hourly fee rates; the resulting figure is then adjusted up or down based on a variety of factors, such as the novelty and complexity of the case, the special skill or experience of counsel, the quality of representation, the results obtained, the undesirability of the case, special time limitations imposed by the case or by circumstances, whether the attorney was precluded from other employment, and various other factors.\footnote{163} Moreover, it has been said that "[t]he Court has the authority and responsibility to determine the reasonableness of all fee requests, regardless of whether objections are filed,"\footnote{164} and that "[b]y proceeding carelessly, . . . [the attorney] proceeds at his own peril."\footnote{165} It is possible that Delaware courts will adopt a similar judicial review process in connection with a trustee's lien for legal fees.

Fee applications in bankruptcy and civil rights cases are, however, just that — applications to the court,\footnote{166} which are submitted directly by the petitioning attorneys.\footnote{167} In contrast, the Act contemplates different procedures. The Act does not provide for direct attorney fee petitions that are subject to judicial review, but instead provides security to trustees who do not act in bad faith. The trustee's lien is designed to directly benefit trustees. Any fee benefit to attorneys is, therefore, an indirect consequence. Moreover, given the Act's lack of a mechanism for direct fee petitions, one must question how anxious courts will be to interfere in the attorney-client relation of the trustee and his lawyers. Absent objections by a party with standing to complain, courts will presumably allow trustees whatever lien they care to assert, and will leave the task of scrutinizing and approving fees to the trustees who have hired the attorneys in question. More precisely, courts will probably abstain from hearing most lien challenges.

The urge to abstain can only be heightened by a trustee's duty to preserve trust property and the rule that trustees may only incur

\footnote{163\textit{See, e.g., In re One City Centre Assocs., 111 B.R. 872, 875-79} (Bankr. E.D. Cal. 1990).}


\footnote{165\textit{In re Shades of Beauty Inc.,} 56 B.R. 946, 952 (Bankr. E.D.N.Y. 1986).}

\footnote{16642 U.S.C. \textsection{} 1988(b) (1998) (stating that "the court, in its discretion, may allow the prevailing party . . . a reasonable attorney's fee"); 11 U.S.C. \textsection{} 330(a)(1)(A) (1997) (allowing court to award "reasonable" and "necessary" fees and "actual, necessary expenses" after notice and hearing).}

\footnote{167David v. Leavitt, 900 F. Supp. 1547 (D. Utah 1995) (regarding a Civil Rights case; application submitted by motion); \textit{Bank. R.} 2016(a) (1998) ("An entity seeking interim or final compensation . . . shall file an application setting forth a detailed statement. . . . [T]his subdivision shall apply to an application for compensation . . . by an attorney . . . .")}
reasonable litigation expenses. Given these factors, many courts might plausibly reason that the trustee should be the person with the primary responsibility to avoid unnecessary or ill-advised litigation expenses. Economic factors reinforce this logic, regardless of a trust fund’s size: in cases involving more modest trust funds, trustees will have incentive to economize and conserve their litigation budget. With larger trust funds, sizeable legal fees are proportionately a much smaller percentage of the trust; therefore, it may make reasonable sense for trustees to spend more freely on legal fees in an attempt to preserve the balance of the fund. This is particularly true since, by definition, such trustees have a great deal to lose, and also because a successful defense effort could still leave a considerable trust fund for the sake of beneficiaries. In light of these considerations, courts could quite reasonably abstain from hearing any lien case absent a prima facie showing of serious abuse of lien rights.

D. More On Procedures for Lien Challenges

There are other issues related to the procedures for challenging a lien. For instance, the Act does not specify whether a challenge should be made via a separate lawsuit, or by a motion in the suit challenging the qualified disposition, or whether the issue should be submitted to the fact finder in the initial suit as part of the case. These are significant procedural questions.

Judicial economy favors resolving the issue by motion in the original case, at least as an optional procedure. The issue can then be resolved by the judge who is already familiar with the case. This would both expedite matters and allow for more informed assessments of whether the costs embodied in the lien were "properly incurred."

If a challenge can proceed via a new lawsuit, or if it can be submitted for trial in the first suit, there arises the question of whether a challenger is entitled to a jury. The Act refers to "the court" in connection with determinations of bad faith, thereby suggesting that this issue should be heard by the bench and not a jury. This, however, is not clear. Moreover, the answer to this question could easily vary from state to state, thus resulting in nationwide disarray as courts in Delaware’s sister states each adopt their own approach to resolving

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168 SCOTT & FRACHTER, supra note 5, § 176, at 482 (discussing the duty to preserve trust property); id. § 188.4, at 62 (trustee may "incur[] such expenses as are reasonable" in judicial proceedings).

challenges raised in their venues.\textsuperscript{170} Even though Delaware will probably view lien challenges as a matter within the jurisdiction of its chancery court,\textsuperscript{171} and hence not triable to a jury as a matter of right,\textsuperscript{172} there is no assurance that other states will follow a similar procedure.

E. Evidence Issues: The Burden and Quantum of Proof

It seems that the plaintiff carries the ultimate burden of proof and must affirmatively show bad faith to block a lien. This is not entirely clear, but several things strongly point in this direction.

To begin, the statute creates an express presumption that "the trustee did not act in bad faith merely by accepting . . . [the] property."\textsuperscript{173} Hence, to avoid the trustee's lien, the plaintiff must rebut this presumption. If it is up to the plaintiff to rebut this fundamental

\textsuperscript{170}It is axiomatic that the forum court is free to apply its own rules of procedure even when applying substantive law originating from another sovereign. \textit{See}, e.g., Hanna v. Plumer, 380 U.S. 469, 471 (1965) (noting that "both the Enabling Act and the Erie rule say, roughly, that federal courts are to apply state 'substantive' law and federal 'procedural' law"); Patch v. Stanley Works, 448 F.2d 483, 492 (2d Cir. 1971); United See. Corp. v. Tomlin, 198 A.2d 179, 180 (Del. Super. Ct. 1964). Therefore, each state will be free to apply its own rules of practice and procedure to lien challenges arising in its court system. Courts cannot apply their own procedural rules when doing so would infringe upon the substantive rights of a party, \textit{see}, e.g., Haynes v. District of Columbia, 503 A.2d 1219, 1223 (D.C. App. 1986); Weber v. Weber, 501 N.W.2d 413, 418 (Wis. 1993); but "[t]he line between 'substance' and 'procedure' shifts as the legal context changes," \textit{Hanna}, 380 U.S. at 471, thus often making this sort of inquiry slippery and prone to \textit{ad hoc} determinations. \textit{See also infra} note 178 (pointing out that federal courts, in a diversity case, will apply the state's substantive law and federal procedural law).

\textsuperscript{171}\textit{See}, e.g., Clark v. Teeven Holding Co., 625 A.2d 869, 875 (Del. Ch. 1992) (stating that the chancery court has "jurisdiction to hear such traditional, equitable matters as trusts and fiduciary relations"); Bovay v. H.M. Bylesby & Co., 38 A.2d 808, 813 (Del. 1944) ("The execution of a trust and the following and administering of trust funds are immemorial heads of equity jurisprudence."); Bovay v. H.M. Bylesby & Co., 29 A.2d 801, 804 (Del. Ch. 1943) (stating that "[a]n express trust is within the exclusive jurisdiction" of the chancery); \textit{see also In re O'Day Corp.}, 126 B.R. 370, 413 (Bankr. D. Mass. 1991) (discussing equitable subordination of liens as an equitable remedy in bankruptcy); \textit{Getty Ref. & Mktg. v. Park Oil, Inc.}, 385 A.2d 147, 149 (Del. Ch. 1978) (pointing out that the chancery court has "at least concurrent jurisdiction" over fraudulent transfers claims).

\textsuperscript{172}The Delaware Chancery Rules, which are modelled after the Federal Rules of Civil Procedure, expressly omit any provisions regarding juries. \textit{Cf.}, \textit{e.g.}, \textit{Del. Ct. Ch. R.} 38 with \textit{Fed. R. Civ. P.} 38 (concerning jury trials of right). The chancery court, however, has discretion to refer various fact issues to a jury trial in Delaware's Superior Court. \textit{See}, \textit{e.g.}, Tull v. Turek, 147 A.2d 658, 666 (Del. 1958); Saunders v. Saunders, 71 A.2d 258, 261 (Del. 1950); \textit{Del. Code Ann. tit.} 10, § 369 (1975). Delaware's Chancery Court also has discretion to empanel a nonbinding advisory jury for cases tried in equity. \textit{Getty Ref. & Mktg.}, 385 A.2d at 151.

presumption, then it is consistent and logical that the plaintiff should also bear the ultimate burden of proving bad faith, even if at some point the burden of going forward with the evidence momentarily shifts to the trustee.

Next, section 3572 makes UFTA the general vehicle for challenging a qualified disposition, and it is generally accepted that UFTA places the burden of persuasion on plaintiffs, sometimes even by clear and convincing evidence rather than a mere preponderance.174 If an UFTA plaintiff bears the ultimate burden in connection with avoiding a settlement, it would again be consistent to make the plaintiff bear that burden in connection with the ancillary question of whether the trustee’s lien will attach.

Giving plaintiffs the ultimate burden on a lien challenge would also avoid the confusion that might arise if a jury was handed instructions with differing burdens of proof for different issues in the same case.175 The plaintiff will be charged with the ultimate burden of proof on the underlying UFTA claim.176 A jury could easily be confused if the burden of proof was shifted away from the plaintiff and to the trustee. This risk would exist even if the lien question was bifurcated from the main case and heard only after the plaintiff prevails on the main claim.177 Juries often receive mixed instructions of this nature so there is no precedential bar to mixed instructions, particularly with a new statute. Because the Act is newly created, however, there is also no stare decisis rationale for cluttering proceedings with varying instructions. Consistency in burdens of proof is the preferable route; the plaintiff who bears the burden of challenging a transfer should also bear the ultimate burden of showing that the trustee acted in bad faith, if for no other reason than avoiding jury confusion.

In addition, allocating the ultimate burden of proof to the plaintiff is wholly consistent with the legislative policy embodied in the innocent

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175This, of course, assumes that the question would be heard by a jury, but this prospect must be taken as a realistic one. Even if Delaware eschews juries in connection with this aspect of a case, judges in other states may submit this issue to a jury.

176See supra note 174.

177Shifting the burden away from the plaintiff in the second phase of a trial, after she has won the underlying UFTA claim, might actively encourage many jurors to invalidate a trustee’s lien. Put simply, some jurors might think that the judge is signalling a desire to punish the trustee by shifting the burden. Consequently, the trustee could be unduly prejudiced.
trustee provision in the first place: trustees are to be protected unless they have done wrong. Making plaintiffs prove bad faith will promote this legislative aim, while making trustees disprove bad faith would contravene legislative policy.

If the plaintiff must prove bad faith, the next issue is how much evidence is needed. Put differently, must a plaintiff prove bad faith by a mere preponderance of the evidence, or must the plaintiff do more, such as prove bad faith by clear and convincing evidence? Good arguments exist for either view. The preponderance approach would comport with the typical burden of proof carried by plaintiffs in the overwhelming bulk of civil suits, and there is no express statement by the legislature requiring a departure from that norm. A clear and convincing approach, however, would enhance the security of a trustee’s lien, thereby advancing the legislature’s obvious intent to protect trustees. This issue must ultimately be resolved by the courts. In the absence of any express statement or clear implication by the legislature to the contrary, however, the safest prediction is that the plaintiff’s burden would only be the normal preponderance of the evidence standard.

Another question that must be resolved is whether these evidentiary rights, whatever they might be, are substantive matters of Delaware law. If the burdens and quantum of proof are intended to be substantive rights under Delaware law, then there is a substantially greater likelihood that these rights will attach even in cases tried outside the Delaware court system. If, however, these rights are viewed as merely procedural in nature, then other state courts will be able to fashion their own rules regarding these evidentiary issues. At the moment, however, this matter is an open question.

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178See, e.g., Palmer v. Hoffman, 318 U.S. 109, 117 (1943) (noting that "burden of establishing contributory negligence is a question of local law which federal courts in diversity of citizenship cases . . . must apply"); Cities Serv. Oil Co. v. Dunlap, 308 U.S. 208, 212 (1939) (stating that in a diversity case, allocation of burden of proof based on state law is a "substantial right" and otherwise rejecting the notion that state law burdens of proof are matters of procedure instead of substantive law). See also supra note 170 (regarding substantive/procedural distinction); Sheldon R. Shapiro, Annotation, Conflicts of Laws as to Presumptions and Burden of Proof Concerning Facts of Civil Case, 35 A.L.R.3d 289, 303 (1971) [§ 4] (stating exceptions to the general rule that the law of the forum governs).

179See supra note 170.
F. The Plaintiff's Fee Award: An Offset, or Merely More Food for the Sharks?

Under the Act, a successful plaintiff might be awarded attorney fees to be paid out of the trust fund.¹⁸⁰ At first blush, this seems to be a factor that could offset some of the practical economic advantages that accrue to a trustee during litigation. After all, a successful plaintiff could ultimately end up with the defendant-settlor's trust fund paying for the plaintiff's lawyer. This could make litigation more economically attractive for creditors considering suits to avoid a qualified disposition. On closer examination, though, this is not as much comfort as it might initially appear. First, the plaintiff must win. Second, the court must award fees. And third, unless bad faith is shown, the trustee's lien will be left intact. More importantly, the trustee's lien will be "first and paramount."¹⁸¹ Therefore, the trust fund, if it pays plaintiff's legal fees at all, will do so only if anything remains after the trustee has been paid. If the trustee's lien consumes the whole trust fund, then the plaintiff will not get any fee relief.

