addition to title 68, section 5816 of the Ohio Revised Code).

⁶⁸ A spendthrift provision in Ohio is defined as “a term of a trust that restrains both voluntary and involuntary transfer of a beneficiary’s interest.” OHIO REV. CODE ANN. § 5801.01(T) (LexisNexis 2012). Also, the spendthrift provision of a Legacy Trust must restrain both voluntary and involuntary transfer of a transferor’s interest in a trust.

⁶⁹ BILL ANALYSIS AM. SUB. H.B. 479, *supra* note 55.

⁷⁰ The Ohio Revised Code defines a creditor as “a person who has a claim against a transferor and any transferee or assignee of, or successor to, that claim.” Ohio Rev. Code Ann. § 5816.02(F) (LexisNexis 2012).

⁷² *Id.* § 5816.07(B)(1). If a creditor does exist at the time of the establishment of the trust, a settlor should factor this into his or her solvency analysis and set aside sufficient assets to settle matters or the settlor can negotiate and resolve matters with the creditor in advance of establishing the trust. Some planners may even value a creditor’s claim and make provisions within the trust for payment or settlement of the creditor’s claims.

⁷² *Id.*

⁷³ *Id.*

⁷⁴ Although the wording of the Ohio Legacy Trust Act varies slightly from the wording found in Alaska and Delaware, the Ohio requirements can be interpreted to afford similar protections.

instrument names a qualified trustee for the property that is subject to the qualified disposition, incorporates the laws of Ohio, expressly states the trust is irrevocable, and contains a spendthrift provision.⁷⁵ A qualified trustee, as defined in House Bill 479,⁷⁶ means a person who is not a transferor,⁷⁷ is a natural person,⁷⁸ and is a resident of the state. If the person is not a natural person, it must be authorized by Ohio law or by a court of “competent jurisdiction” to act as a trustee and also is subject to supervision by the Ohio Superintendent of Banks, the Federal Deposit Insurance Corporation (FDIC), the Comptroller of the Currency, or the Office of Thrift Supervision, or a Successor of any of them.⁷⁹ Also, the qualified trustee must maintain records for the Legacy Trust and participate in the administration of the trust.⁸⁰

The definition of a qualified trustee would result in only banks and other financial institutions qualifying to serve as a non-natural person trustee. It would be permissible for an attorney to serve as trustee in a personal capacity because they are a natural person, but a law firm would be barred from acting as a qualified trustee unless it was supervised by one of the agencies listed above. These limitations have the potential to encourage numerous financial institutions to establish subsidiaries or divisions within Ohio to manage these trusts. The narrow definition will also ensure that settlors appoint reputable institutions to manage their Legacy Trusts.

An additional requirement to establish a Legacy Trust is that a qualified disposition⁸¹ must occur.⁸² A qualified disposition is defined by O.R.C. Section 5816.02(R) as “a disposition by or from a transferor to any trustee of a trust that is, was, or becomes a legacy trust.” Upon the execution of a qualified disposition, the transferor must sign a qualified affidavit. A qualified affidavit must be notarized, signed under oath, and contain the following statements:

- (1) The property being transferred to the trust was not derived from unlawful activities.
- (2) The transferor has full right, title, and authority to

⁷⁵ OHIO REV. CODE ANN. § 5816.01 (West 2013).

⁷⁶ *Id.* § 5816.02(S).

⁷⁷ A transferor is defined as “[o]ne who conveys an interest in property.” BLACK’S LAW DICTIONARY 1636 (9th ed. 2009).

⁷⁸ Natural person refers to a real person as compared with a legal person, which could be a corporation. *Id.* at 1257-58.

⁷⁹ OHIO REV. CODE ANN. § 5816.01(S)(1)(B) (West 2013). Those who can supervise a person that is not a natural person include: the Ohio Superintendent of Banks, the Federal Deposit Insurance Corporation, the Comptroller of the Currency or the Office of Thrift Supervision or a Successor of any of them. *Id.*

⁸⁰ *Id.* § 5816.02(S)(2).

⁸¹ A disposition is defined as “a transfer, conveyance, or assignment of property, including, but not limited to, a partial, contingent, undivided, or co-ownership interest in property. ‘Disposition’ includes the exercise of a general power so as to cause a transfer of property to a trustee or trustees, but does not include . . . [t]he release or relinquishment of an interest in property that, until the release or relinquishment, was the subject of a qualified disposition.” OHIO REV. CODE ANN. § 5816.02(H) (LexisNexis 2013).

⁸² *Id.* § 5816.02(R).

transfer the property to the legacy trust. (3) The transferor will not be rendered insolvent immediately after the transfer of the property to the legacy trust. (4) The transferor does not intend to defraud any creditor by transferring the property to the legacy trust. (5) There are no pending or threatened court actions against the transferor, except for any court action identified by the affidavit or an attachment to the affidavit. (6) The transferor is not involved in any administrative proceeding, except for any proceeding identified by the affidavit or an attachment to the affidavit. (7) The transferor does not contemplate at the time of the transfer the filing for relief under the Bankruptcy Code.⁸³

However, when the transferor is not a named beneficiary⁸⁴ of the Legacy Trust, a qualified affidavit is not required.⁸⁵ This requirement prevents a transferor from making the disposition for the sole purpose of defrauding a creditor. The statute even goes so far as to state that a failure or defect in the qualified affidavit may be considered as evidence in any proceeding commenced by a creditor.⁸⁶

For a creditor to void a qualified disposition, the creditor must prove by clear and convincing evidence that it was the intent of the settlor to defraud that specific creditor at the time of the disposition.⁸⁷ This high evidentiary standard might be difficult for creditors to meet. However, there have been numerous cases in other states where the creditors have met this burden of proof. For example, a Washington court in *In re Mastro*⁸⁸ held a real estate developer and his spouse, whose holdings collapsed due to the 2008 economic downturn, created an APT for the sole purpose of defrauding their creditors. The court voided the couple's assignment of many of their luxury homes to the trust and ordered that assets assigned to overseas self-settled trusts be returned to the couple.⁸⁹ Even though an offshore APT was the focus of this case, it is still a good example of how Ohio courts could rule when encountering a Legacy Trust that appears to have been created for fraudulent purposes.

Under the Ohio Legacy Trust Act, a settlor is permitted to retain certain rights which are not typically allowed under an irrevocable trust. A settlor of a Legacy Trust can retain the following rights in the instrument: the right to (1) implement a provision in the trust instrument that causes the trust to terminate upon the happening of an event; (2) veto distributions; (3) power of appointment; (4) receive

⁸³ *Id.* § 5816.06(B)(1)-(7).

⁸⁴ *Id.* § 5801.01(C) (defining a beneficiary as “a person that has a present or future beneficial interest in a trust, whether vested or contingent, or that, in a capacity other than that of trustee, holds a power of appointment over trust property, or a charitable organization that is expressly designated in the terms of the trust to receive distributions. ‘Beneficiary’ does not include any charitable organization that is not expressly designated in the terms of the trust to receive distributions, but to whom the trustee may in its discretion make distributions”).

⁸⁵ *Id.* § 5816.06(D)(1).

⁸⁶ *Id.* § 5816.06(E).

⁸⁷ *Id.* § 5816.07(A), (C).

⁸⁸ *In re Mastro*, 465 B.R. 576 (Bankr. W.D. Wash. 2011).

⁸⁹ *Id.*

trust income; (5) invade the trust corpus up to five percent each year; and (6) remove advisers. The settlor can pick and choose from this buffet of powers to tailor the Legacy Trust to his desired needs. Reserving certain power, such as the power to veto distributions, has the potential to affect whether the trust assets will be included in the settlor's gross estate.

B. Will Ohio Legacy Trusts Make Ohio Competitive In the Trust Market?

Ohio's wealth management laws currently respect creditors' rights and provide very little protection for an individual's assets.⁹⁰ Ohio residents have continually moved their assets to states with more favorable asset management laws or have changed their domicile because of Ohio's lack of asset protection.⁹¹ Legacy Trusts are an important step in modernizing Ohio's wealth management laws and, in conjunction with increasing the homestead exemption,⁹² will make Ohio a more appealing location for an individual's assets.⁹³ However, the creation of Legacy Trusts has the potential to have significant negative effects, such as an individual not being held financially accountable for their heinous actions.

Ohio Legacy Trusts will be as appealing, if not more appealing, than the APTs of other states, because Legacy Trusts afford creditors less time to file an objection to the funding of the Legacy Trust.⁹⁴ Ohio's legislation grants creditors an eighteen month period in which they can challenge and protest the creation of a domestic APT or six months after it should have reasonably been discovered.⁹⁵ Ohio creditors

⁹⁰ Representative Hagan, "in sponsor testimony . . . before the House Judiciary and Ethics committee, [stated that] . . . HB 479 is designed to modernize Ohio's legal infrastructure in the areas of trust, asset protection and business." Tiffany L. Parks, *Proposed Legislation Designed to Slow Retiree Exodus*, AKRON LEGAL NEWS (Apr. 6, 2012), <http://www.akronlegalnews.com/editorial/3386>.

⁹¹ *Testimony on H.B. 479*, *supra* note 22, at testimony of Johnson Trust Co.

⁹² The homestead exemption in Ohio allows an individual to shield \$125,000 per person from creditors. A married couple that jointly own property can shield up to \$250,000 from creditors. This is likely to make Ohio more appealing to individuals looking to protect their wealth, but states such as Florida have an unlimited homestead exemption amount. H.R.B. 479, 129th Gen. Assemb., Reg. Sess. (Ohio 2012).

⁹³ *See Testimony on H.B. 479*, *supra* note 22, at testimony of Johnson Trust Co.

⁹⁴ A comparison is only being drawn between Ohio's Legacy Trust and Alaska, Delaware, and Nevada because they are three of the best asset protection trust jurisdictions and were some of the earliest states to adopt them.

⁹⁵ OHIO REV. CODE ANN. §§ 5816.07(B)(1)(A) & (B)(1)(B) (LexisNexis 2013).

