When to TIST? Here's a List



Effective July 1, Tennessee became the 10th state, and the first in the Southeast, to authorize "domestic asset protection trusts," which our legislature labeled "Tennessee Investment Services Trusts," or TISTs. If the requirements are met, a grantor can create a trust for his own benefit, yet prevent his creditors from reaching the trust. Recent articles in this *Journal* have addressed the legislative history and technical requirements.[1] But when should TISTs be used? Which of our clients are good candidates for them? The possibilities may be broader than many realized, and here is a sampling of situations where a TIST may be valuable to your client, assuming in each case, of course, that all the statutory prerequisites have been met.

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(1) Wealthy clients. Well, duh. Any client can create a TIST with some reasonable portion of his wealth that he never expects to need, to ensure that neither lawsuit nor divorce will divest him of financial security. Such a TIST would give the client only a discretionary interest, but client would typically select a "friendly" trustee or trust advisor that client is confident will use the trust assets for client's benefit if necessary. Two design considerations are important. First, trusts are increasingly drafted to name a "trust advisor" or "trust protector," who, unlike the trustee, usually has no specific fiduciary duties, but who can nevertheless instruct the trustee to make certain types of distributions and can even be permitted to amend the trust to accommodate changing circumstances. TISTs are more likely than other trusts to use trust advisors, especially if the grantor of the trust wants someone other than a Tennessee resident to be the important decisionmaker. Second, the client can choose whether or not to treat the irrevocable transfer to a TIST as a taxable gift, because the inclusion of a testamentary limited power of appointment can make it an incomplete gift for both federal and Tennessee gift tax purposes.[2]

(2) Clients with liability exposure. A physician concerned about malpractice risk, a corporate officer or director concerned about shareholder suits, or any businessperson planning to assume big debts or obligations, may have strong incentive to set aside more than a modest share of his current net worth into a TIST.

(3) Spendthrift clients. Clients with inherited wealth and spendthrift tendencies may find their assets disappearing far too quickly. A TIST may protect them from themselves.

(4) Clients with failing health. An octogenarian with early signs of dementia might create a TIST to protect himself from "disgruntled girlfriends" or other dubious claims.

(5) Clients who want to preserve wealth but still preserve the option of qualifying for Medicaid benefits. Under prior and existing law, one can create a "special needs trust" for someone else, and that other person will not lose eligibility for means-tested benefits such as Medicaid. Tennessee's new TIST statute provides no exception for the state or taxing authorities as creditors. Therefore unless the statute is changed, it appears that clients could deliberately give away significant wealth into a TIST, reserving "special needs" provisions for themselves. If their remaining assets later became depleted, they could be treated as impoverished for purposes of means-tested government benefits. The transfer to the

Continued on page 26

TIST would be subject to a five-year lookback in addition to any requirements of the TIST statute.

(6) Clients with untrustworthy or spendthrift descendants. Elderly parents may be quite willing to make significant gifts to their descendants, except for their concern (remember the Depression?) that they might need it back for their care someday. A TIST can make the descendants the primary beneficiaries, but reserve the possibility, however remote, of having the assets available to the parents. Although the elderly parents' retention of a right to receive discretionary distributions from the TIST may prevent their qualifying for Medicaid to pay for nursing home care, clients with estates big enough to create a TIST are unlikely ever to care about qualifying for Medicaid, and anyway the point of the trust is to prevent the spendthrift descendants from depleting the trust assets during the parents' lives.

(7) Children with wealth. Many clients make annual exclusion gifts over many years to their children, in Uniform Transfers to Minors Act (UTMA) accounts or in "age 21" trusts under Code section 2503(c), only to discover that at age 21 the children have far more wealth in their name than the parents are comfortable with. Such parents are often able to persuade their children to create irrevocable trusts for themselves, naming their parents as trustees until some later age. By making those trusts TISTs, such children can protect themselves not only from themselves but from future creditors and divorces. This gives the parents yet another incentive in persuading the children to create such a trust, especially when done at the time in the children's lives when they are less likely to have encountered significant business entanglements or bad marriages, i.e., when doing so is least likely to be considered a fraudulent transfer.

(8) Children holding an important family asset. Successful estate planning often results in passing family wealth to lower generations at zero or reduced gift tax rates, and often the asset is an important family asset rather than cash or publicly traded securities. For example, parents may have given their children stock in the family business or interests in a family limited partnership. Or a Qualified Personal Residence Trust (QPRT) may result in children owning the parents' primary residence, with the parents paying rent to their children. Parents might worry, however, that if the children got sued, an important family asset could be lost or fall into the hands of outsiders. Accordingly, children could create a TIST with the family assets.[3]

(9) Minor beneficiaries of legal judgments. If a minor (or other legally incompetent person) receives the benefit of a wrongful death judgment, TCA Section 20-5-106 allows the court to order it added to a trust and further provides that it is exempt from the claims of creditors. Making the trust a TIST uses "belt and suspenders" to further insulate the trust assets from the minor's creditors, for periods potentially far beyond age 21.

(10) Single clients that hate premarital agreements. How many single clients really want to broach the subject of a prenuptial agreement with their betrothed? With sufficient advance planning, and assuming the marriage doesn't end before the end of the four-year waiting period for a transfer to a TIST to become exempt from creditors' claims, a TIST may be sufficient protection against potential future spousal claims.

(11) Nonresidents of Tennessee. The laws governing which trusts are taxed in which state are complex. Nevertheless, under the right circumstances, income generated by a TIST may be taxed only in Tennessee, or not at all, rather than in the state of the beneficiary's domicile.

(12) Nonresident aliens. If a nonresident alien plans to immigrate to the U.S., he can create a TIST as a completed gift with assets situated outside the country. After immigrating, the new resident will have access to the TIST but the trust will not suffer any U.S. gift, estate, or GST tax.

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Notes

1. See Holbrook, "The TIST Test: Tennessee Competes for Trust Dollars," 43 *Tenn. Bar J.* 21 (August 2007), and Sirknen, "Tennessee's Investment Services Act: A Monumental Change in Tennessee Trust Law," 43 *Tenn. Bar J.* 16 (September 2007).

2. See PLR 200637025.

3. When a child creates a TIST with family assets received from his parents, the TIST could give parents a power to withdraw all the trust income exercisable only during one day per year (probably Dec. 31). Under Internal Revenue Code Section 678, that would cause the parents to be treated as the "owners" of the TIST for income tax purposes, or in other words, the TIST would be a "grantor trust" as to the parents. If so, then the parents must pay all the income taxes on income earned by the TIST, which is equivalent to the parents making a tax-free gift to the trust each year. Moreover, if the asset is the family residence acquired by the child from a successful QPRT, then rent payments from parents would no longer be taxable income to the child, nor would it be taxable income to the trust. Finally, lapses of the parents' power to withdraw income are treated as cumulative contributions by parents to the trust for income tax purposes only, making the parents increasingly grantors over the principal as well as the income. To that extent, if the TIST also provides that the parents have the power to reacquire trust corpus by substituting property of equivalent value pursuant to Code Section 675(4)(C), then the parents could buy the house back from the TIST without capital gain because it will be a "grantor trust" as to parents as to principal as well as income.