2007 Al Todd Estate Planning Workshop Outline

Protecting Inheritances in South Carolina

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Part One
Discretionary Trusts and Beneficiary Controlled Trusts

I. Discretionary Trusts; Definitions and Distinctions[i]

A. Discretionary Trust:

A settlor may provide that his trustee shall have absolute and uncontrolled discretion whether to pay or apply trust income or principal to or for the benefit of a named beneficiary, without fixing any standard or guide which the trustee is to consider. Income that the trustee does not choose to use for the beneficiary shall be accumulated or paid to another beneficiary or to a class of other beneficiaries.' Such a trust has been called a "discretionary trust," and this term has a technical meaning for the purpose of determining the rights of the beneficiary and his assignees and creditors. It must be distinguished from trusts where the discretion of the trustee pertains only to the time or manner of the payments, or to the size of the payments needed to achieve a certain purpose.[ii] A further distinction must be made between a discretionary trust and a "support" trust

Here is a look at how discretionary trusts are treated under the Restatements, the UTC Model Act, and the UTC as adopted in South Carolina (SCTC).

Discretionary Trusts			
Rest. 2nd	**Rest. 3rd**	**Model UTC**	**SCTC**
§155 If the trustee has uncontrolled discretion, neither the beneficiary nor any creditor of the beneficiary can compel the trustee to pay any part of the trust income or principal. **A spendthrift provision is not an issue and not required to protect the interest**	**§60** The discretionary trust distinction is abolished**. Creditors of a beneficiary may reach the interest in a discretionary trust <u>if there is no spendthrift provision</u>**	**Section 501** To the extent a beneficiary's interest is **<u>not protected by a spendthrift</u>** provision, the court may authorize a creditor or assignee of the **<u>beneficiary to reach the beneficiary's interest by attachment of present or future distributions</u>** to or for the benefit of the beneficiary or other means.	**§ 62-7-501** (b) a trustee shall have no liability to any creditor of a beneficiary for any distributions made to or for the benefit of the beneficiary to the extent a beneficiary's interest:(2) <u>is a discretionary trust</u> interest as referred to in S.C. Code Section 62-7-504. A spendthrift provision is not required to protect the interest

The commentary to the introduction of the Uniform Trust Code describes the UTC and its impact on discretionary trusts as follows:

> ***Article 5 – Creditor's Claims; Spendthrift and Discretionary Trusts*** *– This Article [i.e., Article5 of the UTC] addresses the validity of a spendthrift provision and other issues relating to the rights of creditors to reach the trust to collect a debt. To the extent a trust is protected by a*

spendthrift provision, a beneficiary's creditor may not reach the beneficiary's interest until distribution is made by the trustee. To the extent not protected by a spendthrift provision, a creditor can reach the beneficiary's interest, subject to the court's power to limit the award. Certain categories of claims are exempt from a spendthrift restriction, including certain governmental claims and claims for child support or alimony.

B. Support Trusts

Section 154 of Restatement 2nd provides that if by the terms of a trust it is provided that the trustee shall pay or apply only so much of the income and principal or either as is necessary for the education or support of the beneficiary, the beneficiary cannot transfer his interest and his creditors cannot reach it. In other words, there is no property interest belonging to the beneficiary to form the basis of action for him to compel distribution. In a trust for support, it is the nature of the beneficiary's interest rather than a spendthrift provision which prevents the attachment of the beneficiary's interest by a creditor.

Exceptions are self settled trusts and particular classes of exception creditors.

Restatement 3rd, Section 60, and the Model UTC abolish the distinction and generally creditors can attach the beneficiary's interest in a support trust if <u>there is no spendthrift provision.</u>

Support Trusts			
Rest. 2nd	**Rest. 3rd**	**Model UTC**	**SCTC**
§154 If the trustee distributes only so much as is necessary for the education or support of the beneficiary, the beneficiary cannot transfer his interest and his creditors cannot reach it. . **A spendthrift provision is not an issue and not required to protect the interest.** Exceptions are self-settled trusts and exception creditors	**§60** The discretionary support/trust distinction is abolished**.** **Creditors of a beneficiary may reach the interest in a discretionary trust <u>if there is no spendthrift provision.</u>** In a support trust, Trustee may take into account beneficiary's actual needs and allocate between beneficiary and creditor. (Comment c)	**Section 504** The rights of a creditor are the same whether the trust is discretionary, subject to a standard ("support") or both. Other than for exception creditors, a beneficiary's creditor may not reach the beneficiary's interest. Eliminating this distinction affects only the rights of creditors. The affect of this change is limited to the rights of creditors. It does not affect the rights of a beneficiary to compel a distribution.	**§ 62-7-504** (b) a creditor of a beneficiary may not compel a distribution from a trust in which the beneficiary has a discretionary trust interest, even if the discretion is expressed in the form of a standard of distribution A spendthrift provision is not required to protect the interest

The South Carolina Trust Code adds to the UTC version the proviso at the end of subsection (d), which prevents a beneficiary's creditor from enforcing on behalf of the beneficiary the beneficiary's right, to the extent it exists, to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard of distribution.

C. Mandatory Trusts

Some trusts by their terms require mandatory distributions of income. These include marital deduction trusts, grantor retained annuity trusts, and charitable remainder trusts.

