Ohio Legacy Trusts 101

By Ted Gudorf and Michael Menninger

Passed in March 2013, the **Ohio Legacy Trust Act** changed the rights of Ohio creditors, trustmakers, trustees and their assets. Learn the rules of creating, protecting and planning legacy trusts in Ohio.

Owners of small businesses and farms, high net worth individuals and professionals with significant liability exposure often struggle to shelter their assets from creditors in a way that is straightforward, coherent and fully compliant with the law.

To that end, many in the asset protection community cheered when the Ohio Legislature passed the Ohio Legacy Trust Act (OLT) on March 27, 2013. This act empowered individuals to construct trusts that provide numerous benefits, chiefly the establishment of a formidable barrier between trust assets and future creditors of the trustmaker. Even though the asset protection features of the trust, in and of themselves, are enough to celebrate, a trustmaker may also retain the right to be an income and principal beneficiary of the trust. Ohio is not the first state to establish Domestic Asset Protection Trusts (DAPT). That honor goes to Delaware and Alaska, which passed similar laws in 1997. Like its predecessors, the Ohio Legacy Trust Act takes an aggressive anti-creditor stance. Advocates argue that the advent of the Ohio Legacy Trust will encourage wealthy individuals from across the country to bring their money into Ohio's banks and financial institutions. They claim these trusts will increase Ohio's tax revenues, inject money into the economy and increase job opportunities within the state. Critics, however, worry that the strong anti-creditor provisions might, among other things, shield negligent or careless professionals from appropriate liability.

This article will explain the critical basics of these fascinating instruments and explore the implications they have for business owners, farmers, investors, creditors and those who represent these parties.

Creating the Ohio Legacy Trust

The OLT, while a sophisticated planning tool, essentially requires that five elements be in place to ensure validity. First, the trust document must be in writing and be subject to Ohio law. Second, the trustmaker must appoint an independent Ohio trustee. In other words, the trustee may not be related or subordinate to the trustmaker or any institution that could benefit from the OLT. For example, a trustee could be a corporate bank, a certified public accountant or an attorney, but likely not the CFO of the trustmaker's closely held company. Third, the trust must be irrevocable. Once it has been established, the trust cannot be changed except under limited circumstances.

Fourth, the document must include a "spendthrift provision" that prevents a beneficiary from assigning away, and creditors from attaching, his or her beneficial interest in the trust. Fifth, and unlike a number of other states which permit DAPTs, there is a due diligence requirement: The trustmaker must execute an affidavit with numerous provisions, one of which establishes that, after depositing assets in the OLT, the trustmaker will remain solvent. While there are numerous other important considerations in forming an OLT, the rules for who can form an OLT are relatively liberal. In fact, individuals, partnerships and limited liability companies alike both in Ohio and out of state can create these vehicles.

A powerful tool in the Ohio estate planning and business planning toolbox

An Ohio Legacy Trust is not intended to replace traditional estate planning tools, such as revocable living trusts, prenuptial agreements and limited liability companies. In fact, most often, the assets in the OLT remain a part of the trustmaker's taxable estate. In addition, the OLT is normally a grantor trust, and the trustmaker remains liable for any income tax on trust assets during the grantor's lifetime. Finally, while an OLT does not replace the essential estate planning documents mentioned above, it does allow for the disposition of property during the trustmaker's lifetime and upon death, and a trustmaker should consider and design his or her trust for how and when beneficiaries, including the trustmaker, can tap the trust.

One unique strategy is to not expressly name the trustmaker as a lifetime beneficiary, but instead permit a trust advisor to add the trustmaker as such at a later date. OLTs can be used for other purposes as well, including premarital planning. Specifically, the OLT will be protected from a spouse's claim for alimony, provided that the trustmaker establishes and funds the OLT prior to tying the knot. As a result, this tool is now being considered as a powerful prenuptial planning device in addition to the more "classical" use as a creditor shield. It is worth noting that the Ohio Legacy Trust Act carves out an exception in the case of child support, such that OLT assets may be used to satisfy such an obligation.

Assets that can be protected

As with any kind of trust planning, a trustmaker can fund virtually any type of asset into an OLT, including deposit and investment accounts, stocks, business interests, and artwork, jewelry and other valuable personal property. Any transfer of assets into an OLT is considered a "qualified disposition," subject to the same limitations on the transfer of assets in general, and such transfer cannot be done with the purpose to hinder, delay or defraud creditors. Since the trustmaker surrenders direct control of the assets to the trustee, experts advise putting only those "rainy day" assets the trustmaker wishes to protect into the OLT.

The transferor also must establish terms regarding when and how these assets can be distributed, both to the trustmaker and to any beneficiaries. Due in large part to the unique structure of these instruments, specifically the fact that the trustee, as opposed to the trustmaker, controls when and how distributions can be made, most asset protection attorneys advise clients to avoid putting assets into OLTs that are needed to fund recurring or urgent expenses (e.g. mortgage payments, business loans or monthly utilities).

