# Michigan Enacts New Qualified Dispositions in Trust Act

By Daniel Burkhart

On December 8, 2016, Michigan became the 17th state to pass legislation allowing for domestic asset protection trusts (DAPTs). The legislation is set forth in the Qualified Dispositions in Trust Act (the act), which permits the creation of irrevocable trusts, the assets of which cannot be reached by creditors if certain legal requirements are met. Together with the act, Michigan's Uniform Fraudulent Transfer Act (UFTA) was amended, providing, among other things, that certain qualified dispositions under the act are fraudulent only if they were made with the actual intent to hinder, delay, or defraud a grantor's creditor. The act and amendments took effect on March 8, 2017.[1]

## The rationale and analysis behind the legislation

Michigan enacted the act in response to increasing DAPT legislation in the United States and to "remain competitive" among the many states offering asset protection mechanisms. Because the DAPT industry is growing, supporters argued that there could be a significant positive impact on Michigan's trust economy by accommodating the needs of residents and authorizing asset protection trusts.[2]

According to the Senate bill analysis, the act provides for the "creation of irrevocable trusts whose assets could not be reached by creditors, subject to specific requirements and limitations."[3] Or, put more precisely, the act provides for the creation of "trust instruments" which, if properly established and in compliance with the act, will generally insulate "qualified dispositions" of subject property from creditors.[4]

## Key terms; transferor's rights and powers

According to the act, a "qualified disposition" is a disposition where, after it is made, the subject property is owned by at least one qualified trustee and is governed by a trust instrument under which the transferor only has rights, powers, and interests permitted by section 4(2) of the act.[5] A disposition is not a qualified disposition if, at the time of the disposition, the transferor is in arrears on a child support obligation by more than 30 days or if a transferor or any person related or subordinate to the transferor under section 672(c) of the Internal Revenue Code acts as an advisor.[6]

What does "qualified disposition" mean? First, there must be a disposition, which is to say there must be a transfer of property that either creates a new fiduciary relation between at least one trustee and a trust beneficiary or subjects property to a preexisting fiduciary relation between at least one trustee and a trust beneficiary in accordance with the act.[7] The transfer can be made in various ways including by conveyance; assignment; exercise of a power of appointment; a power of revocation or amendment; or by disclaimer, release, or relinquishment.[8]

Second, once the disposition is made, the subject property must be owned by at least one "qualified trustee."[9] The definition of qualified trustee applies equally to individuals and organizations provided all other requirements in the act are satisfied. If the trustee is an individual, he or she must be a Michigan resident, and if the trustee is an organization, it must be authorized by Michigan law to act as a trustee and its activities must be subject to certain supervisions set forth in the act.[10] The trustee must also arrange for custody or maintain in Michigan at least some of the property that is the subject of a qualified disposition and administer at least part of the trust in Michigan. And lastly, the trustee's usual place of business where at least some of the trust records are kept must be located in Michigan or, if the trustee does not have a usual place of business, then the trustee must reside in Michigan.[11]

Third, the subject property must be governed by a trust instrument. The instrument must (1) expressly incorporate Michigan law governing validity, construction, and administration of the trust; (2) be irrevocable; and (3) provide that the interest of the transferor or other trust beneficiary in the trust property may not be transferred, assigned, pledged, or mortgaged before the qualified trustee(s) actually distributes the property to the beneficiary.[12] This provision is considered a restriction on the transfer of the transferor's beneficial interest in the trust and is enforceable under applicable nonbankruptcy law within the meaning of 11 USC 541(c)(2).

Finally, the transferor can only have rights, powers, and interests under the trust instrument that are permitted by section 4(2) of the act. A "transferor" is a person (or each of several persons if there is more than one owner of undivided interests) who makes a disposition of certain property or causes a disposition to be made.[13] For a fiduciary disposition, which is a disposition made by a trustee acting in a fiduciary capacity, the term "transferor" has the meaning given in MCL 700.1042(y)(ii).