(B) A creditor's cause of action or claim for relief under division (A) of this section to avoid any qualified disposition of an asset is extinguished unless that action is brought by a creditor of a transferor who meets one of the following requirements:

(1) The creditor is a creditor of the transferor before the relevant qualified disposition, and the action is brought within the later of the following periods:

(a) Eighteen months after the qualified disposition;

(b) Six months after the qualified disposition is or reasonably could have been discovered by the creditor if the creditor files a suit against the transferor, other than an action under division (A) of this section to avoid the qualified disposition, or makes a written demand for payment on the transferor that in either case asserts a claim based on an act or omission of the transferor that occurred before the

also will have to show, by clear and convincing evidence, that it was the intent of the settlor to defraud the specific creditor bringing the lawsuit. These creditor claim restrictions will make Ohio more appealing because, in comparison, Nevada allows a two year period for a claim to be discovered or six months after it reasonably should have been discovered,⁹⁶ and Delaware allows for a four year period in which the creditor can file a claim.⁹⁷ This shorter statute of limitations will afford assets held in a Legacy Trust slightly more protection from creditors than would be afforded in Delaware or Nevada.

qualified disposition, and that suit is filed, or the written demand is delivered to the transferor, within three years after the qualified disposition.

(2) The creditor becomes a creditor after the qualified disposition, and the action under division (A) of this section to avoid the qualified disposition is brought within eighteen months after the qualified disposition.

Id.

⁹⁶ *Nevada Asset Protection Trust—NAPT*, ASSET PROTECTION PLANNERS INC., <http://www.assetprotectionplanners.com/strategies/nevada-asset-protection-trust.asp> (last visited Oct. 5, 2012, 1:00 PM). The Nevada Revised Statutes states:

1. A person may not bring an action with respect to a transfer of property to a spendthrift trust:

(a) If the person is a creditor when the transfer is made, unless the action is commenced within:

(1) Two years after the transfer is made; or

(2) Six months after the person discovers or reasonably should have discovered the transfer, whichever is later.

(b) If the person becomes a creditor after the transfer is made, unless the action is commenced within 2 years after the transfer is made.

2. A person shall be deemed to have discovered a transfer at the time a public record is made of the transfer, including, without limitation, the conveyance of real property that is recorded in the office of the county recorder of the county in which the property is located or the filing of a financing statement pursuant to chapter 104 of NRS.

3. A creditor may not bring an action with respect to transfer of property to a spendthrift trust unless a creditor can prove by clear and convincing evidence that the transfer of property was a fraudulent transfer pursuant to chapter 112 of NRS or that the transfer violates a legal obligation owed to the creditor under a contract or a valid court order that is legally enforceable by that creditor. In the absence of such clear and convincing proof, the property transferred is not subject to the claims of the creditor. Proof by one creditor that a transfer of property was fraudulent or wrongful does not constitute proof as to any other creditor and proof of a fraudulent or wrongful transfer of property as to one creditor shall not invalidate any other transfer of property.

NEVADA REV. STAT. ANN. § 166.170 (West 2012).

⁹⁷ NENNO, *supra* note 36, at 168. The Delaware Qualified Dispositions in Trust Act states:

(b) A creditor's claim under subsection (a) of this section shall be extinguished unless:

(1) The creditor's claim arose before the qualified disposition was made, and the action is brought within the limitations of § 1309 of Title 6 in effect on the later of the date of the qualified disposition or August 1, 2000; or

(2) Notwithstanding the provisions of § 1309 of Title 6, the creditor's claim arose concurrent with or subsequent to the qualified disposition and the action is brought within 4 years after the qualified disposition is made.

DEL. CODE ANN. tit. 12, § 3572 (2012).

Ohio Legacy Trusts, however, will only be as competitive as states like Delaware when it comes to spousal support claims. A Legacy Trust, similar to a Delaware APT, protects a settlor from spousal support claims which arise after the creation of the APT.⁹⁸ However, Alaska and Nevada laws have a competitive advantage in the area of spousal support claims due to the fact that they provide no statutory exception for it.⁹⁹ In comparison, Ohio Legacy Trusts allow all prior and current spouses the ability to raid the trust for spousal support or alimony payments.¹⁰⁰ Also, Ohio Legacy Trusts are more unfavorable than Nevada APTs for child support claims. Under the Ohio Legacy Trust Act, the trust can be raided for child support payments or by any government agency which is tasked with caring for the child.¹⁰¹ In comparison, Nevada law denies access to an APT for the purpose of obtaining child support payments; however, federal law might allow a child to access the trust in certain circumstances.¹⁰²

In tortious actions, Legacy Trusts will be as competitive as APTs in Alaska and Nevada. Ohio's proposed law, like Alaska and Nevada, allows tort claims filed prior to the creation of the Legacy Trust to reach the trust but bars future claims.¹⁰³ One advantage Legacy Trusts have, over those states regarding tortious claims, is that Ohio only grants creditors an eighteen month statutory period in which they can object to a disposition to the trust. However, this likely will be only a slight advantage, because most creditors will file a claim prior to the running of the statute of limitations.¹⁰⁴ This slight difference could make Ohio as competitive in the asset

⁹⁸ H.B. 479, 129th Gen. Assemb., Reg. Sess. (Ohio 2012) (proposed addition OHIO REV. CODE ANN. § 5816.03(C)(1)); NENNO, *supra* note 36, at 167-70.

⁹⁹ NENNO, *supra* note 36, at 270; NEV. REV. STAT. ANN. § 166 (West 2012).

¹⁰⁰ OHIO REV. CODE ANN. § 5816.03(F) (West 2013); BILL ANALYSIS AM. SUB. H.B. 479, *supra* note 55, at 1; *Testimony on H.B. 479*, *supra* note 22, at testimony of John E. Sullivan III, Sullivan & Sullivan, Ltd. page 020. The Ohio Legacy Trust States:

(C) Notwithstanding division (B) of this section or the terms of any spendthrift provision, but subject to divisions (D), (E), and (F) of this section, a transferor's interest in property that is the subject of a qualified disposition may be attached or otherwise involuntarily alienated in connection with any debt that the transferor owes pursuant to an agreement or court order for either of the following:

- (1) The payment of child or spousal support or alimony to or for the transferor's spouse, former spouse, child, or children, or to any governmental agency that is designated by statute, rule, or regulation to be the payee of that child or spousal support or alimony;
- (2) The division or distribution of property in favor of the transferor's spouse or former spouse.

OHIO REV. CODE ANN. § 5816.03(C) (West 2013).

¹⁰¹ OHIO REV. CODE ANN. § 5816.03(F) (West 2013); *Testimony on H.B. 479*, *supra* note 22, at testimony of Sullivan & Sullivan page 020.

¹⁰² 28 U.S.C. § 1738B(a), (h) (2006); Under the supremacy clause of the United States Constitution, state laws are considered inferior to Federal law. As such, when a state and Federal law conflict, Federal law must be followed. Osborne, *supra* note 29.

¹⁰³ NENNO, *supra* note 36, at 271.

¹⁰⁴ *Id.* at 272, 275.

protection market if the settlor is creating an APT strictly to avoid potential future tortious claims.

C. Practical Uses for an Ohio Legacy Trust

Ohio Legacy Trusts will be applicable in a number of situations, such as to shield assets from creditors upon death, protecting assets from future lawsuits, for estate planning purposes, and as prenuptials. The decision of whether to establish an Ohio Legacy Trust will be determined by the settlor's needs and the risks in which their occupation or actions might result.

1. Creditor Protection

Legacy Trusts will provide individuals with a vehicle by which they can protect their assets from creditors who might come into existence at the end of their life and ensure that, upon their death, some assets will remain for their loved ones, in much the same way an irrevocable trust does. An example of how this could occur is if the settlor gifts a sum of money to his or her Legacy Trust and names his or her children the successor beneficiaries of the trust. This money would not be able to be attacked by creditors if the settlor had substantial medical bills or other end of life expenses. However, a Legacy Trust is limited to only offering protection from non-Medicaid medical bills because of the supremacy of federal law which is discussed in Section IV of this note. Since the Ohio Legacy Trust named the settlor's loved ones as successor beneficiaries, the assets in the trust will be shielded from any liens or claims against the settlor's estate.¹⁰⁵ The one substantial advantage a Legacy Trust has over a standard irrevocable trust is that the settlor retains the ability to access five percent of the trust principal each calendar year. The transferor can also receive income or principle per the terms of the trust standard. However, an Ohio Legacy Trust would not be effective if, at the time of the transfer to the trust, the settlor already had incurred substantial medical expenses.¹⁰⁶ This is because the qualified affidavit requirement is not satisfied, and it could be viewed as an attempt to defraud creditors.

Even though Ohio's proposed legislation allows tortious claims filed prior to the creation of the Legacy Trust to raid the trust, it bars access to tortious claims arising after its creation.¹⁰⁷ Under the Legacy Trust Act, a creditor is defined as "a person who has a claim against a transferor and any transferee or assignee of, or successor to, that claim."¹⁰⁸ Applying this definition, an individual who files a tortious claim after the creation of a Legacy Trust will be barred from having access to the trust, just as any other claimant would be.

The barring of tortious claims could provide a way for doctors, lawyers, or other professionals to shield personal assets from malpractice or other tortious claims.¹⁰⁹ A

¹⁰⁵ OHIO REV. CODE ANN. § 5816.10(G) (West 2013).

¹⁰⁶ This would not meet the requirements of a qualified disposition, and, as a result, the Legacy Trust would be able to be raided by the creditor.

¹⁰⁷ OHIO REV. CODE ANN. § 5816.07(B) (West 2013).

¹⁰⁸ *Id.* § 5816.02(F).

¹⁰⁹ This could be viewed as a weak argument since professionals often have malpractice insurance, which would afford the professional some protection from malpractice lawsuits. However, as stated above, medical organizations cited this as one reason they have a difficult

number of medical associations, such as the Ohio State Medical Association¹¹⁰ and the Ohio State Chiropractic Association, offered testimony in support of the Ohio Legacy Trust Act and stated that the passage of the bill would help attract even better doctors to Ohio.¹¹¹ Ohio Legacy Trusts will also provide small businesses and professionals with the means to protect some of their assets from claims for which they can be held personally liable that might not be insurable.¹¹² If a Legacy Trust was established with the named beneficiary as the settlor's significant other, the assets would be able to be enjoyed by that beneficiary, as well as by the settlor, up to five percent annually of the trust principal, without the risk that everything the individual worked for could be lost in a lawsuit.