Moreover, if fees are awarded, this, too, could work against a plaintiff in some cases. A fee award in favor of plaintiff will, as a practical matter, benefit his attorneys but not necessarily the plaintiff. Depending upon the size of the trust, the trustee's lien, and any fee award, there may be very little left over for the plaintiff. This scenario is reminiscent of many bankruptcy cases, in which it sometimes seems that attorneys for both sides are feeding off the estate at the expense of creditors. Accordingly, the plaintiff's possible right to fees may often prove to be a benefit that is more an illusion than a reality.

Some courts might be tempted to give plaintiffs relief in various ways. For instance, some judges might try to assess the plaintiff's fees against the trustee. This route, however, is precluded by the Act. The Act states that "[a] qualified disposition shall be avoided . . . to satisfy . . . attorneys' fees."¹⁸² This language plainly states that fees shall be paid out of the trust fund, not by the trustee, and the Act does not authorize any other source of payment.¹⁸³ Moreover, assessing fees against a trustee would violate the spirit and intent of the Act: its "first

¹⁸⁰Del. Code Ann. tit. 12, § 3574(a) (1975). See also supra note 85 (noting that attorney's fees and other costs could be awarded to a successful plaintiff).
¹⁸²Id. § 3574(a).
¹⁸³The trustee is potentially liable if he conducted litigation vexatiously or in bad faith, but that is a different issue. See supra note 85.
Gutting the Rule Against Self-Settled Trusts

and paramount lien is designed to protect trustees; it is clearly designed to hold trustees harmless from fees and expenses they incur when discharging their duties to protect trust property and to defend claims.184 Other courts might try to enhance the trust fund available to plaintiff by holding that a trustee acted in bad faith, even though the trustee actually acted in good faith. This would eliminate the trustee’s lien and would free up assets for the plaintiff. This, though, would be a results-oriented abuse by courts at the expense of innocent trustees. Moreover, it should be difficult to reach this result, as the Act creates a presumption in favor of the trustee.185 Finally, some courts might be tempted to award fees directly against the settlor. There is, however, no authority for this in the Act, thereby precluding such relief in most cases.186 Also, even if the Act permitted fees to be taxed to the settlor, awarding such fees is apt to be a futile gesture. If the settlor had attachable funds outside the trust, the plaintiff-creditor would probably have attached them long ago. Consequently, the prospect of fee relief for the plaintiff may be good news for plaintiffs’ lawyers, but not necessarily for plaintiffs.

G. Summary of the Trustee’s Lien

Whatever the eventual answers may be to various questions of procedure and evidence surrounding the trustee’s lien, the fact remains that the trustee’s rights are "first and paramount lien" unless he acts in bad faith. Given the realities of modern litigation, a hotly contested effort to avoid a qualified disposition could easily result in substantial legal fees, and those fees could deplete a trust fund to the point that it is not worth a plaintiff’s effort to challenge the disposition. The risk of dissipation is further enhanced by the prospect of fees awarded to the plaintiff’s attorneys. Put simply, when it comes time to collect, even plaintiffs who win in court may find that they have really lost. The trustee’s lien also assures a trustee that it will usually have the money to vigorously fight back against a challenging plaintiff. Consequently, the trustee’s lien, which is substantially similar to the lien of offshore trustees, creates a tremendous roadblock for plaintiffs wishing to avoid a qualified disposition.

184See Scott & Fratcher, supra note 5, §§ 176, 178 (regarding trustee’s duties).
186See supra note 85 (regarding the American Rule).
VIII. **COMPARE AND CONTRAST: THE STRENGTHS AND WEAKNESSES OF QUALIFIED DISPOSITIONS RELATIVE TO OFFSHORE TRUSTS**

Delaware's qualified disposition is a potent tool, a fact that is obvious from the analysis set forth above. It is also very true that a qualified disposition is, in many ways, much closer to an offshore asset protection trust than it is to a traditional American trust. In order to place things in context, however, it is important to understand that qualified dispositions also suffer from certain weaknesses relative to offshore trusts. These weaknesses include both protective features and certain tax concerns. At the same time, qualified dispositions also have certain advantages over offshore trusts relating to tax reporting requirements and other issues.

**A. Differences in Protective Features**

The best place to begin analyzing the differences is to first recognize the strong protective features associated with many offshore trusts. Specifically, when settling an offshore asset protection trust, a planner should look for jurisdictions whose law provides at least the following four key protective features:

1. The ability to force creditors into an offshore court;
2. Local law that abolishes claims by future creditors;
3. Local law that limits claims by present creditors; and,
4. Relatively short limitations periods.

Each of these features is important because it places substantial obstacles between a plaintiff and the trust fund.

Plaintiffs holding American judgments against foreign trustees will often find their judgments to be of little value, particularly if the trustee is based offshore and if the trust assets have been moved out of the United States. Even though a American court will often have personal jurisdiction over the defendant trustee, the court’s judgments and orders

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187 The jurisdiction of United States courts over persons residing outside the forum state is somewhat unclear. Sometimes, out-of-state trustees can defeat efforts to assert personal jurisdiction over them. See Hanson v. Denckla, 357 U.S. 235 (1958). A trustee's odds of defeating jurisdiction are greater if the trust settlor came to the trustee's home jurisdiction, as
opposed to the trustee soliciting the settlor's business in the settlor's jurisdiction. See, e.g., CompuServe, Inc. v. Patterson, 89 F.3d 1257, 1263 (6th Cir. 1996) (referring to "actions by the defendant himself that create a 'substantial connection' with the forum State"); 4 CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE: FEDERAL RULES OF CIVIL PROCEDURE, § 1067, at 296 (1987) (noting that "[s]pecial jurisdiction" is good if "the defendant's forum contacts are sporadic, but the cause of action arises out of those contacts"). United States courts, however, generally take an expansive view of their jurisdiction over persons. See generally id. §§ 1067, 1067.1 (citing several decision by United States courts with liberal interpretations of personal jurisdiction).

Personal jurisdiction is a function of due process and individual liberty interests. See, e.g., Insurance Corp. of Ir. v. Compagnie Des Bauxites de Guinee, 456 U.S. 694 (1982); World-Wide Volkswagen Corp. v. Woodson, 444 U.S. 286 (1980). Jurisdiction over the person is also somewhat limited by concerns regarding the territorial reach of jurisdiction. Id. at 293-94. the primary focus, however, is on questions of due process. See Insurance Corp., 456 U.S. at 702; Bamford v. Hobbs, 569 F. Supp. 160, 166 n.7 (S.D. Tex. 1983). The key test is whether the defendant had sufficient "minimum contacts" with the forum state. Ins. Corp. of Ireland, 456 U.S. at 702 n.10; World-Wide Volkswagen, 444 U.S. at 291. The "sufficient minimum contacts" doctrine was established in International Shoe Co. v. Washington, 326 U.S. 310 (1945), and is flexibly construed.

The courts have identified various factors to consider when determining whether "sufficient minimum contacts" exist. These are catalogued, in part, in World-Wide Volkswagen, 444 U.S. at 295-98, and include the following acts in the forum jurisdiction:

1. Closing sales.
2. Performing services.
4. "[A]vail[ing] themselves of . . . the privileges and benefits of . . . [the forum jurisdiction's] law."
5. "[I]ndirectly, through others, serve or seek to serve the . . . [forum jurisdiction] market."
6. "[D]eliver[ing] . . . products into the stream of commerce with the expectation that they will be purchased by consumers in the forum [jurisdiction] . . . ."

Any of these factors could apply to a foreign trustee that solicits business in the United States, that receives trustee fees from United States clients, that receives trust assets from Americans, or that otherwise injects itself into United States markets. Moreover, this list is merely illustrative, and is not exhaustive. Other facts may also sustain personal jurisdiction. Indeed, a recent case found that doing business in a state via the internet or by e-mail can, in some instances, confer personal jurisdiction over an out-of-state plaintiff. CompuServe, 89 F.3d at 1263-67. Consequently, an American court will often have viable grounds to assert personal jurisdiction over a foreign trustee.

A corollary issue to personal jurisdiction is the question of service of process. At first blush, it might appear that perfecting service on an overseas trustee might be difficult. In many cases, however, international law makes service relatively easy. This is because the United Kingdom has signed the Hague "Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters" on behalf of itself and various offshore jurisdictions, including:

1. Bermuda
2. British Virgin Islands
3. Cayman Islands
4. Gibraltar
5. Guernsey
are virtually unenforceable under these circumstances. It does little good to have the right to attach assets if the plaintiff cannot find assets to attach. Likewise, a trustee who is out of the country probably will not care about United States court orders simply because the court's bailiffs, sheriffs and marshals will be physically unable to serve papers on the trustee or to arrest him for contempt of any court orders that might be issued. Put simply, the trustee is beyond the long arm of American law. Moreover, these practical limits are heightened by a very real legal constraint as well: Many foreign jurisdictions simply do not recognize any judgments other than their own in connection with their trust laws. Consequently, the trustee's home courts are the only ones with control over the trustee, and they often tell the trustee that he is obligated to ignore American court orders.

Due to the lack of stateside assets, a plaintiff might consider hunting for assets outside the United States. This thought may at first seem particularly attractive if the plaintiff thinks that assets are located in a country that will recognize a United States judgment, even if the trustee is not. If, however, the trustee has opened trust accounts at banks and brokerage houses around the world, the plaintiff's hunt could quickly become cost-prohibitive: very few plaintiffs can afford or justify the

6. Isle of Man
7. Jersey
8. Turks and Caicos Islands

The Hague Convention creates a mechanism for service in each of these offshore centers. Under Article 2 of the Convention, "Each contracting State shall designate a Central Authority which will undertake to receive requests for service coming from other contracting States and to proceed in conformity with the provisions of articles 3 to 6. Each State shall organize the Central Authority in conformity with its own law." Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters, Feb. 10, 1969, U.S.-Neth., art. 2. Under Article 5 of the Convention,

The Central Authority of the State addressed shall itself serve the document or shall arrange to have it served by an appropriate agency, either—(a) by a method prescribed by its internal law for the service of documents in domestic actions upon persons who are within its territory, or (b) by a particular method requested by the applicant, unless such a method is incompatible with the law of the State addressed.

_id. at art. 5. Service under the Convention is an acceptable means of service in American proceedings. See, e.g., Fed. R. Civ. P. 4(f)(1) (expressly approving service in conformity with the Convention). The federal rules also provide for a variety of additional means of serving foreign defendants. See generally id. 4(f) (listing other proper methods of international service). Accordingly, even if a trustee is not physically present, service should not be an obstacle in most proceedings.

expense of pursuing ancillary proceedings in aid of execution in numerous countries. Moreover, until a trustee is restrained from moving assets from one country to the next, there is the distinct possibility that a plaintiff engaged in global hunting may encounter many false starts: the trustee may close out accounts in any given country upon the first inkling of the plaintiff’s activities in that jurisdiction, thereby forcing the plaintiff to start chasing assets all over again. Consequently, the plaintiff will be forced to look for a way to restrain the trustee and control the assets under his direction. Because the only courts that can enter a binding judgment against the foreign trustee are those in the trustee’s home jurisdiction, a plaintiff has no choice but to sue in the trustee’s home venue.

Upon arriving in the trustee’s jurisdiction, a United States plaintiff will suddenly confront many practical and legal difficulties. The practical difficulties will often prove more daunting that any legal obstacles and, in many cases, will cause plaintiffs to give up rather than take a chance under local (i.e., foreign) law.

The big practical factor is expense. Put simply, litigating overseas is very expensive, and for several reasons. To begin, an American plaintiff will suddenly be litigating in a foreign country that can be many miles and time zones removed. This inevitably will create logistical headaches that will magnify the normal difficulties and expenses of meeting deadlines and arranging court appearances. International faxes, phone bills, and courier bills could quickly mount. More significantly, the plaintiff will need to hire foreign lawyers in addition to his American lawyers: unless an American attorney is one of those rare American lawyers who is also admitted to practice before the relevant overseas court, the odds are that the attorney will not be able to represent the plaintiff, as most overseas jurisdictions frown upon appearances pro hac vice. Consequently, an American plaintiff will often be burdened with fees for two sets of lawyers. Moreover, foreign lawyers are expensive,

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189 An appearance pro hac vice is an appearance for purposes of "one particular occasion." BLACK'S LAW DICTIONARY 1212 (6th ed. 1990). In contrast to overseas jurisdictions, appearances pro hac vice are common in the U.S., particularly in federal court, and are usually approved by the court pursuant to a motion. See, e.g., Loc. R. 83.5(e), U.S. Dist. Ct., N.D. Ohio; see also DEL. SUP. CT. R. 71 (stating the requirements for pro hac vice admission). This arrangement allows an out-of-state lawyer to appear in a case despite the lack of a regular license to practice in the relevant court. Cf. CODE OF PROFESSIONAL RESPONSIBILITY DR 3-101(B) (1969) ("A lawyer shall not practice law in a jurisdiction where to do so would be in violation of regulations of the profession in that state."). Often, the client and the court both benefit, as the out-of-state lawyer frequently has a unique understanding of the issues related to the case.
and often charge as much £250 per hour. At today's exchange rates, this translates into billing rates of about $400 an hour. Further, out-of-pocket legal fees cannot be avoided: with the exception of Canada, virtually all non-American jurisdictions prohibit contingent fees, meaning that lawyers must be paid in cash as the case progresses.

