

Asset Protection: Day-to-Day Considerations

Presented By
James M. Kane, Attorney
January 6, 2010

Chamberlain, Hrdlicka, White,
Williams & Martin
34th Floor
191 Peachtree Street, N.E.
Atlanta, Georgia 30303
www.chamberlainlaw.com

JMK Direct: (404) 658-5422
e-mail: james.kane@chamberlainlaw.com

Chamberlain, Hrdlicka, White, Williams & Martin, a full-service commercial law firm with offices in Atlanta, Houston, and Philadelphia, has approximately 100 attorneys representing both public and private companies, as well as individuals and family-owned businesses.

JAMES M. KANE (B.B.A., University of Georgia, M.Tax, Georgia State University, J.D., Emory University). James practices law primarily in the trust and estate planning area, with an emphasis on handling IRS and non-tax disputes and litigation related to trusts and estates. He is a native of Atlanta and graduated from Emory University School of Law.

James also received a finance degree from the University of Georgia *cum laude* with general honors and a Master of Taxation degree from Georgia State University. He is a member of the Georgia, North Carolina and New York bars, and previously maintained a Georgia CPA license. Prior to law school, James was employed in Atlanta as an IRS Revenue Agent in the large-case examination group and as a staff manager with a Fortune 500 corporation in its federal tax audit group.

Table of Contents

	Page
I. ASSET PLANNING IS NOT LIMITED TO A GRAND SLAM	2
II. TIME IS OUR ONLY FINITE ASSET.	2
III. FIVE IMPORTANT PRELIMINARY POINTS.....	3
A. Fraudulent Transfers	3
B. A Solvency Letter as Prerequisite	3
C. Contracts of Adhesion.....	3
D. Don't Sign Documents if You Don't Have to.....	4
E. Don't Do Things Half-Way.....	4
IV. FAIRLY SIMPLE ASSET PROTECTION OPTIONS.....	5
A. Umbrella Liability Coverage	5
B. Title Insurance	5
C. Cash Value and Death Proceeds of Life Insurance	6
D. Signing Documents as an "Agent"	7
E. Signing under "(SEAL)"	8
F. No Legal Requirement to Support a Spouse.....	9
G. Divorce Options if Mentally Incapacitated	9
H. Don't Sign Indemnification Agreements	10
I. Use a Contractor's Affidavit	11
J. Independent Contractor Letter for Child-Care Providers	12
K. Prenuptial Agreements	13
V. MOST VULNERABLE AREA OF EXPOSURE: YOUR ELDERLY YEARS	15
A. A Declaration of Trust (Revocable Trust).....	15
B. Develop a Relationship with a Trusted Investment Manager.....	18
C. Don't Move Out of Your Home at the Request of Your Kids.....	20
D. Don't Give Too Much Away to Your Kids in Your Older Years	20
E. But, as to Your Kids if You Have a High Net-Worth.....	21
F. Reduce the Threat of Contested Wills.....	21
VI. OTHER ASSET PROTECTION OPTIONS.....	22
A. Long-Term Care Insurance.....	22
B. Joint-Ownership Property Agreements.....	23

VII.	ASSET PROTECTION WITH THE USE OF TRUSTS.....	24
A.	Legal Title vs. Beneficial Ownership.....	24
B.	What Local Law Applies to a Trust.....	25
C.	Rule of Perpetuities.....	25
D.	Spendthrift Clause	26
E.	Exceptions to a Spendthrift Clause.....	26
F.	An Exception to a Spendthrift Clause Is Only Half the Battle	27
G.	Ascertainable Standards (“HEMS”)	27
H.	Fully Discretionary Trust.....	29
I.	Which is the Better Option Between a HEMS Trust and Fully- Discretionary Trust?	29
J.	A Discretionary-Support Trust	30
K.	Who is an Interested Party for a Trust	31
L.	Self-Settled Trusts	32
M.	Third-Party Trusts.....	34
N.	Third-Party Trusts that End During the Lifetime of the Beneficiary	34
O.	Limited Powers of Appointment.....	35
P.	The Best of Both Worlds.....	36

Asset Protection: Day-to-Day Considerations

Presented By
James M. Kane

We like immediacy. We are delighted when the price of gas drops 25 cents per gallon or when we get a 2-for-1 coupon at our favorite pizza joint, when Amazon.com offers free shipping, or when the auto dealer knocks a thousand or more off our purchase of a new vehicle. We do not, however, get much satisfaction when having to contemplate, deal with, pay for, or respond to unexpected problems or preventive action.

Even if future threats fail to materialize (and hopefully they don't), the immediate payoff of asset protection is the satisfaction and benefit of a greater level of comfort. Comfort in knowing you finally took action to help protect you and your family's hard-earned assets.

So, why do we still put off helping to protect the assets we still hold? Other than inertia, why procrastinate now? To help the reader move forward against this procrastination, this outline provides specific recommendations for day-to-day considerations for asset protection.

Here also is the essence of the questions each of us should ask in view of this asset protection outline:

- (1) How well are we protected if someone were to assert a claim against us today?
- (2) What would be the cost and burden to our family if we, for example, today fell on the sidewalk, hit our head, and became permanently or temporarily incapacitated physically, mentally, or both?; and
- (3) Does our procrastination affect us, or potentially affect us, in view of the above two questions?

I. Asset Planning is Not Limited to a Grand Slam

The goal of asset protection is not to seek out and implement a grand slam technique with the idea that one great solution (such as an off-shore trust, or domestic “self settled” trust) will provide all the necessary protection. Rarely do these one-technique approaches work for most clients. Furthermore, these techniques are typically very expensive to implement and maintain.

By contrast, this outline deals with an array of asset protection factors that each of us can be aware of on a day-to-day basis in response to a broad range of areas of exposure, so as to avoid facing death by a thousand paper cuts.

Thus, with this array of asset protection factors, a realistic goal of asset protection is to (i) decrease the target area of your exposure, (ii) place someone else (typically your insurance carrier) on the hook for the time and expense of defending you if claims arise; and (iii) keep your assets out of the easy reach of potential and real claimants.

Now, having said that asset protection is not a grand slam, what comes close to a grand slam for many clients is the use of an inter-vivos QTIP trust. This QTIP Trust also includes significant estate tax planning features and stems from the “qualified terminable interest trust” provisions under the estate and gift tax law. I do not discuss this QTIP trust further in this outline.

Even in view of techniques such as the inter-vivos QTIP trust, every client should still be aware of the many asset protection recommendations included in this outline.

II. Time is Our Only Finite Asset

Time is our only finite asset. We can all make more money, accumulate more material items, acquire larger homes, and so forth. But, we can never recover lost time. The clock ticks away without distinction in our net worth and assets.

The lost time in having to worry and respond to claims against you and your family’s assets is a horrible expenditure of time. In my view, this lost time is a greater cost than the dollar expense of dealing with these types of claims. Asset protection should, therefore, enable you to waste less time worrying, sleep better, calm that lurking voice of procrastination, and reduce your expenditure of time dealing with defending claims that might arise against you and your family.

III. Five Important Preliminary Points.

- A. Fraudulent Transfers. Asset protection needs to be implemented before claims arise. We lawyers have seen far too many individuals -- who have failed to plan for asset protection -- frantically seek out legal assistance only after the claim has surfaced.

Implementing asset protection planning after a claim arises can create significant problems if you transfer property out of your ownership and the transfer results in you thereafter having a net worth less than the amount of the known claims that exist at the time of the transfer. This is referred to as a fraudulent transfer. A court can unwind the fraudulent transfer and thereafter make the property available to a claimant.

- B. A Solvency Letter as Prerequisite. If asset protection planning involves a client's transfer of property to another owner (including to a trust), lawyers will typically require the client to sign a Solvency Letter before moving forward with implementing asset protection planning. This letter is kept in the client's file and provides contemporaneous evidence of the client's financial position prior to making any transfers of property for asset protection purposes. It also helps force clients to be open and forthright with their lawyers about their assets and known or potential claims so that no underpinning of the asset protection is grounded otherwise on a fraudulent transfer situation.

Personal guarantees are typically written assurances that a person will guarantee and make good on another borrower's loan if the loan falls into default. For solvency letter purposes, if the underlying loan is not in default and the personal guarantee has not been called into effect, the solvency letter should make a footnote reference only to the existence of the personal guarantee, without showing the amount of the guarantee as an offsetting liability in determining solvency.

- C. Contracts of Adhesion. The term "contracts of adhesion" refers to certain contracts and agreements where the customer generally has no choice but to sign the agreement in order for the deal to come together.

Examples such as signing a required document for horseback riding, renting a car, obtaining cell-phone service, and other situations where there typically is no alternative other than signing the particular

contract. In other words, it is a contract that you are stuck with if you wish to purchase the services.