Whether or not a creditor may attach the distribution at the trust level, that is, the creditor stepping in and compelling a distribution from the trustee to the creditor of the beneficiary, depends on whether or not the trust contains a ***spendthrift*** provision[iii]. A *spendthrift trust* must be distinguished from a *trust for support* and a *discretionary trust*. In a discretionary trust, there is no property right that can be enforced by the beneficiary; therefore there is no interest or right for a creditor to attach. In a trust where the beneficiary is entitled to all of the income of the trust, the beneficiary has an enforceable right and, absent a spendthrift provision, a creditor may step in an exercise that right and attach the mandatory distribution at the trust level[iv]. Rest. 3rd will allow a creditor to reach interests in the trust which, by the terms of the trust should have been distributed and for which the beneficiary can make a demand.

In a spendthrift trust, income received by the trustee but not paid to the beneficiary is protected from attachment by creditor of the beneficiary.[v]

Note that income received by the beneficiary is of course subject to attachment.[vi]

Mandatory Trusts			
Rest. 2nd	**Rest. 3rd**	**Model UTC**	**SCTC**
§132, 150,152,153 A beneficiary may transfer any interest in the trust; thus a creditor may attach. **§150,152,153** A spendthrift provision that prohibits both voluntary and involuntary transfers is effective and c**reditors of a beneficiary may reach the interest in a mandatory trust <u>if there is no spendthrift provision.</u>** Exception Creditors may reach	**§60** The discretionary support/trust distinction is abolished**.** **Creditors of a beneficiary may reach the interest in a discretionary trust <u>if there is no spendthrift provision</u>.** In a support trust, Trustee may take into account beneficiary's actual needs and allocate between beneficiary and creditor. (Comment c) Exception Creditors may reach	**Section 504** The rights of a creditor are the same whether the trust is discretionary, subject to a standard ("support") or both. Other than for exception creditors, a beneficiary's creditor may not reach the beneficiary's interest. Eliminating this distinction affects only the rights of creditors. The affect of this change is limited to the rights of creditors. It does not affect the rights of a beneficiary to compel a distribution.	**§ 62-7-504** (b) a creditor of a beneficiary may not compel a distribution from a trust in which the beneficiary has a discretionary trust interest, even if the discretion is expressed in the form of a standard of distribution A spendthrift provision is not required to protect the interest

II. Beneficiary Controlled Trust.

For purposes of this discussion, a *Beneficiary Controlled Trust* is an irrevocable trust which the beneficiary did **not** create[vii]. The Grantor of the trust, however, has conferred certain rights and powers on the Beneficiary.

First, the Grantor might have designated the Beneficiary as the *sole trustee*, with the power to exercise the discretionary powers over principal and income contained in the trust.

If the Beneficiary is not the trustee, the Grantor of the trust may have conferred upon the Beneficiary the *right to remove and replace trustees*.

If the grantor did not designate the beneficiary as trustee, or if the beneficiary does not have the right to remove and replace trustees, the beneficiary may have the right to *demand withdrawals of trust income or trust principal, or both*. The beneficiary can be given the testamentary (or lifetime) power to appoint trust assets. As you can see, to a greater or lesser degree, the extent to which a trust is "Beneficiary Controlled"[viii] is left entirely to the Grantor of the trust.

Beneficiary Controlled Discretionary Trust With Spendthrift provision: Creditor access				
Beneficiary's "Control"	**Creditor Access Under**			
	Rest. 2nd	**Rest. 3rd**	**Model UTC**	**SCTC**
Sole trustee, sole beneficiary	Not specifically addressed; See 156; No with standard, Section 154; not addressed is benef. as trustee	Creditors can reach what Trustee can distribute; Section 60, comment G	No; IF there is an ascertainable standard [ix]	No; [x] See footnote for SCTC additions; see also SCTC Sec 505(b) and fn. 16
Remove and replace *Independent* Trustee[xi]	No	No	No	No
Power of withdrawal: Crummey or "5&5"		**YES[xii]; even when the holder dies[xiii]**	**YES**; Sec 103[xiv]; Sec 505(b)(1)[xv] Sec 603(b)[xvi]	**NO;**[xvii] SCTC SC Comments[xviii]
Special Power of Appointment	**NO[xix]; Rest. Of PROPERTY**	**Uncertain[xx]**	**Uncertain See fn. 20**	**No**

General Power of Appointment **UNEXERCISED**	**NO; Rest of PROPERTY**[xxi]	**Uncertain** See fn. 20	**Uncertain** See fn. 20	**No**
General Power of Appointment **EXERCISED**	**Yes, generally**[xxii]	**Uncertain** See fn. 20	**Uncertain** See fn. 20	**NO**[xxiii]
Remainder Interest **Divorce proceedings**	This is a developing area of the law; See Marc A. Chorney, INTERESTS IN TRUSTS AS PROPERTY IN DISSOLUTION OF MARRIAGE: IDENTIFICATION AND VALUATION, RPPT 40, Spring 2005.			

C. Typical Planning Scenarios:

Clients are increasingly aware of the threat to accumulated wealth from predatory claimants. Parents and grandparents are keenly interested in providing for the protection and security of children and grandchildren.