Additionally, the plaintiff also runs the risk of paying the other side's legal fees as well as his own. Leading offshore trust jurisdictions function under what is referred to as the "English Rule" of legal fees, whereas the United States functions under the "American Rule." The basic difference between the two approaches is simple. Under the American Rule, the loser rarely pays the winner's legal fees, and usually does so only when there is statutory authority for such fee shifting. Under the English Rule, fee shifting is the norm and the loser typically pays the winner's legal fees and related expenses. Because the fees of opposing counsel could be very costly, this is a profound disincentive to suing overseas. In addition, to prevent nonresident plaintiffs from suing, losing and then fleeing without paying the fees of the trustee's attorneys, offshore courts routinely require nonresident plaintiffs to secure this potential obligation by posting bond or other collateral as a condition to maintaining suit. 

Consequently, simply gaining access to foreign courts can be an expensive proposition.

If a plaintiff is brave enough to tackle these practical obstacles, he will find upon his arrival that a plaintiff's legal rights, while quite real, are diminished compared to those of fraudulent transfers plaintiffs in the United States. Limitations periods are much shorter: two years or less is common in many key jurisdictions. Likewise, many key jurisdictions

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190 But see supra note 85 (noting that Delaware's UFTA statute authorizes the court to award attorney's fees).

191 Section 55 of the Nevis International Exempt Trust Ordinance states:

Every creditor before bringing any action or proceeding against any trust property governed by this Ordinance shall first deposit . . . a bond in the sum of $25,000.00 . . . for securing the payment of all costs as may become payable by the creditor in the event of his not succeeding in such action or proceeding against the trust property.

Nevis International Exempt Trust Ordinance § 55 (1994 as amended). Until recently, the Cook Islands did not have a statutory security plan. Cook Islands courts, however, now seem to have great discretion in determining the amount of security to be posted by a creditor plaintiff. Cook Islands International Trust Act § 13K(4) (1984 as amended).

192 See, e.g., Nevis International Exempt Trust Ordinance § 24(3) (1994 as amended) (limitations periods of one and two years); Cook Islands International Trust Act §§ 13B(3), 13K(2) (1984 as amended) (same); Bahamian Fraudulent Dispositions Act § 4(3) (1991). Under these provisions, the typical creditor has only a two year period to bring claims, and under certain circumstances in the Cooks and Nevis, may only have one year. Not all offshore
have virtually abolished claims by future creditors.\textsuperscript{193} Moreover, present creditors, while their rights are recognized and, in some instances, vigorously protected,\textsuperscript{194} undoubtedly have their rights curtailed under much offshore legislation. The Bahamian statute requires proof that a transferor had "actual notice" of a plaintiff's underlying claim before settling a trust. In the absence of such proof, the plaintiff's claim will not even count as an actionable "obligation," and hence the plaintiff will not be deemed a "creditor" entitled to fraudulent transfers relief.\textsuperscript{195} The jurisdictions, however, have such short limitations periods. For instance, the Cayman Islands have a six year limitations period for fraudulent transfers actions. See Cayman Fraudulent Dispositions Law § 4(3) (1989). This is one of the longest (perhaps the longest) limitations periods in the world for such actions, and is substantially longer than the four year norm found in UFTA's model provisions and in Delaware's Act. DEL. CODE ANN. tit. 12, § 3572(b)(1) (1997). Under UFTA, however, and also under the Act in connection with claims by creditors existing at the time of settlement, there is a date of discovery rule that could conceivably extend the relevant American limitations period to as much as the Cayman's limitations period. DEL. CODE ANN. tit. 12, § 3572(b)(1) (1997) (illustrating how both allow claims after four years if the tardy claim is brought within one year of the date on which the claim "was or could reasonably have been discovered" by the plaintiff). Moreover, American reliance upon the date of discovery doctrine reinforces the distinction between lengthy American limitations periods and short offshore periods such as those found in the Cooks, Nevis, and the Bahamas.

\textsuperscript{193}Future creditors are persons whose claims arose after the transfer in question. Present creditors are persons whose claim arose on or before the date of transfer. See Sullivan, supra note 75, at 966. As to the abolition of claims by future creditors in offshore jurisdictions, see, e.g., id.; Nevis International Exempt Trust Ordinance § 24(4) (1994 as amended); Cook Islands International Trust Act § 13B(4) (1984 as amended). Pursuant to these provisions, future creditors have no standing to assert fraudulent transfers claims regarding transfers to trust. Only present creditors have standing to assert such claims. The Bahamian Fraudulent Disposition Act § 2 (1991), is arguably even more burdensome on creditors. This provision of the Bahamian statute defines "creditor" as somebody owed an "obligation," and in turn defines "obligation" as "an obligation or liability (which shall include a contingent liability) which existed on or prior to the date of a relevant disposition and of which the transferor had actual notice." Id. Under this phrasing, even present creditors are without rights if the transferor did not know of the creditor's claim at the time of transfer. If, however, the transferor did not have notice, then the transfer is substantially less likely to have been made with intent to defraud, and hence is free from the ill intent that is required for actual fraud, at least as to that particular creditor.

\textsuperscript{194}See 515 S. Orange Grove Owners Ass'n v. Orange Grove Partners, Plant No. 208/94 (High Ct. Rarotonga, Civil Div., Nov. 6, 1995) (reversing trial court's application of limitations period for judgment claims), analyzed by Bruce & Wojewodzki, Will the Orange Grove Case Have a Long-Term Impact on Cook Islands' Asset Protection Trust Law, 2 J. ASSET PROTECTION 41 (Jan./Feb. 1997).

\textsuperscript{195}Bahamian Fraudulent Disposition Act § 2 (1991), defines a "creditor" as "a person to whom an obligation is owed." Id. In turn, the same § 2 defines "obligation" as "an obligation or liability (which shall include a contingent liability) which existed on or prior to the date of a relevant disposition and of which the transferor had actual notice." Consequently, unless a plaintiff can show that the transferor had "actual notice" of the relevant claim, the
Cooks and Nevis impose elevated legal standards for claims by present creditors, and require plaintiffs to show much more than is required in the United States. Accordingly, American plaintiffs who consider suing offshore will be confronted with substantial practical and legal deterrents to any suit to avoid a transfer into an offshore trust.

The protective features of offshore trusts also highlight weaknesses in Delaware trusts relative to foreign situs APTs. For instance, the practical problems that afflict offshore plaintiffs will be substantially or entirely eliminated in suits regarding Delaware trusts. The very same factors that could give a plaintiff's local court personal jurisdiction over an offshore trustee will often vest the same court with personal jurisdiction over a Delaware trustee. A Delaware trustee, however, will be unable to force a local (i.e., a non-Delaware plaintiff) into a Delaware court. Under the Full Faith and Credit clause, Delaware will be forced to accept and recognize the judgments issued by courts of her sister states. Once personal jurisdiction is established, significant practical

plaintiff is not even a creditor under Bahamian law.

196 Under the Cooks and Nevis statutes, a present creditor must prove both bad intent and harmful effect. Specifically, a plaintiff must show, first, that the transfer rendered the transferor insolvent (or otherwise without property to pay a valid present creditor claim), and second, that the transferor acted with intent to defraud. Cook Islands International Trust Act § 13B(1) (1984 as amended); Nevis International Exempt Trust Ordinance § 24(1) (1994 as amended). This contrasts with American law, which allows claims based on either intent to hinder, delay or defraud creditors (actual fraud) or adverse economic effect (constructive fraud). Sullivan, supra note 75, at 962-66 (discussing UFTA § 4(a)(1)-(2), 7A U.L.A. at 652-53 (1984)). In addition, Nevis and the Cooks require the plaintiff to prove both bad intent and harmful effect "beyond a reasonable doubt." Cook Islands International Trust Act § 13B(1) (1984 as amended); Nevis International Exempt Trust Ordinance § 24(1) (1994 as amended). This also contrasts with American burdens of proof, which sometimes are only a mere preponderance, and at other times are elevated to the "clear and convincing" standard, but which are never elevated to "beyond a reasonable doubt" in civil fraudulent transfers suits. See supra note 174. Finally, Nevis and the Cooks both require proof that the transferor acted with intent to defraud the plaintiff in particular. A mere generalized intent to defraud will not suffice. This again contrasts with the law of many American jurisdictions in which proof of an intent to defraud any creditor, future or present, suffices to establish an intent to defraud any plaintiff in an American fraudulent transfers action. See Sullivan, supra note 75, at 964 n.25.

197 For a discussion of the elements necessary to an American court's personal jurisdiction analysis, see supra note 187.

198 U.S. Const. art. IV, § 1. The same basic scenario unfolds in connection with federal court litigation in districts outside Delaware, as the judgment of one federal court can be registered in near-automatic fashion in any other federal district across the country. 28 U.S.C. § 1963 (1990). Moreover, once a federal judgment is in place in any particular federal district, it creates a judgment lien in that state "to the same extent and under the same conditions as a judgment of a court of general jurisdiction in such State." Id. § 1962. In addition, a federal judgment may be transferred to the Delaware courts. DEL. CODE ANN. tit. 10, § 4781 (1986) (defining "foreign judgment" to include a "decree or order of a court of the United States");
consequences accrue as well. To begin, an out-of-state plaintiff can avoid the headaches of distant litigation because he knows that a victory in his home state court is as good as a victory in Delaware. This, in turn, shifts the expense and aggravation of distant litigation to the Delaware trustee, who must either defend or risk a default judgment. Moreover, in contrast to offshore litigation, the local plaintiff will undoubtedly be functioning under the American Rule of attorneys’ fees,199 will not need to post bond or collateral to secure the possible legal fees owed to the other side, and can hire attorneys on a contingent fee basis. All of this means that the cost of litigating a Delaware trust will usually be substantially less than the cost of challenging transfers into offshore trusts. This thereby guarantees that Delaware trusts will be challenged much more often than their offshore counterparts. In turn, this makes qualified dispositions less protective than foreign situs APTs because out-of-state plaintiffs are more likely to obtain relatively inexpensive judgments against Delaware trustees.200

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199 See supra note 85.

200 If a prevailing out-of-state plaintiff transfers a judgment to Delaware, collections and post-judgment proceedings against the trustee become relatively easy. The Act essentially requires the trustee to be present in Delaware in at least some fashion, and also raises the likelihood that trust assets and/or records will be in Delaware as well. Section 3570(8) defines "trustee" as

a person who: a. [I]n the case of a natural person, is a resident of this State or, in all other cases, is authorized by the law of this State to act as a trustee and whose activities are subject to supervision by the Bank Commissioner of the State, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision or any successor thereto; and,

b. maintains or arranges for custody in this State of some or all of the property transferred to the trustee, maintains records for the trust on an exclusive or nonexclusive basis, prepares or arranges for the preparation of fiduciary income tax returns for the trust, or otherwise materially participates in the administration of the trust.

Del. Code Ann. tit. 12, § 3570(8) (1997). As a result, the trustee will either be a natural person who resides in Delaware or a major financial institution with some type of presence in Delaware. Moreover, under § 3570(8)(b), there is a substantial likelihood that trust assets and/or records will be in Delaware and available for ready attachment or inspection. This virtually assures that the plaintiff can either use Delaware courts to directly attach assets or, alternatively, get Delaware courts to issue collection orders against a trustee, such as injunctions or other orders requiring the trustee to turn over assets.
Moreover, because Delaware is forced to recognize the judgments of her sister states, it cannot control the application of its own law. If the courts of another state misinterpret the Act, Delaware is still bound to honor any judgments based on that misinterpretation. This differs radically from offshore jurisdictions, which often control their own law by disregarding foreign judgments. Granted, out-of-state interpretations are not binding precedent on any future suits decided by Delaware courts, and Delaware judges may fashion their own interpretations in later cases. This is of little comfort, however, to the settlors, trustees, and beneficiaries whose rights under the Act may have been mangled by out-of-state courts. Such problems could arise from a variety of factors: out-of-state judges will often lack familiarity with the Act and, therefore, some may make good faith errors in applying the Act to motions, bench rulings, or jury instructions. Other out-of-state judges may understand the Act quite well but nonetheless dislike it; therefore, they may deliberately misapply the Act in order to achieve a preferred result. Some courts may allocate burdens of proof in ways that depart from the requirements of Delaware law. Out-of-state jurors may have a visceral reaction against the notion of a self-settled trust, particularly when the trust is not even governed by the law of their own state. Provincialism may lead the fact-finder to disallow a Delaware trustee's "first and paramount lien" when, in fact, it should have been honored. Other factors might also contribute to misapplications by courts in other states. Nonetheless, Delaware will be bound by out-of-state judgments rendered in any given case.

Even if Delaware law is correctly applied, there are still differences between the Act and offshore statutes. Delaware allows a four year limitations period for claims by plaintiffs seeking to avoid a qualified disposition. This is substantially longer than the two years (or less)

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201The Delaware Supreme Court has attempted to alleviate this problem by accepting petitions from federal courts or state supreme courts to resolve questions of unsettled Delaware law. The drawback to this solution on the state level is that it requires an appeal of the state's highest court and that court's willingness to petition the Delaware Supreme Court. See Del. Sup. Ct. R. 41(a)(ii) (1998); see also Roblet Products Corp. v. Nagy, 683 A.2d 37, 38 (Del. 1996) (accepting petition from Seventh Circuit).

202See supra note 188.