These contracts of adhesion sometime also operate to waive all possible claims against the service provider or vendor as a result of any injury or damage that you incur, such as falling off a horse, or injuries sustained while at a skating rink, and so forth.

So, what can you do about these types of contracts?

First, try and not sign the contract and instead merely tender the payment or admission charge, etc. Many vendors (particularly their clerical staff) are more interested in the payment than the details of the paperwork.

Second, make sure that you do not sign an overly broad indemnification provision where you are indemnifying the vendor or service provider from other third-parties. See my separate discussion in this outline on this indemnification subject at page 10.

- D. **Don't Sign Documents if You Don't Have to.** For many of our day-to-day business activities, we are faced with some administrative clerk or other lower-level employee asking us to sign documents. I have found it effective often to casually and in a low-key manner state that I am not going to sign a particular document.

Therefore, simply tell the person in this pleasant manner that you are not going to sign the document, **rather than asking** if you may not sign the document. In many instances, especially if you are tendering a check for payment at the time the person wishes you to sign papers, the clerk or other lower-level employee will not push the issue. Their primary interest generally is getting the check in hand. You have nothing to lose from trying this no-sign approach. Furthermore, if you do have to sign documents, then always at least have some idea of what you are signing.

- E. **Don't Do Things Half-Way.** We are all human and sometimes like to be thrifty in dealing with certain aspects in our lives. Maybe too thrifty on occasion. This deals with our ranking of preferences as to where we spend out money and effort.

Whether or not you are thrifty, you should not go cheap when obtaining legal work. I have seen far too many situations where we now have a client who previously tried to take a cheaper course of action by preparing legal documents using online forms or signing documents without a review by a lawyer, and so forth. In these situations, good preventive care ends up being significantly less expensive than having to deal with what has become a much larger problem.

Also, in my view, individuals may be better off to do nothing than to expend time, money, and energy doing something half-way. Asset protection planning requires well-grounded preventive planning.

IV. Fairly Simple Asset Protection Options.

There are several relatively simple asset protection options available to a large number of clients, as follows:

- A. Umbrella Liability Coverage. Every client should obtain (or confirm that he or she already has) personal umbrella liability coverage to supplement current homeowners and automobile liability coverage. Insurance providers generally have this coverage available in the range of \$1.0 million to \$5.0 million of coverage.

Although this insurance provides coverage for payment of claims, the better part of what you are paying for (with most any liability insurance) is a duty-to-defend. In other words, you are paying the insurance company to get on the hook for your defense and begin paying the legal tab, whether or not the claims are ultimately bona fide.

The insurance company pays its lawyers to defend the claims against you. In our litigious society, defending yourself against uninsured claims can result in expensive litigation even if you ultimately are exonerated completely from the claim.

- B. Title Insurance. Many individuals fail to realize that the title insurance they purchase at a real estate closing is lender's title insurance coverage that insures only their mortgage lender. This lender's policy does not insure the property owner against title defects and title claims against the property.

By contrast, the property owner should purchase -- at the closing -- what is called an owner's title insurance. The premium is much lower for the owner if the owner's policy is issued at closing at the same time the lender's policy is issued. In the absence of an owner's policy, claims against the title will be defended by the insurance company only for the benefit of the lender, not for the benefit of the owner. Thus, an owner's title insurance policy will cover the owner from claims against the title.

The real value of the owner's policy is that the title insurance company has a duty-to-defend. It is on the hook to engage its own lawyers to defend a title dispute pertaining to the property, such as boundary disputes or rights-of-way disputes, and so forth. If the owner of the property has title insurance, the handling of the property dispute generally requires nothing more than the owner informing the title insurance company of the claim. The title insurance company then has to carry the ball in responding to and defending against the claim, and paying its lawyers.

- C. Cash Value and Death Proceeds of Life Insurance. The Georgia statutes under O.C.G.A. § 33-25-11 provide that the death proceeds from life insurance on a Georgia resident at his or her death (including annuity contracts) are exempt from the claims of creditors of the insured unless the insurance policy or a valid assignment thereof provides otherwise. If, however, the life insurance proceeds are payable to the insured's estate, the proceeds will be treated in the same manner as any other assets of the estate and will be subject to creditors of the estate. In other words, the protection from attachment or garnishment does not apply to insurance payable to the insured's estate.

The cash surrender value of life insurance policies issued on the life of a citizen or resident of Georgia also is not subject to claims of creditors unless the insurance policy was assigned to or for the benefit of the creditor or unless the purchase, sale, or transfer of the policy is made with the intent to defraud creditors.

So, what is the protection for payment of premiums, if any?

The present statute does not use the word premiums. Thus, although still untested in the courts, the payment of premiums by the insured, even when the insured is insolvent, arguably does not cause the

insurance policy and its cash value to lose the creditor protection under O.C.G.A. § 3-25-11.

Prior to the present version of this statute, Section 33-25-11(b) stated that "the amount of any premiums for said insurance paid with intent to defend creditors" would inure for the benefit of the creditor from the proceeds of the policy. *See Ambase International Corporation v. Bank South, N.A.*, 196 Ga. App. 336 (1990). This premium reference no longer exists under the above current insurance statute.

- D. Signing Documents as an "Agent". The principal is the person who grants an agent the power to act on behalf of the principal (such as the agent named as attorney-in-fact under a financial power of attorney). The agent needs to be extremely careful about the manner in which he or she signs documents or contracts on behalf of the principal so as to avoid personal liability.

The agent must sign only as agent, and not in his or her individual capacity. The agent should include both a specific reference to the name of the principal within the body of the document or contract and the signature page must make clear that the agent is signing only as an agent on behalf of the principal. In addition, the agent's signature itself must include a clear reference that the agent is signing as agent. This requires generally the agent's signature of the principal's name, followed by "by John Doe under power of attorney for Jane Doe". [Jane Doe is the principal in this example, and John Doe is the agent.]

Why is the above technicality important? Georgia law under O.C.G.A. § 10-6-86 imposes personal liability on an agent if the agent signs a contract and fails to indicate the agent is signing in a representative capacity. *See, for example, Associated Services of Accountable Professionals, Ltd., Inc. v. Workman*, 265 Ga. App. 348 (2004). [A home healthcare agency sued a patient's daughter claiming she did not sign the healthcare contract sufficiently in her representative capacity for her father under a healthcare power of attorney. The court, however, did not uphold the healthcare agency's claim.]

As an aside, Georgia law now provides that the agent named under a Georgia health care directive will not be personally liable for health care facility and services contracted for or on behalf of the principal. *See* O.C.G.A. § 31-32-7(e)(3).

- E. **Signing under "(SEAL)".** Individuals frequently sign documents, contracts, and so forth, with their signature being designated as under "(SEAL)". In some cases, this seal reference is designated with "(L.S.)". These references appear at the end of the signature line. However, most people (including many lawyers) do not know the effect of signing under seal.

Anyone who signs a document, especially a document that subjects the person to some type of liability, needs to understand what a signature under seal means. This meaning also varies from state to state. For Georgia purposes, a document signed "under seal" will extend the statute of limitations to 20 years rather than a shorter period of limitations that otherwise applies to the particular situation without the seal. A document under seal also creates a presumption that the parties exchanged the consideration covered by the agreement. In other words, one party cannot assert, without having the burden to overcome the presumption, that an agreement under seal is not supported by consideration (the exchange of consideration between the parties). See *Autrey v. UAP/GA AG Chem. Inc.*, 230 Ga. App. 767 (1998).

As to the longer statute of limitations, contracts under Georgia law are generally subject to a 6-year statute of limitations. The signature-under-seal that extends the period to 20 years is covered under O.C.G.A. § 9-3-23. This can be good or bad, depending on where you stand in the transaction covered by the "Seal" document.

Keep in mind that there are two requirements under Georgia law in order for a document to be considered "under seal." There must be both a reference to seal in the body of the instrument of an intention to use the seal and the reference to "Seal" or "(L.S.)" at the end of the signature space. This is the reason many documents conclude with the statement "signed under hand and seal, this ____ day of January, 2010". The signature line will include "(SEAL)" or "(L.S.)". See, for example, *Chastain v. L. Moss Music Co.*, 83 Ga. App. 570 (1951).

So what is practical advice for this point?

The point is that under certain circumstances you should strike-through the reference to "SEAL", add your initials to the strike-through, and sign without the SEAL. Many times you will get no objection due

to most people (including many lawyers) not knowing what SEAL means.

- F. No Legal Requirement to Support a Spouse. Why this point? The primary point is to be careful in signing any contract or other obligation on behalf of your spouse. For example, in an emotional height of concern during a medical emergency, one spouse may inadvertently sign hospital admission papers as the primary party responsible for the other spouse's hospital services, and so forth, rather than more appropriately signing as an agent. This can create unnecessary liability exposure.

