PUBLICATION

Spotlight on Tennessee: How to Protect Your Assets

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Asset protection planning is a strategy for arranging assets with the objective of preserving as much value as possible in advance of uncertain times – such as in advance of creditors arising out of business disputes, office/director liabilities, environmental responsibilities, family disputes and other creditor attacks. Asset protection almost always requires the taking of an inventory of assets and liabilities, and therefore is usually done in conjunction with estate planning.

Techniques to protect assets commonly involve the use of domestic or off-shore trusts established in jurisdictions that will not enforce claims against the trust. Historically, Tennessee law has not allowed an individual to create a trust containing a "spendthrift" provision (i.e., a provision that prohibits a beneficiary from transferring his interests in the trust or allowing a creditor of the beneficiary to seize his interests) while also naming himself as a beneficiary of the trust. However, effective July 1, 2007, the Tennessee Investment Services Act (the "Act") allows an individual to establish a trust for his own benefit while protecting the assets of the trust from future creditors beginning four years after the trust is created if certain requirements are met. Even though the Act is now several years old, it is important to keep in mind the benefits that the Act can provide to an individual seeking asset protection.

The requirements that must be satisfied under the Act are as follows:

1. The trustee of the trust is either an individual resident of Tennessee or a bank or other entity that has trust powers under Tennessee law, and the trustee administers the trust in Tennessee. (The grantor of the trust may not serve as trustee.)
2. The trustee is a bona fide trustee who "materially participates" in the administration of the trust.
3. The trustee keeps custody of some or all of the trust property within Tennessee.
4. The trust instrument incorporates Tennessee law.
5. The trust is irrevocable.
6. The trust prohibits voluntary and involuntary transfers of the beneficiary's interest in the trust.
7. The grantor of the trust signs an affidavit in which he states, among other things, that he is not intending to defraud his creditors by transferring his assets to the trust, and he will not be rendered insolvent by the transfer of the assets to the trust.

Once this trust is established, the Act prevents creditors from bringing actions to set aside the grantor's transfer of his assets to the trust unless (a) the creditor's claim arose before the grantor transferred his assets to the trust and the action is brought before the statute of limitations expires for setting aside fraudulent conveyances, or (b) the creditor's claim arose after the transfer and the action is brought within four years after the transfer.

Although the grantor cannot serve as trustee of the trust, the Act allows the grantor to retain a number of powers over the assets of the trust while still protecting the assets of the trust from creditors. Some of the rights that the grantor can retain include the following:

8. The grantor can retain the right to remove the trustee and appoint a new one so long as the new trustee is not someone who is related or subordinate to the grantor within the meaning of the tax code.
9. The grantor can reserve the right to name trust "advisors" who have the authority to remove the trustee and to direct, consent to or disapprove distributions from the trust.
10. The grantor can retain the right to receive all trust income and up to five percent of the trust principal each year and the right to receive additional principal distributions either in the discretion of the trustee or pursuant to an "ascertainable standard" (for health, support, maintenance and education of the grantor).
11. The grantor can have the right to receive distributions from the trust while also having the right to veto distributions to the grantor or to any other beneficiary (which the grantor may want to exercise if a creditor obtained a judgment against the grantor after the four-year period and tried to seize assets distributed from the trust).
12. The grantor can retain a testamentary power of appointment and decide who shall take the assets of the trust following death.
13. The grantor can serve as the trust's investment advisor.

The Act does contain some limitations. For example, it will not protect against claims for past due child support or alimony. However, it does purport to protect individuals from almost all other claims of creditors that arise more than four years after assets are transferred to the trust.

We have previously addressed the Act in our alert dated June 11, 2007. The purpose of this current alert is to remind you of the benefits that the Act can provide with respect to asset protection. Should you have any questions regarding asset protection strategies, please contact an attorney in the Firm's Tax Department.