203State court judges, especially elected ones, often follow their own agendas. See, e.g., Neely, supra note 22 (quoting Justice Richard Neely of the West Virginia Supreme Court of Appeals).

204Del. Code Ann. tit. 12, § 3572(b) (1997). Moreover, the four-year limitations period is subject to a one year date of discovery rule governing claims by present creditors. The Act allows claims to be brought more than four years after the qualified disposition provided the plaintiff brings an UFTA claim "within 1 year after the qualified disposition was or could reasonably have been discovered by the creditor." Id. § 3572(b)(1); see also supra
limitations period offered by several key offshore jurisdictions. Future creditors have rights under Delaware law. This again differs from many key jurisdictions, which have abolished claims by future creditors. Finally, the hurdles confronting present creditors are substantially less than those overseas. Delaware is an UFTA state; it therefore functions under basic UFTA principles recognizing claims for both actual fraud, which focuses on the transferor's intent, and constructive fraud, which focuses on the economic effects of a transfer. This means that present creditors will have a far easier time under Delaware law than under offshore statutes, which essentially require a plaintiff to prove that a transfer into trust was afflicted with both bad intent and adverse economic effect. Moreover, offshore plaintiffs are also burdened with substantially elevated burdens of proof compared to American litigants. Taken together, these combined factors make offshore trusts more protective than Delaware trusts.

note 75 (regarding present and future creditors). This means that the four year period might be substantially extended in favor of present creditors so long as there are not good grounds for discovering the relevant transfer. Id. § 3572(b)(1); see also supra note 192 (discussing limitation periods). The fact that they are present creditors, however, reduces, but does not eliminate, the chance of extending the limitations period ad infinitum. Because present creditors held claims on or before the date of transfer, litigation regarding their claims will often be underway and well into the post-judgment collections phase before or shortly after the basic four-year limitations period has run. Hence, in many cases, the plaintiff will have reasonable grounds to discover the qualified disposition before the four years has run, and in others cases will have reasonable grounds within a relatively modest time after the four years has run. The risk of a 10 or 20 year extension of the limitations period, while possible, is not likely to be a factor in many cases. Moreover, in connection with future creditors, there is no risk at all of such an extension of the limitations period, as future creditors do not benefit from a date-of-discovery rule. Id. § 3572(b)(2).

205See supra note 192.
206Del. Code Ann. tit. 12, § 3572 (1997); see also Delaware's UFTA, Del. Code Ann. tit. 6, § 1304(a) (1996) (giving rights to creditors whose "claim arose . . . after the transfer").
207See supra note 193.
209See supra note 196 (discussing how foreign jurisdictions define the elements of fraudulent conveyances).
210Id.
B. Tax and Administrative Concerns

1. Estate and Gift Tax Issues

Delaware trusts are also less flexible than offshore trusts in that Delaware trusts provide a settlor with fewer opportunities to retain powers. Under the Act, a settlor can clearly retain only three powers:

1. The right to veto a distribution from a trust;\(^{211}\)

2. The right to exercise a testamentary special power of appointment or other similar power;\(^{212}\) and

3. The right to receive distributions from the trustee, provided that the trustee is truly independent and that the trustee is free to exercise discretion without reference to any ascertainable standard.\(^{213}\)

The Act is silent as to whether a settlor can retain other powers as well, and settlors who retain additional powers might jeopardize the trust’s protected status as a qualified disposition. This ambiguity in the Act should caution settlors to retain only these three powers until the courts or legislature provide further guidance.

This uncertainty creates some lingering doubt as to whether settlements under the Act will trigger immediate gift taxes, or whether settlors will instead have some leeway in controlling the timing of estate and gift taxes. The Delaware legislature apparently thought that qualified dispositions would count as transfers out of a settlor’s estate.\(^{214}\) As

\(^{212}\)Id.
\(^{213}\)Id. §§ 3570(9)(b), 3571.
\(^{214}\)The legislature summarized its intent:
The purpose of the Act is to facilitate the establishment in Delaware of irrevocable trusts that will allow trust settlors to transfer assets from their estates, in order to reduce the federal estate taxes that would otherwise be due upon their death. In order to effectively remove such assets from their estates, the settlors cannot retain any enforceable right to the income or principal of the trusts, but may receive wholly discretionary distributions of income or principal if the trustee is not a related or subordinate party. In addition, these trusts cannot be subject to the claims of the settlors’ creditors if they are to be excluded from the settlors’ estates.

shown below, taking assets out of a settlor's estate would trigger immediate gift tax exposure. It is not clear, however, that the legislature achieved this objective. For the sake of those using qualified dispositions, it should be hoped that the legislature failed in its objective, and it appears that the better argument is that the legislature did, in fact, miss the mark on this key point.

The estate and gift tax laws are coordinate statutes that must be read in pari materia.215 These two statutes represent "a unified scheme of taxation of gifts whether made inter vivos or at death,"216 and, from the government's perspective, have resulted in a system of transfer taxes that can be accurately described in general terms as a "pay me now or pay me later" system.217 Subject to any credits, deductions, or exclusions

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215 Estate of Sanford v. Commissioner, 308 U.S. 39, 44 (1939) ("The gift tax was supplementary to the estate tax. The two are in pari materia and must be construed together.").

216 Id. at 48.

217 Hence, in Estate of Sanford, the Court stated:

It is true . . . gift taxes will not be imposed on transactions which fall short of being completed gifts. But if for that reason they are not taxed as gifts they remain subject to death taxes . . . and the Government gets its due, which was precisely the end sought by the enactment of the gift tax.

Id. at 47. The Court added that an "important, if not the main purpose of the gift tax was to prevent or compensate for avoidance of death taxes by taxing the gifts of property inter vivos which, but for the gifts, would be subject in its original or converted form to the tax laid upon transfers at death." Id. at 44.

The Internal Revenue Code also has income tax provisions regarding trusts in which the grantor or other person retains substantial control over property settled into trust. See I.R.C. §§ 671-679 (1994) (commonly dubbed the "grantor trust rules"). Under these provisions, income is taxed to the person considered the "owner" of the trust for income tax purposes. Id. § 671. The basic theory of the grantor trust rules is similar to the theory of incomplete gifts: a person's retention of control over trust property will cause that person to be deemed the "owner" of trust property and its income despite an otherwise valid transfer of legal title. See generally Estate of Sanford, 308 U.S. at 44 (noting that "the main . . . purpose of the gift tax was to prevent or compensate for avoidance of death taxes by taxing the gifts of property inter vivos which, but for the gifts, would be subject in its original or converted form to the tax laid upon transfers at death"); see also Corliss v. Bowers, 281 U.S. 376, 378 (1930) (commenting that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed"); Vercio v. Commissioner, 73 T.C. 1246, 1253 (1980) ("[I]ncome must be taxed to the one that earns it. . . . Attempts to subvert this principle by deflected income away from the true earner to another entity . . . are not recognized as dispositive for Federal income tax purposes despite their validity under applicable state law."). Congress adopted the grantor trust rules to prevent tax losses due to income shifting, such as might result from assigning income from a high income/high tax bracket head of household to a low income/low bracket minor child. See, e.g., Estate of Sanford, 308 U.S. at 47 (noting Congressional intent "to prevent or compensate for the loss of surtax upon income where large estates are split up by gifts to numerous donees"); Vercio, 73 T.C. at 1253. Unless income is
allowable under the gift tax code, present transfers result in gift taxes that are due and owing upon the time of transfer.\textsuperscript{218} Hence, as a general rule, transfers that are "complete gifts" result in present gift tax liability but avoid later estate tax liability. If assets are not given away, however, or

attributable to a high bracket grantor with broad retained powers, the grantor would still have \textit{de facto} control over and benefit from the trust fund's income, while simultaneously avoiding the full brunt of taxes on income.

The retained controls that make a transfer incomplete for gift tax purposes can differ from the retained control needed to make a transfer incomplete for income tax purposes. While many grantor trusts are also incomplete gifts, and \textit{vice versa}, there is not a perfect harmony between the two provisions of the Code. The Supreme Court recognized this possibility many years ago, see \textit{Estate of Sanford}, 308 U.S. at 48 (stating that "retention of a lesser degree of control [may] be deemed to render a transfer incomplete for purpose of laying gift and death taxes"). \textit{See also} Commissioner v. Prouty, 115 F.2d 331, 337 (1st Cir. 1940) (stating that gift tax might be due even when transfer is incomplete for income tax purposes; noting that "the interrelation of the income, estate, and gift taxes presents many puzzling problems").

It is also possible that a transfer will be considered a complete gift but, due to certain technical provisions of the estate tax code, also be considered part of the transferor's taxable estate on death. For instance, if a person transfers property subject to certain retained controls that are exercisable in conjunction with anybody else, that property will always be included in the transferor's estate on death. 26 U.S.C. § 2036(a)(2) (1996) (referring to "the right, either alone or in conjunction with \textit{any} person, to designate the persons who shall possess or enjoy the property or the income therefrom") (emphasis added). Whether the same transfer triggers a gift tax, however, will depend upon whether the co-holder of the power has "a substantial adverse interest" \textit{vis-a-vis} the transferor in connection with the exercise of the powers or the disposition of trust property. 26 C.F.R. § 25.2511-2(e) (1997) (noting that certain reserved powers render a gift "incomplete"); \textit{id.} § 25.2511-2(e) (noting that reserved powers are treated as transferor's when "exercisable . . . in conjunction with \textit{any} person \textit{not having} a substantial adverse interest in the disposition of the transferred property or the income therefrom") (emphasis added); Commissioner v. Prouty, 115 F.2d 331 (1st Cir. 1940) (finding that co-holder had a substantial adverse interest and that transferor consequently lost dominion and control over the property, thereby making gift complete). For more historical examples of this phenomenon, see Higgins v. Commissioner, 129 F.2d 237, 241 (1st Cir. 1942) (citing examples). As an aside, note that at least one of \textit{Higgins}' examples of the completed-gift-but-in-the-estate syndrome has been modified by legislation. At one point, completed gifts were treated as part of a decedent's gross estate if the gifts were made in contemplation of death, which was a subjective test of the transferor's intent. \textit{See id.} Now, however, that subjective question has been replaced with an objective question: was the transfer made within three years of death? \textit{See} 26 U.S.C. § 2035(a) (1996).

\textsuperscript{218} The general rule of gift tax liability is imposed by I.R.C. § 2501(a), but is then substantially mitigated by various credits, deductions and exemptions that apply to gift taxes. For instance, certain transactions are free from gift tax no matter how much is transferred. Examples include deductions for inter-spousal giving and gifts to qualified charities. \textit{id.} §§ 2522-2523. Gifts in the form of payments to certain health care or education providers are excluded from gift tax computations. \textit{id.} § 2503(e). Gifts of up to $10,000 per donor per donee per year are usually excluded. \textit{id.} § 2503(b). The Code also provides for a unified credit that a taxpayer or his estate may apply against any and all estate and gift taxes due during the taxpayer's life or upon death. \textit{id.} §§ 2010, 2505.
if the gift is "incomplete," then the general rule is that no gift tax is due and transfer taxes are deferred until death.219

Many people want to avoid present gift taxes and defer taxes until death because gift taxes come out of a taxpayer's wallet while she is alive220 whereas estate taxes are paid by the decedent's estate after she is deceased.221 Because many people do not care about what happens with their money after they are deceased, but care deeply about what happens to it while they are alive, the notion of incurring an immediate gift tax liability is unappealing. A large number of people, therefore, prefer incomplete gifts into trusts over completed gifts that are subject to a gift tax. The economic impetus to defer taxation is also heightened by the notion of opportunity costs: every dollar a settlor keeps from the government today is another dollar — plus interest — that is available for profitable investment in the future. Conversely, dollars presently spent on taxes reduce the settlor's pool of future capital, thereby potentially costing her lost profits in addition to taxes. Further, by avoiding gift taxes today, a settlor will have that much more money to transfer on a gift tax free basis during her remaining years.222 This also heightens the desirability of avoiding immediate gift taxes. Finally, recent tax code changes make tax deferral even more attractive: pursuant to 1997 legislation, the unified credit will be substantially increased from the equivalent of a $600,000 per person estate and gift tax exemption to the equivalent of a $1 million per person exemption.223 Hence, it pays to wait. To the extent that the Act accelerates tax liabilities, it is potentially detrimental to many settlors.224

219There are instances, however, in which both estate and gift taxes have been potentially due. See supra note 217.
220"[T]he [gift] tax is a primary and personal liability of the donor [and] is an excise upon his act of making the transfer ...." 26 C.F.R. § 25.2511-2(a) (1997).
222See supra note 218, for a partial listing of ways to minimize gift taxes.
224Note, however, that at any given time it is generally cheaper to incur a gift tax than to pay an estate tax. For example, in order to make an inter vivos net gift (i.e., net after taxes) of $1 million to a donee, and assuming that no unified credit remains to offset taxes, the donor would have to pay $244,275 in taxes, meaning that a total capital pool of $1,244,275 is needed to pay the tax and make the lifetime gift. See 26 U.S.C. § 2502 (1996). In order to pass the same net $1,000,000 at death, however, and again assuming that no credit remains, the decedent's estate would need to have a pre-tax value of slightly more than $1.6 million. See 26 U.S.C. § 2001 (1996) (noting that taxes due on estate of $1.6 million are $600,800). This bias in favor of lifetime giving stems from the fact that the estate tax rates apply against the
Whether qualified dispositions trigger gift taxes will depend upon whether they are "gifts" within the meaning of the tax code. Unfortunately, "The gift tax provisions of the Internal Revenue Code do not define the term 'completed gift.'"\textsuperscript{225} Whether a transfer into trust is a complete gift, and whether immediate gift tax liability arises, therefore, becomes a question to be answered based "upon all the facts in the particular case."\textsuperscript{226} The test is whether the settlor has given up dominion and control over the relevant property.\textsuperscript{227} Although no precise definition of "gift" exists, tax law nonetheless yields certain basic principles to guide the inquiry.\textsuperscript{228}

Generally speaking, transfers into discretionary trusts, such as those contemplated by the Act, are treated as completed gifts.\textsuperscript{229} This is because the transferor has "so parted with dominion and control as to leave in him no power to change its disposition."\textsuperscript{230} The general rule, however, is subject to exceptions.