Under Georgia law there is no legal obligation to support one's spouse, except under certain situations involving divorce and alimony. See O.C.G.A. § 19-6-1 ["alimony is an allowance out of one party's estate, made for the support of the other party when living separately. It is either temporary or permanent"].

The better approach is for the agent-spouse who signs the documents on behalf of the other spouse to sign only in a capacity as agent for the other spouse.

Here is an important point. Whether or not the spouse who signs on behalf of the other spouse is named under a financial power of attorney, the spouse still should sign "By Jane Doe, as attorney-in-fact for John Doe." This helps keep the agent-spouse from taking on the personal liability for the other spouse. This is not to create any shortcoming for the hospitalized spouse; rather it is a common-sense way to avoid unnecessary financial exposure and obligations that otherwise are avoidable.

- G. Divorce Options if Mentally Incapacitated. Why this point? If a person becomes permanently mentally incapacitated, the optimal care situation may be Medicaid provided nursing home care regardless of the age of the person.

For married couples, both the non-incapacitated and incapacitated spouses' assets are "countable" assets in determining whether the incapacitated spouse can qualify for Medicaid. Thus, virtually all of the family's financial resources may have to be exhausted by private-paying for the nursing home care until the assets for both spouses are

depleted enough thereafter to qualify for Medicaid nursing home assistance.

This nursing home question is particularly relevant for younger married couples with young children. The entire family's financial situation can be seriously jeopardized by this nursing home exposure if one of the younger parents becomes incapacitated.

One option as a possible defense for this situation is to include an express provision in each spouse's financial power of attorney document that allows the non-incapacitated spouse to obtain a divorce from the incapacitated spouse if necessary. This arguably would sever the married-couple link to the countable assets qualification for Medicaid.

The power of attorney for each spouse can include a provision along the following lines:

Divorce Options During My Mental Incapacity. If I am mentally incapacitated as determined below, my attorney-in-fact (including my wife Jane W. Doe acting as my sole attorney-in-fact) shall have the power to file a complaint for divorce on my behalf from my wife Jane or to consent on my behalf to a judgment of divorce from my wife Jane if in my attorney-in-fact's sole discretion such divorce provides any benefit to my wife or my children, including but not limited to, the protection of my wife's assets, the preservation of assets for my wife or our children, my qualification for governmental benefits for medical or nursing home care, or any other benefit to my wife or my children that otherwise would not exist in the absence of such divorce. The determination of my incapacity shall be made in the same manner as set forth below under paragraph (bb) of this Power of Attorney. My attorney-in-fact also shall be held harmless for any reason from any action or failure to act under this paragraph. [Underlining added.]

Finally, this divorce option may in some instances not be appropriate in view of their client's religious views, and so forth.

- H. Don't Sign Indemnification Agreements. Local churches, neighborhood community associations and community centers, for example, make their facilities available for private parties, such as children's birthday parties and so forth. In many cases, there will be a written agreement that sets forth the rental payment (if any), scheduling of the party, and the rules and regulations.

Keep in mind that these written agreements also will often include an indemnification provision. This is a provision where the person signing the agreement (such as a mother setting up a birthday party for her child and his friends) is essentially agreeing to defend and pay any third-party claims that might arise against the facility or organization.

The following is an excerpt from a local Atlanta neighborhood center rental agreement that is required when someone wishes to rent the facilities for a party or other gathering. This excerpt is an extremely broad indemnification clause that subjects the renter to the possibility of defending and holding harmless the recreation center from any and all claims of virtually any nature and from any other person:

Renter shall indemnify, hold harmless and defend [recreation center], its officers, directors, agents, employees and members from and against any and all claims and demands (including, without limitation, court costs, expenses and attorneys' fees), whether for injury to person, loss of life or damage to property, that are the result of any act or omission by Renter, or any of Renter's Employees or Guests or that otherwise are in any way related to or arising out of the entry into the Recreation Center, Premises and/or the use of the Recreation Center (or any of the equipment or furnishings therein, by Renter or any of Renter's Employees or Guests. This indemnification shall survive any termination of this agreement and/or the completion of the Usage Term. [Underlining added.]

So what do you do with a provision like this?

First, don't be the eager volunteer to sign this agreement when there is the possibility that other participants may be willing to sign the agreement to facilitate the party. Second, tender the rental check without offering the signed agreement. Third, if you have to sign the document, inquire as to whether your umbrella liability policy will apply in this type of situation. Fourth, if necessary, find another place for the party.

- I. Use a Contractor's Affidavit. Most of us who hire contractors to repair or improve our homes rarely give thought to our financial exposure if the contractor fails to pay his or her subcontractors. In short, Georgia law provides a procedure where a subcontractor, materials provider, vendor, architect, land surveyor, and a wide range of material and service providers in the chain can obtain a property lien that attaches to the customer's residence. In other words, this typically is a lien that

you cannot remove until the lien is paid and satisfied. These statutory provisions are under Georgia law at O.C.G.A. § 44-14-361.

From an asset protection prospective, this subcontractor lien can occur even where you have clear evidence that you paid the contractor in full. You also do not have to have any knowledge that your contractor failed to pay a subcontractor for labor, services or materials. Thus, the relevant issue is whether the contractor paid the subcontractors.

So, what can you do?

Georgia law provides an option for protecting yourself in this situation. You can use a "contractor's affidavit". A contractor's affidavit is a sworn written statement from the contractor to you under O.C.G.A. § 44-14-361.2. These statutory provisions provide that the sworn written statement from the contractor must state that the contractor has been paid (from you) the agreed price or reasonable value of the labor, services or materials; and, that at the time of the contractor's sworn statement, the contractor is not aware of any valid preliminary notice or claim of a lien that exists as to the work.

The property owner ideally should prepare and give the contractor a draft copy of the contractor's affidavit at the onset of the work and make the contractor aware that he or she will have to sign the sworn statement before getting paid for the work. The contractor should then give the property owner the original signed contractor's affidavit in exchange for payment after completion of the work. A sample John Doe copy of a contractor's affidavit is attached hereto as Exhibit A.

- J. Independent Contractor Letter for Child-Care Providers. Many families use one or more child-care providers to provide home child care or babysitting for the children. In situations where the child-care provider is not an employee who works full-time and exclusively for a family, it may be appropriate to use an independent contractor letter for a non-employee child-care provider or babysitter.

Although there are various employment tax considerations that exist in the distinction of an employee versus an independent contractor (and which I do not address further in this outline), if the provider is an independent contractor, my recommendation is to use some form of

letter or agreement that clearly characterizes the child-care provider as an independent contractor.

The primary non-tax asset protection reason is to prevent the child-care provider from being deemed an agent of the family, such as an employee. Under this agent relationship, if the child-care provider damages another's property or has an automobile accident and so forth, the family may be treated as the primary responsible party (thus, the principal) with liability for the actions of their agent (the child-care provider). By contrast, the status of independent contractor provides a level of argument to help reduce or eliminate this principal/agent exposure for the family.

The independent contractor letter or agreement should also specifically refer to the child-care provider's option not to use his or her own automobile for transporting the family's children, if necessary. If the provider uses his or her automobile, the independent contractor agreement can provide some manner of reimbursement, such as 50 cents per mile.

As an example of an independent contractor letter, I attach a "Joe Doe" version to his outline as Exhibit B.

- K. Prenuptial Agreements. Prenuptial agreements for married couples set out how their property will be handled and divided in the event of divorce. These agreements can be an effective means for some couples to provide a level of asset protection and avoid disputes and controversies in the event the marriage fails.

For many clients, the greatest hurdle is getting both soon-to-be-married individuals to agree prior to the marriage to use a prenuptial agreement and agreeing to the terms. This is all much easier said than done in most cases because clients typically wait until the week or two before the marriage to broach the subject of a prenuptial agreement.

For purposes of this outline, I do not include a broad discussion of prenuptial agreements, other than to point out that the following five elements, at a minimum, are essential in helping a prenuptial agreement withstand attack later if a divorce occurs. These elements are:

1. Separate legal counsel is absolutely imperative so that one spouse cannot later argue that he or she was disadvantaged due to the absence of legal counsel. Also, the same lawyer cannot represent both individuals for purposes of preparing a prenuptial agreement.
2. If there is a disparity in the value of assets between the two individuals, or if a disparity will likely exist in the future, the prenuptial agreement needs to include an acknowledgment that each party understands the present disparity and understands that a disparity may exist in the future and that each party will not challenge the prenuptial agreement on the basis of the disparity. Thus, full financial disclosure is essential. *See, for example, Corbett v. Corbett*, 280 Ga. 369 (2006) (after 15 years of marriage, a prenuptial agreement was rendered unenforceable due to the husband's failure to disclose certain income the court determined was material to the agreement).
3. The prenuptial agreement should include a provision for each party to waive the right for future modifications of alimony as otherwise provided under Georgia law at O.C.G.A. §19-6-19 *et seq.* This waiver should exist even if the prenuptial agreement does not in its present form require any alimony payments.
4. The prenuptial agreement needs to require that each of the parties after they get married will sign whatever documents are needed in order to waive ERISA retirement benefits that otherwise exist under federal law for married couples.
5. In most situations, a prenuptial agreement generally should not waive the following rights that will exist by virtue of the marriage: social security survivor's and spouse's benefits; benefits under properly executed beneficiary designations for life insurance policies; and the right to recover damages from a wrongful death claim or from loss of consortium resulting from injury or death of the other spouse.