If Legacy Trusts can provide a substantial degree of protection for an individual's assets, why wouldn't everyone put their home in a Legacy Trust? Even though Legacy Trusts provide substantial protection for a settlor's assets, they do have some drawbacks. If a settlor decided to put his or her home into a Legacy Trust, one problem might arise when the individual potentially decides to move. The settlor would have to convince, if possible, the trustee to sell the home and buy another

time retaining highly qualified doctors and specialists. If a doctor is able to shield some of his or her personal assets from a possible creditor, there is the potential that doctors would not carry as high an amount of malpractice insurance, thus lowering their costs. Also, there are those freak accidents in which a small business owner might have to decide whether it is worth the higher cost in insurance premiums to avoid being liable for this. If small businesses are required to insure against every possible accident, the financial burden could be too great for the business to bear and, as a result, cause the business to shut down.

¹¹⁰ In the corporate world, the board of directors is protected from shareholder lawsuits by the "business judgment rule" if they acted in a reasonable manner. However, doctors have not been afforded this same protection until now. Ohio Legacy Trusts have the potential to allow doctors and other professionals to shield some of their assets from potential lawsuits. If corporate officers can be protected from liability, then why should doctors not be protected as well? Not allowing doctors to shield their assets from malpractice or other lawsuits could discourage doctors from being innovative. A good example of this is Dr. Arthur Steffee, who created and founded a company that made screws for back surgeries. Dr. Steffee and his company were sued for encouraging doctors to use these new revolutionary plates and screws in people's backs. The lawsuit eventually settled for \$100 million. Milt Freudenheim, *\$112 Million Offered to End Legal Claims on Spine Pins*, N.Y. TIMES (Dec. 10, 1996), <http://www.nytimes.com/1996/12/10/us/112-million-offered-to-end-legal-claims-on-spine-pins.html>. If doctors are unable to shield their assets from lawsuits, then there is limited incentive for them to try to create revolutionary methods to save people's lives. It could be argued that doctors taking risks will cause significantly more harm than a board of directors. However, if a board of directors makes risky business decisions that result in the company's demise, this would have a significant impact on individuals as well. Doctors having the ability to shield their assets from creditors' claims will hopefully encourage doctors to continue to be innovative.

¹¹¹ Throughout the testimony in front of the Judiciary and Ethics Committee, numerous medical organizations offered testimony in support of House Bill 479. The commonly stated support for the bill was based off of the inability of the medical community to retain highly qualified physicians and specialists because of the inability to insulate some of their assets from creditor actions. This argument was rather surprising since it is commonly thought that doctors have malpractice insurance, which would isolate them from malpractice claims.

¹¹² *Testimony on H.B. 479*, *supra* note 22, at testimony of Ohio Chamber & Ohio Small Business Council.

house for the settlor to use. Another potential problem is that, if there are other beneficiaries, the trustee will have a fiduciary duty to them as well. If selling the house is not in the best interest of the trust and the majority of its beneficiaries, the house would not be sold by the trustee because his fiduciary duty is to all beneficiaries, not just the settlor. Also, as will be explained later, if a settlor maintains “dominion and control” over an asset, it will not be deemed to be a completed gift when assigned to the trust for gift tax purposes. In addition, since the settlor retained the use and enjoyment of the property, the property would be included in the settlor’s gross estate for estate tax purposes upon the settlor’s death. Another problem that might arise is that, by maintaining control over the house, it might grant creditors access to the house and weaken the protection offered by the Legacy Trust. A creditor would argue that the transfer was made for the purpose of defrauding that specific creditor and that the entire qualified disposition was a sham, since the settlor continues to enjoy the property. However, under Section 5816.08(a)(1)(A), a “qualified disposition shall be avoided only to the extent necessary to satisfy a transferor’s debt to the creditor who brought the action”¹¹³ Overall, it is recommended that a settlor put only excess wealth above and beyond what is necessary for daily life into a Legacy Trust.

Another possible use for Legacy Trusts would be to shield assets from lawsuits resulting from the actions of a minor child. If an individual was sued for the injuries sustained from the negligent actions of his or her child, the person would have only minimal assets by which a judgment could be attached. A creditor to gain access to the trust would have to prove the settlor intended to defraud that specific creditor at the time of the disposition, which would be difficult. Ohio Legacy Trusts will provide a vehicle by which an individual can safeguard a portion of their assets in the event that a lawsuit occurs.

2. Estate Planning Uses

Ohio Legacy Trusts could also be used for estate planning tax purposes as a vehicle to remove assets from an estate. Even though Ohio’s estate tax expired January 1, 2013,¹¹⁴ the federal estate tax is currently forty percent, and the amount a person can gift tax-free is only \$5.25 million.¹¹⁵ To better understand the potential federal tax implications of an Ohio Legacy Trust, one can look to similar legislation in other states, such as the Delaware Qualified Dispositions in Trust Act.

A Legacy Trust could provide a vehicle by which a settlor can remove assets from his or her estate for tax purposes and still retain some access to the assets, if the settlor is concerned that the assets will be needed in the future. The fear of needing the assets in the future and lacking control over them is a common one among estate planning clients. If an individual uses the federal gift tax exemption¹¹⁶ to gift a certain amount of assets to the APT, this will allow the settlor to decrease the taxable assets within his or her estate and will reduce the estate tax owed upon the death of

¹¹³ OHIO REV. CODE ANN. § 5816.08(A)(1) (West 2013).

¹¹⁴ *Frequently Asked Questions—Estate Tax*, OHIO DEP’T OF TAXATION, <http://tax.ohio.gov/faq.aspx> (select category “Estate”) (last visited Oct. 10, 2012) (citing House and Senate Bill 153).

¹¹⁵ American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, 126 Stat. 2313 (2013).

¹¹⁶ *Id.*

the settlor. However, as will be discussed later in Subsection E, reserving certain powers will result in the assets in the Legacy Trust being pulled back in the gross estate.

If the settlor instead makes a *taxable* gift to the APT, the settlor will then be able to access some of the funds if their situation becomes dire.¹¹⁷ In a 2004 Revenue Ruling, the I.R.S., applying the “reach of creditor test,”¹¹⁸ stated that if a state does not subject trust assets to the claims of the trustor’s creditors, the assets of the trust will not be taxed.¹¹⁹ Overall, until Ohio’s legislation is implemented and the I.R.S. interprets the language of the Ohio Legacy Trust statute, it will be difficult to determine the exact federal tax implications.

Legacy Trusts could also be a valuable tool that estate planners can use to protect trusts established for the mentally disabled. A settlor, who wants to leave assets to care for a mentally disabled loved one, could put the assets into a Legacy Trust and name the mentally disabled individual as the beneficiary. This would be a way to shield the assets from those who might try to take advantage of their loved one. If the disabled individual was taken advantage of, creditors would be denied access to the trust. Also, if the assets were in a Legacy Trust, the settlor’s creditors would not have access to the assets if the settlor fell on hard times after creating the trust.¹²⁰ The assets also would be protected from possible judgments against the mentally disabled individual if he or she were sued for damages or injuries they caused as the result of their illness.

D. The Impact of Ohio Legacy Trusts

Ohio Legacy Trusts could have a significant impact on Ohio. The ability to create Legacy Trusts could provide tax revenue, jobs, and the possibility of attracting assets from out of state residents, which would be managed by Ohio financial institutions. Ohio Legacy Trusts could possibly have some negative consequences as well, but the benefits appear to outweigh the negative implications.

1. Income Generation

Ohio Legacy Trusts should create a significant source of revenue for the State of Ohio. If the studies conducted on how Alaska¹²¹ has benefited, and if the tax

¹¹⁷ NENNO, *supra* note 36, at 261; Sirknen, *supra* note 30, at 147-48 (emphasis added). This is also pursuant to the “rights, powers, interests [and] provisions” that can be reserved in the Legacy Trust instrument. OHIO REV. CODE ANN. § 5816.05 (West 2013). The rights, powers and interests set forth in this section establish to what extent the settlor will have the ability to access and control the assets within the trust.

¹¹⁸ Rev. Rul. 76-103, 1976-1 C.B. 293; Sirknen, *supra* note 30, at 148; NENNO, *supra* note 36, at 256.

¹¹⁹ Rev. Rul. 2004-64, 2004-2 C.B. 7 (cited in NENNO, *supra* note 36, at 262).

¹²⁰ The assumption is being made in this situation that the creditors did not exist prior to the creation of the Legacy Trust and that all the requirements in the establishment of a Legacy Trust have been met.

¹²¹ “The best indicator to date was a survey of Alaska trustees and attorneys done in 2002, five years after the Alaska Legislature enacted the law authorizing self-settled asset protection trusts. As of 2002, Alaska trustees had formed approximately 870 trusts for nonresidents of Alaska; approximately 310 were self-settled asset protection trusts. The creation of these trusts employed approximately 110 Alaska attorneys. In addition, approximately 125 self-settled

collected by Delaware from Delaware APTs is any indication, Ohio could potentially collect between \$17 million and \$33 million annually in-state income tax alone.¹²² Also, the “non-Delaware trust business contributes between \$600 million and \$1.1 billion annually to Delaware’s economy and accounts for two percent of the state’s economic growth.”¹²³ This is a significant amount of wealth which Ohio could benefit from and potentially use to meet the state’s projected budget deficit.¹²⁴

Ohio Legacy Trusts will encourage Ohio residents to maintain their wealth within the state and to leave their wealth within the state upon retiring to a warmer climate. A study conducted in New York also indicated that New York’s trust business was decreasing significantly as individuals left for states that had trust friendly laws, such as Delaware, Alaska, and Nevada.¹²⁵ There is no indication that Ohio is not currently suffering from the same phenomenon, as suggested by the testimony offered before the Ohio Judiciary Committee.¹²⁶ Significant amounts of

asset protection trusts had been created for Alaska residents while another 200 to 300 perpetual trusts, which were made available through Alaska’s repeal of the rule against perpetuities, were formed.” Lee, *supra* note 5, at 172.