The transferor must also sign a qualified affidavit before making a qualified disposition.[14] A qualified affidavit certifies that certain conditions are satisfied at the time the transferor transfers property to the trust. The validity of the qualified disposition is not affected if a transferor fails to timely sign a qualified affidavit or signs a defective qualified affidavit. Rather, the failure or defect may be considered evidence in a creditor's avoidance, attachment, or other action.[15]

## Creditors' rights, actions, and claims

Creditors' rights with respect to qualified dispositions are set forth in sections 5 and 7 of the act. Specifically, section 5(2) describes the requirements that must be met if a creditor wants to bring an action to avoid a qualified disposition or bring an action for attachment or other provisional remedy against the property that is the subject of a qualified disposition.[16]

First, the action may only be brought under UFTA sections 4 and 5, which govern transfers with the intent to defraud and fraudulent transfers by the debtor. Second, if the creditor's claim arose *after* the qualified disposition, the action must involve a disposition that was made with the actual intent to defraud the creditor. Finally, the creditor must prove the allegations in the action by clear and convincing evidence.[17]

In addition to the previous requirements, creditors' rights to bring avoidance actions or attachment or other actions are subject to statute of limitations periods. Michigan's statute of limitations periods under the act are divided into two categories: future creditor actions and preexisting creditor actions.

A creditor whose claim arose concurrent with or after the qualified disposition was made must bring its action within two years after the qualified disposition was made.[18] If a creditor's claim arose before the qualified disposition was made, the creditor must bring its action by the later of the following two periods: (1) two years after the qualified disposition was made or the obligation was incurred or (2) one year after the qualified disposition was or could reasonably have been discovered by the claimant if the person who is or may be liable for any claim fraudulently concealed the existence of the claim or the identity of any person who is liable for the claim from the knowledge of the person entitled to sue on the claim.[19]

It is important to note that the statute of limitations periods begin after the disposition or knowledge of disposition, and the date on which the trust instrument is formed has no bearing on when the applicable statute of limitations period begins. It is also worth mentioning that based upon a cursory review of information available online, Michigan falls in the middle of the pack in terms of statute of limitations periods compared to other asset protection trust states.[20]

As to any qualified disposition, creditors do not have claims or causes of action against the trustee, an advisor, or any person involved in counseling, drafting, preparing, executing, or funding the trust. Rather, a creditor's claim or cause of action would be against the transferor.[21]

### FAST FACTS

Michigan is the 17th state to pass legislation allowing for domestic asset protection trusts.

If properly established and in compliance with the Qualified Dispositions in Trust Act, qualified dispositions of subject property can be insulated from creditors.

Creditors can protect themselves by having a valid preexisting lien or by entering into a written agreement with the transferor.

Although the act offers many rights and protections to transferors, qualified trustees, advisors, and qualified trust beneficiaries, creditors are also protected to some extent. If a creditor has a valid preexisting lien on property that attaches before a qualified disposition of that property is made, then the lien will survive the disposition and the trustee takes title to the property subject to any agreements that created or perfected the lien. In other words, the lien will not be extinguished simply by virtue of the disposition.[22]

A creditor can also protect itself by entering into a written agreement with a transferor providing that (1) the transferor has a continuing or periodic obligation to disclose any qualified disposition to the creditor, (2) a qualified disposition requires the creditor's prior written consent, or (3) the transferor is under certain other obligations as the creditor may require with respect to qualified dispositions.[23] If a transfer that would otherwise qualify as a qualified disposition violates any of these agreements, then as to that creditor only, the transfer is not a qualified disposition and the act does not affect the rights of that creditor.[24] Accordingly, a cautious creditor may consider entering into an agreement with its borrower if it is concerned that the borrower may create an asset protection trust in the future.

## Avoidance of qualified disposition

Section 7 of the act sets forth the rules governing actions to avoid qualified dispositions. A qualified disposition can only be avoided to the extent necessary to satisfy or provide for the present value of the transferor's debt to the creditor who brought the action.[25] On avoidance of a qualified disposition, a creditor's sole remedy is an order directing the trustee to transfer to the transferor the amount necessary to satisfy the transferor's debt to the creditor.[26]