V. Most Vulnerable Area of Exposure: Your Elderly Years.

The care and oversight of our property during our elderly years, in my experience, is the most vulnerable area of exposure we each may face in dealing with asset protection.

This is worth repeating. The care and oversight of our property during our elderly years, in my experience, is the most vulnerable area of exposure we each may face in dealing with asset protection.

There are countless devastating situations where an elderly person's assets are mismanaged, misappropriated and, in some instances, simply stolen. The misappropriation and theft is also problematic in that it generally occurs over a long period of time with repeated smaller amounts that mask red flags identifying the problem.

Furthermore, individuals who fail to plan for these issues prior to becoming elderly (or disabled at a younger age) face the threat of a court-appointed guardianship which in many cases is far from an optimal remedy. A court-appointed guardianship can be extremely time-consuming, expensive, and greatly limits the flexibility otherwise needed for the care and management of your property. Furthermore, whether the court-appointed guardian is competent and possesses judgment and skill will be the luck of the draw.

So what can someone do to best protect themselves in their elderly years? The following suggestions are applicable to virtually every one of us:

- A. A Declaration of Trust (Revocable Trust). A Declaration of Trust is a written revocable trust and can be a person's core estate planning document in place of a last will and testament. The person (you) who creates the revocable trust is the "settlor." You can also be the sole trustee. You can amend or revoke the trust while you are alive. The trust uses your own SSN number and does not require a separate trust income tax return. At the time of your death, the Declaration of Trust becomes your core estate planning document and includes the provisions for your family and other beneficiaries that you would otherwise include in your last will and testament.

From an asset protection perspective, the primary benefit of using this Declaration of Trust during your lifetime is to avoid your family having to obtain a court-managed guardianship to oversee your property.

How does the Declaration of Trust help in the situation?

The key point is the trust document includes provisions for naming the successor trustee or trustees who will step into your shoes in the event you are later incapable of handling your own affairs.

By contrast, merely relying on a written financial power of attorney for the management of property if you are incapacitated is not alone sufficient. Increasingly, the ease of convincing a third-party to rely on a financial attorney-in-fact document that the attorney-in-fact (the agent) presents as his or her authority to act on your behalf is becoming more problematic each year.

Here is the specific problem. If a third-party will not rely on the financial power of attorney, the only other option in the absence of having the Declaration of Trust is to obtain a judicial determination of the principal's incapacity and a court-managed guardianship. Under Georgia law, once the guardianship is in place, the financial power of attorney effectively becomes no longer operative. It is the court-managed guardianship that will control.

Now, back to the above Declaration of Trust. A successor trustee is not an agent, but is the legal owner of the trust property. Thus, the trustee is not acting in the capacity of an agent on behalf of the trust. A third-party is, therefore, typically much more inclined to deal with a trustee rather than dealing with an attorney-in-fact under a power of attorney.

1. Tie-In to a Financial Power of Attorney. Keeping in mind an optimal situation is to have your assets under the management of a successor trustee in a Declaration of Trust rather than agent (attorney-in-fact), an excellent belt-and-suspenders approach with the above Declaration of Trust is to include the following provision in your financial power of attorney. This can help give the attorney-in-fact authority to transfer assets into the Declaration of Trust in your older years or if you become incapacitated rather than the attorney-in-fact continuing to oversee the assets as an agent (attorney-in-fact) under the financial power of attorney. The person you name as your successor trustee can be the same person named as your

attorney-in-fact in the financial power of attorney (typically your spouse).

Here is the property transfer provision for the power of attorney:

(s) To transfer any portion or all of my real or personal property on my behalf to any revocable trust of which I am the settlor (in some instances referred to as my "Declaration of Trust"), or any corporation, limited liability company (LLC), or partnership (whether limited or general partnership) now in existence or created hereafter in exchange for my receipt of an interest in such corporation, LLC or partnership (whether a limited or general partnership interest); [Underlining added.]

2. **Power to Amend the Trust During Incapacity.** For optimal flexibility, the Declaration of Trust can include a provision that allows the trust to be amended if you (the settlor of the trust) are incapacitated (the settlor is the person who creates and funds this revocable trust). By contrast, this amendment flexibility does not exist for a Last Will and Testament. For example, if a person signs a Will today and becomes permanently incapacitated tomorrow, the Will is for all practical purposes etched in stone. A court will typically not allow an amendment to a Will unless there is some scrivener's error or ambiguity in the Will that requires a judicial remedy.

Thus, the Declaration of Trust can include the following amendment provision in the event of incapacity:

1.4 A court of competent jurisdiction at all times during my incapacity without a judicial determination of my incapacity (see section 7.10) shall have the power by judicial reformation or modification to alter, amend, or modify this trust agreement if the alteration, amendment or modification is in my best interest, or in the best interest of my estate or the collective estates for me and my wife for estate or gift tax purposes. [Underlining added.]

B. Develop a Relationship with a Trusted Investment Manager.

Part of sleeping well at night is knowing that someone is assisting you with the preservation (and hopefully growth) of your investment assets. We cannot all be experts in all areas of our lives.

Also, the Madoff tragedy shows how people's lives can be turned completely upside down if they lose their life savings. The lesson has been, and still is, that you must take actions to protect your investments and savings.

Here are some points to consider for the asset protection of your investments:

1. **Know What Your Rate of Return is for Your Investments.** Many people who handle their own investment management have no idea what are the annual and cumulative rates of return for their investments. This means most people do not know whether the return on their assets is at least keeping up with inflation.

Relying simply on marketing and advertising materials from mutual funds for their 1-year, 5-year, 10-year, etc. historical rates of return does not adequately reflect a particular individual's own experience of success or failure with the funds. The variance in these marketing rates of return can vary significantly depending on what are the starting and ending points of the various reporting periods.

Thus, not knowing your rates of return is enough, in my view, to compel you to use an investment manager for your investment assets, rather than trying to handle the task without professional assistance.

2. **Investment Management Fees.** It is essential that you know what direct and indirect fees/commissions you are paying if you are handling your own investments, but do not let the concept of fees bias you against using an investment manager. Some clients are reluctant to use investment managers due to their fear of the management fees. These clients typically further state they handle their own investments by using their own selection of

mutual or index funds and, therefore, do not need to pay an investment manager.

We lawyers do not, and cannot, give investment advice. But, I do inform clients -- who do not use an investment manager -- that they should look at what fees they are paying, including mutual and index fund management fees, 12b-1 expenses, redemption fees, and load fees.

For example, *Kiplinger* magazine recently reported that the general average expense for domestic equity funds is 1.4%; bond funds 1.1%; and international funds 1.9%.

The client who is reluctant to consider an investment manager should compare his or her mutual fund management fees expenses to the fees an investment manager will charge to handle the client's investments.

Using an investment manager in comparison to self-directed investments may actually result in a reduction of fees in some instances.

3. **Functional Separation and Oversight.** This was the Achilles Heel in the Madoff situation. The phantom investment assets Madoff ostensibly held for his clients were also under his own phantom custody. Thus, the periodic statements the clients were receiving listed descriptions and number of shares, and so forth, that were non-existent. No one, including Madoff, had custody of the purported stock and other investments.

Because investment firms differ as to their structure and procedures, the key point is to review and discuss with the investment firm what is its functional separation and oversight for the investments and the underlying securities.

This functional separation and oversight involves factors including the external auditors (such as a CPA firm), the internal controls and procedures of the investment firm, and the insurance coverage for the investment account. Madoff, unfortunately, illustrates that governmental regulatory oversight, alone, is not a sufficient safeguard.

- C. **Don't Move Out of Your Home at the Request of Your Kids.** There are far too many situations where an elderly widow or widower ends up living in a relatively small apartment or condominium primarily at the request of their children. Although there are any number of well-intended reasons the children use to influence their parent to make these moves, the move is inappropriate in many situations.