¹²² *Testimony on H.B. 479, supra* note 22, at testimony of John E. Sullivan III, Sullivan & Sullivan, page 018.

¹²³ *Id.* at 017.

¹²⁴ Currently, Ohio is projected to have an estimated budget deficit of \$8 billion for the fiscal year of 2012-2013. Matt A. Mayer, *Governor John Kasich’s 2012-2013 State Budget: Big Strides Made in Some Programs, But Missed Opportunities Undermine His Message*, BUCKEYE INSTITUTE, available at <http://www.buckeyeinstitute.org/uploads/files/Analysis%20of%20Governor%20John%20Kasich%E2%80%99s%202012-2013%20Budget.pdf>.

¹²⁵ *Testimony on H.B. 479, supra* note 22, at testimony of Sullivan & Sullivan, page 018.

¹²⁶ During testimony before the Ohio House of Representatives Judiciary & Ethics Committee, the following testimony was offered:

Ohio client established limited liability company (“LLC”) that holds approximately \$100 million in liquid assets, partly managed by Johnson Investment Counsel, Inc. Previously-established irrevocable trust holding 40% of the LLC terminated recently and distributed the ownership interest to the client’s adult son. The son was advised to establish an irrevocable domestic asset protection trust (“DAPT”) [Domestic Asset Protection Trust], which would be permitted by the OAMMA [Ohio Asset Management Modernization Act], and transfer the ownership interest to the DAPT, part as a taxable gift to the trust, and part as an installment sale to the trust in exchange for a promissory note. Son was also advised to transfer the installment promissory note to a second DAPT.

Client appointed Schwab Trust Company, Delaware as trustee of both DAPTs, but included Johnson Trust Company’s Standard Trust Provisions in the trust agreements to allow for the future option to appoint JTC as trustee. The trust agreements also appoint Johnson Investment Counsel, Inc. as Investment Advisor, and a JTC employee as a member of a Trust Advisory Committee. The trust agreements were drafted by an Ohio attorney, but reviewed by Schwab legal counsel. Schwab annual trustee fees for both trusts will be \$9,000. A second Delaware bank quoted \$23,000 annually for both trusts.

Id. at testimony of Johnson Trust Co.

wealth are not only moving out of Ohio, but are generating taxable income in other states through the establishment and management of these trusts.¹²⁷

The adoption of Legacy Trust legislation could also potentially create jobs in Ohio.¹²⁸ Each Legacy Trust is required to be managed by an approved trustee, and this could result in Ohio financial institutions, law firms, or wealth management firms being appointed as trustees.¹²⁹ Also, some large financial institutions¹³⁰ are establishing divisions in states that allow APTs for the purpose of taking advantage of the asset protection laws.¹³¹ Allowing APTs to be created in Ohio could result in financial institutions establishing new subsidiaries within Ohio or those institutions already established in Ohio hiring additional employees, which would lower Ohio's unemployment rate.¹³² However, like most legislation, there are some potential negative implications which need to be taken into account.

2. The Negative Implications of Ohio Legacy Trusts

The Ohio Legacy Trust legislation could have a negative impact on Ohio's creditors and prevent individuals from being able to obtain the judgment awarded to them in a lawsuit. Legacy Trusts will require creditors to be more diligent and thorough in their screening of borrowers since a creditor would want to be aware of the borrower having a Legacy Trust. This could also foreseeably increase the administrative costs for the lenders since it is conceivable that it would take more time to process loan applications. Creditors will also need to be aware of individuals who have established Legacy Trusts so that they are able to object to their creation within the eighteen month statute of limitation.¹³³

It could also be argued that Legacy Trusts will promote a culture in which individuals are not held accountable for their actions.¹³⁴ If an individual knows that a substantial portion of his or her excess wealth is protected from creditors or claims, there will be little incentive for the individual to avoid risks, such as making risky investments in the hopes of large returns. However, it has been fifteen years since this argument was initially made in 1997, when Alaska first proposed the passage of APT legislation. Since that time, no research has been found that suggests moral degradation has occurred as the result of APTs. It could also be argued that justice is

¹²⁷ *Id.*

¹²⁸ *Id.*

¹²⁹ *Testimony on H.B. 479, supra* note 22, at testimony of Sullivan & Sullivan, page 017-18.

¹³⁰ Both KeyBank and PNC Bank recently created Delaware subsidiaries and offered support for the passage of Bill 479 along with Citizens Wealth Management and the Private Trust Company. *Id.*

¹³¹ *Id.* at 56-57.

¹³² The Ohio unemployment rate, as of September 2012, was 7.1%. Benjamin Johnson, *Ohio and U.S. Employment Situation*, OHIO DEPARTMENT OF JOBS AND FAMILY SERVICES (Nov. 16, 2012), <http://jfs.ohio.gov/releases/unemp/201210/index.stm>.

¹³³ OHIO REV. CODE ANN § 5816.07(B)(1)(a) (LexisNexis 2013).

¹³⁴ Many commentators and scholars decried asset protection trusts for this reason. It was often argued that self-settled spendthrift trusts would be used to shelter a person's assets and prevent the person from being held accountable.

unobtainable for the plaintiff who wins a judgment against a defendant who has a Legacy Trust, since the plaintiff is unable to collect on that judgment. A Legacy Trust could be used in the same way as an irrevocable trust with a spendthrift provision that was used in *Scheff v. Kruger*.¹³⁵ In this particular case, an individual was accused of sexually assaulting a child. The plaintiff was awarded \$551,286.25 in damages and sought to attach the judgment to funds held in a trust fund for Kruger. The New Hampshire Supreme Court held that the spendthrift provision barred the plaintiff's claim against the trust. A similar result would be obtainable in Ohio if a defendant held his assets in a Legacy Trust, because there are only two exceptions that allow a creditor access to a Legacy Trust, and this type of situation would not fall in either category. This is another argument against allowing the creation of APTs, because a settlor will not always be held financially accountable for his or her actions.¹³⁶

Ohio Legacy Trusts are not without some negative implications. These potential negative implications need to be weighed against the possible benefits that Ohio Legacy Trusts could have on Ohio. Assuming that the benefits actually are realized as predicted, the benefits likely will outweigh any negative implications.

E. Tax Implications of Ohio Legacy Trusts

The tax implications of Ohio Legacy Trusts can best be determined by looking at the tax implications of Delaware's asset protection legislation, the Delaware Qualified Dispositions in Trust Act. In this section, the federal income and estate tax implications of an Ohio Legacy Trust are explored by looking at what various powers a settlor can reserve. The Ohio estate tax consequences for an Ohio Legacy Trust do not need to be examined because as of January 1, 2013 the Ohio estate tax was abolished.¹³⁷

1. Income Tax Implications

In establishing an Ohio Legacy Trust, an attorney will first need to determine whether to establish the Legacy Trust as a non-grantor or grantor trust. If the Legacy Trust is established as a non-grantor trust, the settlor will not be liable for paying the income tax for the trust each year.¹³⁸ However, for estate planning purposes, it might

¹³⁵ *Scheff v. Krueger*, 782 A.2d 410 (N.H. 2001).

¹³⁶ This is a viable argument; however, it is unrealistic that an individual will put a substantial portion of their wealth into a Legacy Trust over which they will have only moderate control for the sole purpose of avoiding a lawsuit. It is foreseeable that an individual is more likely to put excess wealth into a Legacy Trust for tax purposes or for protection from creditors than they would be to avoid judgments. Another flaw in this argument is that if an individual makes the disposition to the trust after the incident occurred and has knowledge that a lawsuit is likely, the argument could be made that the disposition was made for fraudulent purposes. If the disposition is made for fraudulent purposes, the disposition is considered void, and the assets can have judgments attached to them. Also, if the event occurred prior to the disposition, the creditor could file an objection to the creation of the trust within the statute of limitations to avoid the assets being unreachable in a Legacy Trust.

¹³⁷ *Ohio Estate Tax Update*, OHIO DEPARTMENT OF TAXATION (Dec. 19, 2012), http://www.tax.ohio.gov/Portals/0/communications/information_releases/Estate_Tax_Infor_Release_121912.pdf

¹³⁸ Sirknen, *supra* note 30, at 148.

be more favorable to establish the Legacy Trust as a grantor trust. If the Legacy Trust is a grantor trust, the settlor will be responsible for paying the income tax of the trust each year.¹³⁹ This is referred to as an “intentionally defective grantor trust.”¹⁴⁰ This could be beneficial because the individual will not only be able to gift assets to the trust, as will be discussed below, but will be able to reduce the assets outside of the trust by using those assets to pay the income tax for the trust each year.¹⁴¹

If the APTs already established in Delaware are any indication, most Legacy Trusts will be established as grantor trusts and structured as incomplete gifts for federal estate tax purposes. Also, if the settlor retains the right of discretionary income and principal distributions from the Legacy Trust, the trust will be considered a grantor trust with respect to its ordinary income and capital gains unless distributions to the settlor must be approved by an adverse party.¹⁴²

2. Estate Tax Implications

To determine whether the assets held in a Legacy Trust are includable in a settlor’s gross estate for federal estate tax purposes, a discussion of Sections 2038(a)(1) and 2036(a)(1)-(2) is necessary. Section 2038(a)(1) states

[i]n general [t]he value of the gross estate shall include the value of all property. . . . To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money’s worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent’s death.¹⁴³

Under this provision, the Legacy Trust will be included in the settlor’s gross estate if the settlor retains enough power to enable creditors to reach trust assets.¹⁴⁴ Section 2036(a)(1) would require the inclusion of a Legacy Trust in the settlor’s gross estate if the settlor has “the possession or enjoyment of, or the right to the income from, the property.”¹⁴⁵ This will result in the Legacy Trust being includable in the settlor’s gross estate if the settlor reserves the power to receive up to five

¹³⁹ NENNO, *supra* note 36, at 256.