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whole of a decedent's estate, whereas the gift taxes apply only on the portion that is actually given away.

\textsuperscript{225}Outwin v. Commissioner, 76 T.C. 153, 159-60 (1981).
\textsuperscript{226}26 C.F.R. § 25.2511-2(b) (1997).
\textsuperscript{227}"[I]t is well settled that a conveyance in trust will not be subject to gift tax where the donor retains dominion and control over the property transferred." Outwin, 76 T.C. at 160.
\textsuperscript{228} Accord 26 C.F.R. § 25.2511-2(b) (1997), which states:
As to any property . . . of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case.
\textsuperscript{229} But see 4 JACOB RABKIN & MARK H. JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION § 51.04[1] (1998). Rabkin and Joyhnson state that
[t]he essential elements of a valid gift . . . [are]: (1) a donor competent to make the gift; (2) a donee capable of accepting the gift; (3) a clear and unmistakable intention on the part of the donor to divest himself of title, dominion, and control over the subject matter of the gift; and, (4) an irrevocable transfer by the donor to the donee, or to someone acting as trustee or agent for the donee.
\textsuperscript{229}Id.
\textsuperscript{230}"Where the trust agreement specifies . . . that distributions to the settlor are to be made in the absolute discretion of the trustees, with no enforceable standard provided the transfer is generally held to be complete for gift tax purposes." Outwin, 76 T.C. at 162. But, "[a] different result obtains . . . where [s]tate law permits creditors of the settlor-beneficiary to pierce the trusts for satisfaction of claims." Id.
\textsuperscript{230}26 C.F.R. § 25.2511-2(b) (1997).
In the case of an ordinary self-settled trust, the settlement is an incomplete gift to the extent of any retained interest. Because the rule against self-settled trusts allows creditors to reach that retained interest, the settlor has not really parted with anything. For instance, in a case involving a retained income interest, "the taxpayer could at any time obtain the economic benefit of the trust income simply by borrowing and then forcing her creditors to look to her interest in the trust income for a source of repayment."\textsuperscript{231} This exception should have no impact on most qualified dispositions: because the transferor's creditors will not have access to the trust fund, the transferor usually cannot obtain the economic benefit of the transfer by forcing or allowing creditors to attach the trust fund.\textsuperscript{232}

There are, however, other exceptions that are likely to cause a qualified disposition to be included in a settlor's taxable estate. One example is a self-settled trust in which the settlor is the only beneficiary.\textsuperscript{233} This is sensible because the only person who benefits is the settlor, who has, in essence, made a gift to himself and thus, in reality, parted with nothing. This result is even more likely if the settlor retains a modest power of appointment:

\begin{quote}
If a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to
\end{quote}

\textsuperscript{231}\textit{Outwin}, 76 T.C. at 162 (citing Paolozzi v. Commissioner, 23 T.C. 182 (1954)), in which the settlor gave the trustee discretion to make income payments to the settlor during her lifetime. Noting that Massachusetts law allowed the settlor's creditors to attach that life estate, the Tax Court reasoned that the gift was incomplete to the extent of the value of the settlor's life estate. \textit{Paolozzi}, 23 T.C. at 186. See also Estate of Paxton v. Commissioner, 86 T.C. 785, 815 (1986) (stating that the creation of a trust for the owner to retain a beneficial interest in property that cannot be reached by creditors is against public policy).

\textsuperscript{232}Note, however, that certain creditors have rights under the Act, such as relying creditors, the holders of certain domestic relations orders, and creditors who have rights under Delaware's UFTA. \textit{Del. Code Ann. tit. 12, §§ 3572(a), 3573(a)-(b) (1995)}. Because these creditors may be able to pierce the protective veil of a qualified disposition, it is possible that a disposition would be considered a wholly or partially incomplete gift, depending upon the facts and circumstances of a particular case. 26 C.F.R. § 25.2511(b) (1997) (noting that gift may be wholly or partially incomplete); \textit{Outwin}, 76 T.C. at 162 (1981) (noting ability of settlor to force creditors to look to trust fund rendered gift incomplete).

\textsuperscript{233}See Estate of Vak v. Commissioner, 973 F.2d 1409, 1413 (8th Cir. 1992) (noting that if settlor "had retained all of the certificates" of beneficial interest in a trust, "the trustees would not have had the power under the terms of the trust to distribute income or corpus to anyone but him"); see also Commissioner v. Vander Weele, 254 F.2d 895 (6th Cir. 1958) (holding that trust settled with understanding that it was to be for the primary benefit of settlor was not a taxable gift).
appoint the remainder among his descendants, no portion of the transfer is a completed gift.\textsuperscript{234}

Hence, if the settlor is the sole beneficiary of a qualified disposition and has also reserved a testamentary special power of appointment under the Act, it is unlikely that the settlement will trigger an immediate gift tax.\textsuperscript{235}

Another pair of exceptions to the general rule regarding discretionary trusts is set forth in Treasury Regulations:

A gift is also incomplete if and to the extent that a reserved power gives the donor the power to . . . change the interests of the beneficiaries as between themselves unless the power is a fiduciary power limited by a fixed or ascertainable standard. Thus, if an estate for life is transferred but, by an exercise of a power, the estate may be terminated or cut down by the donor to one of less value, and without restriction upon the extent to which the estate may be so cut down, the transfer constitutes an incomplete gift.\textsuperscript{236}

These exceptions are significant because the Act allows a settlor to retain certain powers, specifically the right to retain a veto over trust distributions, the right to make appointments of trust assets upon the settlor’s death, and the right to receive discretionary distributions from the trustee.\textsuperscript{237} If a settlor does, in fact, retain all of these powers, then the following scenario unfolds: the settlor can settle a trust in which he is one of several beneficiaries. The settlor, though, can veto all proposed distributions to any other beneficiaries, thereby forcing the trustee to

\textsuperscript{234}26 CFR 25.2511(b) (1997).

\textsuperscript{235}\textit{Del. Code Ann. tit. 12, § 3570(9)(b) (1995) (regarding retention of testamentary special power of appointment)}. Moreover, the reserved power does not necessarily need to be defined in terms of "descendants," provided it is defined in any way that leaves the settlor some choice or control over final disposition. "[I]t does not seem to matter how wide or narrow the range of potential donees may be, so long as the donor, within that range, retains full power to control the disposition of the property." Higgins v. Commissioner, 129 F.2d 237, 242 (1st Cir. 1942). Note, however, one potential glitch: if the retained power is phrased in terms of appointments to any particular class, whether "descendants" or otherwise, and if one of the class is a "creditor," then the retained power could easily be deemed a general power of appointment, 26 C.F.R. § 2514(c) (1996); accord id. § 2041(b)(1), and thus negate the Act’s protections. Consequently, the retained power should be phrased in a way that excludes creditors, as well as other persons who fall within the tax code’s definition of a "general" power of appointment. \textit{Id.}

\textsuperscript{237}26 C.F.R. § 25.2511-2(c) (1997).

distribute to the settlor or no one. In other words, nothing can be dispensed without the settlor's approval. Finally, insofar as any trust assets are left at the settlor's death, she will have the ability to determine the ultimate recipients via the testamentary power of appointment.

Under this scenario, a qualified disposition could be deemed an incomplete gift. Because a settlor may veto distributions at whim and keep all other beneficiaries from enjoying the trust estate, the settlor's retained veto power is arguably tantamount to a power to "cut down" the beneficial interests that are nominally enjoyed by others. Indeed, for all practical purposes, the veto enables the settlor to essentially treat the trust as one in which he is the sole beneficiary. Likewise, the veto gives the settlor the ability to favor one beneficiary over another by allowing distributions to favored persons but vetoing distributions to those in disfavor. This is roughly equivalent to the "power to . . . change the interests of the beneficiaries as between themselves." These arguments are even more compelling in light of the settlor's testamentary special power of appointment, which will enable the settlor to control the ultimate disposition: a settlor could veto all distributions during life and on death give the entire trust fund to preferred heirs, even to the exclusion of other trust beneficiaries, and even to persons who are not even named as beneficiaries. Accordingly, these reserved powers, though minimal, may cause the gift to be incomplete.

This prospect is heightened by case law. In the leading Sanford case, the Supreme Court stated:

[A] retention of control over the disposition of the trust property, whether for the benefit of the donor or others, renders the gift incomplete until the power is relinquished in

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239 26 C.F.R. § 25.2511-2(e) (1997); see also Joseph Goldstein, 37 T.C. 897 (1962), acq. 1964-2 C.B. 5; Priv. Ltr. Rul. 95-35-008, at 39 (May 8, 1995) (holding that "[a]s soon as Taxpayer or Spouse exercise, relinquish, or otherwise lose the power to change the beneficiaries, there will be a completed gift").
240 Note that the relevant issue is not whether the settlor actually exercises the retained power; all that matters is that the settlor has retained a power that he can exercise at a later date. See 26 C.F.R. § 25.2511-2(b) to (e) (1997) (referring to donor's reservation of powers); Estate of Sanford v. Commissioner, 308 U.S. 39, 42-48 (1939) (referring to retained or reserved powers); infra note 255. If, however, the settlor's reserved power is subject to a "fixed or ascertainable standard," then the donor's reserved power may be so limited or restricted that he has given up "dominion and control" and thus made a complete gift. See 26 C.F.R. § 25.2511-2(b) to (e) (1997) (regarding "fixed or ascertainable standard[s]" as a limiting factor on the donor's exercise of his power); id. § 25.2511-1(g)(2) (giving examples of ascertainable standards).
. . . life or at death. . . . [A] transfer of property upon trust, with power reserved to the donor either to revoke it and recapture the trust property or to modify its terms so as to designate new beneficiaries other than himself is incomplete, and becomes complete so as to subject the transfer to death taxes only on relinquishment of the power at death.241

Shortly thereafter, in Helvering v. Hutchings, the court stated:

The gift tax provisions are not concerned with mere transfers of legal title to the trustee without surrender by the donor of the economic benefits of ownership and his control over them. A gift to a trustee reserving to the donor the economic benefit of the trust or the power of its disposition, involves no taxable gift. It is only upon the surrender by the donor of the benefit or power reserved to himself that a taxable gift occurs.242

A leading case from the First Circuit reviewed key Supreme Court holdings and reached a similar conclusion:

241Estate of Sanford, 308 U.S. at 43-44 (emphasis added). The Court also based its decision on tax policy grounds. The Court noted that the donor has primary gift tax liability, but that the donee has secondary liability if the donor does not pay. Id. at 46; see also 26 C.F.R. § 25.2502-2 (1997) (discussing the rate of tax). In instances in which the donor can somehow undo the gift, however, "[i]t can hardly be supposed that Congress intended to impose personal liability upon the donee of a gift of property, so incomplete that he might be deprived of it by the donor the day after he had paid the tax." Estate of Sanford, 308 U.S. at 46. The Court also noted the ability to make tax free gifts to various charitable organizations. Id.; see also 26 C.F.R. § 2522(a) (1996) (discussing tax consequences for charitable and similar gifts). If a donor settled a trust for the primary benefit of a charity, while also retaining the ability to later redirect actual distributions to other persons who were not tax-free beneficiaries, this obviously could create a significant tax loophole if the gift to the charity was deemed complete. A settlor could route otherwise taxable gifts through charitable trusts first and then name the true intended beneficiary later, but, if the gift were deemed complete upon settlement, no tax would be due and owing when benefits were later conferred upon the ultimate beneficiary. Consequently, we should hesitate to accept as correct a construction under which it could plausibly be maintained that a gift in trust for the benefit of charitable corporations is then complete so that the taxing statute becomes operative and the gift escapes the tax even though the donor should later change the beneficiaries to the non-exempt class through exercise of a power to modify the trust in any way not beneficial to himself.

Estate of Sanford, 308 U.S. at 46-47.

Once it was decided . . . that the reservation of a power to alter the disposition of the property prevents the imposition of a gift tax at the time the trust is created, even though the donor has irrevocably conveyed the beneficial interest out of himself, it does not seem to matter how wide or narrow the range of potential donees may be, so long as the donor, within that range, retains full power to control the disposition of the property.\textsuperscript{243}

Consequently, case law lends much support for the view that settlors of a qualified disposition can avoid immediate gift taxes by retaining a veto power and a testamentary power of appointment.