We have all heard any number of reasons why these situations occur. From a planning perspective, one might try and argue that Mom or Dad's reduction in assets that inure to the benefit of the children is a method of asset protection or easy estate planning. Or Mom and Dad will be protected from losing their assets to a nursing home, and so forth.

However, in my view, this reduction in assets also can produce one of the most severe and damaging effects on the widow or widower's sense of autonomy and independence. Or, simply on the widow or widower's joy of life. The benefit of preserving assets for the children is not worth this cost in many family situations.

The solution? Have a family agreement or pact with your children, or prepare a letter of intent, stating that you desire to remain in your own home until your death, to the greatest extent possible, and without regard for the value of your estate or the financial interests of your children. Or if you wish to make a gift of the residence, at least retain a life estate.

- D. **Don't Give Too Much Away to Your Kids in Your Older Years.** Subject to whether you have a high net-worth and fall into the following paragraph E immediately below, parents should not be compelled to give too much away to their children prior to death.

Children can exert tremendous pressure in trying to convince their parents that giving them gifts prior to death is necessary for tax planning or for protecting against the threat of nursing home expenses, etc.

This point centers on the same loss of autonomy and independence I referred to above under paragraph C.

- E. **But, as to Your Kids if You Have a High Net-Worth.** By contrast to the above two situations, some older clients with large estates hold on to too much of their net-worth due to an unwarranted fear that they ultimately may run out of money.

The problem here is that these clients generally have more than enough assets and, therefore, end up paying far too much estate tax at death. Every dollar held beyond what the client needs will likely be taxed at the 45% estate tax rate. By contrast, there are numerous ways to help reduce a potential estate tax burden without the parents becoming destitute (that I do not discuss in this outline).

From an asset protection perspective, these high net-worth clients should obtain assistance from a CPA, financial, or investment professional and run financial projections on how much of the clients' net worth can be given up (through effective estate and gift tax planning) and still maintain the cash-flow and reserves necessary for their lifetimes. To do otherwise too often results in a considerable amount of unnecessary estate tax payable after the clients' deaths.

- F. **Reduce the Threat of Contested Wills.** One of the other most time-consuming and wasteful expenditures of funds involves litigation where beneficiaries challenge the Will. This generally is a challenge using what is called a "caveat". The person filing the caveat is referred to as the caveator.

This caveator generally will attack a Will by stating that the Will was not signed in proper manner and thus, the formalities of executing the Will are subject to the attack; that the person who signed the Will did not have sufficient testamentary capacity to know what he or she was signing; and that the person was under undue influence or fraud, or both, as to the Will.

These types of litigation cases trigger a considerable amount of emotion among the parties and unfortunately can result in one or more parties trying to take a scorched earth approach in perpetuating the litigation. This regrettable situation can result in one party having the attitude that "I don't care if I ever get anything from the estate. I just want to make sure that my sister gets nothing".

There are two primary ways to help reduce this threat of a Will contest: (1) adhere absolutely to all formalities for the signing of your Will with assistance from a well-qualified attorney; and (2) use the above Declaration of Trust as your core estate planning document in lieu of a Will. It generally is much more difficult for a beneficiary or other interested party to challenge your testamentary capacity or to assert undue influence as to a trust document that you signed and placed into operative effect prior to your death.

VI. Other Asset Protection Options.

The following asset protection options have greater complexity and require more time and expense for implementation. However these options are also extremely effective in many client situations.

- A. Long-Term Care Insurance. Medicaid does not pay for “assisted-care”, but covers only nursing home care. Some clients are under the mistaken impression that Medicaid will be beneficial for them if they ever need elderly assisted-care and housing.

Some children of clients will also push their parents to give away their property (of course, to the children) so as to qualify Mom or Dad for Medicaid nursing home care.

This is a mistake. Instead, clients should find every way possible to help ensure that they can afford private-pay assisted-care rather than Medicaid nursing home care. Remember, Medicaid does not cover assisted-care.

Here are some important points to consider:

1. What is "Assisted-Care"? This is housing care of the elderly that provides a substantially greater degree of autonomy for the resident compared to nursing home care. It is also about half the cost of nursing home care.
2. How Different from "Nursing Home Care?" Nursing home care is for residents who need the staffing of 24-hour registered nurses; by contrast, assisted-care generally does not require a 24-hour nursing staff and is for residents who need daily or periodic assistance, including close oversight of their prescription medicine schedules.

3. Possible Financing Options for Assisted-Care. Private-pay planning for assisted-care, for example, can be accomplished with long-term care insurance, or the use of a reverse mortgage, or the use of a second-to-die life insurance policy. The second-to-die policy allows a client to use his or her other assets to pay for assisted care (other than what is needed to pay the insurance premiums), and helps provide assurance that some level of inheritance (funded with the insurance) passes to the client's children in the event the client's assets are depleted substantially for assisted-care.

The long-term care insurance option is essential for most clients. Furthermore, a well-qualified salesperson who is trustworthy, competent, and knowledgeable in this area can be very helpful in the selection process. In many cases, the most cost-effective time to purchase long-term care insurance is when you turn 50.

- B. Joint-Ownership Property Agreements. Joint ownership of property in Georgia does not prevent lawsuit judgment holders or other claimants from levying a joint-owner's share of the property to satisfy a judgment. Thus, for example, the mere fact that a husband and wife own their home jointly in Georgia does not protect each spouse from claims against the other spouse. In the worst case, one spouse can end up being the joint owner with a claimant who is successful in executing a claim against the other spouse's portion of the property. This is a surprise most people do not want.

Under Georgia law jointly-owned property that is owned as joint tenants with right of survivorship passes by law automatically at the time of death of one joint owner to the surviving joint owner. Thus, at death the joint interest is not subject to the estate claims of the deceased joint owner. But, this death treatment still leaves exposed any claims against a joint owner that develop while the joint owners are alive (as I mentioned above).

As an aside, some states (but not Georgia) have joint ownership called a tenancy-by-the-entirety, which is a special type of joint ownership for married couples. Tenancy-by-the-entirety provides an excellent degree of asset protection for both spouses. By law, a claim against one spouse cannot attach to that spouse's portion of the joint property that is held as a tenancy by the entirety.

So, what can a joint owner do in Georgia for a level of better asset protection for jointly-owned real estate?

The owners can agree in writing to a joint property agreement. This is a written agreement that is recorded in the real property deed records, with a cross-reference back to the ownership deed for the property.

Essentially under this agreement none of the joint owners can sell or transfer their joint interest in the residence without first offering it for sale to the other joint owner(s). The written agreement can also provide that any required sale between the joint owners is subject to an extended installment payment arrangement (for example, 20 years with a balloon payment). The asset protection goal is that a third-party claimant can seek to obtain only a charging order to receive what, if any, payments occur under the long-term installment arrangement.

One caveat. Keep in mind this written joint property agreement is not effective generally if a third-party claim against the jointly-owned property involves a claim where both joint owners are mutually and jointly liable. This, by the way, is the same risk that exists for the above tenancy-by-the-entirety property for mutual claims.

VII. Asset Protection with the Use of Trusts.

If a person plans to use a trust, it is important that her or she understands the following key technical points about trusts. Merely knowing nothing more than “I am using a trust” is not sufficient in helping provide the optimal trust design for a client’s particular situation:

- A. Legal Title vs. Beneficial Ownership. The basic definition of a trust is that the trust property is held and managed by a trustee for the benefit of one or more trust beneficiaries. More technically, the trustee is the legal owner of the trust property; the trust beneficiaries are the beneficial owners of the trust property. The degree and extent to which the trust beneficiary holds a beneficial interest in the trust depends on the written provisions of the trust document and, in many instances, on the effect of whatever state law applies to the trust document.

As a very important aside, the trustee as the legal owner of the trust property is the key point about my recommendation that most clients need to have a revocable Declaration of Trust for their assets while

alive, particularly in their elder years or in the event of incapacity. See page 15 of the outline.

B. What Local Law Applies to a Trust.

In the absence of designating a mandate within the trust document as to which law applies to the trust, the general rule is that the trust will be governed by the law where the trustee resides. There are also instances where co-trustees are located in different state jurisdictions, requiring some conclusion by the parties or by a court that a balancing of factors will apply in determining which state law controls.

The balancing of factors might include a review of where the trust property is located, where the beneficiaries are located, where the settlor is, or was, located when he or she created the trust, and various other factors. However, the actual location of where the trustee resides is typically the trump card in these situations, absent a specific mandate in the trust document of the controlling law.

Keep in mind the written designation of law is not always controlling, as a mandate of a particular state law is not effective if the trust has no connections (or nexus) in that state.

C. Rule of Perpetuities. The rule of perpetuities is a legal term as to how long a trust may operate before the law requires that the trust terminate. As a general rule, most states allow a trust to operate for 90 years from the date of creation of the trust. This 90-year duration is often referred to as a rule of perpetuities period for the trust.

