Nevis introduces new asset protection trust for tenancy by the entireties property

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The law of several jurisdictions in the United States recognises tenancy by the entireties ("TBE").[1] TBE is a form of ownership that can only exist between a married couple.[2] Although the rules relating to TBE property can vary greatly between the states that recognise it as a form of ownership, generally property owned in TBE cannot be reached to satisfy the claims of a creditor of only one spouse.[3] Every state that recognises TBE as a form of ownership permits real estate (or certain types of real estate, e.g., a homestead) to be owned by married individuals in TBE.[4] A few of the states that recognise TBE as a form of ownership, such as Delaware, Florida, Michigan and Pennsylvania, also permit ownership of personal property in TBE.

In many instances advisors will meet with married couples who were resident or own property in states that recognise TBE as a form of ownership. The conversation in many of these meetings should include an extensive discussion of the fundamental principles of ownership of property in TBE. The discussion should also include the potential pitfalls of continuing to own property in TBE and relying on this form of ownership as an asset protection strategy.

Although the unexpected loss of the protection provided by ownership of property in TBE could be disastrous, for example, as the result of an untimely death, many married couples will desire to continue to use TBE as their form of primary asset protection. Furthermore, in some instances only one spouse may resist the changes an advisor may recommend in structuring the ownership of assets held in TBE, however, the reasons such couples provide for not doing the planning prudent advisors will recommend, will vary.

As an asset protection strategy TBE has its limitations and it is important for planners to understand these limitations. The limitations include the following:

1) Divorce severs the TBE estate;
2) Death severs the TBE estate.[5] No one can predict when another individual might die. An unexpected death could lead to disastrous results for an asset protection plan that relies on property continuing to be owned in TBE property; and
3) In United States v. Craft, 122 S.Ct. 1414 (2002), the United States Internal Revenue Service successfully argued that TBE does not protect an interest in TBE property of a debtor-spouse from a federal tax lien under United States Internal Revenue Code Section 6321.[6] Thus, case law in both federal and state court can have a profound and unexpected effect on the ability of TBE to protect wealth.

While estate planners could offer advice to clients regarding the use of strategies to "hedge" against all of the foregoing risks, in many instances the use of such strategies will prove impractical, costly or unworkable for clients. For example, one such strategy might include the spouse which has little risk of incurring significant liability (that is, the low risk spouse or "LRS"), if any, establishing an irrevocable life insurance trust (**"ILIT"**) that could hold life insurance with a face value that approximated the value of the TBE property that could be lost to creditors if the LRS died unexpectedly.

In such a case, the spouse with a greater likelihood of incurring significant liability (that is, the high risk spouse or the **"HRS"**) would be a discretionary beneficiary of the ILIT. If the ILIT is drafted properly, there would be little or no risk of a creditor of the HRS ever reaching the trust assets in satisfaction of a judgment against the HRS.

Another example of a strategy to deal with the potential problems of TBE ownership as an asset protection strategy would be to advise the HRS to transfer such spouse's interest in such property to the LRS. In this case the LRS could revise such spouse's estate plan to ensure that should the HRS survive, all of this property would pass for the benefit of the HRS through trust arrangements designed to maximise the protection of such wealth. Alternatively, the LRS could take such spouse's interest in this property and contribute it to a properly structured wealth protection trust arrangement.

In many instances the foregoing solutions to the potential creditor protection problems of owning property TBE are not acceptable to one or both spouses. For example, the cost of insurance might be expensive, one spouse might be concerned that transferring ownership of such spouse's interest to the other spouse could be the impetus for a surprise divorce or the other spouse might not be cooperative with further planning with the property after such spouse is given full ownership.

The Nevis International Exempt Trust Ordinance (the **"Ordinance"**) provides an additional and perhaps more flexible solution to these problems. Nevis provides this new strategy through an innovative type of trust known as a statutory tenancy by the entireties trust (or a **"STET"**).

The statute authorising a STET is set forth in Section 52(2) of the Ordinance for TBE property contributed to an international trust. Section 52(2) applies to both revocable and irrevocable trusts pursuant to Sections 2 and 13 of the Ordinance. The Ordinance protects revocable trusts from the reach of creditors under Section 13 by limiting the exposure of the assets held in a trust to the settlor's exercise of a general power of appointment. Section 52(2) provides:

> Where spouses transfer property to one or more trusts established under an international trust or a trust that subsequently becomes an international trust and, immediately before such transfer, such property or any part thereof or any accumulation thereto was, pursuant to applicable law, owned by them as tenants by the entirety, then notwithstanding such transfer and except where the terms of the trust deed may provide to the contrary, that property and any accumulation thereto shall when the trust deed expressly declares the property to be tenancy by the entirety property, it shall be tenancy by the entirety property while held in trust during the lifetime of both spouses and shall be dealt with in a manner consistent with that applicable law however, in every other respect shall be dealt with in accordance with the terms of the trust deed.