Although this conclusion is attractive, it is nonetheless uncertain. One source of this uncertainty is the total lack of published opinions regarding the tax consequences of a qualified disposition. Another source is the fact that the Act is silent as to whether a settlor can add more powers beyond the trilogy of the veto, testamentary special power, and discretionary interest in distributions. If a settlor could safely reserve additional powers not specifically named in the Act, then all doubt could be eliminated. The Act does not say if a settlor may safely retain the right to add beneficiaries, but if settlors can retain this right, then they could unquestionably structure qualified dispositions to avoid gift taxes.\textsuperscript{244} Likewise, may a settlor expressly reserve the right to delete beneficiaries? Reserving this power would also render a gift incomplete.\textsuperscript{245} Moreover, it elevates substance over form to say that settlor can "veto" beneficiaries out of trust fund distributions but cannot expressly delete them as beneficiaries. Nonetheless, it is unclear whether an express power of deletion can be included without jeopardizing the protections of the Act.

\textsuperscript{243}Higgins v. Commissioner, 129 F.2d 237, 242 (1st Cir. 1942).

\textsuperscript{244}A gift is . . . incomplete if and to the extent that a reserved power gives the donor the power to name new beneficiaries . . . ." 26 C.F.R. § 25.2511-2(e); see also Joseph Goldstein, 37 T.C. 897 (1962), acq. 1964-2 C.B. 5; Priv. Ltr. Rul. 95-35-008, at 39 (May 8, 1995) (commenting that because "of their limited powers of appointment, Taxpayer and spouse have retained the power to change the beneficiaries of the Trust"). Moreover, allowing this additional power would not offend the Act. The Act plainly seeks to divorce settlors from day-to-day control of the trust fund. See, e.g., DEL. CODE ANN. tit. 12, § 3570(9)(b) (1995) (requiring trustee to be somebody "who is neither the transferor nor a related or subordinate party of the transferor"). Giving the settlor the right to add beneficiaries will not, however, enhance the settlor's interest in the trust or its administration. If anything, adding other beneficiaries will dilute the interests of all prior beneficiaries, including the settlor.

\textsuperscript{245}[I]f an estate . . . may be terminated or cut down by the donor . . . without restriction upon the extent to which the estate may be so cut down, the transfer constitutes an incomplete gift." 26 C.F.R. § 25.2511-2(e).
Likewise, can a settlor retain an express power to reallocate interests between beneficiaries?\textsuperscript{246} The functional equivalent of this power can be exercised by vetoing distributions at life and making preferred distributions at death. But the Act does not expressly allow an explicit power of reallocation. It is, therefore, risky to include such an explicit power in a trust. Indeed, because settlors cannot safely include any express power that is not specifically enumerated in the Act, settlors are left wondering whether the Act’s \textit{de facto} equivalents will suffice to avoid gift taxes.

These tax uncertainties create yet another relative advantage for offshore jurisdictions: their statutes do not preclude the retention of broad powers, but instead affirmatively encourage settlors to retain many rights.\textsuperscript{247} Estate and gift tax concerns may, therefore, encourage many people to shelter assets offshore rather than use a qualified disposition.

2. The Income Tax Concerns

Prospective settlors of qualified dispositions are confronted with at least two income tax issues to consider. The first is the income tax phenomenon known as "bracket compression," which has potential application to any trust settlement. The second concern is preserving the tax advantages associated with owning residential real estate. This latter issue is limited to those trusts which might take title to a settlor’s principal residence. This is further complicated by the fact that a settlor’s right to use his own homestead will thereafter be a matter of discretion with the trustee.\textsuperscript{248} Some people may not want to cede control over their homestead to a trustee. Because other people may be willing to trade control for a sheltered homestead, however, the taxation of homeownership is a potentially significant concern in some cases. Fortunately, the legislature has left settlors adequate control over these income tax issues.

Bracket compression refers to the fact that present income tax rates for trusts are effectively much higher than present tax rates for individuals.\textsuperscript{249} It is, therefore, desirable to attribute trust income to

\textsuperscript{246}A gift is also incomplete if and to the extent that a reserved power gives the donor the power to . . . change the interests of the beneficiaries as between themselves . . . ." 26 C.F.R. \textsuperscript{2} 25.2511-2(c) (1997); accord Priv. Ltr. Rul. 95-35-008 (May 8, 1995).
\textsuperscript{247}See infra notes 263-64 and accompanying text.
\textsuperscript{248}Del. Code Ann. tit. 12, § 3570(9)(b), 3571 (1975) (giving trustee sole discretion over distributions from trust).
\textsuperscript{249}Cf. 26 C.F.R. § 1(c) (1994) (noting that the maximum rate of 39.6% for single
settlors, and to avoid attribution to trustees, thus saving on income taxes. Such attribution is possible with a qualified disposition if the trust can be classified as a grantor trust under any of the provisions of sections 671-679. The basic theory of the grantor trust rules is that settlors who retain certain powers have kept for themselves the de facto benefit and control of the relevant trust property and, therefore, should be deemed the party responsible for any income tax liability for income generated by that property. This theory of attribution extends to deductions, credits and exclusions, as well as to income. Consequently, a grantor may claim the tax breaks conferred on homeowners who sell their principal residence, even though the real estate was titled in the trustee’s name. The ability to defer capital gains on the sale of a home, however, will be lost if real estate is titled in a nongrantor trust.

individuals begins at income of $250,000) with id. § 1(e) (stating that the maximum rate of 39.6% for trusts begins at $7,500).

250 See 26 C.F.R. §§ 672-678 (1994), for a description of those powers, which include, but are not necessarily limited to retention of reversionary interests, id. § 673; retention of broad powers to direct or control beneficial enjoyment, id. § 674; retention of certain administrative powers, including the right to take unsecured loans from the trust, id. § 675; the power to revoke a trust, id. § 676; or other factors.

Note that the settlor of an offshore trust is free to reserve virtually any grantor trust power: offshore statutes virtually encourage the retention of such broad powers. See infra notes 263-64 and accompanying text. Offshore settlors, therefore, have many tools they can use to shift income between themselves and their trustee. Moreover, in an often overlooked provision of the tax code, a foreign trust with domestic beneficiaries is automatically treated as a grantor trust for income tax purposes. 26 C.F.R. § 679(a)(1) (1994); see also I.R.C. § 7701(a)(31) (1994) (defining "foreign trust").

251 See supra note 80; infra note 255.

252 See Rev. Rul. 85-45, 1985-1 C.B. 183 (regarding once-in-a-lifetime capital gains exclusion for older citizens on home sales under old I.R.C. § 121 (1985)); Rev. Rul. 66-159, 1966-1 C.B. 162 (regarding former two year rollover rule under old I.R.C. § 1034 (1966), which permitted nonrecognition of capital gains provided sales proceeds of a home were reinvested in another home in two years). As previously mentioned, former 26 C.F.R. §§ 121 and 1034 have been supplanted by new 26 C.F.R. § 121, which generally allows every taxpayer the right to exclude up to $250,000 in capital gains from home sales during every two year cycle. Presumably, the logic of the prior Revenue Rulings would extend to the new preferential capital gains treatment.

253 Under 26 C.F.R. § 641(a) (1994), a trust is treated as a separate taxable entity that is distinct from its beneficiaries. See also Grey v. Commissioner, 118 F.2d 153, 154 (7th Cir. 1941) (holding that under the revenue act, a trust is a taxable party which is separate and distinct from its beneficiaries). Under 26 C.F.R. § 643(a)(3) (1994), capital gains and losses are included in trust income calculations. Under 26 C.F.R. § 641(b) (1994), the general rule is that "[t]he taxable income of an estate or trust shall be computed in the same manner as in the case of an individual." The home rollover exclusion, however, is available to taxpayers only if the real estate in question was "used by the taxpayer as . . . [the taxpayer's] principal residence." 26 C.F.R. § 121(a) (1994). Because the typical trustee will not use trust realty as
The few powers that settlors can safely retain under the Act should also enable settlors to avoid higher income taxes upon settling a qualified disposition. Under I.R.C. section 674(a), the general rule is:

The grantor shall be treated as the owner of any portion of a trust in respect of which the beneficial enjoyment of the corpus or the income therefrom is subject to a power of disposition, exercisable by the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.\textsuperscript{254}

The combined effect of the settlor’s veto, retained interest, and testamentary special power of appointment will fit this description: as noted, the settlor can effectively block lifetime distributions to anybody but himself; can allow lifetime distributions to those he prefers; and, at death, can control the trust fund’s ultimate disposition. Qualified dispositions should, therefore, be treated as grantor trusts if the settlor reserves these enumerated powers because the settlor will have ultimate control over the final disposition of trust income.\textsuperscript{255}

There is an exception to the general rule of section 674(a) that is superficially relevant and might act to negate grantor trust treatment. Under I.R.C. section 674(b)(3), "[a] power exercisable only by will" is not a power that is within section 674(a).\textsuperscript{256} Since a testamentary special power of appointment is, by definition, exercisable only by will,\textsuperscript{257} the basic exception of section 674(b)(3) will apply if the only power reserved by a settlor is a power of appointment. There is, however, an exception to the exception, which is particularly relevant in light of the settlor’s ability to insert veto powers. Section 674(b)(3)’s basic rule is inapplicable if the testamentary power to dispose of trust property is

\textsuperscript{254}26 C.F.R. § 674(a) (1994).

\textsuperscript{255}The power to dispose of income is the equivalent of ownership of it. The exercise of that power to procure the payment of income to another is the enjoyment, and hence the realization, of the income by him who exercises it." Helvering v. Horst, 311 U.S. 112, 118 (1940). Note, though, that it is not necessary to actually exercise a power in order to generate grantor trust treatment. Instead, the mere retention or acquisition of that power will trigger grantor trust status. See Carson v. Commissioner, 92 T.C. 1134, 1139 (1989); supra note 240.

\textsuperscript{256}26 C.F.R. § 674(b)(3) (1994).

\textsuperscript{257}See BLACK’S LAW DICTIONARY (6th ed. 1990) ("testamentary" entry).
coupled with a power vested in the grantor to accumulate and retain income for ultimate disposition. As stated in Treasury regulations:

Under paragraph (3) of section 674(b) a power in any person to control beneficial enjoyment exercisable only by will does not cause a grantor to be treated as an owner under section 674(a). However, this exception does not apply to income accumulated for testamentary disposition by the grantor or to income which may be accumulated for such distribution in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

Because a settlor’s veto can easily ground a claim that the settlor has discretion to force accumulations of income, a veto right combined with a testamentary special power of appointment should generate grantor trust status for a qualified disposition. In turn, this allows settlors of qualified dispositions to avoid bracket compression and lets them retain their right to the tax benefits of home ownership.

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258 Section 674(a) shall not apply to . . . [a] power exercisable only by will, other than a power in the grantor to appoint by will the income of the trust where the income is accumulated for such disposition by the grantor or may be so accumulated in the discretion of the grantor or a nonadverse party, or both, without the approval or consent of any adverse party.

26 C.F.R. § 674(b)(3) (1994) (emphasis added). Note that the accumulation of income can be either at the grantor’s discretion or pursuant to other methods, such as a trust provision calling for accumulation of trust income.


260 The one caveat is that the settlor’s veto should be wholly discretionay and not infringed upon in any way. The trust should contain an affirmative statement to this effect and should disavow the existence of any standard, fiduciary or otherwise, for measuring the settlor’s right to veto. See also id. (regarding no need for approval or consent by an adverse party).

261 Several additional comments are warranted about the use of trusts to protect homesteads. To begin, the use of trusts to shelter homesteads is a matter of interest only in states whose exempt property laws afford inadequate homestead protection. Residents in states with significant homestead exemptions will not need a trust, as the homestead is already sheltered. C.f. OHIO REV. CODE ANN. § 2329.66 (Anderson 1994) (having a minimal $5,000 exemption as general rule); see also In re Clements, 194 B.R. 923, 925 (Bankr. M.D. Fla. 1996) (discussing Florida debtors and giving a liberal exemption for homestead property in Florida); In re Miller, 188 B.R. 302, 308-09 (M.D. Fla. 1995) (noting that Florida’s homestead exemption available even if nonexempt asset converted into homestead in face of creditor claims). Hence, the demand for this trust service will vary considerably from state-to-state. Next, as a general matter, any transfer into any trust should withstand a fraudulent transfers attack, provided that the settlor does not render himself insolvent or otherwise violate
3. Concern Over Administrative Powers

As noted, the safest interpretation is one suggesting that the Act allows a settlor to retain only three powers or interests in the trust: a veto, a testamentary special power of appointment, and the right to receive discretionary distributions from the trustee.\(^{262}\) This, however, is much less than many offshore jurisdictions allow. For instance, under

UFTA. \textit{See generally} Sullivan, \textit{supra} note 75, at 988-1023 (discussing the relation between solvency, intent, and other related issues); \textit{accord} Schofield v. Cleveland Trust Co., 21 N.E.2d 119 (Ohio 1939), Syl. ¶ 1. Moreover, a transfer of realty into trust should be accompanied by the filing of a deed or other comparable instrument in local real estate records. Consequently, real estate placed in trust will usually benefit from the doctrine that disclosed transfers are more resistant to creditor attack, especially attacks by future creditors, because the world is on notice and, therefore, has no right to thereafter claim reliance upon the transferred asset. Sullivan, \textit{supra} note 75, at 1030-34; \textit{see also} Nichols v. Eaton, 91 U.S. 716, 726 (1875) (holding that a creditor has no right to payment from exempt property). Under the general American rule against self-settled trusts, however, a settlor's interest is attachable even if the trust settlement did not violate UFTA. Now, however, new tools exist: Delaware, Alaska and offshore trusts can be used with any property in any jurisdiction and, therefore, provide a chance to shelter land titles, regardless of where the real estate is located.