In an effort to expand beyond 90 years, there is a current trend among some states to change their laws to allow significantly longer allowable periods for the trust, and in some cases place no limit on the duration of the trust.

From an academic perspective the notion of an expanded rule of perpetuities period that allows, for example, a 360 year or 1,000 year trust, might be appealing at first glance. But in reality, a client should consider the following effect of these extended periods for trusts from a practical perspective.

The National Conference of Commissioners on Uniform State Laws published a press release in 2000 stating that the average married

couple will have 2.1 children. Under this assumption, a person who creates a trust today will likely have more than 100 descendants (who are beneficiaries of the trust) 150 years after the trust is created, around 2,500 beneficiaries 250 years after the trust is created, and 45,000 beneficiaries 350 years after the trust is created. Five hundred years after the trust is created, the number of living beneficiaries could increase to 3.4 million. The internet site for additional information on these statistics is www.nccusl.org/nccusl/pressreleases/pr1-00-7.asp

- D. **Spendthrift Clause.** A spendthrift clause is a written provision typically included in a trust document. It prevents a trust beneficiary from depending on the future value or future distributions from the trust. More specifically, a trust beneficiary cannot anticipate, assign, pledge or transfer a future-interest in the trust income or trust principal.

For example, a child cannot purchase a new automobile by promising the seller that the seller will receive whatever future payments the child expects to receive from the trust. This also generally prevents the seller in this example from suing the trustee to compel payment to satisfy these types of future promises from a beneficiary.

By statute, Georgia law under O.C.G.A. § 53-12-28 states that “the interest of the beneficiary in the income or in the principal or in both may not be voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee” (underlining added).

- E. **Exceptions to a Spendthrift Clause.** Many states, including Georgia, have laws that mandate exceptions to a spendthrift clause. These exceptions vary in terms according to the particular state law.

The Georgia exception to a spendthrift clause is by statute under O.C.G.A. § 53-12-28(c). This statute allows a claimant to garnish trust distributions to the beneficiary in order for the garnishment to satisfy (i) tort judgments, (ii) taxes, (iii) governmental claims, (iv) alimony, (v) child support, or (vi) a judgment for necessities that were not voluntarily provided by the claimant.

The key point is that the spendthrift exceptions allow only a garnishment against distributions from the trust to a beneficiary. The

exceptions generally do not allow a claim against the trust property or the trustee in order to try and get inside the trust to satisfy the claim.

Thus, under this exception a claimant under one of the above categories can garnish any distribution by the trustee to the beneficiary. Beyond the scope of this outline, I note that this garnishment is subject procedurally to the same limitations for garnishment applicable to disposable earnings. See O.C.G.A. §§ 53-12-28(c) and 18-4-20.

- F. An Exception to a Spendthrift Clause Is Only Half the Battle. As stated above, an exception to a spendthrift clause is essentially a garnishment available only against a beneficiary's distribution from the trust.

Thus, the other half of the question when dealing with potential third-party claims against a trust or against the trust beneficiary is what interest does the trust beneficiary have, if any, in the trust. This is completely separate and apart from a spendthrift exception.

Depending on the provisions in the trust itself, a beneficiary may have an identifiable vested interest in the trust. If there is such interest, a third-party claimant under certain circumstances can pursue its claim directly against the trust itself – not merely a garnishment action – and seek to force the trustee to make a distribution from the trust to the claimant to satisfy the claim against the beneficiary.

As to what kind of interest a beneficiary has in a trust can involve complicated terms such as a contingent interest, a vested interest subject to open, a vested interest subject to divestiture, a defeasible vested interest, and so forth. These fine distinctions are beyond the scope of this outline.

However as indicated below, in broader terms whether a beneficiary has an interest in the trust in most instances depends on if the trust is a self-settled trust, a third-party trust, a fully discretionary trust, an ascertainable HEMS trust, or a discretionary-support trust.

I touch on these broader categories below.

- G. Ascertainable Standards (“HEMS”). The term ascertainable standards applies to a method of instruction to the trustee as to what authority he or she has to make distributions from the trust to the trust beneficiaries.

Typically, the written trust provisions authorize the trustee to make distributions for ascertainable standards for the health, education, maintenance, and support of the trust beneficiary (HEMS, for short).

The popularity of using these HEMS standards stems from the tax law requirement that mandates the HEMS ascertainable standards in situations where a family member or beneficiary is serving as the trustee (thus, a non-independent trustee). For tax purposes, the HEMS standard keeps the trust beneficiary, who is also a trustee, from being deemed to hold a general power of appointment over the trust property. In short, a general power of appointment can cause the trust property to be valued as property of the beneficiary-trustee for estate and gift tax purposes.

A HEMS trust has been interpreted by the courts as an objective standard for the trustee. Thus, under this interpretation the trustee has discretion only as to the timing, manner, and size of the distributions needed to achieve the health, education, maintenance, and support of the beneficiaries. The trustee cannot withhold distributions contrary to the HEMS standards (as he otherwise can do with a fully-discretionary trust).

Thus, the trustee does not have absolute and full discretion due to the HEMS standards. A beneficiary (or a court on behalf of the beneficiary or a claimant who has provided health, education, maintenance, or support to the beneficiary) has the ability to compel the trustee to make distributions if the beneficiary or a claimant can demonstrate a necessity for his or her health, education, maintenance or support.

See, for example, Eckes v. Richland County Social Services, 621 N.W.2d 851 (N.D. 2001)(a support trust allows a beneficiary to compel distributions of income, principal, or both, for expenses necessary for the beneficiary's support, and a governmental agency may consider the support trust as an available asset when evaluating eligibility for governmental assistance); *In re Trust Created by Hansen*, 739 N.W.2d 170 (Neb. 2007) (trustee's discretion to determine what is needed for beneficiary's support does not preclude a beneficiary from seeking to show that a trustee has abused its discretion in failing to make support payments).

- H. **Fully Discretionary Trust.** A discretionary trust is a trust where the trustee has absolute discretion as to the payment of trust principal and income to the beneficiaries. *See Henderson v. Collins*, 245 Ga. 776, 779 (1980); Restatement, Second, Trusts § 155 (1959). There are no objectively ascertainable HEMS standards for health, education, maintenance, or support, nor any other standard applicable to the trustee. The trustee has absolute discretion over whether, when, and how much a distribution should be to a beneficiary and provides the greatest amount of asset protection for the trust property.
- I. **Which is the Better Option Between a HEMS Trust and Fully-Discretionary Trust?** In short, a fully discretionary trust provides much greater asset protection for the trust beneficiaries compared to a HEMS trust.

Here is the reason. A HEMS trust can potentially enable a third-party creditor who provides a service or goods to the trust beneficiary to sue the trustee to compel a distribution by the trustee to satisfy the ascertainable standards for the health, education, maintenance, and support of the trust beneficiary. A beneficiary can also sue the trustee to compel a HEMS distribution.

Also the trust beneficiary's obligation upon divorce to pay alimony as support to his or her ex-spouse, or to pay child support, is arguably a support item for the trust beneficiary that falls within the HEMS distribution standards. Here the third-party (such as the ex-spouse) has an argument that he or she appropriately can compel the trustee to make the alimony and child-support distributions under the ascertainable HEMS standards.

Also, a third-party in a HEMS trust situation is more likely to be deemed an interested party in the trust, thus giving the third-party legal standing to pursue a claim against the trust. See the additional discussion about interested parties below at page 30.

Even against the backdrop of the above differences, unless the greater level of asset protection is needed in the future, it is fine, and generally typical, for family members to serve as trustees using the HEMS provisions.

- J. **A Discretionary-Support Trust.** Some trust documents include hybrid distribution language, such as: “The trustee, in the trustee’s discretion, may make distribution of income and principal for the beneficiary’s health, education, maintenance, and support”. This hybrid language includes elements of both an ascertainable HEMS trust and a fully discretionary trust. Although under certain client circumstances I purposely use this type of hybrid language, the asset protection features of the trust by this hybrid language are not as strong as a fully discretionary trust.

A court may likely construe the language as falling more in line with a HEMS trust, thus opening the avenue for a third-party to file a claim directly against the trust for recovery, as compared to the defensive strength of a fully discretionary trust.

There is not much Georgia law on a discretionary-support trust. I find only one 1962 Georgia judicial opinion that refers to a discretionary support trust. *See Lanier v. Lanier*, 218 Ga. 137 (1962)(the court referred to the trust at issue as a discretionary support trust; the trust provided that the beneficiaries are “to be given amounts the trustees in their sole discretion deemed proper to support them in comfort and happiness”).

