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**Steve Leimberg's Asset
Protection Planning Newsletter**
"Hawaii's Permitted Transfers in Trust Act"
By Daniel S. Rubin

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"The Hawaii legislature's desire to position Hawaii as a world-class financial management jurisdiction through the enactment of the Permitted Transfers in Trust Act is, in my opinion, highly unlikely to succeed.

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By enacting the "Permitted Transfers in Trust Act," the State of Hawaii has become the eleventh domestic jurisdiction to provide for self-settled spendthrift trust protections. Now comes **Dan Rubin**, who provides **LISI** members with his analysis of the good, the bad and the ugly of Hawaii's Permitted Transfers in Trust Act.

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Here is Dan's commentary:

EXECUTIVE SUMMARY:

What do the Cook Islands and the State of Hawaii have in common? If you answered "palm trees" or "beautiful beaches" you're right, of course. But as of July 1, 2010, they *also* both provide for effective self-settled spendthrift trusts, otherwise known as "asset protection" trusts.

With the enactment of the "Permitted Transfers in Trust Act" the State of Hawaii has become the eleventh domestic jurisdiction to provide for self-settled spendthrift trust protections,ⁱⁱⁱ continuing the trend towards permitting domestic asset protection trusts that began with the enactment of the Alaska Trust Act on April 2, 1997, and the enactment shortly thereafter of the Delaware Qualified Dispositions in Trust Act on July 7, 1997.

Citing to the fact that “Hawaii relies heavily on the travel industry as an economic engine” and due to “instabilities in that industry,” the Hawaii legislature has determined that:

Hawaii can build on proven domestic and international estate and financial planning methodologies to amend its laws for the purpose of attracting foreign source capital.

The intent of [the Permitted Transfers in Trust] Act is to offer incentives to high net-worth individuals throughout the United States and throughout the world to transfer a portion of their liquid net worth into this State for asset and trust management. [The Permitted Transfers in Trust] Act is designed to increase the assets under management by Hawaii’s private financial sector, increase state tax revenues, and position the State as a world-class financial management jurisdiction.^{lii}

The cited incentives are (i) as indicated, the ability to create self-settled spendthrift trusts under the Permitted Transfers in Trust Act, and (ii) an exclusion from the statutory rule against perpetuities for trusts created under the Permitted Transfers in Trust Act,^{liii} presumably whether or not structured as a self-settled spendthrift trust.

FACTS

The crux of Hawaii’s Permitted Transfers in Trust Act (hereinafter the “Act”), provides for the enforceability of a provision in a trust instrument to the effect that the interest of a beneficiary of the trust including, most significantly, a beneficiary who is also the transferor of the trust, may not be transferred, assigned, pledged, or mortgaged, whether voluntarily or involuntarily, before the actual distribution of the property or income to the beneficiary by the trustee.^{lii}

In addition, in an attempt to provide for the enforceability of such a spendthrift clause under federal bankruptcy law, the Act provides that

“[a]ny provision of this type contained in the trust instrument shall be deemed to be a restriction on the transfer of the transferor’s beneficial interest in the trust that is enforceable under applicable nonbankruptcy law within the meaning of 11 United States Code Section 541(c)(2) of the Bankruptcy Code...”^{lii}

For such a self-settled spendthrift trust provision to be enforceable, however, requires the transfer to a “permitted trustee” of only “permitted property” pursuant to a trust instrument.^{lii} Such a transfer is called a “permitted transfer” under the Act.^{liii}

“Permitted Trustee”

The concept of a permitted trustee generally follows the domestic asset protection trust legislation of predecessor domestic asset protection trust jurisdictions, and provides that a

“permitted trustee” is “...a person, other than the transferor, who is a resident of [Hawaii], or a bank or trust company authorized to do business in [Hawaii] that possesses and exercises trust powers and has its principal place of business in [Hawaii].”^{liii}

In the event that the permitted trustee ceases to be a permitted trustee, and there is no other trustee that is a permitted trustee, the formerly permitted trustee shall be deemed to have resigned.