The creation of an irrevocable discretionary trust for the benefit of a beneficiary's lifetime should be discussed with every client who is planning for the disposition of wealth among family members. The *bypass trust* has been a common arrangement for more than 50 years. All the attention has been paid to the income and estate tax benefits of this trust, with scant attention directed toward the protection it provides for the surviving spouse. Assets in the bypass trust are not susceptible to the elective share, are not part of any marital asset in the event of remarriage, and are likely exempt from predatory claimants against the surviving spouse.

The configuration on a discretionary bypass trust for any beneficiary will fit on the chassis of the typical bypass trust.

The ascertainable *standard* is the shibboleth for favorable transfer tax treatment if the beneficiary is to be trustee with a power to invade corpus is.[xxiv]

The main rule under the Uniform Trust Code is that, unless the terms of the trust expressly indicate that the rule in this subsection is not to apply, the power to make discretionary distributions to a beneficiary-trustee is automatically limited by the requisite *ascertainable standard* necessary to avoid inclusion of the trust in the trustee's gross estate or result in a taxable gift upon the trustee's release or exercise of the power.[xxv] This default provision is extremely valuable to rescue the poor or ignorant scrivener.

A defined standard that originated in tax law has now been codified in trust law in states adopting the Uniform trust Code.

II. General Tax Considerations

The creation of an irrevocable trust has distinct tax implications.

Gift Tax or Estate Tax: Upon creation: If the trust is an *inter vivos* trust, the grantor in virtually every instance has made a taxable gift[xxvi]. If the trust is a testamentary trust, the death of the grantor subjected the assets passing to the trust to the estate tax and possibly the generation-skipping transfer tax.

Income Tax GST Tax: In operation: an irrevocable trust is a taxpayer, almost always with a calendar taxable year[xxvii], and almost always requiring a separate income tax return[xxviii]. Depending on the terms of the trust, income earned by the trust may be accumulated and taxed to the trust, or maybe distributed, deducted by the trust, and taxed to the beneficiary.[xxix] In a trust with an exclusion ratio other than zero, distributions are subject to the GST tax

Upon Termination: Estate or GST tax.: depending upon the terms of the particular trust, a beneficiary of a lifetime trust may die in possession of a general power of appointment, subjecting the property in the trust subject to the power to the estate tax in deceased beneficiary's estate.[xxx] Termination of a trust could result in the imposition of the generation skipping transfer tax if a taxable termination occurs[xxxi].

Part Two
Qualified Plans and IRAs
Rolling Over and Stretching: New tricks for old dogs

I. **Qualified Plans**: **unique assets**

Qualified Retirement Plans and Individual Retirement Accounts are unique assets. While no asset is safer from predatory claimants, no asset is more subject to confiscatory taxes.

Strict rules dictate both the amount and the timing of distributions from qualified plan. Failure to comply with a minimum distribution rules results in a 50% penalty tax.

Where possible, leaving the account balance of a qualified retirement plan or IRA inside the retirement plan trust or custodial account affords maximum protection and deferred growth.

The spendthrift protection afforded by ERISA protects the assets of a Qualified Retirement Plan from judgment creditors and predatory claimants whether or not the plan participant files for bankruptcy. As explained below, even if there is a bankruptcy, assets in a Qualified Plan are not a part of the bankrupt estate and do not pass to the control of the trustee.

There is a critical distinction for purposes of asset protection between assets held in a Qualified Retirement Plan and assets held in an Individual Retirement Account or SEP.

ERISA protection is **<u>not</u>** afforded to IRA and SEP accounts <u>unless</u> the plan participant is in a bankruptcy proceeding. Consequently, in South Carolina Individual Retirement Accounts and SEPs are protected only by South Carolina's statutory exemption. That protection is limited:

> *(12) [Exempt is]…The debtor's right to receive individual retirement accounts as described in Sections 408(a) and 408A of the Internal Revenue Code, individual retirement annuities as described in Section 408(b) of the Internal Revenue Code, and accounts established as part of a trust described in Section 408(c) of the Internal Revenue Code,* ***to the extent reasonably necessary for the support of the debtor and any dependent of the debtor****. A claimed*
>
> *exemption may be reduced or eliminated by the amount of a fraudulent conveyance into the individual retirement account or other plan. For purposes of this item, "Internal*

> *Revenue Code" has the meaning provided in Section 12-6-40(A)*. (Emphasis added).[xxxii]

There appears to be no decided case in South Carolina on the point of what is "reasonably necessary" for the support of the debtor and any dependent of the debtor. However, a decision out of the 4Th Circuit is instructive, and grim:

> The "appropriate amount to be set aside for the debtor ought to be sufficient to sustain basic needs, not related to his former status in society or the lifestyle to which he is accustomed." In short, the fresh start guaranteed by bankruptcy, and supported by the exemption scheme, does not entitle the debtor to maintain the lifestyle to which he was accustomed in better times.[xxxiii]

There is no exemption for funds withdrawn from an IRA.[xxxiv] This fact is critical to protecting the inheritance of an IRA from the predatory claimants of the beneficiary.

IRAs and Roth **IRAs** are exempt in **bankruptcy**, but subject to a $1 million cap, as adjusted for inflation. The cap, however, does not apply with regard to most rollover contributions from other kinds of plans. Further, the cap can be increased "if the interests of justice so require. [xxxv]

II. Federal and State statutory exemptions for IRAs and Qualified Plans

At the outset, it is important to distinguish the statutory protection afforded qualified retirement plans under ERISA and Individual Retirement Accounts (IRAs).