However, in other jurisdictions there are instances where the court has to decide whether the hybrid discretionary/support trust is or is not fully discretionary. *See, for example, Miller v. Dept. of Mental Health*, 432 Mich. 426, 442 N.W.2d 617 (1989); *In re Estate of Gist*, 763 N.W.2d 561 (Iowa 2009);

In the above *Miller* case the trust document created by the trust beneficiary’s father stated that the trustee shall pay “so much of the income” and “such amounts of principal (even to the extent of all) as the Trustee deems proper for the support, maintenance and welfare” of the trust beneficiary (the settlor’s disabled daughter). At issue was the State of Michigan’s argument that the trust was not a fully/discretionary trust and, therefore, must be taken into account to disqualify the daughter’s eligibility for state medical benefits until the trust is exhausted. By contrast, if the trust is a fully discretionary trust, the trust would not disqualify the daughter from the state benefits.

We do not know the ultimate conclusion of this *Miller* situation. The Michigan appeals court sent the case back (remanded) to the trial court

to determine the father's intention as to whether he intended the trust to be a fully discretionary trust or a support trust.

This is not a fight a client needs to face if the strongest asset protection is desired. Therefore, make the trust a fully discretionary trust.

- K. **Who is an Interested Party for a Trust?** Fully discretionary trusts (as compared to a HEMS trust) help insulate against a broadening definition of what is a non-beneficiary interested party with standing to sue the trust (by suing the trustee). Georgia law at O.C.G.A. § 53-12-2 defines an interested party as a trustee, beneficiary, or any other person having an interest in or claim against the trust. The statute states further that "This meaning, as it relates to particular persons, may vary from time to time and must be determined according to the particular purposes of and matter involved in any proceeding." O.C.G.A. § 53-12-2(4).

Why is this interested-party factor important? It can open the door for a much broader range of persons who have standing and opportunity to sue the trustee of a trust so as to try and satisfy a claim against a trust beneficiary, and also as an interested party who can file a lawsuit to force a trust accounting or seek a removal of a trustee. See O.C.G.A. § 53-12-176. The concern, of course, is having to deal with an interested party who is not a trust beneficiary, but who can assert a claim against the trust, such as for alimony from a trust beneficiary. An interested party also has standing to compel discovery to get financial information about the trust and its assets, and so forth.

By contrast, a fully discretionary trust provides the narrowest group of interested parties, defined primarily as only the settlor and the trust beneficiaries. By contrast, a HEMS trust has a broader range of potential interested parties, particularly non-beneficiary parties (such as divorcing spouses) who rely on the exceptions to the Georgia spendthrift clause statute. [I discussed spendthrift clauses above under a separate heading.] For more information on this interested party issue, see the majority and dissenting opinions in *Richards v. Richards*, 281 Ga. 285 (2006).

[Note: the following portion of this outline expands the scope of additional factors that apply to the design of trusts; the above distinction in a HEMS trust versus a fully

discretionary trust remains essential and must be taken into account along with the effect of these additional factors.]

- L. **Self-Settled Trusts.** As a general rule, a person who creates and funds the trust with his or her own property, while also a beneficiary of the trust, cannot stand behind the trust document for asset protection purposes. In other words, a person cannot create his or her own trust and use it as a shield for that same person's asset protection purposes.

This is in contrast to a third-party trust not funded by a beneficiary of the trust, as discussed in the following section of this outline.

However, this general rule for a self-settled trust applies differently based on the particular design of the trust at issue, as illustrated below:

1. **Self Settled Single Beneficiary Trust.** Under Georgia law a person who creates a trust (called the trust settlor) for his or her own benefit as sole beneficiary of the trust gets no protection from claimants or creditors against the trust, regardless of the trustee distribution language and regardless of whether there is a spendthrift clause.

Technically, as both settlor and sole beneficiary there is a merger of the legal and beneficial interest of the trust for the benefit of the sole beneficiary who also created and funded the trust. Thus effectively, there is no trust for asset protection purposes.

For example, where John Smith creates his own revocable trust as the settlor, such as "The John Smith Declaration of Trust," and transfers his own property to the trust, there is no asset protection for John.

But, don't let this non-protection point prevent a client from implementing a revocable Declaration of Trust. As I discuss above at page 15, the Declaration of Trust can provide other significant benefits to the client during his or her lifetime with this type of trust. Also, the Declaration of Trust can include the after-death trust provisions for the benefit of the client's family members to help protect the trust property for them for asset protection purposes.

Now, for another example of a one person trust, in *Speed v. Speed*, 263 Ga. 166 (1993), a quadriplegic individual transferred settlement proceeds for damages he received in an automobile accident into a spendthrift irrevocable trust with himself as the sole beneficiary. The Georgia courts concluded the spendthrift provision within the trust document prohibiting involuntary transfer of trust property was not enforceable due to both the settlor and sole beneficiary being the same person. This trust, therefore, was available to satisfy the settlor's wife's claims for alimony and division of marital property upon their divorce.

2. Self-Settled Irrevocable Trust with More Than One Beneficiary. The above general rule against self-settled trusts may not apply where a person creates an irrevocable self-settled trust that includes that person plus other trust beneficiaries.

For example, in *Avera v. Avera*, 253 Ga. 16 (1984), an individual created an irrevocable trust with himself as sole trustee of the trust for his lifetime. The trust provided that the net income from the trust would be payable to the settlor during his lifetime. The trust also provided that upon the settlor's death, the assets in the trust would be divided into equal shares for the settlor's children and held in continuing trust until each child reached age 55.

The terms of the trust also provided that the trustee could encroach on the trust corpus for the benefit of the settlor in the limited circumstances of "misfortune, illness, accident or infirmity" and for necessary sums where there are no other "funds reasonably available" to meet the particular needs.

The settlor also under the terms of the trust held a general power of appointment so as to amend the trust documents to provide for the distribution of the remaining trust principal at his death to and among any person or persons, but excluding the settlor's own estate or the creditors' estate. In other words, this was a general testamentary power of appointment for the settlor.

At issue in *Avera* was whether the trust corpus was available for alimony and child support claims against the settlor by his wife in their divorce action. As a result of the settlor's right to all

trust income, the court concluded the income was available to satisfy claims for alimony and child support.

As to the trust corpus, the Georgia court in *Avera* concluded that the trustee did not have unlimited discretion to make distributions to the settlor. Also of significance was the court's conclusion that even though the settlor was the sole beneficiary of the trust for his lifetime, the terms of the trust provided that the remaining trust corpus would be distributable to his children at the time of his death, or alternatively by exercise of the settlor's general power of appointment. The settlor was, therefore, deemed as not being the only beneficiary of the trust, thus precluding an argument by his divorcing wife that the legal and beneficial interest of the trust merged in favor only of the settlor.

- M. Third-Party Trusts. By contrast to the above exposure for the person who creates and funds a self-settled trust, a trust funded by a third-party who is not a beneficiary of the trust offers much greater asset protection for the trust beneficiaries, depending on what distribution provisions exist in the third-party trust (such as whether the trust is an ascertainable HEMS trust or a fully-discretionary trust as discussed above). These trusts are typically called "third party trusts."
- N. Third-Party Trusts that End During the Lifetime of the Beneficiary. What I am about to discuss is a surprise to most people. That is, even with a third-party trust, a trust beneficiary has greater exposure to claims against the trust if the trust is designed to end during the beneficiary's lifetime, such as the trust being fully distributable to the beneficiary upon turning age 35.

In *In re McLoughlin*, 507 F.2d 177 (5th Cir. 1975), a Georgia federal bankruptcy case, the issue centered on a trust created by the bankrupt debtor's deceased father under the father's Last Will and Testament. The trust included a provision for the termination of the bankrupt debtor's trust when he turned age 35, with the remaining trust property distributable outright to him (the bankrupt debtor). The bankrupt debtor was age 30 at the time of this bankruptcy proceeding.

The court concluded that the bankruptcy trustee could, as part of the bankruptcy action, sell the bankrupt debtor's future right to receive the

distribution of the trust at age 35 (even though the bankrupt debtor was at that time age 30). The sale of the remainder interest in the hands of the buyer would, however, continue to be subject to all trust provisions, including discretionary encroachment on trust corpus for the beneficiary's education and support (prior to age 35).

The lesson here is to use only lifetime trusts for the trust beneficiaries.

- O. **Limited Powers of Appointment.** The person who creates a trust can, under the written provisions of the trust, give a trust beneficiary a limited power of appointment. The key point here is that a limited power of appointment provides significantly greater flexibility for the design of the trust and is not a power that can fall into the hands of a creditor or bankruptcy trustee.

From an asset protection perspective, a claimant or bankruptcy trustee cannot step into the shoes of the person who holds a limited power of appointment. *See In Re: Kinsler*, 24 B.R. 962 (Bankr. N.D. Ga. 1982).