At that time, a successor permitted trustee provided for in the trust instrument shall become the permitted trustee of the trust, or absent a successor permitted trustee provided for in the trust instrument, a trust advisor or protector provided for in the trust instrument shall appoint a successor permitted trustee, or absent an appointed trust advisor or protector, a Hawaii court of competent jurisdiction shall, upon application of any interested party, appoint a successor permitted trustee.^{lxv}

Moreover, in the event that an action is brought against a trustee of a trust resulting from a permitted transfer, and a court declines to apply the law of Hawaii in determining the validity, construction or administration of the trust, the trustee, immediately upon the court's action and without the further order of any court, shall cease to be trustee of the trust (and shall have no power or authority other than to convey the trust property to a successor trustee), and a successor trustee shall thereupon be appointed as a trustee in accordance with the terms of the trust instrument, or if the trust instrument does not provide for a successor trustee, or does not provide for an advisor or protector with power to appoint successor trustees, a Hawaii court of competent jurisdiction shall appoint a successor permitted trustee upon the application of any beneficiary of the trust.^{lxvi}

“Permitted Property”

Unlike the concept of a “permitted trustee”, the concept of “permitted property” under the Act is unique to Hawaii’s Act. The Act defines “permitted property” as “cash, marketable securities, life insurance contracts, and non-private annuities.”^{lxvii}

“Cash” is further defined as meaning only “United States currency”.^{lxviii}

“Marketable securities” is further defined as meaning only securities that are “exchanged on a governmentally regulated exchange within the United States” and “does not include real estate or any interest in corporations, partnerships, and limited liability companies that are not publicly traded.”^{lxix}

Moreover, although a permitted trustee can later diversify the trust fund, the permitted trustee is still authorized to invest *only* in permitted property.^{lxx}

The Act contains a provision that states that the transfer of permitted property shall be deemed completed (and, presumably, thereby only effective) upon the completion of *all* of the following:

1. The delivery of permitted property by the transferor to the permitted trustee and the written acceptance of the permitted property by the permitted trustee;
2. The delivery by the transferor to the permitted trustee of a signed and notarized certificate of solvency that states that the amount of the transfer is equal to or less than twenty-five percent of the transferor’s net worth and that the transfer will not result in delay, defrauding, or hindrance of a creditor who is known or knowable

to the transferor at the time of the permitted transfer with a claim against the property that is subject to the transfer; and

3. The filing of the appropriate form by the transferor with the department of taxation and payment of the attendant transfer tax (as discussed in further detail below).

The Trust Instrument

For a permitted transfer under the Act, the trust instrument must be *irrevocable* and must expressly incorporate the laws of the State of Hawaii as governing the validity, construction, and administration of the trust.^{lxvi}

A trust instrument will not be deemed to be revocable, however, on account of the inclusion of:

1. The transferor's power to veto distributions from the trust;
2. The transferor's testamentary power of appointment, provided that the transferor cannot appoint the trust property to himself, his creditors, his estate, or the creditors of his estate;
3. The transferor's potential or actual receipt of income, including rights to income retained in the trust instrument;
4. The transferor's annual receipt of a percentage not to exceed five per cent of the initial value of the trust assets or its value determined from time to time pursuant to the trust instrument or of a fixed amount that on an annual basis does not exceed five per cent of the initial value of the trust assets;
5. The transferor's potential or actual receipt or use of the trust's principal due to the discretionary action of a permitted trustee or to a provision in the trust instrument that governs the distribution of principal; provided that any included provision shall not confer upon the transferor a substantially unfettered right to the receipt or use of the principal;
6. The transferor's right to remove a permitted trustee or advisor and to appoint a new permitted trustee or advisor;
7. The transferor's potential or actual receipt of income or principal to pay income taxes due on income of the trust if the trust instrument includes a provision allowing or directing the use of trust funds to pay income taxes due, or if the permitted trustee acts in the trustee's discretion to allow payment of income taxes due on the trust income; or
8. A permitted trustee's authority pursuant to discretion, direction, or the transferor's exercise of a testamentary power of appointment to pay all or any part of the transferor's debts outstanding at the time of the transferor's death, the expenses of

administering the transferor's estate, or any estate or inheritance tax imposed on or with respect to the transferor's estate.^{[lxvii](#)}

The Act further expressly provides for the appointment by the transferor, through the trust instrument, of one or more advisors or protectors, who may be given authority (i) to remove and appoint permitted trustees, advisors or protectors, (ii) to direct, consent to, or disapprove of distributions from the trust; and (iii) to serve as investment advisors to the trust.^{[lxviii](#)} Furthermore, the transferor may direct that in the event of a dispute, deadlock or difference of opinion between a permitted trustee and an advisor, the determination of the advisor shall control, in which case the permitted trustee shall bear no liability or accountability for any act or transaction, provided only that the permitted trustee expresses its dissent in writing.^{[lxviii](#)}

Creditors' Rights Against a Permitted Transfer in Trust

The Act provides that a claim or judgment by a creditor that arises after a permitted transfer, or to avoid a permitted transfer, shall not be brought unless the permitted transfer was found to have been made with *actual intent* to defraud, hinder, or delay the creditor.^{[lxix](#)}