ERISA's anti-alienation provisions protect retirement benefits from creditors in a non-bankruptcy context. Thus, retirement benefits cannot be garnished, prosecuted, or voluntarily assigned pursuant to state court remedies, including those for levy of state taxes. (Liability for federal taxes, can, however, pierce ERISA protection.) This protection applies even when the participant is about to receive a lump-sum distribution, and even where the plan is about to terminate and distributions are inevitable. The antialienation provisions, however, do not apply to traditional support obligations for spouse and children.

The interest of a nonparticipant-beneficiary of an ERISA plan is also protected by ERISA. This extended protection is applicable because the protection applies to "benefits" under the ERISA plan. This rule is consistent with the U.S. Supreme Court's decision in *Guidry v. Sheetmetal Pension Fund*, where the Court noted that ERISA's protection was intended to safeguard a stream of income for pensioners and their dependents.

A person who is not designated as "beneficiary" by the plan participant or otherwise is not to be treated as a beneficiary for purposes of ERISA.

Most retirement plans that are qualified under the IRC are now exempt, including IRAs, regardless of whether the debtor is domiciled in a state like South Carolina that has opted out of the federal exemption scheme.

Under new Section 522(b)(3)(C) of the Bankruptcy Act, retirement plans that are specifically exempted from taxation under Code Sections 401, 403, 408, 408A, 414, 457 or 501(a) are not property of the bankruptcy estate.

Direct transfers between such plans and rollover distributions from such plans will also be exempt.

The Bankruptcy Code's exemption for IRAs and Roth IRAs is limited to $1 million, as adjusted for inflation, but that cap does not apply with regard to most rollover contributions from other kinds of retirement plans. Thus, the cap will generally not be relevant. If it is, the cap amount can still be increased “if the interests of justice so require.”

Also under the new bankruptcy rules, a distribution that qualifies as a rollover distribution will be exempt.

III. **Distributions to non-participants**

As noted above, it appears that distributions from an **ERISA protected plan** to a beneficiary are protected from the beneficiary’s creditors and predatory claimants.

If the beneficiary of an ERISA protected plan is in bankruptcy, the plan assets should not be a part of the bankrupt estate.

However, this may mean nothing more than that the creditor cannot force the ERISA plan trustee to make distributions directly to the creditor. In other words, the creditor cannot tap the income at the source, but may very well be able to attach the income after it is in the hands of the beneficiary and commingled with other funds.

The beneficiary of an inherited IRA may be entitled to significantly less protection in a non-bankruptcy setting.

The following tables explain the issues concerning protecting qualified plan assets.

Qualified Plans
Owner/Participant Protection

Plan Type	*Federal Protection*		*State (SC) Protection*	
	ERISA[xxxvi]	**Bankruptcy**	**Exemption**	**Bankruptcy**
Title I ERISA; 401(a) Qualified Plans[xxxvii]; 403(b)[xxxviii] for 501(c)(3); government plans are EXCLUDED	YES Unlimited; even outside bankruptcy[xxxix]	YES Unlimited; not a part of estate	YES Unlimited 15-41-30 (13)	YES Unlimited; not a part of estate
Plan for Single Employee/owner; Sole shareholder; HR-10 (Keough) for LLC, partnership, proprietor.	NO[xl] outside bankruptcy; YES, if there is at least common law employee.	YES		YES
IRA, SEP, ROTH IRA	NO	YES $1,000,000 limit for IRA; unlimited for rollover IRA, SEP or SIMPLE IRA[xli]	VERY Limited; To extent reasonably necessary for support of debtor or dependents.	YES
Non qualified plans	NO	NO	NO	NO

Distributions from Qualified Plan to Participant

Distribution Type	**ERISA**
	ERISA's anti-alienation[xlii] provision does not apply where the funds have already been disbursed to the plan beneficiary. So holds four circuits.[xliii].
Where an employee elects to draw on her ERISA plan **<u>prior to her retirement</u>**, she forfeits the protection provided by the Act.	One court has held that § 1056(d)(1) bars alienation of benefits after distribution to the beneficiary if those benefits are post-retirement annuity payments (but not if they are pre-retirement lump sum payments).[xliv] This minority view is in the Fourth Circuit. We believe there is a distinction between funds disbursed from an ERISA plan before an employee has retired and such funds paid as an annuity for retirement purposes. The Supreme Court has noted that the purpose of ERISA is to safeguard a stream of income for pensioners. Guidry, 493 U.S. at 376, 110 S.Ct. at 687. Where an employee elects to draw on her ERISA plan prior to her retirement, she forfeits the protection provided by the Act. Where, however, the funds are paid pursuant to the terms of the plan as income during retirement years, ERISA prohibits their alienation. In fact, we found in Tenneco that "the funds here had been accumulated under a general plan for retirement, and the statutory scheme clearly contemplates that they should remain available for that purpose...."