As background, a power of appointment is a written provision in a trust document that gives a trust beneficiary the power to redirect how much and to whom the trust property passes. Thus, with powers of appointment a beneficiary can increase, decrease, or eliminate what the trust beneficiaries are to receive from the trust. This increase, decrease, or elimination can be different than the way the property is otherwise slated to be distributed under the terms of the trust document.

Clients often include these powers to provide post-death flexibility for unforeseen future events, such as a change in the relative financial needs of the trust beneficiaries, divorce actions involving children, asset protection, and so forth. These powers can also sometimes be triggered for very effective after-death tax planning.

Typically, clients include their spouse and their children as the holders of these powers. Most often the powers cannot be triggered by a holder until after the death of the person who gives the power.

If a trust beneficiary has a power of appointment, but chooses not to trigger (exercise) the power, then the trust property is controlled by the written provisions of the trust document as though the power of appointment did not exist.

The flip-side for the holder of a power of appointment are the potential recipients who can benefit (or have their interests decreased) from the holder's exercise of the power. These recipients are described by the person who grants the power under the written terms of the trust document. In most cases, this recipient group is defined as a person's descendants and the spouses of the descendants.

Thus, a power of appointment cannot be exercised by a power holder for any recipient persons outside the defined group. Also the power holder cannot exercise the power to increase his or her own share of the trust property. This is why the power is more accurately called a limited power of appointment (as compared to a general power of appointment).

- P. **The Best of Both Worlds.** For most clients the use of a family member or trust beneficiary as trustee works fine; correspondingly, the required HEMS support provisions are fine in lieu of fully discretionary trust provisions for the trust. This HEMS support trust feature may not, however, provide the optimal asset protection for the trust, if greater protection is needed at some point in the future.

As illustrated by the excerpts below, a best-of-both-worlds solution is to design the trust document so that it is characterized either as a support trust if a family member is serving as trustee (a non-independent trustee) or as a fully discretionary trust with an independent trustee who is not a family member or beneficiary. Thus, the support trust effectively is the best of both worlds and can be flipped if necessary into a fully-discretionary trust without amending the trust document.

One caveat. As set forth above under the following trust provision excerpt section 6.2, if a beneficiary later chooses to remove herself or another family trustee and replace with an independent trustee, that beneficiary's removal and replacement power will thereafter be limited only to independent trustees. This limitation helps strengthen the asset protection argument with a fully discretionary independent trustee by preventing the beneficiary from merely later switching back and forth between independent and non-independent trustees.

Here are excerpts of provisions that give a trust the dual-option of triggering the fully discretionary trustee provisions instead of the

support trust HEMS provisions (health, education, maintenance and support):

-
- 4.3 The Trustee is authorized to apply, in the Trustee's discretion subject to section 6.9, the income and principal from any trust under this Article IV for the benefit of my wife, after taking into account other resources reasonably available to her.
- 6.2 If any beneficiary (other than me) under this trust agreement removes a trustee and appoints an Independent Trustee under the provisions of this Article VI, that beneficiary's removal and appointment power thereafter shall at all times be limited only to trustees that are Independent Trustees as defined under section 6.10.
- 6.9 When a Trustee is not an "Independent Trustee" (Independent Trustee defined in section 6.10), the distribution powers of that non-Independent Trustee shall not be fully discretionary, but instead shall be limited to making distributions of income and principal, in the non-independent Trustee's discretion, only for the ascertainable standards for the health, education, maintenance and support of the beneficiaries to whom distributions can be made, after taking into account other resources reasonably available to the beneficiaries. Whether or not an Independent Trustee is serving and regardless of this section 6.9, the Trustee may make distributions to my wife to enable her to make annual exclusion gifts as provided under section 3.6. Nothing in this section 6.9 shall eliminate or deny my wife's right to all income for purposes of any trust or trusts under Article III or Article IV for which my personal representative claims a marital deduction and my wife shall in all events be entitled to all income from any such marital deduction trust regardless of whether the trustee is an Independent Trustee.
- 6.10 An "Independent Trustee" shall be a trustee that is not "related or subordinate" to me or to any beneficiary under this Declaration of Trust within the meaning of Section 672(c) of the Code. [Underlining added.]
-

Asset Protection: Day-to-Day Considerations
by James M. Kane, Attorney
Chamberlain, Hrdlicka, White, Williams & Martin
January 6, 2010

EXHIBIT A

CONTRACTOR'S AFFIDAVIT

The undersigned is an officer of _____, Inc., whose business address is 1996 Smith Drive, Suite 110, Atlanta, Georgia 30333 (the "Contractor"), and is authorized to execute this Contractor's Affidavit both in a representative capacity on behalf of the Contractor, as well as in his [or her] individual capacity, this _____ day of September, 2009.

The Contractor has performed work for Jane J. Doe (the "Owner") consisting of the Contractor's provision of labor, supplies, and materials for the repair and construction of _____ (the "Work") at the Owner's residence located at 1234 Peachtree Street, N.E., Atlanta, Georgia 30303 (the "Property").

The Contractor acknowledges that the Contractor has received full payment from the Owner of USD \$_____ for the agreed price and reasonable value of all labor, services, materials, and completion of the Work and that this full payment is for all amounts due and payable from Owner to Contractor for this Work.

The Contractor acknowledges there is no outstanding balance or unpaid amount owed by Owner to Contractor for labor, services, or materials for the Work, consisting of but not limited to, equipment, parts, supplies, appliances, fixtures, or subcontractor labor, that may in any manner otherwise attach as a lien to the Property.

The Contractor represents and acknowledges that there are no valid preliminary notices or claims of lien that exist or have arisen as a result of the Work nor any notices or claims of liens that have not been previously cancelled, dissolved, or expired as of the date of this Contractor's Affidavit.

The Contractor agrees to indemnify and hold harmless Owner against any damages, loss, attorneys' fees, or other costs arising out of any lien or other claim filed by a subcontractor, supplier, materialman, laborer, agent, or other third-party in any way relating to or arising from the Contractor's provision of labor, supplies, and materials for the Work.

The Contractor signs this sworn written statement before a notary public under hand and seal as of the date first written above.

Sworn to, signed, sealed and delivered
in the presence of:

John Doe, Inc.

By: _____

James Doe, Vice President

Notary Public

My Commission Expires: _____

(Corporate Seal)

(Notary Seal)

Asset Protection: Why Procrastinate Now?
by James M. Kane, Attorney
Chamberlain, Hrdlicka, White, Williams & Martin
September 9, 2009

EXHIBIT B

JOHN M. DOE
191 Peachtree Street, N.E. 34th Floor
Atlanta, Georgia 30303

Tuesday, January 18, 2010

**Ms. Angela Smith
by Hand Delivery**

Re: Your Childcare Services as an Independent Contractor

Dear Angela:

This letter summarizes the status of your independent contractor work for your childcare services for our three children. As to your status as an independent contractor, we are not your employer and you are not providing these services to us as an employee.

You and we understand that you also may provide childcare services for other families and that we are not limiting or restricting you from working for other families. We also are not requiring you to commit to a fixed or rigid work schedule on our behalf.

You can provide our childcare services on your own schedule. You also have the right at all times to reject or change our request for the time and date of your childcare services. However, we would appreciate you giving us at least 24 hours advance notice for any change in your schedule. You can give us notice by telephone or e-mail. My e-mail address is: john.doe@chamberlainlaw.com

As part of your childcare services for us, you may decide, completely on your own, whether or not to transport our children to local parks, restaurants, camp or other locations, as part of your childcare services. You understand that you are not obligated or required by my wife Jane or me to use your automobile for transporting our children. If you do use your automobile, at your request we will provide you with funds for any park admissions fees or other charges for these excursions. We will also reimburse you 50 cents per mile for any use of your car for transporting our children.

Also if you choose to use your automobile for our children, we understand you will not be transporting our children as our agent nor as an employee on our behalf. Your transportation of our children with your own automobile will be solely as an

independent contractor under the above terms. You also represent to us by your signature below to this letter that you maintain your automobile in good operating condition, that you and our children will use seat-belts at all times, and that you will maintain adequate automobile liability insurance coverage for your own automobile.

Finally, we discussed with you the income tax withholding status for your work as an independent contractor. You understand that we will not withhold federal or state tax from the money we pay you for your childcare services, nor will we withhold employment taxes on your behalf. You may wish to consult with your own tax advisor as to your own tax situation and how this independent contractor status may affect you.

We are very pleased with your childcare services and hope that you find the work enjoyable and worthwhile from your perspective.

Thank you.

Sincerely,

John M. Doe

By my signature below I acknowledge that I have read this letter, that I understand the contents of this letter, and that I am providing childcare services to John and Jane Doe as an independent contractor, and not as an employee consistent with the terms of this letter.

Angela Smith

Date