

---

THE LAW FIRM OF  
**BOVE & LANGA**  
A PROFESSIONAL CORPORATION

---

TEN TREMONT STREET, SUITE 600 – BOSTON, MASSACHUSETTS 02108

Telephone: 617.720.6040 – Facsimile: 617.720.1919

[www.bovelanga.com](http://www.bovelanga.com)

**SELF-SETTLED TRUSTS AND SIMILAR DEVICES UNDER THE BANKRUPTCY  
CODE**

**MELISSA LANGA AND ALEXANDER A. BOVE JR.**

**October 12, 2011**

*In re Porco*, 447 B.R. 590 (S.D. IL 2011) is a case of first impression interpreting the term "similar device" as used in the 2005 Bankruptcy Act's §548(e), which imposed a ten year reach-back on transfers to a self-settled trust or "similar device". In the context of the law, for most of us a "similar device" seemed to mean something (presumably a legal entity or arrangement) that would have the same protective effect as a self-settled asset protection trust, but it wouldn't be a trust. The *Porco* case finally gives the asset protection bar a hint as to how a court would interpret the term, similar device, but as explained below, it does not inspire confidence in ways to plan within the confines of the law.

The Debtor in *In re Porco* was a corporation (Porco), and the Plaintiff an unsecured judgment creditor. In an earlier unrelated action, the Debtor had settled a lawsuit, under the terms of which the Debtor was to receive a parcel of real estate. Instead of the Debtor receiving the real estate under the terms of the settlement, the principal owner of the Debtor had the realty transferred directly to

an LLC (Fog LLC), also controlled by the principal owner of the Debtor. The Debtor received no consideration for this transfer.

Five years later, the Debtor declared bankruptcy. The trustee in bankruptcy declined to attempt to set aside the transfer to Fog LLC, which permitted the Plaintiff to bring suit itself. Count One attempted to set aside the transfer under a fraudulent transfer claim based on state (Illinois) law, and in Count Two the Plaintiff attempted to set aside the transfer under §548(e) of the Bankruptcy Code (the “Code”), which extended the statute of limitations to ten years and also brought in the “self-settled trust or similar device” argument. The Debtor moved to dismiss both claims, the first as time-barred, and the second for a failure to state a cause of action.

The court held for the Plaintiff on Count One, as there was a question of fact as to whether Plaintiff's discovery of the transfer came within the extended "one year period" of the state's fraudulent transfer law.

Turning to Count Two, the court examined the elements for a cause of action under §548(e). The elements are: (1) there is a transfer within ten years of the filing of the bankruptcy petition; (2) the transfer is to a self-settled trust or similar device; (3) the transfer is by the debtor; (4) the debtor is a beneficiary of the self-settled trust or similar device; and (5) the debtor made the transfer with the actual intent to hinder, delay, or defraud any entity to which the debtor was or became

indebted. [Note that the court restated the elements as four elements, omitting the ten year rule since the transfer was clearly within ten years.]

The Plaintiff claimed that it had meet the requirements of §548(e) by demonstrating a transfer of a property interest (the contractual right), made by the Debtor, for the benefit of the Debtor, and that Fog LLC was a device similar to a self-settled trust. Why a similar device? The Plaintiff made two arguments: First, that a constructive trust was created upon the transfer to Fogg LLC since the LLC was always intended to benefit the Debtor's business. Second, a resulting trust was also created because the Debtor has used funds to pay off a mortgage on the real estate prior to the transfer to Fog LLC.

Referring to Collier on Bankruptcy, and on what the court considered to be Congress' purpose in enacting §548(e), the court concluded that §548(e) "requires an express trust" and thus did not have to reach the issue of whether the Plaintiff was correct in its characterization of the facts as creating a resulting trust and a constructive trust. [Although the court did discuss the elements of each.]