Inherited IRAs
"Several cases from other jurisdictions illustratrat[e] a trend against allowing debtors to exempt IRAs that are not funded by the debtor. E.g., *In re Sims*, 241 B.R. 467 (Bankr.N.D.Okla. 1999); *In re Navarre*, 332 B.R. 24 (Bankr. M.D.Ala.2004); *In re Greenfield*, 289 B.R. 146 (Bankr.S.D.Cal.2003); *Anderson v. Seaver* (In re Anderson), 269 B.R. 27 (8th Cir. BAP 2001); *In re Stover*, 332 B.R. 400 (Bankr.W.D.Mo.2005); see also *In re Taylor*, 2006 WL 1275400 (Bankr.C.D.Ill.). [The Wisconsin Court noted that] Sims, Navarre, Greenfield, and Taylor all concerned debtors who attempted to exempt their interest in an inherited IRA; in those cases, the debtors obtained their interest in IRA proceeds through the death of someone else. In each case, the courts denied the debtors' exemptions."   **344 B.R. 908 (Bankr. E.D. Wis. 2006); IN RE KIRCHEN;**   **The upshot is that an inherited IRA is not a protected asset, in or out of bankruptcy.**

Stand Alone Retirement Trust
Requirements for a "Look-through" trust

Because an inherited IRA is **not** protected from the predatory claimants of the beneficiary, even in bankruptcy, the only effective strategy available to protect the account balance in an inherited IRA is to name a **trust** as the **beneficiary**. However, because a **designated beneficiary** must be an individual, for a trust is to qualify you must be able to "*look through"* the trust to identify the oldest potential beneficiary. Q&A-5 of Section 1.401(a)(9)-4 of the regulations provides that beneficiaries of a trust with respect to the trust's interest in an employee's benefit may be treated as Designated Beneficiaries if the following four requirements are met:

(1) The trust is valid under state law or would be but for the fact there is no corpus.

(2) The trust is irrevocable or will, by its terms, become irrevocable upon the death of the employee.

(3) The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's benefit are identifiable within the meaning of A-1 of this section from the trust instrument.

(4) Relevant documentation has been timely provided to the plan administrator.

Stand Alone Retirement Trust
Design Choices: Conduit or Accumulation

A trust that meets the requirements to be a *look through* trust may be designed to be either a ***Conduit Trust*** or an ***Accumulation Trust***. The ***Conduit Trust*** is often referred to as a safe harbor trust, but the facility of administration comes at the expense on exposing the required minimum distributions to the creditors of the beneficiary upon receipt.

An ***Accumulation Trust*** is the trust of choice for asset protection, but the protection of required minimum distributions comes at the expense of considerably more complex drafting considerations and possibly higher income taxes on the accumulated distributions.

The critical distinction between a ***Conduit Trust*** and an ***Accumulation Trust*** is that with the ***Conduit Trust***, where required minimum distributions are required to be distributed upon receipt to the ***Designated Beneficiary***, the identity and nature of remainder beneficiaries may ignored.

Stand Alone Retirement Trust
Design Requirements: Conduit Trust

(1) Withdrawal of Required Minimum Distributions

Each year, beginning with the year of my death, my Trustee shall withdraw from qualified retirement accounts made payable to the Sweet Polly Purebreath Bypass Trust the minimum required distribution under Section 401(a)(9) of the Internal Revenue Code.

(2) Withdrawal of Additional Amounts

Additionally, my Trustee shall withdraw so much of the net income and principal of qualified retirement accounts payable to the Sweet Polly Purebreath Bypass Trust as my Trustee determines is necessary for Sweet Polly Purebreath s' health, education, maintenance and support.

(3) Required Conduit Distributions

Notwithstanding any other provision of this agreement, my Trustee is directed to distribute any and all amounts withdrawn from any qualified retirement accounts payable to the Sunil Thaddaeus Bypass Trust to my daughter, Sweet Polly Purebreath, as soon as possible during the lifetime of the trust. The purpose of this subsection is to qualify the Sweet Polly Purebreath Bypass Trust as a "conduit trust" under Treasury Regulation Section 1.401(a)(9)-5, A-7, Example 2. This subsection is to be interpreted to constitute a conduit trust for purposes of the required minimum distribution rules. My Trustee may deduct trust expenses prior to payment to Sweet Polly Purebreath 80 provided deduction of expenses does not disqualify conduit trust status.

The trust generally authorizes the trustee to withdraw and distribute from the plan amounts in excess of required minimum distributions. If the trust has other income producing assets, income from these assets could be accumulated and paid out pursuant to an ascertainable standard. Other trust principal could be held and distributed pursuant to an ascertainable standard, thus protecting such accumulated income and principal from the claims of the beneficiary's creditors.

Required minimum distributions will be taxed to the beneficiary, to whom the trust will issue K-1. Because distributions are income in respect of the decedent, the trust may allocate the entire required distribution to distributable net income, taxable to the beneficiary.

The identity of the remainder beneficiary is irrelevant. The beneficiary may be given a special or general power of appointment. Individual remainder beneficiaries will receive the remaining balance of the IRA over the remaining life expectancy of the designated beneficiary.

Stand Alone Retirement Trust
Design Requirements: Accumulation Trust

My Trustee shall administer the share set aside for DUDLEY DORIGHT in trust as provided in this Section.

1. Qualified Retirement Plan Benefits

This Section contains provisions for the withdrawal and distribution of qualified retirement plan benefits payable to Dudley DoRight'strust:

(a) Withdrawal of Required Minimum Distributions

Each year, beginning with the year of my death, my Trustee shall withdraw from qualified retirement accounts made payable to Dudley DoRight's trust, the minimum required distribution under Section 401(a)(9) of the Internal Revenue Code.