¹⁴⁰ Matthew Landon, *2012 Estate Planning: Intentionally Defective Grantor Trusts*, MOODY, FAMIGLIETTI & ANDRONICO (Nov. 14 2012), <http://www.mfa-cpa.com/alerts-and-insights/blog/2012/11/2012-estate-planning-intentionally-defective-grantor-trusts>.

¹⁴¹ *Id.*

¹⁴² NENNO, *supra* note 36, at 256 § 143.

¹⁴³ 26 U.S.C.A. § 2038(a)(1) (West 2012).

¹⁴⁴ NENNO, *supra* note 36, at 259.

¹⁴⁵ I.R.C. § 2036(a)(1) (2012).

percent of the trust principle not subject to the discretion of the trustee.¹⁴⁶ However, if the settlor only receives distributions “upon the exercise of absolute discretion”¹⁴⁷ of another individual, the question becomes whether this is enough retained power to cause estate tax inclusion?

A trust will be included in the settlor’s gross estate under I.R.C. § 2036(a)(2) if, at the settlor’s death, the settlor has “the right . . . to designate the persons who shall possess or enjoy the property or the income therefrom.”¹⁴⁸ This issue of whether enough power has been retained to allow creditors to gain access to the assets arises under § 2036(a)(2). With an Ohio Legacy Trust, the determining factor as to whether the trust assets are includable in the settlor’s gross estate is whether creditors can access the trust assets. All the pertinent cases and rulings provide that the trustor will be required to include for estate-tax purposes the Legacy Trust assets if he or she retains the powers to incur debt and to relegate creditors to trust assets.¹⁴⁹ By authorizing the creation of APTs in Ohio, creditors are unable to reach the assets held in the Legacy Trust except in a few instances, and; therefore, this allows speculation that a settlor shall be able to exclude the trust assets from his or her estate.¹⁵⁰

Additionally, the IRS further supported this line of reasoning in finding that seven irrevocable California self-settled trusts were not includable in the settlor’s gross estate and were not completed gifts, because California does not recognize self-settled trusts.¹⁵¹ The IRS, again, in a 2009 Private Letter Ruling, found that a transfer of assets to an Alaska APT was a completed gift.¹⁵² However, the settlor in that case did not retain the power to change the interest of the beneficiaries, which suggests the settlor did not reserve the ability to veto distributions.¹⁵³ If a settlor retains the power to veto distributions from a Legacy Trust, then a completed gift will not occur and the trust will likely be includable in the settlor’s gross estate. The IRS also has stated that “[i]n addition [to] the trustee’s discretionary authority to distribute income and/or principal to Grantor, does not, by itself, cause the Trust corpus to be includable in Grantor’s gross estate under § 2036.”¹⁵⁴ The IRS, however, also stated that “[w]e are specifically not ruling on whether Trustee’s discretion to distribute income and principal of Trust to Grantor combined with other facts (such as, but not limited to, an understanding or preexisting arrangement between Grantor and trustee regarding the exercise of this discretion) may cause inclusion of Trust’s assets in Grantor’s gross estate for federal estate tax purposes under § 2036.”¹⁵⁵

¹⁴⁶ I.R.C. § 318 (2012).

¹⁴⁷ *Id.*

¹⁴⁸ I.R.C. § 2036(a)(2); NENNO, *supra* note 36, at 260.

¹⁴⁹ NENNO, *supra* note 36, at 261.

¹⁵⁰ *Id.*

¹⁵¹ NENNO, *supra* note 36, at 262 n.4 (citing I.R.S. Tech. Adv. Mem. 1999-17-001 (Apr. 30, 1999)).

¹⁵² *Id.* at 262 n.7 (citing I.R.S. Priv. Ltr. Rul. 2009-44-002 (Oct. 30, 2009)).

¹⁵³ I.R.S. Priv. Ltr. Rul. 2009-44-002 (Oct. 30, 2009).

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

The argument can be made that these rulings are only applicable to states such as Alaska and Nevada who do not have statutory exceptions which allow creditors to raid the trust.¹⁵⁶ The Legacy Trust Act contains an exception to allow spousal support and child support claims to raid the assets of the trust.¹⁵⁷ The argument can be made that the Legacy Trust will fail the “reach of creditor” test, and the dispositions to the trust will not be considered a completed gift or be deemed excludable from the settlor’s gross estate.¹⁵⁸ One issue with this argument is that all domestic APTs are reachable by what are often referred to as super creditors. Super creditors typically are federal agencies seeking payment. Under the Supremacy Clause, which is discussed in Section IV below, all federal agencies can raid APTs.¹⁵⁹ If all APTs are vulnerable to federal creditors, no assignment of assets to an APT would ever be a completed gift. Given the right set of facts and circumstances, all APTs will be reachable by creditors.

If a settlor is concerned with the possibility that his or her Legacy trust will be found to be an incomplete gift and is includable in his or her gross estate, the settlor should report the transfer of the assets on a gift tax return.¹⁶⁰ This will start the running of the statutory period in which the IRS can deem the gift an incomplete gift. Upon the running of the statutory time period, the transfer will only be included in the settlor’s gross estate to the extent that a completed gift would be includable.¹⁶¹

The estate tax consequences of an Ohio Legacy Trust are impacted significantly by the powers which one retains. With the Legacy Trust statute providing a buffet of powers which a settlor can, but is not required to reserve, it makes it difficult to determine exactly when too much power has been reserved. The IRS has indicated that if a settlor reserves the power to veto distributions, it will be includable in the settlor’s gross estate. The IRS has also indicated that if a settlor receives distributions from an APT at the discretion of the trustee, this likely will not be enough power to require inclusion of the Legacy Trust in the settlor’s gross estate.¹⁶² However, the exact line of when too much power has been reserved is difficult to determine, and the few Private Letter Rulings on the matter cannot be cited as precedence and offer only minimal guidance. The IRS explicitly stated in a 1998 Private Letter Ruling that it was not commenting on whether assets would be includable in the settlor’s gross estate.¹⁶³ With the IRS providing little guidance on whether APTs will be included in the settlor’s gross estate, it is beyond the scope of this note to speculate as to what combination of powers would be considered too much power and what would be accepted by the IRS. A definitive answer will not be attainable until after the IRS challenges an Ohio Legacy Trust and offers its insight

¹⁵⁶ NENNO, *supra* note 36, at 263; Sirknen, *supra* note 30, at 148.

¹⁵⁷ OHIO REV. CODE ANN. § 5816.03(C)(1) (West 2013).

¹⁵⁸ Sirknen, *supra* note 30, at 148-49.

¹⁵⁹ NENNO, *supra* note 36, at 264.

¹⁶⁰ *Id.* at 268.

¹⁶¹ *Id.* at 269.

¹⁶² I.R.S. Priv. Ltr. Rul. 2009-44-002 (Oct. 30, 2009) (cited in NENNO, *supra* note 36, at 146).

¹⁶³ I.R.S. Priv. Ltr. Rul. 98-37-007 (Sept. 11, 1998).

into how it interprets the statute. Overall, like many of the other states that have adopted domestic APT legislation, it could take years until Ohio attorneys have a better indication of how the IRS will view Legacy Trusts.

F. A New Kind of Prenuptial Agreement

Prenuptial agreements are a commonly talked about method of protecting an individual's assets from their spouse. We frequently hear about prenuptial agreements on the news in the context of multimillionaires and Hollywood celebrities. Prenuptial agreements provide a way by which the wealthy can protect their assets, but not without a cost. A prenuptial agreement requires that, prior to marriage, the soon-to-be spouse signs the agreement¹⁶⁴ which can signal mistrust between the two and create a rift in the relationship.

Prenuptial agreements provide ample protection for the rich and wealthy, but do not offer the middle class substantial protection if a marriage ends in divorce. Under the doctrine of equitable distribution, the court will determine how the assets should be distributed, even if the prenuptial agreement specifies a certain distribution if the assets are disproportionately distributed.¹⁶⁵ For upper middle class individuals who do not have millions of dollars, this will generally result in the marital property being divided equally between the two individuals. However, Ohio Legacy Trusts have the potential to not only protect the wealthy, but also the middle class, in the case of divorce.

If an Ohio Legacy Trust is established *prior* to the individuals' marriage, the assets which are held in the APT will be protected in the event of the couple's divorce. The Ohio Legacy Trust Act defines "spouse" and "former spouse" as only "the person to whom a transferor was married on or before a qualified disposition is made."¹⁶⁶ The Ohio Legacy Trust Act also states that:

[A] transferor's interest in property that is the subject of a qualified disposition may be attached or otherwise involuntarily alienated in connection with any debt that the transferor owes pursuant to an agreement or court order for either of the following: (1) The payment of child or spousal support or alimony to or for the transferor's spouse, former spouse, child, or children, or to any governmental agency that is designated by statute, rule, or regulation to be the payee of that child or spousal support or alimony; (2) The division or distribution of property in favor of the transferor's spouse or former spouse.¹⁶⁷

Because the statute defines a former spouse as someone whom the settlor married prior to the qualified disposition, if a settlor establishes a Legacy Trust prior to the marriage, the assets in the trust cannot be attached by the court when ordering the

¹⁶⁴ 46 OHIO JUR. 3D FAMILY LAW § 156 (2013).

¹⁶⁵ See generally 2 BALDWIN'S OHIO PRAC. MERRICK-RIPPNER PROB. L. § 101:9 (2013); David R. Dawson, *What You Can Do with a Prenuptial Agreement*, BOYER, DAWSON AND ST. PIERRE (April 16, 2013, 3:47 PM), <http://www.boyerdawson.com/2013/04/16/what-you-can-do-with-a-prenuptial-agreement/>.

¹⁶⁶ OHIO REV. CODE ANN. § 5816.02(U) (West 2013).