Substantial trustmaker rights

Transferors may hold substantial power in that they can change trustees, establish successors for ownership of the trust, change the names of heirs and beneficiaries as well as alter the terms by which these people or institutions can access what is in the trust and take charge of investments. Furthermore, the trustmaker can still use real estate or other personal effects (such as artwork, jewelry or valuable technology) and can veto certain distributions. The trustmaker can also set aside some assets or income from the trust to pay for expense items, such as taxes that the trust owes (or will owe), estate administration and the trustmaker's debts.

The trustmaker must formally request that assets be distributed for a particular purpose, and the OLT may only allow such distribution under the terms of the trust and for the particular purpose the trustmaker espouses. For the trustee to make distributions pursuant to the trustmaker's request, the trustmaker must have formed and funded the trust correctly. In addition, the trustee must have access to and agency over the trust principal and income. Finally, a time limit of 18 months must elapse, during which time no creditor or other entity asserts or threatens a claim against the trustmaker or the trustee (in the capacity of trustee). While the OLT is not absolutely impermeable to creditors, if properly drafted, funded and managed, it can create significant, and even insurmountable, hurdles for creditors to overcome.

What can creditors do, if anything, to access funds in OLTs?

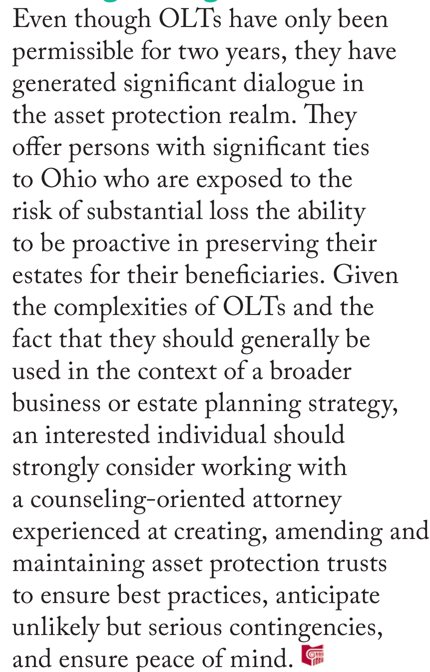
Creditors who seek to penetrate the trust's barriers generally must demonstrate that the trustmaker transferred the assets to the OLT with the specific intent to defraud the specific creditor bringing the action, and the creditor must bring any such claim typically within 18 months of the transfer to the trust (unless the creditor has a claim based on an act or omission of the trustmaker that occurred prior to the transfer, in which case, other statute of limitations rules apply). Among all state DAPTs, Ohio's statute of limitations in this regard is the shortest. Moreover, a creditor must prove the trustmaker's intent to defraud the creditor by "clear and convincing evidence," the highest standard that can be applied in civil law. Ultimately, even if a creditor is

successful in attacking the OLT, its claim may still be subject to priority determination among other creditors.

The asset protection the OLT provides is not without limitations. For example, assets that the trustee distributes to beneficiaries, including the trustmaker, may be subject to attachment by the creditors of such individuals. Furthermore, an OLT alone will not assist a trustmaker in his or her efforts to qualify for government benefits, such as Medicaid or Veterans Administration Aid & Attendance; a trustmaker must use other planning techniques to protect assets from the nursing home or other long-term care costs.

Potential out-of-state issues

If a creditor takes a judgment against the trustmaker in another state, an Ohio court would first need to enforce the out-of-state judgment. Depending on how the facts of the case implicate choice-of-laws issues, the Ohio Legacy Trust Act may not offer the same protections as it would against a claim from within Ohio. For example, if an Ohio physician treats a patient in Indiana, and that patient suffers complications, which give rise to a claim against the physician, the OLT might be vulnerable to the Indiana judgment certified in Ohio. Likewise, in bankruptcy cases, creditors may prevail under federal law to pull assets from an OLT. These and other issues will be answered in the coming years as Ohio's case law on OLTs is developed.



Finding the right answer

Even though OLTs have only been permissible for two years, they have generated significant dialogue in the asset protection realm. They offer persons with significant ties to Ohio who are exposed to the risk of substantial loss the ability to be proactive in preserving their estates for their beneficiaries. Given the complexities of OLTs and the fact that they should generally be used in the context of a broader business or estate planning strategy, an interested individual should strongly consider working with a counseling-oriented attorney experienced at creating, amending and maintaining asset protection trusts to ensure best practices, anticipate unlikely but serious contingencies, and ensure peace of mind.

Author bios

Ted Gudorf is the owner of Gudorf Law Group, LLC in Dayton. Gudorf Law Group is a boutique estate planning, tax advisory and elder care law firm. Ted obtained his Master of Laws degree from Western New England College School of Law. He is an AV-rated, OSBA Certified Specialist in estate planning, trust and probate law.

Michael Menninger graduated from Northern Kentucky University Salmon P. Chase College of Law in 2006. Still under 40, Michael has been named a Rising Star by Ohio Super Lawyer's Magazine numerous times. He has significant experience in estate, trust and guardianship matters, as well as in debtor/creditor litigation, which gives him a unique perspective on asset protection issues.