(b) Withdrawal of Additional Amounts

Additionally, my Trustee shall withdraw so much of the net income and principal of qualified retirement accounts payable to Dudley DoRight's trust as my Trustee determines is necessary for Dudley DoRight's health, education, maintenance or support.

(c) Administration of Amounts Withdrawn

My Trustee shall administer and distribute the amounts withdrawn as provided in this Section.

2. Distributions of Income and Principal

My Trustee shall distribute to DUDLEY DORIGHT as much of the income and principal of his trust as my Trustee determines is necessary or advisable for his health, education, maintenance or support.

Any undistributed net income shall be accumulated and added to principal.

3. Distribution Upon the Death of DUDLEY DORIGHT

DUDLEY DORIGHT shall have the testamentary limited power to appoint all or any portion of the principal and undistributed income remaining in his trust at his death among my descendants. However, DUDLEY DORIGHT may not exercise this limited power of appointment to appoint to himself, his estate, his creditors or the creditors of his estate. DUDLEY DORIGHT may not exercise this testamentary limited power of appointment to appoint to anyone who was born before DUDLEY DORIGHT.

I intend that this be a limited power of appointment and not a general power of appointment as defined in Section 2041 of the Internal Revenue Code.

Insofar as any part of DUDLEY DORIGHT'S trust shall not be effectively appointed, my Trustee shall distribute the remaining unappointed balance *per stirpes* to the descendants of DUDLEY DORIGHT. If DUDLEY DORIGHT has no living descendants, my Trustee shall distribute the balance of the trust property *per stirpes* to my descendants. But any persons born before DUDLEY DORIGHT shall be deemed deceased.

If I have no living descendants, my Trustee shall distribute the balance of the trust property as provided in Article ___ [ALL must be people (heartbeats) and no possible taker older that Dudley]

Stand Alone Retirement Trust
Design Requirements: Accumulation Trust (Cont)

The regulations are at best unclear about who might be a "mere potential successor" who is not required to be counted in determining the age of the oldest potential beneficiary.
Every potential should be taken into account; all potential beneficiaries are "countable in an accumulation trust.

If there are multiple trusts, EACH TRUST MUST BE NAMED IN THE BENEFICIARY DESIGNATION FORM; THE SEPARATE SHARES FOR EACH BENEFICIARY MUST BE IDENTIFIED IN THE BENEFICIARY DESIGNATION FORM.
See PLR 200537044

- If conduit trust is used, potential appointees under a power of appointment can be ignored
- If an accumulation trust, all potential takers under a power of appointment must be considered
- In IRA Where Charity is named as one of the Beneficiaries, payout charity by September 30 and effect Division by December 31 of year following death
- Consider other savings provisions to ensure that the measuring life for purposes of determining the distributions that will be accumulated will never be older than the designated beneficiary.

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[i] See the excellent article by Steve Oshins, *Asset Protection other than Self-Settled Trusts: Beneficiary Controlled Trusts, FLPs, LLCs, Retirement Plans and Other Creditor Protection Strategies*, 39 Heckerling Inst. on Est. Plan., Ch 3.

[ii] Bogert, The Law of Trusts and Trustees, Section 228 (Re. 2d Edition 1992). ("Bogert")

[iii] Rest. 2nd, Section 152

[iv] Rest. 3rd, Section 56,; A valid spendthrift protects the income and principal interests while is trust; Rest. Section 58, Comment d and example 7.

[v] Rest. 2nd, Section 152, Comment h.

[vi] Rest. 2nd, Section 152, Comment j. also, rest 3rd. Section 58, Comment d

[vii] The model uniform trust code would treat the holder of a power of withdrawal as the settlor of the trust with respect to the property subject to the power. South Carolina did not adopt this provision, which is wholly inconsistent with existing trust law virtually everywhere. Such a provision would guarantee that the beneficiary holder of the power would be taxed on trust income, not under 678, but rather under 671 and following. Moreover, such a provision that would invoke the common law antipathy toward self settled trust and subject the assets to creditors of the beneficiary.

[viii] The possession of these rights by the beneficiary may create adverse income or estate tax consequences, or both.

[ix] This sub-section was added in 2004 by NCCUSL; (e) If the trustee's or cotrustee's discretion to make distributions for the trustee's or cotrustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee or cotrustee.

[x] SCTC: Sec 504: (d) This section does not limit the right of a beneficiary to maintain a judicial proceeding against a trustee for an abuse of discretion or failure to comply with a standard for distribution; provided, however, this right may not be exercised by a creditor of the beneficiary.

(e) Whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution from insurance proceeds payable to the trustee as beneficiary to the extent state law exempts such insurance proceeds from creditors' claims.

(f) A creditor of a beneficiary who is also a trustee or cotrustee may not reach the trustee's beneficial interest or otherwise compel a distribution if the trustee's discretion to make distributions for the trustee's own benefit is limited by an ascertainable standard.

[xi] RICHARD A. OSHINS AND NOEL C. ICE, ATTORNEYS ,*The Inheritor's Trust Preserves Wealth as Well as Flexibility*, Estate Planning Journal, Oct 2003 Estate Planning Journal (WG&L).

[xii] UTC Comment; Restatement (Third) of Trusts Section 56 cmt. b (Tentative Draft No. 2, approved 1999). If the power is unlimited, the property subject to the power will be fully subject to the claims of the power holder's creditors, the same as the power holder's other assets.