The court concluded that based upon the legislative history of §548(e), Congress only intended to capture a "similar device" that had the same effect as a self-settled trust, and only an express trust was within that definition. The court stated that the purpose of Congress in §548(e) was to thwart the protection of the then four "domestic asset protection jurisdictions" and was aimed only at irrevocable trusts with an independent trustee, absolute discretion, and distributions to beneficiaries.

Therefore, a constructive or resulting trust was outside of §548(e) and did not constitute a transfer to a “similar device”. Since an element of the cause of action was not shown, the Court held for the Debtor on Count Two.

The court was correct that a self-settled trust is typically a fully discretionary irrevocable trust settled and funded by the client for the client’s own benefit, but often including the client’s family within the class of permissible discretionary beneficiaries, all controlled by an independent trustee. The general rule in Massachusetts and 39 other states is that a creditor of the settlor can reach the assets within a self-settled trust to the maximum extent a trustee could distribute those assets to the settlor, even if the trust contains spendthrift provisions. For example, if client settles and funds a self-settled spendthrift irrevocable trust in Massachusetts and retains only a discretionary income interest, absent the application of fraudulent transfer rules, a creditor of the settlor can only reach the income of the trust. Eleven U.S. jurisdictions (AK, DE, MO, NV, RI, UT, SD, TN, WY, NH, and HI) and many offshore jurisdictions hold the opposite. (Oklahoma allows a settlor to retain the power to revoke the trust but not to be named as a beneficiary.) That is, in those jurisdictions, a client can settle and fund an irrevocable trust, retain the right to discretionary payments of income and principal, and the trust will be outside the reach of the client’s creditors under the law of that jurisdiction. Again, fraudulent transfer rules apply to varying degrees, and certain “super creditors” are given preferential rights against the trust, at least in the relevant U.S. states.

During Congressional deliberations over the terms of the 2005 Bankruptcy Act, a New York Times editorial decried the protections afforded by these domestic and offshore asset protection jurisdictions and asserted that corporate executives involved in Enron-like transgressions would avoid the reach of the bankruptcy court by transferring funds to an offshore trust or to a trust within a protected domestic jurisdiction. In response, Senator Schumer proposed a \$125,000 limit on self-settled spendthrift trusts. This was rejected in favor of a proposal by Senator Talent which added a new Code section that imposes a special ten year reach-back provision for self-settled trusts or a “similar device”.

The Code had always contained a protection for spendthrift trusts enforceable (i.e., protected) under applicable state law, but a question persisted as to whether this protection included self-settled spendthrift trusts. The addition of the ten year reach-back in the new section seems to indicate that the Code does protect self-settled spendthrift trusts -- whatever the amount held within -- as long as the applicable state law protects them. This is consistent with the approach taken in the Code with homestead protection. There was much debate at the time as to whether to set federal limits on assets protected from creditors. Many wanted to limit homestead protection and do away in bankruptcy with the unlimited protections of some jurisdictions such as FL, IA, KS, SD, TX, and DC. These amendments were defeated, and instead a federal floor of \$125,000 was imposed on homesteads, but this could be increased to an unlimited amount under state law if certain limitation periods were complied with.

But was the court here correct that only trusts are captured by §548(e)? Courts are limited by the facts before them, and from the decision it appears the creditor itself was trying to clothe its argument in a trust wrapper to come within §548(e). If only trusts are considered, maybe the court is correct that a constructive trust can't be a "similar device" since intent is not an element [as it is in §548(e)], but falls short where a resulting trust is concerned, since intent is a critical factor, and its analysis should have gone further than it did. What is interesting is that the court's reasoning seems to bring within §548(e) the estate planner's tools under Chapter 14 of the Internal Revenue Code (QPRTs, GRITs, and GRATs) as a similar device.