Unfortunately, even if a homestead is titled in a Delaware, Alaska, or offshore trust, this approach may ultimately prove ineffective. Judges in other states may use conflicts of law doctrine to vitiate the right to self-settle a protective trust conferred by the laws of other jurisdictions. In other words, they might apply the rule against self-settled trusts, despite the Act or other legislation. Conflicts doctrine could, therefore, become a handy excuse for a local judge who wants to disregard out-of-state rules that might affect local real estate titles. This is especially true if the judge personally disagrees with the notion of self-settled protective trusts. This risk of a hostile reaction is probably stronger with offshore trusts than it is with Alaska or Delaware trusts. Offshore trusts may elicit a adverse reaction from many local judges who equate offshore with money laundering, drugs, and other unsavory acts. In contrast, a local judge may think twice before undoing the protective features of a Delaware or Alaska trust that holds title to local real estate. While the realty may not be in Alaska or Delaware, these states are nonetheless part of the Union; their laws warrant more deference than do the laws of overseas jurisdictions. Notions of interstate comity and Full Faith and Credit may, therefore, make domestic protective trusts more suitable for holding real estate than offshore trusts. This is particularly true if the court perceives the issue as one of creditor's rights in a trust instead of one of local land titles. If the issue is land titles, then the forum state's interest in preserving orderly chains of title will probably trump any Delaware or Alaska trust law. EUGENE F. SCOLES & PETER HAY, \textit{CONFLICT OF LAWS} §§ 19.2, 19.3 (2d ed. 1992) (stating that law of situs governs validity and effect of conveyance of real estate). If the issue is seen as a matter of trust law, however, a non-Delaware court may be more willing to give effect to the Act; it may conclude that Delaware's interest in applying the Act outweighs the interest of any particular local creditor. \textit{Id.} § 21.3 (regarding \textit{inter vivos} trusts).

Still, the risk remains that local judges might disregard the governing law of a trust in connection with local real estate, thus making it difficult to shelter land titles with a protective trust. Accordingly, many people will continue to opt for the time-honored tactic of borrowing against real estate and placing the loan proceeds in trust.

\(^{262}\) \textit{See supra} notes 97-100.
Nevis law, a settlor is permitted to retain the powers to revoke the trust; to amend the trust; to remove or appoint a trustee or protector; to direct a trustee or protector on any matter; and to retain or hold any benefit, interest or property in or from the trust. The Cook Islands statute also confers similarly broad rights on settlors.

This distinction between the Act and these two offshore statutes is considerable in several ways. Because going offshore offers a wider array of permissible retained powers, many settlors may choose the offshore option because it affords greater rights to control their own property. There is also a tax consideration: the broad choice of retained powers makes it much easier to safely structure an estate in order to avoid immediate gift taxes. Accordingly, the Act is relatively more restrictive, even though it does enable settlors to retain a fair amount of control over the disposition of their assets.

4. The Easier Reporting Requirements

The federal government has recently imposed enhanced reporting requirements on offshore trusts. In particular, an information return will now be required within ninety days of settling a foreign trust and within ninety days of certain other events, such as transferring property to a foreign trust. If the trust is a grantor trust, then the "owner" (i.e., the grantor) will also be responsible for filing an annual information return every year thereafter. Recent I.R.S. pronouncements indicate that the reporting requirements could be quite extensive. Whether, in fact, these reports are burdensome, and costly to prepare, could easily turn on how a trust is structured. If a trustee has direct ownership of myriad income-producing or tradable assets, then the reporting could become very expensive. It is also possible that a trustee could simply hold one or two assets, such as interests in underlying holding companies that are managed by the grantor or other persons. If the trustee is in such a passive role, it is possible that the annual reports by the trustee will be minimal, as all accounting activity will take place in connection with the preparation and filing of the return for the underlying company.

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263Nevis International Exempt Trust Ordinance § 47(a)-(f) (1994 as amended).
266Id. § 6048(a).
267Id. § 6048(b); see also id. §§ 671-679 (grantor trust rules).
Either way, the mere prospect of elevated tax compliance costs could encourage many people to opt against a foreign trust and, instead, seek domestic alternatives. 269 One possibility would be to use a qualified disposition, and another option would be to use a qualified disposition coupled with a stand-by offshore trustee. So long as certain technical criteria are met, the trust can be a domestic trust and, thus, avoid many reporting requirements. 270 Moreover, this "standby" method enables the settlor and/or the trustees to change the trust to a more protective offshore trust if and when such a change is deemed advisable. Until then, however, reports will be minimized. This may be attractive to many clients, because failure to comply with the reporting requirements could result in substantial tax penalties. 271

Therefore, for clients who are interested in minimizing or postponing reporting requirements, the qualified disposition may be a

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269 This possibility was suggested in Richard Wo Hompesch, II et al., Does the New Alaska Trusts Act Provide an Alternative to the Foreign Trust?, 2 J. Asset Protection 9, 16 [No. 6] (July/Aug. 1997). As noted above, however, the reporting burden may not be that extensive, depending upon how a trust is structured, although this remains to be seen.

Hompesch et al. also suggested some other possible advantages to an onshore trust relative to an offshore trust. One was the possibility that some American judges might be less hostile to a domestic alternative, and the other is that clients may be concerned about the political risk associated with going offshore. Id. The first point is a legitimate concern. See supra note 261 (discussing possible advantages of using a Delaware or Alaska trust to hold title to a homestead). The second concern, while initially quite prevalent in the minds of many clients, can be easily disposed. To begin, offshore trusts statutes typically do not require trust property to be held in the trust situs. Instead, assets can be held in any country, including the United States (although it is advisable that funds be held out of the country in order to minimize the risk of a freeze order or other attachment of funds by an American judge). In this sense, offshore trusts are analogous to Delaware corporations. Apart from a registered agent, there is no requirement for Delaware corporations to have offices in Delaware, nor is there any requirement for them to have bank accounts in Delaware. Offices and accounts can be anywhere for Delaware corporations, and the same is true of offshore trusts. This flexibility enables clients to keep property out of unstable jurisdictions. Second, most offshore trusts contain a "flee" clause or other provisions enabling the settlor to change trustees and/or the law governing the trust. In this way, if instability afflicts either the trustee or host country, the settlor can opt for a more stable venue in a moment's notice. Third, many offshore jurisdictions are exceedingly stable, although this can obviously vary from place to place. Finally, in many cases, the client has day-to-day control over the assets in any event, as the trustee will often own nothing except interests in holding companies controlled by the settlor. All of these work to assuage the ultimate concern raised by the instability issue, which is whether a client can retain secure control over his or her assets.

270 See 26 C.F.R. § 7701(a)(31) (1994) for the definition of "foreign trust"; id. § 7701(a)(30) for the definition of "U.S. person."

271 Penalties are 35% of "the gross reportable amount" that should have been reported but was not. Id. § 6677(a). The penalty does not apply if failure to report is due to "reasonable cause" and not "willful neglect." Id.
viable alternative whether standing alone, or in conjunction with a stand-by offshore trustee.

IX. CONCLUSION: RECOMMENDATIONS AND PREDICTIONS FOR THE FUTURE

Delaware’s Qualified Dispositions in Trust Act represents a halfway house between traditional American trusts and the protective trusts that are available in other jurisdictions. On the negative side, Delaware trusts offer weaker protection than offshore trusts. Some of these weaknesses are unavoidable: no matter what laws Delaware enacts, Delaware courts will still be forced to recognize the judgments of other states; Delaware trustees will still be forced to defend actions in other American courts; and settlors of Delaware trusts will still see their efforts subject to attack by American litigants who can hire lawyers on contingent fees and who do not have to worry about paying somebody else’s legal fees if they lose. Other weaknesses, however, are correctable, especially those pertaining to taxes and evidence issues. Moreover, the Act avoids the potentially onerous reporting requirements associated with foreign trusts.

On the positive side, the Act offers some notable protections that are quite similar in concept to many offshore statutes; these benefits cannot be found anywhere else in the U.S. except Alaska. Delaware now allows self-settled spendthrift trusts, which is the key principle underlying much offshore trust law. Delaware also limits the means by which its trusts can be attacked by generally restricting creditors to proving violations of the fraudulent transfers laws. American fraudulent transfers laws are admittedly more favorable to creditors than are the fraudulent transfers laws of many offshore venues. Nonetheless, Delaware’s limited means of attacking trusts are in keeping with principles underlying offshore trust law. Likewise, in a passage that virtually restates Bahamian law, the Act confers on innocent trustees a "first and paramount lien" on trust assets to secure payment of legal fees the trustee may incur in fighting off claims against the trust.

Finally, in many instances, the Act permits innocent beneficiaries to keep distributions they have received, even if the transfer into trust is deemed fraudulent. This is true unless the court concludes that the beneficiary acted in bad faith. This, too, closely parallels on Bahamian law. It is, therefore, very safe to say that, in many ways, Delaware has joined the offshore community. Moreover, many of the weaknesses in the Act can be addressed through supplemental legislation.
Take, for instance, the issue of allocating burdens of proof regarding innocent trustees and beneficiaries. It seems that the legislature intended plaintiffs to bear the ultimate burden of proof regarding the trustee’s lien, as indicated by the presumption arising in the trustee’s favor under section 3574(b)(1)(c), but this allocation of the evidentiary burden is not entirely clear. As to beneficiaries, there is no comparable presumption in their favor, so it is more difficult to draw a similar inference of legislative intent in their favor. If, however, the legislature intended trustees to benefit from a favorable allocation of burdens of proof, it seems even more likely that it also intended beneficiaries to receive a similar treatment.\textsuperscript{272} Trustees are often involved in structuring trust settlements and many are professional trustees with substantial experience. They are well positioned to ferret fraudulent transfers from their inception, and a good argument could have been made to hold them in an elevated standard of accountability. Trustees nonetheless seem to benefit from a favorable and indulgent allocation of the burden of proof.

In contrast, many beneficiaries will have no role in settling a trust and will have no experience trust administration except for the occasional passive act of receiving distributions. Accordingly, a rule of law requiring beneficiaries to prove the absence of bad faith, instead of making plaintiffs show its presence, is illogical because it can be safely presumed that most beneficiaries are truly ignorant and thus innocent. Nonetheless, doubt remains as to how the burden of proof is allocated.

This doubt can and should be erased legislatively. The legislature should state expressly that the ultimate burden of proving bad faith rests on plaintiffs who challenge a trustee’s lien or a beneficiary’s right to keep distributions. Indeed, the Bahamian statute makes just such an express declaration.\textsuperscript{273} Because so much else of Delaware’s statute mimics the innocent trustee and beneficiary provisions of Bahamian law, it would be quite natural for Delaware to follow this evidentiary aspect of the Bahamian statute as well, especially since it would resolve a lingering and important question. Moreover, to prevent courts in other states from disrupting any legislative allocation of the burden of proof, the General Assembly should also declare that such allocations are substantive rights

\textsuperscript{272}But see supra note 131.

\textsuperscript{273}"The burden of proving that a transferee or beneficiary has acted in bad faith shall be upon the person making the allegation." Bahamian Fraudulent Disposition Act § 5(b)(2) (1991).
The legislature also can and should remove doubt about a settlor’s ability to control the gift tax liability associated with a qualified disposition. As shown above, there is a good but inconclusive case that the Act already allows settlors to avoid immediate gift taxes. This residual doubt should be conclusively erased by an amendment that adds to the list of enumerated powers that may be retained by a settlor. At a minimum, the Act should expressly allow settlors to add and delete beneficiaries and to direct distributions among beneficiaries other than the settlor. To assuage creditor protection concerns, the permissible additional beneficiaries could be limited to persons other than the settlor’s estate, the settlor’s creditors, or creditors of his estate: the legislature plainly desires to allow protective trusts and to generally limit creditor relief to cases involving fraudulent transfers. By eliminating various creditors and the settlor’s estate from the list of permissible additional beneficiaries, the legislature would assure that its intent could not be circumvented by court orders compelling a settlor to add creditors to the list of beneficiaries. This limitation would also comport with the Act’s preference for a special, rather than a general, testamentary power of appointment and would also address the legislature’s evident concern about protecting assets from creditors while simultaneously allowing the settlor the right to use assets for his own benefit. The same concern would be addressed by limiting the settlor’s ability to reallocate the trust fund to persons other than himself. Nonetheless, even with these limits, these additional powers should clarify the right of a settlor to control the estate and gift tax ramifications of a qualified disposition. In the absence of such clarification, many settlors may opt against Delaware and instead go offshore simply to avoid the risk of triggering immediate gift taxes.

See supra notes 170, 178.

Conceivably, such an order might also be accompanied by companion orders enjoining a settlor from vetoing distributions to a creditor or an estate. Whether, however, a court could also order a trustee to make distributions to a creditor in the absence of a fraudulent transfer is more problematic. As an aside, note that any distribution to a settlor’s estate is usually attachable by the settlor’s creditors pursuant to local probate rules providing for the submission of claims against an estate.

See supra note 98.

A settlor who had the right to add a creditor as a beneficiary might be tempted to name a creditor in order to advance the settlor’s own dealings with that creditor.

Giving settlors the right to add and delete beneficiaries and to shift the beneficial interest among beneficiaries other than the settlor would also give settlors more opportunity to invoke the benefits associated with grantor trusts. The presence or absence of these powers is

274See supra notes 170, 178.