[xiii] UTC Comment: If the power holder retains the power until death, the property subject to the power may be liable for claims and statutory allowances to the extent the power holder's probate estate is insufficient to satisfy those claims and allowances. For powers limited either in time or amount, such as a right to withdraw a $10,000 annual exclusion contribution within 30 days, this subsection would limit the creditor to the $10,000 contribution and require the creditor to take action prior to the expiration of the 30-day period.

Upon the lapse, release, or waiver of a power of withdrawal, the property formerly subject to the power will normally be subject to the claims of the power holder's creditors and assignees the same as if the power holder were the settlor of a now irrevocable trust. Pursuant to subsection (a)(2), a creditor or assignee of the power holder generally may reach the power holder's entire beneficial interest in the trust, whether or not distribution is subject to the trustee's discretion

[xiv] UTC 103 (11) "Power of withdrawal" means a presently exercisable general power of appointment other than a power: (A) exercisable by a trustee and limited by an ascertainable standard; or (B) exercisable by another person only upon consent of the trustee or a person holding an adverse interest.

[xv] UTC 505(b)(1) during the period the power may be exercised, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust to the extent of the property subject to the power; Subsection (b)(1) treats a power of withdrawal as the equivalent of a power of revocation because the two powers are functionally identical.

[xvi] UTC 603(b) During the period the power may be exercised, the holder of a power of withdrawal has the rights of a settlor of a revocable trust under this section to the extent of the property subject to the power.

[xvii] The SCTC does not contain the Model UTC provisions: 505(b) SCTC: (b) For purposes of this section, a beneficiary who is a trustee of a trust, but who is not the settlor of the trust, cannot be treated in the same manner as the settlor of a revocable trust if the beneficiary-trustee's power to make distributions to the beneficiary-trustee is limited by an ascertainable standard related to the beneficiary-trustee's health, education, maintenance, and support.

[xviii] The SC Comment: The South Carolina Trust Code does not include the UTC version of subsections (b)(1) and (b)(2), and the UTC Comment should be adjusted accordingly.

South Carolina adds subsection (b)(1), which is not the UTC version of subsection 505(b)(1). The UTC version of Subsection (b)(1) is not included in the SCTC. The UTC and the Restatement (Third) of Trusts Section 60 cmt. g (Tentative Draft No. 2, approved 1999) appear to take the position that a creditor may attach a beneficiary's interest merely because the beneficiary is the sole trustee or cotrustee, even if the trustee/beneficiary (or cotrustee/beneficiary) is limited by an ascertainable standard. SCTC Section 62-5-505(b)(1) provides that neither a sole trustee/beneficiary nor a cotrustee/beneficiary will be treated in the same manner as the settlor of a revocable trust so long as the trustee/beneficiary or cotrustee/beneficiary's interest is subject to the ascertainable standard described in that subsection.

[xix] § 13.1 Creditors of the Donee -- Non-General Power.
Appointive assets covered by a non-general power cannot be subjected to the payment of the claims of creditors of the donee, or the expenses of administration of the donee's estate, except to the extent required by rules of law relating to fraudulent conveyances. Restat 2d of Prop: Donative Transfers, § 13.1

Property covered by a non-general power has traditionally not been available to satisfy claims of creditors of a bankrupt donee.

The Bankruptcy Act clearly excludes from the bankruptcy estate all non-general powers of the bankrupt. The bankruptcy estate **does** include **general** powers of the bankrupt that are **Presently Exercisable** because they inherently are exercisable for the benefit of the bankrupt. A general power not presently exercisable, such as a general power to appoint by will, is excluded from the bankruptcy estate under the quoted language because it is exercisable "solely for the benefit of an entity other than the debtor."

The effect of the inclusion in the bankruptcy estate of a power of the debtor gives the trustee in bankruptcy the ability to exercise the power for the benefit of the creditors of the bankrupt. It is immaterial that the instrument creating the general power presently exercisable provides that "no interest of any beneficiary, whether in principal or income shall be assignable or subject to the claims of creditors."

[xx] UTC Model Act Comment to Sec 505: The Uniform Trust Code does not address creditor issues with respect to property subject to a special power of appointment or a testamentary general power of appointment. For creditor rights against such interests, see Restatement (Property) Second: Donative Transfers Sections 13.1-13.7 (1986).

[xxi] Appointive assets covered by an unexercised general power of appointment, created by a person other than the donee, can be subjected to payment of claims of creditors of the donee, or claims against the donee's estate, but only to the extent provided by statute. Restat 2d of Prop: Donative Transfers, § 13.2

1. The following statute provides that property over which a debtor holds a general power of appointment, *presently exercisable*, may be subject to the payment of claims of creditors, whether or not the power has been exercised:

   New York Estates, Powers & Trusts Law § 10-7.2 (McKinney 1967)

2. The following statutes provide that property over which a debtor holds a general power of appointment may be subject to the payment of claims of creditors to the extent that other property available for the payment of the claims is insufficient, whether or not the power has been exercised:

   California Civ.Code § 1390.3 (West 1982)
   Michigan Comp.Laws § 556.123 (1979)
   Minnesota Stat. § 502.70 (1982)
   Oklahoma Stat. tit. 60, § 299.9 (1981)
   Wisconsin Stat. § 702.17 (1979-80)

3. The following statutes provide that an "absolute power of disposition", not accompanied by a trust, is changed into a "fee" in the donee with respect to creditors under certain circumstances. A power is an "absolute power of disposition" if the power is a general power exercisable inter

vivos, or if the donee is a tenant for life or for years with a general power to devise the property. Under such a statute the donee's creditors can reach the appointive property even though the power is unexercised.