Even then, an otherwise allowable claim shall be extinguished unless the creditor's claim arose *before* the permitted transfer was made and the action is brought before the date of the permitted transfer, or the creditor's claim arose concurrent with or subsequent to the permitted transfer and the action is brought within two years thereafter.^{[lxxi](#)} In each such case, the burden of proof, which is upon the creditor, is set at the standard of clear and convincing evidence.^{[lxxii](#)}

Where the transferor of the permitted transfer is the trustee of a trust, the permitted transfer is deemed made as of the date that the property was originally transferred via trust instrument that meets the requirements of the Act (presumably, therefore, intending to allow the "tacking" of statute of limitations periods from asset protection trusts earlier created in other jurisdictions).^{[lxxiii](#)}

As in other domestic asset protection trust jurisdictions, Hawaii's new domestic asset protection trust law provides that a claim cannot be brought against a person involved in drafting, preparing, executing or funding a trust or who counseled the parties to a trust that is the subject of a permitted transfer, but only if, as of the date of the action, the action would be time barred as against the trustee under the Act.^{[lxxiii](#)}

Again, as is the case in other domestic asset protection trust jurisdictions, Hawaii's new domestic asset protection trust law provides for a class of exception creditors who may avoid permitted transfers.

Hawaii's stated class of exception creditors, however, is relatively broad, and includes:

- any person to whom the transferor is indebted on account of a family court-supervised agreement or family court order for the payment of support or alimony to the transferor's spouse, former spouse, or children, or for a division or distribution of property to the transferor's spouse or former spouse, but not for any claim for forced heirship, legitime, or elective share;

- any person who suffers death, personal injury, or property damage on or before the date of a permitted transfer by reason of the tortious act or omission of the transferor or another person for whom the transferor is or was vicariously liable;
- lender who extended a secured or collateralized loan to the transferor based upon the transferor's representation that the assets transferred to the trust would be available as security; or
- the State of Hawaii in connection with the transferor's tax liabilities.^{[lxxiv](#)}

In contrast, both the Alaska Trust Act and the Delaware Qualified Dispositions in Trusts Act provide for more limited classes of exception creditors. Specifically, the Delaware Qualified Dispositions in Trusts Act provides that the spendthrift provision will not apply, in the case of a self-settled spendthrift trust, against (1) any person to whom the transferor is indebted on account of an agreement or order of court for the payment of support or alimony in favor of such transferor's spouse, former spouse or children, or for a division or distribution of property in favor of such transferor's spouse or former spouse, to the extent of such debt (excluding, however, claims for forced heirship or legitime); or (2) any person who suffers death, personal injury or property damage on or before the date of a qualified disposition by a transferor, which death, personal injury or property damage is at any time determined to have been caused in whole or in part by the act or omission of either such transferor or by another person for whom such transferor is or was vicariously liable.^{[lxxvi](#)}

The Alaska Trust Act limits exception creditors to the single situation where the transfer to the trust was made when the settlor was in default 30 or more days in making child support payments.^{[lxxvii](#)}

Excise Tax in Connection With Permitted Transfers

Finally, unique to Hawaii's asset protection trust legislation, a one-time one per cent excise tax is imposed on the fair market value of all permitted transfers.

COMMENT

The Hawaii legislature's desire to position Hawaii as a world-class financial management jurisdiction through the enactment of the Permitted Transfers in Trust Act is, in my opinion, highly unlikely to succeed.

First, since Hawaii is now the eleventh state to enact domestic asset protection trust legislation, the most significant question asset protection planners will need to ask is "Why Hawaii?" Based upon a review of Hawaii's undistinguished legislation, very few if any asset protection planners will be able to come up with a justification to use Hawaii in lieu of the law of one of the other ten domestic asset protection trust jurisdictions.

In this regard, let us consider "the good, the bad and the ugly" of Hawaii's Act.

The "Good": For a prospective settlor whose primary concern lies in avoiding spousal elective share rights, Hawaii may very well be the jurisdiction of choice since under the Act a claim by

the transferor's spouse or former spouse for forced heirship, legitime, or *elective share* rights is specifically excluded from the status it might otherwise be afforded as an exception creditor claim. Of course, the true effectiveness of a Permitted Transfer to avoid elective share, legitime or forced heirship rights will, as a practical matter, likely be limited by reason of (i) the fact that "permitted property" includes only liquid assets, and (ii) the transferor cannot fund the trust with an amount in excess of twenty-five percent of his or her net worth.