But is "similar device" limited to trusts? The debates in Congress articulate the fear that clever lawyers will devise alternatives to "self-settled trusts" if that language alone is used in the Code, and thus it is reasonable to assume that "similar device" was added to take into account unforeseen situations and structures which are currently unknown to Congress or which might arise in the future. If Congress had wanted to limit the alternatives to some other kinds of trusts, it would have said so. Using the plain meaning of "device" as "a thing made for a particular purpose", any structure created by an individual, not revocable by the individual, funded by an individual, and which benefits that individual in a discretionary manner fits the definition of a device similar to a self-settled trust. Think of a Liechtenstein foundation (stiftung) and you see what we mean. Taxed like a trust in the U.S., yes, but definitely not a trust in the traditional sense. Surely a stiftung is captured by §548(e). Or how about an LLC, or a Nevada corporation, both of which protect owners by a charging order?

And what about retirement plans? Clearly a self-created and funded plan is similar to a self-settled trust, although perhaps lacking the "irrevocability" of asset protection trusts. As an interesting aside, since the debates over the Bankruptcy Act the term "self-settled trust and similar device" was used in proposed legislation to protect employee retirement rights when a company goes bankrupt. In the section which would provide a claw back for certain benefits paid to highly compensated employees, the legislation proposed being able to reach into a self-settled trust and similar device as well as into certain nonqualified retirement plans. Query whether it was necessary to include the nonqualified retirement plan language if a retirement plan was a similar device. See 156 Cong. Rec. S744. Holding that a retirement plan is not a similar device would be consistent with the unlimited protection provided elsewhere in the Code for certain plans.

So, *Porco*, sadly, leaves us wanting more regarding guidance as to "similar device", but trusts are a fundamental building block of a modern estate plan, and asset protection a fundamental concern of many clients. Can asset protection trusts and §548(e) coexist? Can we plan around the application of the reach-back section if the debtor is not a beneficiary of the trust, but his wife and children are? And what if there is a trust protector that can add the debtor (among others) as a discretionary beneficiary at a later date? Can a debtor fund a ten year charitable lead trust that pours over into a self-settled trust in, say, Delaware, and circumvent the Act? Or a purpose trust that can add beneficiaries after a ten year period?

Where an offshore asset protection trust is concerned, inclusion within the bankruptcy estate may be a pyrrhic victory. This is because the assets in the offshore trust typically would not be reachable by the trustee nor by the debtor/settlor, unlike the assets held in the self-settled trust in the recent *In re Mortensen* case, applying §548(e) to an "Alaska Asset Preservation Trust". *In re Mortensen*, \_\_\_\_ B.R. \_\_\_\_ (Alaska May 26, 2011). This is not to say that the trustee or the court would have no other recourse against the debtor/settlor of the offshore trust. For one, the court could refuse to grant a discharge, as was the case in *In re Portnoy*, 201 B.R. 685 (S.D.N.Y. 1996). For another, if the court believed the debtor/settlor could find a way to recover the funds but did not, the debtor/settlor could be held in contempt of court. In two well-publicized cases on similar facts, the debtor/settlor was imprisoned for contempt. See *In re Stephan Jay Lawrence*, 227 B.R. 907 (S.D. Fla. 1998) and *FTC v. Affordable Media, LLC*, 179 F.3d 1228 (9<sup>th</sup> Cir. 1999)

These are just a few of the unanswered questions being discussed within the asset protection bar, and which will probably be resolved in the courts, or in a similar device.

**Melissa Langa and Alexander A. Bove Jr.** are partners in the Boston law firm of Bove & Langa P.C. Melissa is the current co-vice chair of the ABA's Real Property, Probate and Trust Law Asset Protection Committee, and an adjunct professor in the Graduate Tax Program at Boston University School of Law. Alexander is a former chair of the ABA's Asset Protection Committee,

---

THE LAW FIRM OF  
**BOVE & LANGA**  
A PROFESSIONAL CORPORATION

---

editor of the ABA's two volume "Asset Protection Strategies", and has written and lectured widely on the topic of asset protection planning.

[www.bovelanga.com](http://www.bovelanga.com).