¹⁶⁷ *Id.* § 5816.03.

payment of spousal support.¹⁶⁸ Unlike a prenuptial agreement, the Ohio courts will be unable to apply the doctrine of equitable distribution to the assets in the Legacy Trust. This will result in the court only dividing the assets outside of the Legacy Trust. However, the court could possibly take the assets that are in the trust into account when dividing the assets outside of the trust. This is one potential issue with using Ohio Legacy Trusts as prenuptial agreements.¹⁶⁹

The primary advantage that a Legacy Trust has over a prenuptial agreement is that the soon-to-be spouse is not required to be informed that a Legacy Trust is in place.¹⁷⁰ This could be viewed as deceitful, but it would not signal that the settlor is untrusting of his soon-to-be spouse and believes the marriage could end in divorce. A Legacy Trust also, unlike a prenuptial agreement, can have a dual purpose. Not only can the Legacy Trust protect the individual's excess assets if a divorce occurs, but also the trust can protect the assets from other creditors.¹⁷¹

A middle class individual also will be less likely to care about the potential tax ramifications of reserving certain powers in a Legacy Trust because of the smaller amount of assets. If a qualified disposition is made to the trust as an incomplete gift, the settlor may be required to pay taxes upon gifting the assets, but this might be a relatively small price to pay for not losing half of one's wealth in a divorce.¹⁷² The use of Legacy Trusts by individuals of lower means might not be cost effective if the cost of establishing a Legacy Trust proves to be high, but it has the potential to provide substantially more protection for upper middle class settlors in a divorce than a prenuptial agreement.

G. The Ethical Responsibilities of Attorneys and Ohio Legacy Trusts

When working with a client to establish a Legacy Trust, an attorney will need to act ethically and gauge the potential that he or she could be sued or held liable for his or her actions.¹⁷³ Forty-nine states, including Ohio, have adopted some version of the Model Rules of Professional Conduct that were adopted by the American Bar Association.¹⁷⁴ No specific portion of the Model Rules refers to asset protection planning, but the most applicable provision is Rule 1.2(d),¹⁷⁵ which deals with fraud and fraudulent¹⁷⁶ conduct.¹⁷⁷ Model Rule 1.2(d) provides that:

¹⁶⁸ *Id.* § 5816.02(U).

¹⁶⁹ Dawson, *supra* note 165.

¹⁷⁰ No provision is found under the Ohio Legacy Trust Act that requires the soon to be spouse to be notified that a Legacy Trust is in place. *See generally* OHIO REV. CODE ANN. ch. 5816 (West 2013).

¹⁷¹ *Id.* § 5816.07.

¹⁷² NENNO, *supra* note 36, at 256 § 143.

¹⁷³ *Id.* at 250.

¹⁷⁴ *Id.* at 251.

¹⁷⁵ Model Rules of Prof'l Conduct R. 1.2(d) (2012).

¹⁷⁶ *Id.* R. 1.0(d) defines fraud or fraudulent as "conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction and has a purpose to deceive."

¹⁷⁷ NENNO, *supra* note 36, at 251.

A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.¹⁷⁸

In a variety of states, “ethics opinions involving the propriety of asset protection planning” have been issued.¹⁷⁹ These cases have largely dealt with attorneys helping their clients engage in fraudulent transfers.¹⁸⁰

Ethics opinions have been issued in California, Connecticut, Florida, New York, Oregon, and South Carolina and they seem to suggest that an attorney is engaging in unethical behavior only if the attorney helps the client defraud foreseeable or known creditors.¹⁸¹ If an attorney engages only in planning which involves unknown and unforeseeable creditors, the attorney is not committing any ethical violations.¹⁸² Ohio attorneys who are unfamiliar with APT planning should question clients as to why they wish to establish an Ohio Legacy Trust and determine whether creditors already exist to prevent ethics violations. If an attorney fails to ask the necessary questions to thoroughly explore the motives of his or her client in an attempt to be ignorant to the client’s true motives, this will likely not be a viable defense for the attorney.

The case of *In re Huber*, a bankruptcy case, demonstrates what might occur if an attorney fails to thoroughly question a client’s motives as to why they want to establish a Legacy Trust.¹⁸³ This case involved the establishment of an Alaska Asset Protection Trust by a highly educated and experienced estate planning attorney.¹⁸⁴ Mr. Huber was a “long time large Washington state real estate developer and ha[d] a fairly successful track record.”¹⁸⁵ As a result of the 2008 economic downturn, Mr. Huber was facing significant financial issues when he hired attorney Snow to establish a Domestic Asset Protection Trust (DAPT).¹⁸⁶ The DAPT was doomed from the very outset because of the fraudulent purpose for which Mr. Huber sought to establish the trust.¹⁸⁷ As a result of the funding and establishment of this DAPT by attorney Snow, not only will the Federal Bankruptcy courts unwind the planning that occurred, but attorney Snow could also face ethics violations.¹⁸⁸ This case stands as a reminder that attorneys must thoroughly explore and probe into a client’s motives

¹⁷⁸ MODEL RULES OF PROF’L CONDUCT R. 1.2(d) (2012).

¹⁷⁹ NENNO, *supra* note 36, at 251.

¹⁸⁰ *Id.*

¹⁸¹ *Id.*

¹⁸² *Id.* at 251-52.

¹⁸³ *In re Huber*, 493 B.R. 798 (Bankr. W.D. Wash. 2013).

¹⁸⁴ D. Bowen Loeffler, *When an Estate Planner Meets Asset Protection Planning: Warnings and Lessons from the Huber DAPT Case*, 24 OHIO PROB. L.J. 6 (2013).

¹⁸⁵ *Id.*

¹⁸⁶ *Id.*; *see also* Huber, 493 B.R. at 803-06.

¹⁸⁷ Loeffler, *supra* note 186.

¹⁸⁸ *Id.*

when establishing a Legacy Trust to avoid one being established for fraudulent purposes.¹⁸⁹

An attorney, however, cannot simply refuse to participate in asset protection planning or the use of APTs under the assumption that they have no ethical obligation to inform their clients about them.¹⁹⁰ Attorneys are required to represent their clients competently,¹⁹¹ and failing to provide information about the use of Legacy Trusts simply because the attorney does not know how to use them would not be competent representation.¹⁹² Commentators in 2003 provided the following caution to attorneys:

So far there are no reported ethics decisions or malpractice cases addressing whether a lawyer is obligated to promote a client's lawful asset protection plan. But it is only a matter of time before such claims begin to be heard. Therefore, professionals should not shrink from asset protection. Handled responsibly, it should be as ethically and legally innocuous as any other type of planning. Certainly, to protect themselves, professional advisors must do their due diligence. At a minimum, they should follow established "know your client" procedures, conduct or obtain a solvency analysis of the client, review the client's circumstances—and always document that due diligence.¹⁹³

The Supreme Court of Colorado, in a 2003 opinion, suspended and eventually disbarred an attorney for providing ineffective asset protection advice.¹⁹⁴ Under their ethical obligation to represent their clients, Ohio attorneys will need to develop the necessary knowledge regarding the use of Ohio Legacy Trusts or, in the appropriate situation, refer their clients to another attorney who specializes in asset protection planning to avoid possible malpractice claims.¹⁹⁵

Ohio attorneys will also need to be careful to avoid being potentially liable to clients for losses suffered as the result of poor planning. If an attorney fails to inform a client about the use of Ohio Legacy Trusts, the attorney could be liable to the client if the client's assets are reached by a creditor. In a 2001 case, *Butler v. Mooers*,¹⁹⁶ an attorney was sued for malpractice for failing to provide effective asset protection advice regarding the use of offshore APTs. This case ultimately was barred on the basis of collateral estoppel, but the case represents the dangers of ineffective advice to clients regarding APTs.¹⁹⁷

¹⁸⁹ Some tips that might help to avoid attorneys violating their ethical duties when establishing Legacy Trusts can be found in Loeffler, *supra* note 184.

¹⁹⁰ MODEL RULES OF PROF'L CONDUCT R. 1.3 cmt. 1 (2012).

¹⁹¹ OHIO RULES OF PROF'L CONDUCT R. 1.1 (2012).

¹⁹² NENNO, *supra* note 36, at 251.

¹⁹³ Gideon Rothschild & Daniel S. Rubin, *Asset-Protection Planning: Ethical? Legal? Obligatory? It's All of the Above*, 142 TRUSTS & ESTATES 42, 45 (2003).

¹⁹⁴ *People v. Woodford*, 81 P.3d 370 (Colo. 2003); NENNO, *supra* note 36, at 252.

¹⁹⁵ NENNO, *supra* note 36, at 252.

¹⁹⁶ *Butler v. Mooers*, 771 A.2d 1034 (Me. 2001).

¹⁹⁷ NENNO, *supra* note 36, at 253

Another concern for attorneys who improperly use Ohio Legacy Trusts is the possibility of being held liable by third parties. Ohio, unlike Delaware, is one of eight states that allow the awarding of monetary damages against an attorney who aids in or participates in a conspiracy to commit a fraudulent transfer.¹⁹⁸ However, Section 5816.07(D) prevents a creditor or a third party from suing an attorney for establishing a Legacy Trust on behalf of a client.¹⁹⁹ Even if an Ohio attorney cannot be held liable by third parties or creditors for establishing and funding a Legacy Trust, an attorney should still screen clients thoroughly to determine their purpose for establishing a Legacy Trust. Even though an attorney cannot be held liable, the attorney could still be required to provide information to the Court under the crime-fraud exception.²⁰⁰ Attorneys should thoroughly question a client's motives to avoid potential ethical violations and also to minimize any potential liability.

IV. WILL OHIO LEGACY TRUST ACTUALLY WORK TO PROTECT A SETTLOR'S ASSETS?

There is a substantial debate surrounding whether APTs can actually protect a settlor's assets because of the Full Faith and Credit Clause,²⁰¹ the Contract Clause,²⁰² and the Supremacy Clause²⁰³ of the United States Constitution. The answer as to whether these Constitutional provisions will frustrate or void an APT is still unknown because there has not been a federal appellate court case involving an APT that had at issue one of these Constitutional provisions.