Aside from that one point, the only other reason that a client might select Hawaii for the creation of a domestic asset protection trust, as opposed to one of the other ten states that permit such trusts, would be the possible presence of a friend or family member who is resident within the state to act as the permitted trustee (under the assumption that such a permitted trustee would not charge a trustee fee).

The "Bad": As noted previously, "permitted property" is a limited class of property under the Act. In addition, the class of exception creditors under the Act is relatively broad when compared to Alaska (as well as South Dakota and Nevada). The most likely consequence of a relatively broad class of exception creditors is the increased likelihood that a permitted transfer will *not* be removed from the transferor's estate for federal estate tax purposes.^{lxxviii}

The "Ugly": The one per cent excise tax that will be imposed on the fair market value of all permitted transfers is a truly "ugly" aspect of the Act. In light of this excise tax, and the fact that ten other domestic jurisdictions permit the creation of essentially the same type of trust without the imposition of any tax whatsoever, it is highly unlikely that many trusts will be created under the Act. In fact, in light of this excise tax, it seems likely that even Hawaii residents will choose to create their domestic asset protection trusts elsewhere!

Although I feel strongly that few, if any, trusts will ever be established under the Act, unless the excise tax is repealed, as an asset protection planning attorney, it is heartening to add yet another state to the rolls of those states whose laws permit the creation of self-settled spendthrift trusts.

The true effect of this trend is as ammunition to defend against the argument raised in asset protection trust cases such as *In re Portnoy*^{lxxviii} and *In re Brooks*^{lxxix} which suggest that the existence of a "strong public policy" against the validity of self-settled spendthrift trusts in the forum state would permit a court to disregard the validity of a self-settled spendthrift trust established in another jurisdiction.

However, as more and more states sign on to the validity of self-settled spendthrift trusts under their own laws, it becomes more and more difficult for a creditor to argue that giving respect to such a trust, even in a jurisdiction that has yet to enact its own asset protection trust legislation, offends anyone's strong public policy.

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Endnotes:

[i] The ten other states are Alaska, Delaware, Missouri, Nevada, New Hampshire, Rhode Island, South Dakota, Tennessee, Utah and Wyoming. A twelfth state, Oklahoma, permits an individual to create a trust with up to \$1 million for the benefit of his or her spouse, descendants and any one or more qualified charities, and to retain the right to revoke the trust, without causing the trust to thereby be available to creditors; such a trust is not, however, technically self-settled because the settlor is not a permissible beneficiary thereof.

[ii] Section 1, Hawaii Act 182 (10).

[iii] Hawaii Rev. Stat., Chap. ____, §§ 525-4.

[iv] Hawaii Rev. Stat., Chap. ____, § (4)(d).

[v] Id.

[vi] Hawaii Rev. Stat., Chap. ____, § (2).

[vii] Id.

[viii] Hawaii Rev. Stat., Chap. ____, §§ (2), (4)(a).

[ix] Hawaii Rev. Stat., Chap. ____, § (4)(b).

[x] Hawaii Rev. Stat., Chap. ____, § (5)(h).

[xi] Hawaii Rev. Stat., Chap. ____, § (2).

[xii] Id.

[xiii] Id.

[xiv] Hawaii Rev. Stat., Chap. ____, § (6).

[xv] Hawaii Rev. Stat., Chap. ____, § (5)(a).

[xvi] Hawaii Rev. Stat., Chap. ____, § (5)(c).

[xvii] Hawaii Rev. Stat., Chap. ____, § (5)(e).

[xviii] Hawaii Rev. Stat., Chap. ____, § (5)(f).

[xix] Hawaii Rev. Stat., Chap. ____, § (8)(a).

[xx] Hawaii Rev. Stat., Chap. ____, § (8)(b).

[xxi] Hawaii Rev. Stat., Chap. ____, § (8)(c).

[xxii] Hawaii Rev. Stat., Chap. ____, § (8)(d).

[xxiii] Hawaii Rev. Stat., Chap. ____, § (8)(f).

[xxiv] Hawaii Rev. Stat., Chap. ____, § (9).

[xxv] Del. Code Ann. tit. 12, §3573 (2003).

[xxvi] Alaska Stat. §34.40.110(b)(4) (2003).

[xxvii] While this tax issue is beyond the scope of this article, see the analysis of this tax issue contained in Rothschild, Blattmachr, Gans & Blattmachr, IRS Rules Self-Settled Alaska Trust Will Not Be in Grantor's Estate, 37 Estate Planning 3 (2010).

[xxviii] 201 B.R. 685 (Bankr. S.D.N.Y. 1996).

[xxix] 217 B.R. 98 (Bankr. D. Conn. 1998).

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