The STET provides an additional weapon in an estate planner's arsenal to deal with the pitfalls of TBE ownership as an asset protection strategy. Of course, the client must be domiciled or own property in a jurisdiction that recognises TBE as a form of ownership and also recognises it in regards to the ownership of personal property. However, creative planning may enable a married couple who does not reside in such a jurisdiction to convert their intangible personal property into TBE. Delaware law, by way of example, permits married couples domiciled in a state that does not recognise TBE ownership of personal property to transform non-TBE personal marital assets into TBE ownership by first contributing such property to a Delaware bank or brokerage account titled as TBE. Subsequent to such property being transformed into TBE it can then be used to fund a Nevis STET by transferring the assets from such an account directly into the STET. This should work because generally the title to and rights in an account are governed by the law of the state where an account is established.[7]

Furthermore, in the jurisdictions that recognise this extended form of TBE ownership such as Florida, it should be possible to use a STET even though there is an existing creditor with a claim or a judgment against one spouse. This is because the Uniform Fraudulent Transfer Act (**"UFTA"**) specifically exempts the transfer of property held in TBE that cannot be reached by a creditor of only one spouse from the application of the fraudulent transfer rules. UFTA provides that an interest in property that is owned in TBE to the extent such property is not subject to process by a creditor who possesses a claim against only one tenant is not subject to the application of the statute.

END NOTES:

[1] *See e.g., Estate of Berlin v. Pecora, 968 So.2d 47 (Fla. 4th D.C.A. 2007); In re McRae, 282 B.R. 704 (2002);In re Koesling, 210 B.R. 487 (1997); and Amsouth Bank of Florida v. Hepner, 647 So.2d 907 (Fla. 1st D.C.A. 1994).*

[2] *Id.*

[3] *See e.g., Beal Bank, SSB v. Almand and Associates, 780 So.2d 45 (Fla. 2001); Neu v. Andrews, 528 So. 2d 1278 (Fla. 4th D.C.A. 1988); and Winters v. Parks, 91 So.2d 649 (Fla. 1956).*

[4] *See e.g., Cohen v. Mathews, 307 Fed. Appx. 266, (11th Cir. 2009); Estate of Berlin v. Pecora, 968 So.2d 47 (Fla. 4th D.C.A. 2007); In re McAnany, 294 B.R. 406 (Bankr. M.D. Fla. 2003); Beal Bank, SSB v. Almand and Associates, 780 So.2d 45 (Fla. 2001); Cacciatore v. Fisherman's Wharf Realty Ltd. Partnership ex rel. Emalfarb Investment Corp., 821 So.2d 1251 (Fla. D.C.A. 2002); In re Bundy, 235 B.R. 110 (Bankr. M.D. Fla. 1999); In re Campbell, 214 B.R. 411 (Bankr. M.D. Fla. 1997); Lapp v. U.S., 316 F. Supp. 386 (S.D. Fla. 1970);Bailey v. Smith, 89 Fla. 303, 103 So. 833 (1925); Winters v. Parks, 91 So.2d 649 (Fla. 1956); Lauderdale v. Lauderdale, 96 So.2d 663 (Fla. 3rd D.C.A. 1957); Anderson v. Carter, 100 So.2d 831 (Fla. 2nd D.C.A. 1958);Lacker v. Zuern, 109 So.2d 180 (Fla. 2nd D.C.A.1959); Tingle v. Hornsby, 111 So.2d 274 (Fla. 1st D.C.A. 1959); Lacker v. Zuern, 109 So.2d 180 (Fla. 2nd D.C.A. 1959); Lerner v. Lerner, 113 So.2d 212 (Fla. 2ndD.C.A. 1959); Crawford v. U.S. Fidelity & Guaranty Co., 139 So.2d 500 (Fla. 1st D.C.A. 1962); Colclazier v. Colclazier, 89 So.2d 261 (Fla. 1956); and Doing v. Riley, 176 F.2d 449 (5th Cir. 1949).*

[5] *See e.g., Estate of Berlin v. Pecora, 968 So.2d 47 (Fla. 4th D.C.A. 2007); Cacciatore v. Fisherman's Wharf Realty Ltd. P'ship, 821 So.2d 1251 (Fla. 4th D.C.A. 2002); Colclazier v. Colclazier, 89 So.2d 261 (Fla. 1956);Baumgardner v. Kennedy, 343 So.2d 1323 (Fla. 3rd D.C.A. 1977); Menendez v. Rodriguez, 106 Fla. 214, 143 So. 223 (1932); Knapp v. Fredricksen, 148 Fla. 311, 4 So. 2d 251 (1941); Bamber v. Bamber, 216 So.2d 806 (Fla. 3rd D.C.A. 1968); Bendl v. Bendl, 246 So.2d 574 (Fla. 3rd D.C.A. 1971); Anderson v. Trueman, 100 Fla. 727, 130 So. 12 (1930); Logan Moore Lumber Co. v. Legato, 100 Fla. 1451, 131 So. 381 (1930); and Winters v. Parks, 91 So.2d 649 (Fla. 1956).*

[6] *See also, Howard D. Popky et ux. v. United States) (No. 04-2798) (United States Court of Appeals for the Third Circuit) and U.S. v. Hatchett, 330 F.3d 875 (6th Cir. 2003).*

[7] *10 Am Jur 2d Banks and Financial Institutions § 673 (2013).*

Amendments to Nevis Trusts and LLC laws
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