A. The Full Faith and Credit Clause

The Full Faith and Credit Clause states that "full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state."²⁰⁴ With the use of APTs, the question is raised as to what occurs when a settlor is sued in a state which does not recognize APTs. A creditor attempting to access assets in an APT would argue that the judgment entered in the other state must be honored under the full faith and credit clause. However, this might not be the case since, under the Full Faith and Credit Clause, a state is not required to honor the judgment of another state, if that state lacked jurisdiction over the trust assets or the trustee.²⁰⁵

For a court to render a verdict against a settlor of an APT, the court must have jurisdiction over some aspect of the trust, such as the trustee of the trust or the assets of the trust itself. States have jurisdiction over all individuals who are domiciled within the state's borders, as well as having jurisdiction over all property within the

¹⁹⁸ *Id.* (citing *Profeta v. Lombardo*, 600 N.E.2d 360, 363-64 (Ohio Ct. App. 11th Dist. 1991)).

¹⁹⁹ OHIO REV. CODE ANN. § 5816.07(D), (E), (G) (LexisNexis 2013).

²⁰⁰ OHIO RULES OF PROF'L CONDUCT R. 1.6(b)(3) (2012).

²⁰¹ U.S. CONST. art. IV, § 1; Sirknen, *supra* note 30, at 152.

²⁰² U.S. CONST. art. I, § 10, cl. 1.

²⁰³ Sirknen, *supra* note 30, at 153.

²⁰⁴ U.S. CONST. art. IV, § 1.

²⁰⁵ Sirknen, *supra* note 30, at 152-53.

state's borders.²⁰⁶ The Supreme Court in *Hanson v. Denkla*²⁰⁷ held that a Delaware court was not required to give full faith and credit to a Florida judgment because Florida courts lacked personal jurisdiction over the trustee or in rem jurisdiction over the trust assets themselves.²⁰⁸

The Ohio Legacy Trust statute, in an attempt to prevent courts in non-asset protection states from acquiring jurisdiction, requires that a trustee be a resident of Ohio or be supervised by an Ohio citizen.²⁰⁹ To minimize the possibility that a non-asset protection state could claim in rem²¹⁰ jurisdiction, a settlor should keep all of their trust assets within Ohio.²¹¹ The Supreme Court, in the case of *Phillips Petroleum Co. v. Shutts*,²¹² denied Kansas the ability to apply its own law to all members of a class merely because it had jurisdiction over the parties.²¹³ Applying the Court's reasoning, it could be argued that, even if a non-asset protection state has jurisdiction over an out of state trustee, the state still cannot substitute Ohio law governing the trust for the law of their own state.

In *Franchise Tax Board v. Hyatt*,²¹⁴ the Supreme Court unanimously upheld the Nevada Supreme Court's refusal to extend full faith and credit to a California statute immunizing the California tax-collection agency from lawsuits.²¹⁵ In making its decision, the Court stated that:

“[O]ur precedent differentiates the credit owed to laws (legislative measures and common law) and to judgments.” Whereas the full faith and credit command “is exacting” with respect to “[a] final judgment . . . rendered by a court with adjudicatory authority over the subject matter and persons governed by the judgment,” it is less demanding with respect to choice of laws. We have held that the Full Faith and Credit Clause does not compel a state to substitute the statutes of other states for its own statutes dealing with a subject matter concerning which it is competent to legislate. 216

²⁰⁶ Osborne, *supra* note 29, at 39 (citing *International Shoe Co. v. Washington*, 326 U.S. 310 (1945)).

²⁰⁷ *Hanson v. Denkla*, 357 U.S. 235 (1958).

²⁰⁸ Osborne, *supra* note 29, at 48.

²⁰⁹ OHIO REV. CODE ANN. §5816.02(S)(1) (LexisNexis 2013).

²¹⁰ In rem jurisdiction is “[a] court’s power to adjudicate the rights to a given piece of property, including the power to seize and hold it.” BLACK’S LAW DICTIONARY 929 (9th ed. 2009).

²¹¹ Sirknen, *supra* note 30, at 153.

²¹² *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985).

²¹³ Sirknen, *supra* note 30, at 156 (citing *Phillips Petroleum Co.*, 472 U.S. at 822).

²¹⁴ *Franchise Tax Bd. of Cal. v. Hyatt*, 538 U.S. 488 (2003).

²¹⁵ Richard W. Nenno & John E. Sullivan III, *Planning and Defending Domestic Asset Protection Trusts*, SRO34 ALI-ABA 1825 (LexisNexis Apr. 2010); Sirknen, *supra* note 30, at 156.

²¹⁶ *Hyatt*, 538 U.S. at 494.

Even if Ohio courts are required to give a judgment of a non-asset protection state full faith and credit, Ohio laws can still restrict the remedies available to most creditors.²¹⁷ Ohio can permissibly regulate the method by which the judgments of other states are enforced within its borders, as was established by the Supreme Court's decision in *Baker by Thomas v. General Motors Corp.*²¹⁸ The Court stated that "full faith and credit, however, does not mean that enforcement measures must travel with the sister state judgment as preclusive effects do; such measures remain subject to the evenhanded control of forum law."²¹⁹ Applying the Court's reasoning, the Full Faith and Credit Clause merely would require Ohio to acknowledge that the judgment is valid and would allow Ohio to apply its rules for enforcing the judgment.²²⁰ The provisions of the Ohio Legacy Trust Act operate within the parameters of the Court's decision, not by restricting the plaintiff's actions, but rather by barring any action to enforce judgments to collect funds from Ohio Legacy Trusts unless it is within the eighteen month statute of limitations.²²¹

The Supreme Court decision suggests that, if a settlor of an Ohio Legacy Trust is sued in a state that does not recognize APTs, and the court has jurisdiction over the trustee and renders a verdict against the settlor, under the Full Faith and Credit Clause, Ohio might not be required to honor the judgment.²²² However, even if a non-asset protection state has jurisdiction, this does not guarantee that the creditor will win. The creditor will still be required to convince the court that the underlying judgment should be enforced against the debtor's APT.

1. Arguments Creditors Attempt to Use to Pierce an Asset Protection Trust

There are three broad categories into which the arguments made by creditors will fit when trying to convince a court to enforce a judgment. These categories are: (1) the APT offends public policy in the state where the action was brought, (2) the domestic APT is a sham trust because the settlor retains some control over the assets in the trust, and (3) the settlor fraudulently made the transfer.²²³ A court, after determining that it has jurisdiction, must determine whether to apply the law of the state in which the trust was created or the law of the state in which the court resides.²²⁴ The general rule is that a court will apply the governing law of the trust and not the law of where the court sits; however, if strong public policy exists against a provision of the governing law of the trust, the court can choose to ignore the law of the trust and substitute it for its own state law.²²⁵ What this could mean for

²¹⁷ See generally NENNO, *supra* note 36, at 233.

²¹⁸ *Baker v. Gen. Motors Corp.*, 522 U.S. 222, 240-41 (1988).

²¹⁹ *Id.* at 235.

²²⁰ See generally NENNO, *supra* note 36, at 234.

²²¹ OHIO REV. CODE ANN. § 5816.07 (LexisNexis 2013); see generally NENNO, *supra* note 36, at 234.

²²² Sirknen, *supra* note 30, at 152.

²²³ Osborne, *supra* note 29, at 49.

²²⁴ *Id.*

²²⁵ AUSTIN WAKEMAN SCOTT ET. AL., SCOTT AND ASCHER ON TRUSTS, vol. 7 § 626(c) (5th ed. 2010); see also Osborne, *supra* note 29, at 49-50.

an individual with an Ohio Legacy Trust is that a state could substitute the requirement of the Legacy Trust that Ohio law governs the trust for the law of the state in which the court sits, thus, resulting in the assets no longer being protected.

Another argument made by creditors is that the trust was created as a sham because the settlor retains control over some of the trust, and the settlor is able to obtain some assets from the trust each year.²²⁶ A court might be receptive to the sham trust doctrine when the settlor is the only beneficiary and appears to be the primary beneficiary, not just an incidental beneficiary.²²⁷ To avoid this argument, an attorney who is establishing an Ohio Legacy Trust should designate at least one other beneficiary to the trust in addition to the settlor. Under the Ohio Legacy Trust Act, a settlor is only able to retain the ability to make those decisions as set forth in the Legacy Trust act and is only able to access up to five percent of the trust principal each year, besides any amount designated in the trust standard for the settlor.

A third argument made by creditors is that the assets were assigned to the trust in an attempt to defraud the creditor.²²⁸ This argument is persuasive to a court if the transfer to the trust would not be considered fraudulent under the law of the trust but would be considered fraudulent under the law of that state.²²⁹ This would be a weak argument against an Ohio Legacy Trust, because, under the Legacy Trust Act, all transfers made with the intent to defraud are considered void and can be accessed by creditors.²³⁰ Also, creditors are given the opportunity to object to the creation of a Legacy Trust within the statutory period.²³¹

B. Contracts Clause

In the U.S. Constitution, the Contracts Clause prohibits state legislatures from enacting laws that impair contractual rights and obligations.²³² The Contract Clause was “specifically intended by the framers to prevent the states from passing extensive debtor relief laws.”²³³ For APT legislation to violate the Contracts Clause, it must substantially impair the obligations of a party’s already existing contracts or make it difficult to enforce the contract.²³⁴ Even if a law meets the criteria of violating the Contracts Clause, it is not automatically determined to be void, but rather is subject to the strict scrutiny²³⁵ standard of review.²³⁶

²²⁶ Osborne, *supra* note 29, at 50-51.

²²⁷ *Id.* at 51.

²²⁸ *Id.*

²²⁹ *Id.*

²³⁰ OHIO REV. CODE ANN. § 5816.07(A) (LexisNexis 2013).

²³¹ *Id.*

²³² U.S. CONST. art. I, § 10, cl 1.

²³³ Osborne, *supra* note 29, at 59.

²³⁴ Sirknen, *supra* note 30, at 153.

²³⁵ Strict scrutiny is “[t]he standard applied to suspect classifications (such as race) in equal-protection analysis and to fundamental rights (such as voting rights) in due-process analysis. Under strict scrutiny, the state must establish that it has a compelling interest that justifies and necessitates the law in question.” BLACK’S LAW DICTIONARY 1558 (9th 2009).