Alabama Code § 35-4-291 and § 35-4-292 (1977)
District of Columbia Code Ann. § 45-105 (1981)
North Dakota Cent.Code § 59-05-39 (1960)
South Dakota Cod.Laws Ann. § 43-11-18 (1983)
Tennessee Code Ann. 66-1-106 (1982)

4. The following statute provides that except to the extent that a donee shall appoint to his or her estate or to his or her creditors, property which the donee is authorized to appoint will not be subject to the claims of creditors of the donee:

Rhode Island Gen. Laws § 34-22-13 (1969)

[xxii] § 13.4 Creditors of the Donee -- General Power Exercised by Will. Appointive assets covered by an exercised general power toappoint by will, created by a person other than the donee, can be subjected to the payment of claims against the donee's estate. Restat 2d of Prop: Donative Transfers, § 13.4

[xxiii] Adger v. Kirk, 116 S.C. 298, 108 S.E. 97 (1921), which holds that the remainder over which the donee exercised a power of appointment was not part of his estate, but passed under the will of the donor of the power, and that it could not, therefore, be used to satisfy the debts of the donee.

[xxiv] IRC Section 2041(b)(2) reads: A power to consume, invade, or appropriate property for the benefit of the decedent which is limited by an ascertainable standard relating to the health, education, support, or maintenance of the decedent shall not be deemed a general power of appointment (emphasis added).

[xxv] Article Eight, Section 814 (b) "… unless the terms of the trust expressly indicate that a rule in this subsection does not apply:

(1) a person other than a settlor who is a beneficiary and trustee of a trust that confers on the trustee a power to make discretionary distributions to or for the trustee's personal benefit may exercise the power only in accordance with an ascertainable standard relating to the trustee's individual health, education, support, or maintenance within the meaning of Section 2041(b)(1)(A) or 2514(c)(1) of the Internal Revenue Code of 1986, as in effect on [the effective date of this [Code]] [, or as later amended."

[xxvi] Generally, gifts to an irrevocable inter vivos trusts are gifts of a future interest
.
[xxvii] IRC Sec. 644: For purposes of this subtitle, the taxable year of any trust shall be the calendar year. (charitable trusts may be different).

[xxviii] The discretionary trust under consideration is not a grantor trust. An irrevocable trust may be drafted with purposeful "defects" that will cause the income of the trust to be taxed to the grantor.

[xxix] IRC Se. 644. The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part. The tax shall be computed on such taxable income and shall be paid by the fiduciary. IRC 661: there is a decuction for any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year);

[xxx] IRC 2041: The value of the gross estate shall include the value of all property. To the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942,

[xxxi] IRC Section 2612

[xxxii] § 15-41-30. Property Exempt from Attachment, Levy and Sale.

[xxxiii] In re Moorehead, 283 F.3d 199 (4th Cir. 2002) (quoting In re Taff, 10 B.R. 101, 107 (Bankr. D. Conn. 1981)). Taken from Frank W. Cureton, EXEMPTIONS AVAILABLE FOR IRAs IN SOUTH CAROLINA, contained in Leimberg Service, Copyright © 2007 Leimberg Information Services Inc

[xxxiv] Cf. In re Eisan, 181 B.R. 848 (Bankr. D.S.C. 1995).

[xxxv] See the Article by Spero*, New Bankruptcy Act's Impact on Exemptions for Retirement Plans and Homesteads*, Estate Planning Journal, May 2006.

[xxxvi] Exceptions are federal taxes – IRC 401(a)(13), and Qualified Domestic Relations Orders; in other words, plan assets can be "taken" in a divorce.
[xxxvii] 401(a) Requirements for qualification.
A trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section
[xxxviii] A 403(b) custodial account – not in a trust – may be at risk outside bankruptcy.
[xxxix] *Guidry v. Sheet Metal Workers,* 110 S. Ct. 680; *Patterson v. Shumate*, 112 S. Ct. 2242 (1992).
[xl] *Raymond B. Yates, M.D., P.C. Profit Sharing Plan v. Hendon,* 124 S. Ct. 1330 (2004). "Plans that cover only sole owners or partners and their spouses, the regulation instructs, fall outside Title I's domain. Plans covering working owners and their nonowner employees, on the other hand, fall entirely within ERISA's compass"

[xli] Rollover from SEP or SIMPLE to IRA may be limited to $1,000,000
[xlii] 29 U.S.C. § 1056(d) Assignment or alienation of plan benefits
(1) Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated.
[xliii] Wright v. Riveland, 219 F.3d 905, 919-21 (9th Cir. 2000); Robbins v. DeBuono, 218 F.3d 197, 203 (2d Cir. 2000); Guidry v. Sheet Metal Workers Nat'l Pension Fund, 39 F.3d 1078, 1081-83 (10th Cir. 1994) (en banc); Trucking Employees of North Jersey Welfare Fund, Inc. v. Colville, 16 F.3d 52, 54-56 (3d Cir. 1994).
[xliv] United States v. Smith, 47 F.3d 681, 682-84 (4th Cir. 1995).