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Also, the legislature should clarify whether the innocent beneficiary clause extends to distributions made by a trustee pursuant to a schedule set in the trust agreement. It appears sensible to allow such protection. From a beneficiary’s viewpoint, there is no reason why his or her right to keep assets should turn on whether a particular distribution was mandatory or discretionary, though there are some potential risks to creditors if mandatory payouts are protected, as noted above. Those risks, though, are minimal and, in any event, represent a respectable balance of competing interests. Nonetheless, the issue is cloudy, and the General Assembly should take steps to clarify this matter.

Even without making any of the changes suggested by this article, the fact remains that Delaware has vigorously embraced the concept of self-settled spendthrift trusts, as well as other offshore trust concepts. Settlers may now use American trusts to shelter their assets from general creditors while still retaining potentially broad economic benefits in trust property. This is a radical departure from pre-existing American trust law.

The Act’s impact is unlikely to be confined to just Delaware, but is, instead, likely to be felt all across the United States. When Alaska first enacted its counterpart law, it was possible for the American legal community to consider the Alaska statute as a local aberration, especially given Alaska’s remoteness and small population. It is impossible, however, to similarly ignore Delaware’s Act. Small though Delaware may be in size and population, its stature as a leading business law jurisdiction is unparalleled in the United States. This factor alone is enough to confer respect on the notions of self-settled trusts and limited creditor remedies. In turn, this increases the probability that protective trusts will gain widespread acceptance, and that other states might also jump on the bandwagon by adopting their own protective trust statutes.

Basic business and political concerns make it likely that Delaware’s Act will force other states to follow suit. Because of the Act’s obvious advantages, it is likely that many people will take their current or future
trust business to Delaware instead of to local banks or trust companies.\footnote{279} Hence, Delaware’s law has created a significant competitive advantage for its trustees. This competitive edge is further enhanced by Delaware’s proximity to major markets all along the Eastern seaboard. Delaware trustees will find it an easy task to market their services in major population centers like New York, Philadelphia, Washington, and elsewhere, all of which are just a short drive away from Delaware. The resulting loss of business for trust officers in other states will eventually induce trustees in other states to lobby their own legislators to enact comparable laws in their own jurisdictions.

Consequently, it is just a question of time before marketplace competition prompts other states to enact comparable legislation. When this finally happens, as eventually it will, then other states will also be "going offshore" to at least a limited degree, and Delaware will have played a key role in that considerable change.

This article was drafted in the first two and a half months of 1998. Because it was initially prepared and submitted for editorial review and revision, the Delaware General Assembly has already made one significant change to the Act, which considerably diminishes the rights of creditors. This change passed in April 1998. The legislature is also contemplating additional modifications to the Act. All of the actual or potential changes are designed to make the Act more attractive to settlors and beneficiaries, but it is not entirely clear that they accomplish this objective.

The legislature adopted a very pro-settlor change in April 1998 when it repealed the preference that previously existed for relying creditors; the repeal is retroactive to July 9, 1997, which was the date on which the Act initially became law.\footnote{280} As initially written, section 3573(2) of the Act gave preferential treatment to creditors who extended credit in reliance upon an express written statement that trust property was really the settlor’s property and was available to satisfy the settlor’s debts.\footnote{281} This preference is now eliminated. As a result, relying creditors will now be treated as general creditors, which in turn means relying creditors will not be able to attach trust fund property unless they can show that a trust settlement violated Delaware’s version of the UFTA.

\footnote{279}To one degree or another, the trustee of a qualified disposition must be a Delaware resident or business. \textsc{Del. Code Ann. tit. 12, § 3570(8)} (1994).


\footnote{281}See supra note 102 (quoting § 3573(2)).
This result, which does much to enhance trust fund security, is mandated by section 3572(a) of the Act, which states the general rule that UFTA is the sole source of relief for persons trying to attach trust property.282 The repeal of the preference for relying creditors also puts an added premium on creditor due diligence. While the preference existed, injured creditors could attach trust property if they had good documentary proof that a debtor-settlor had misrepresented his rights in a trust. This remedy was significant because it was separate and distinct from UFTA, which generally allows creditors to sue any time within the four years after the date of a transfer.283 A settlor’s misrepresentation, however, could easily occur long after the UFTA limitations period expired. The relying creditor preference therefore gave creditors important additional protection, as it was an independent claim for relief that would not arise until the date of the misrepresentation. Now, however, that extra protection is missing. Henceforth, creditors will need to take extra steps to verify the accuracy of financial statements or other similar documents tendered by prospective borrowers. If creditors do not take care, they may find themselves in the position of being misled (intentionally, negligently, or otherwise) as to the availability of trust funds, but having no right to attach those funds because their UFTA rights have long since expired. This need for additional due diligence will undoubtedly add something to lenders’ costs of doing business, and may also result in fewer loans being made. In light of the considerable growth in questionable lending practices in recent years,284 however, the prospect of more selective lending is not necessarily a bad thing. And, in any event, the repeal of the relying creditor preference is an express legislative

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282See supra note 83 (quoting § 3572(a)).

283See supra note 192 (regarding the Act’s four year limitations period for UFTA claims). There is also a one year date of discovery rule applicable to UFTA claims under the Act. See Del. Code Ann. tit. 12, § 3572(b)(1) (1997). This rule allows claims to be brought "within 1 year after the qualified disposition was or could reasonably have been discovered by the creditor." Id. Whether a creditor should have discovered the qualified disposition before extending credit will be a question of fact for each case.

284See supra note 120 and accompanying text. See also John Campbell, The Boom in Busts, 8 Fed. Reserve Bank of Boston Regional Rev. 21, 24 (1998), in which the author notes:

The new credit economy is especially treacherous for borrowers who are uninformed or under equipped. Lenders’ easing of credit standards after the 1990-91 recession resulted in an explosion of credit card mailings. . . . At the same time, mortgage lenders have been aggressively extending low down-payment loans, often to the same people getting credit card and consumer solicitations.
policy decision that must be respected by the courts unless it is constitutionally flawed.

This, of course, leads to the question of constitutionality. The bottom line seems quite simple: the Act’s elimination of tort claim rights is constitutional. Admittedly, tort claims, including claims for fraud, are valuable property rights. The legislature’s broad authority to enact economic legislation, however, and a legislative re-ordering of economic rights, including tort claim rights, is generally permissible unless a statute’s provisions are arbitrary, discriminatory, or irrational. Thus, in general, such a re-ordering does not offend notions of substantive due process. Such is the case here, for the legislature can point to numerous rational grounds for this particular limit on creditors’ rights. For instance, there is the general rationale for the Act, which is preserving wealth from the onslaught of contemporary American litigation. Eliminating claims by relying creditors enhances the overall protective strength of qualified dispositions and thus foster’s the Act’s basic objective. There is also a more targeted rationale, specifically being a desire to promote more conservative lending practices, to reduce the ill effects associated with overly liberal lending, and to generally shift the balance of lender-borrower relations more in favor of the borrower. Consequently, the legislature had good grounds to proceed as it has, which in turn makes it very unlikely that the elimination of creditor fraud claim rights will be seen as unconstitutional under notions of substantive due process.


[286] See, e.g., Nebbia v. New York, 291 U.S. 502, 537 (1934) (noting that "a state is free to adopt whatever economic policy may reasonably be deemed to promote public welfare").

[287] Id. at 516 (stating that economic legislation is permissible so long as it has "a reasonable relation to a proper legislative purpose, and [is] neither arbitrary nor discriminatory"); see also Logan, 455 U.S. at 433 ("[I]t remains true that the State’s interest in fashioning its own rules of tort law is paramount to any discernible federal interest, except perhaps an interest in protecting the individual citizen from state action that is wholly arbitrary or irrational."). (internal quotes and brackets omitted).

[288] See, e.g., New Motor Vehicle Bd. of Cal. v. Orrin W. Fox Co., 439 U.S. 96, 106-107 (1978) (noting that "since the demise of the concept of substantive due process in the area of economic regulation, this Court has recognized that, legislative bodies have broad scope to experiment with economic problems") (internal quotes and brackets omitted); id. at 106-08 (collecting cases regarding legislative discretion in the economic arena).

[289] See supra note 120 and accompanying text. See also Campbell, supra note 284, at 24.
The repeal of the preference is also constitutional when measured against other clauses of the constitution. For instance, the elimination of fraud claim rights does not offend concepts of procedural due process because the matter was duly considered by the legislature.\(^{290}\) Likewise, the Fifth Amendment's Just Compensation Clause is not implicated. Apart, perhaps, from persons holding claims that existed before the April 1998 repeal, creditors cannot point to any particular property they have lost, but can only complain about the loss of future rights against potential or hypothetical debtors. This lack of immediate concrete interests is a substantial obstacle to relief. The Fifth Amendment is concerned with property that is actually "taken,"\(^{291}\) and is "intended to preserve practical and substantial rights, not to maintain theories."\(^{292}\) Consequently, Fifth Amendment law "recognize[s] an important distinction between a claim that the mere enactment of statute constitutes a taking and a claim that the particular impact of government action on a specific piece of property requires payment of just compensation."\(^{293}\) Where, as here, a complaining party cannot point to the loss of any specific property, and instead claims that the enactment of a statute is by itself a taking, the party seeking compensation must show that the legislation deprives him of the "economically viable use" of his property.\(^{294}\) This, however, cannot be done here. Lenders are not deprived of their right to loan money. They are instead deprived of one remedy (a fraud claim) relative to a small group of borrowers (persons with an interest in qualified dispositions). Lenders can still assert fraud claims against other borrowers, who undoubtedly will make up a much larger portion of their clientele. Likewise, lenders can still lend to persons with interests in qualified dispositions, but they will simply need to be more careful about preserving their other remedies, such as collateral rights in non-trust property. Lenders may also withhold loans from beneficiaries of qualified dispositions and place their loan dollars elsewhere. In light of these conditions, it seems fair to paraphrase the Supreme Court: lenders can "not claim . . . that the Act makes it commercially impracticable for them to continue" lending elsewhere.\(^{295}\)

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\(^{290}\)"In each case, the legislative determination provides all the process that is due." Logan v. Zimmerman Brush Co., 455 U.S. 422, 433 (1982).

\(^{291}\)U.S. CONST. amend. V.

\(^{292}\)United States v. Dickinson, 331 U.S. 745, 748 (1947) (internal quotes omitted).


\(^{294}\)Id. at 495.

\(^{295}\)See id. at 495-96 ("[P]etitioners have not claimed, at this stage, that the Act makes it commercially impracticable for them to continue mining their bituminous coal interests in western Pennsylvania.").
In sum, then, this limitation on creditor rights seems very likely to pass constitutional muster.

The General Assembly is also considering legislation to broaden the rights or interests that may be retained by a settlor. For instance, one proposal would enable the settlor to appoint a trust advisor who could direct distributions by the trustee. Under this proposal, the settlor himself could not be a "direction advisor," and thus could not directly control distributions to himself. If, however, the settlor chooses wisely, a very friendly advisor could be appointed who could quite reasonably be expected to look after the settlor's interests. The same bill would also allow the settlor to appoint an advisor (once again not the settlor himself) who could remove and replace the trustee. This, too, could easily make the trust structure more responsive to the settlor's wishes. Consequently, these proposals will make the Delaware trust even more attractive if they are adopted.

Interestingly, one proposal might give settlors the optional right to undermine the security of a qualified disposition. The same bill that would allow trust advisors would also amend section 3570(9)(b) so that settlors may retain the right to receive principal distributions pursuant to an ascertainable standard set forth in a trust. If adopted, this law would basically enable a settlor to compel distributions for his own benefit.296

This certainly broadens a settlor's rights, but it may also give creditors additional relief. The proposed legislation would leave unchanged section 3572 of the Act, which relegates creditors to UFTA as their sole remedy "against property that is the subject of a qualified disposition or for avoidance of a qualified disposition."297 If a qualified disposition contains an ascertainable standard that governs distribution of principal, however, a creditor might proceed directly against the settlor and procure an order compelling the settlor to exercise his rights under the ascertainable standard. In particular, the order might require a settlor to demand distribution by the trustee.298 Because this creditor suit would be an action directly against the settlor, it would not literally be an action "against property" or "for avoidance," and thus would not technically breach section 3572's restriction of creditor suits against the trustee or trust fund. It is anybody's guess as to whether this circumvention of section 3572 would be acceptable to Delaware's courts. The scenario outlined above could be deemed impermissible as contrary to the intent of the statute or acceptable given the exact phrasing of the Act.

296See supra note 94 and accompanying text.
298See supra note 94 and accompanying text.
Consequently, if the ascertainable standard proposal is adopted, settlors would be well advised to either wholly forego any ascertainable standards in their favor or settlors may wish to draft very circumscribed standards, such as standards regarding health and education but which allow for few or no distributions for maintenance and support. Moreover, the uncertainty over a creditor’s right to compel the exercise of an ascertainable standard also leaves cloudy the estate and gift tax status of qualified dispositions.

The proposed legislation also fails to address many of the concerns raised in the main part of this article. For instance, it does not clarify the right of settlors to expressly add or delete beneficiaries or to explicitly shift benefits among beneficiaries. Consequently, the estate and gift tax questions raised in the main text are still present. The legislature also has failed to address allocations of burdens of proof, and the related question of whether these burdens are substantive or procedural matters. Consequently, there is still room for significant improvement in the Act. Despite these shortcomings, it seems that the Delaware General Assembly is intent upon improving the Act and making it even more "user friendly." It, therefore, is probably just a matter of time before some of the changes suggested in this article are considered.

\[^{299}\text{See supra note 94 and accompanying text.}\]

\[^{300}\text{See supra note 231 and accompanying text.}\]