1. Creditor Contract Clause Arguments

For a creditor to be able to reach the assets in an Ohio Legacy Trust by way of the Contracts Clause, the creditor would need to argue that the Legacy Trust eliminates the creditor's ability to seize the assets which, otherwise, could have been seized by the creditor for nonpayment.²³⁷ However, the Legacy Trust Act has specific sections which address creditor claims and provide a remedy for existing creditor claims. Claims which existed prior to the creation of the Legacy Trust are not barred if the creditor objects to the creation of the trust within the statutory time period of eighteen months.²³⁸ If a creditor does not object within the statutory time period, the creditor could argue that the Legacy Trust altered the obligations of the parties and, thus, violated the Contracts Clause. "Because the settlor can potentially continue to use the assets that have been 'discretionarily' distributed, the settlor's enjoyment of the trust assets is not impaired, but the possibility of creditors reaching those assets is restricted. Because the debtor will not be harmed if he refuses to repay the debt, the debtor's obligation to do so becomes illusory." Thus, the creditor can claim that the debtor's repayment obligations were obstructed.²³⁹

It is unlikely that a Legacy Trust will interfere with current contractual obligations because creditors are afforded the opportunity to object to the creation of the Legacy Trust during the eighteen month period. Also, under the Legacy Trust Act, if an individual creates a trust for the purpose of defrauding a specific creditor, the disposition of the assets to the trust is void²⁴⁰ only to the extent necessary to satisfy a transferor's debt to the creditor who brought the action.²⁴¹ If a Legacy Trust is void because it does not meet the qualified disposition requirement, it cannot be said to interfere with the contractual obligations of another party.

²³⁶ Osborne, *supra* note 29, at 59.

²³⁷ *Id.*

The U.S. Supreme Court first used the contract clause to invalidate a state law on the basis of unreasonable interference with contracts in *Fletcher v. Peck*, 10 U.S. 87 (1810). The Court continued to use the clause for this purpose throughout the nineteenth century. See, e.g., *Sturges v. Crowninshield*, 17 U.S. 122 (1819); *Ogden v. Saunders*, 25 U.S. 213 (1827); *Bronson v. Kinzie*, 42 U.S. 311 (1843). However, the clause fell into obscurity during the Court's "substantive due process" era, because "substantive due process" gave the Court greater discretion in passing on the constitutionality of state legislation. Thereafter, the contract clause was considered of little or no importance until its revival in 1977 in *United States Trust Co. v. New Jersey*, 431 U.S. 1 (1977). The next year, it was used by the Court to invalidate a statute for unreasonable interference with private contracts in *Allied Structural Steel v. Spannaus*, 438 U.S. 234 (1978), and the Court has continued to use a contract clause analysis for this purpose. See, e.g., *Exxon Corp. v. Eagerton*, 462 U.S. 176 (1983); *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400 (1983); *Keystone Bituminous Coal Assoc. v. DeBenedictis*, 480 U.S. 470 (1987); *General Motors Corp. v. Romein*, 503 U.S. 181 (1992).

Id. at 59 n.404.

²³⁸ OHIO REV. CODE ANN. § 5816.07(B)(1)(a) (LexisNexis 2013).

²³⁹ Osborne, *supra* note 29, at 59.

²⁴⁰ OHIO REV. CODE ANN. § 5816.07(A) (LexisNexis 2013).

²⁴¹ *Id.* § 5816.08(A)(1).

C. Supremacy Clause and the Bankruptcy Code

The United States Constitution states that federal courts are not bound by state statutes and that federal law is superior to state law.²⁴² The supremacy of federal law can become an issue for APTs because of federal bankruptcy proceedings. Under the Federal Bankruptcy Code § 541(c)(2),²⁴³ it appears that assets from a debtor's bankruptcy estate would have to be included even if they are held in an Ohio Legacy Trust.²⁴⁴ Since federal bankruptcy courts have national jurisdiction, the court can

²⁴² U.S. CONST. art. VI, cl. 2.

²⁴³ 11 U.S.C. § 541(c)(2) (2012) (“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.”).

²⁴⁴ Sirknen, *supra* note 30, at 153. In *Battley v. Mortensen*, the court invalidated a transfer to an Alaska asset protection trust and voided the transfer of property to the trust, even after the statute of limitations period of four years, because the court found under Bankruptcy Code § 548(e) that the trust was created to hinder, delay, or defraud future creditors. *Battley v. Mortensen*, No. A09-90036-DMD, 2011 Bankr. LEXIS 5560, at *19-23 (Bankr. D. Alaska May 26, 2011). This case appears to provide little hope for individuals wanting to protect assets in an asset protection trust, but this unfavorable decision is likely the result of poor facts. In this particular case, Mr. Morrison transferred 1.25 acres of property located in Alaska to an asset protection trust which *he* created using a template he found. *Id.* at *2, 5. He then had an attorney review the document and suggest a few minor changes. *Id.* at *5.

At the time he funded the trust, Mortensen had approximately \$29,881 in his bank accounts, \$9,339 in business accounts receivable, and two modest vehicles. His mother sent him \$100,000 after he established the trust, bringing his total assets outside of the trust to \$153,000. At that time, he owed \$49,711 in credit card debt and had no other debts. There was, at that time, no litigation against the grantor pending or threatened. Mortensen transferred to the trust about \$80,000 of the money from his mother. Thereafter, his credit card debt increased significantly.

Kurt A. Friesen, *Domestic Asset Protection Trusts: 15 Years After Alaska and Delaware*, ABA TR. & INVESTMENTS, Mar.-Apr. 2012 at 6, 8, available at http://www.aba.com/Products/ti/Documents/5a9c9898d3eb49b494796b4889c12948Cover_Story_MAR_APR_12.pdf.

Four years after the creation of the trust, Morrison had over \$250,000 in credit card debt, as well as an additional \$8,140 in medical debt resulting in him filing for bankruptcy. The court held, that it was allowed, pursuant to section 548(e) of the Bankruptcy Code, “to void the transfer of property to an Alaska asset protection trust because the trust itself was created with the intent to hinder, delay or defraud future creditors.” In addition, section 548(e) allows a trustee to void a transfer of property to a self-settled trust by a debtor if the property was transferred within ten years prior of filing for bankruptcy if the debtor is a beneficiary of the trust like Mr. Morrison was in this particular case.

Id.

This case appears to be a matter of bad facts. When Mr. Morrison made the initial transfer of property to the trust, it was clear that he was doing it to protect assets from a creditor and not merely to preserve wealth for future generations. The trust instrument even stated that it was being created for the purpose of hindering creditors. *Id.* What can be drawn from this case is that the statute of limitations is ten years under the Bankruptcy Code for transfers to self-settled trusts. *Id.* at 8-9. What this means for Ohio Legacy Trusts is that, when these trusts are

render a valid judgment no matter where the trust sits in the United States. This is the biggest disadvantage of a domestic APT compared to an offshore APT. However, it could be argued that Congress, when creating this legislation, only meant it to be applicable to spendthrift trusts and not self-settled spendthrift trusts because the legislative history only discusses spendthrift trusts.

A creditor can also attempt to gain access to an APT through the use of federal courts by claiming there is a federal question or diversity jurisdiction.²⁴⁵ If a federal court has jurisdiction, the court will not be bound by debtor-friendly provisions of the APT venue. Therefore, the court could determine the assets are not shielded from the creditor's claims.²⁴⁶ If a creditor was able to convince the federal court that a federal question existed, this could be a significant weakness in the use of Ohio Legacy Trusts. However, even though the federal court is not bound by the state APT legislation, the federal court could still choose to abide by the state statute to avoid forum shopping by creditors. Also, a federal court will only have diversity jurisdiction if the disputed amount is in excess of \$75,000.²⁴⁷

Ohio Legacy Trusts have the potential to offer substantial protection from non-federal creditors since they can only be attacked in a few situations. A quote from Professor Bradley Fogel best sums up the protection offered by APTs and whether they will actually work:

The long and short of this discussion is two-fold. First, a self-settled trust created in an asset protection jurisdiction provides an enormous amount of protection against non-Medicaid creditors. Second, for most non-Medicaid creditors, the only means of enforcing a judgment against such a domestic asset protection trust may be to attack the creation of the trust as a fraudulent transfer. Whether or not the post-transfer creditor will be successful will likely depend on whether the particular creditor was a contemplated creditor at the time of the transfer.²⁴⁸

V. CONCLUSION

The Ohio Legacy Trust Act is an important step in the modernization of Ohio's wealth management laws. The Act will help make Ohio more competitive within the asset management market. Legacy Trusts have the potential to spur economic growth through the addition of more employees at financial institutions and could increase revenue for the State of Ohio. Legacy Trusts are not without their downfalls, such as the inability to collect on judgments awarded to a plaintiff if the assets were properly assigned and held in a Legacy Trust. However, the positive effects of retaining wealth within the state and the safeguards, such as allowing child support and alimony to have access to a Legacy Trust, have the potential to offset any negative effects.

being created, the attorneys and financial advisors need to be keenly aware of the individual's financial situation and make it apparent that the trust is not being created to hinder creditors.

²⁴⁵ Osborne, *supra* note 29, at 54.

²⁴⁶ *Id.*

²⁴⁷ 28 U.S.C. § 1332(a) (2006).

²⁴⁸ Bradley E.S. Fogel, *Scylla and Charybdis Attack: Using Trusts for Medicaid Planning and Non-Medicaid Asset Protection*, 35 AM. C. OF TR. AND EST. COUNS. J. 45, 47 (2009).

Since House Bill 479 has only recently been passed by the Senate and signed into law by the Governor, it is difficult to determine what the long term impact of the Ohio Legacy Trust legislation will be. If the benefits obtained from the passage of APT legislation in Alaska and Delaware are any indication, Ohio has the potential to reap substantial benefits from its passage of the Ohio Legacy Trust Act.

It is human nature to want to protect what one has worked hard for from unforeseen life events. Legacy Trusts have the potential to protect an individual's assets in life, as well as upon death. Legacy Trusts will financially benefit Ohio and promote Ohio as a wealth preservation friendly state. The passage of House Bill 479 should impact the state in a positive manner.