With respect to any avoidance action, trustees are given certain powers if the court is satisfied that the trustee has not acted in bad faith in accepting or administering property that is the subject of the qualified disposition. First, the trustee is given a lien against the property that is the subject of the qualified disposition in an amount equal to the entire cost (including attorney's fees) incurred by the trustee in defending the creditor's action to avoid the qualified disposition.[27] This lien has priority over all other liens against the property, whether or not the other liens accrued or were recorded before the accrual of the trustee's lien. Second, if all or any part of the qualified disposition is avoided, it is avoided subject to the trustee's fees, costs, preexisting rights, claims, and interests.[28]

A trust beneficiary also has certain protections in avoidance actions if the court is satisfied that the trust beneficiary did not act in bad faith. Specifically, a creditor's avoidance of a qualified disposition is subject to the trust beneficiary's right to retain any distribution received before the creditor brings an action to avoid the qualified disposition.[29]

Creditors have the burden of proving bad faith in an avoidance action.[30] Generally speaking, creditors must establish by clear and convincing evidence that a trustee or trust beneficiary acted in bad faith. However, if the trust beneficiary is the same person as the transferor, the creditor need only establish that the transferor-beneficiary acted in bad faith by a preponderance of evidence.[31]

## Trust beneficiary's power or capacity to transfer income

A trust beneficiary's power or capacity to transfer trust income under the act is limited in several respects. Under section 9, a trust beneficiary does not have the power or capacity to transfer any income from a trust that is a qualified disposition. This includes transfers by the trust beneficiary's order or by a court's order or direction.[32] Moreover, except as otherwise provided in the act, a beneficiary's interest in a trust or portion of a trust that is a qualified disposition is not subject to a process of attachment issued against that beneficiary.[33] Nor may the beneficiary's interest in the trust be taken in execution under any form of legal process directed against the beneficiary, trustee, trust estate, or any part of the trust estate's income. Rather, the entirety of the trust estate and the income of the trust estate must go to and be applied by the trustee solely for the benefit of the beneficiary in a manner that is free, clear, and discharged of and from all of the beneficiary's obligations.[34]

Trustees of qualified dispositions are required to disregard and oppose any attempted assignment or other action that is otherwise contrary to section 9 of the act.[35] Any trustee who performs this duty is entitled to reimbursement for all associated attorney's fees, costs, and expenses, which amount to a lien against the property that is the subject of the qualified disposition. Trustees are not liable for a breach of this duty unless the trustee's breach was in bad faith or the result of reckless indifference to the purposes of the trust or the interests of the trust beneficiary or beneficiaries.[36] Notwithstanding anything contained in section 9, however, a beneficiary may still disclaim an interest in a trust that is a qualified disposition or exercise a power of appointment.[37]

## Amendments to the Uniform Fraudulent Transfer Act

The UFTA sets forth the conditions under which a transfer made or obligation incurred by a debtor is fraudulent as to a creditor. In connection with the act, the Michigan legislature amended the UFTA to account for qualified dispositions. Specifically, the following new subsection was added and is found at MCL 566.34(4):

> A qualified disposition is fraudulent as to the creditor whose claim arose after the qualified disposition only if the qualified disposition was made with actual intent to hinder, delay, or defraud any creditor of the debtor.[38]

There are a few points worth noting about MCL 566.34. First, MCL 566.34(4) only applies if a creditor's claim arose after the qualified disposition. It does not apply if a creditor's claim arose concurrent with or before the qualified disposition. Second, under MCL 566.34(1)(a) the qualified disposition must have been made with the *actual intent* to hinder, delay, or defraud the creditor. In determining actual intent, consideration may be given to the factors described in section MCL 566.34(2), such as whether the transfer or obligation was to an insider, whether the debtor retained possession or control of the property transferred after the transfer, and so on.

Section 9 of the UFTA was also amended to provide for the statute of limitations periods regarding fraudulent transfer or obligation actions related to qualified dispositions. The amended language is reflected in MCL 566.39(c):

> A claim for relief with respect to a transfer or obligation under this act is extinguished unless action is brought under 1 or more of the following: . . . [i]f the claim for relief is under section 4 or 5, with respect to a qualified disposition, the time provided in section 5 of the qualified dispositions in trust act.

This would either be (1) within the later of two years after the qualified disposition was made or the obligation was incurred or one year after the qualified disposition was made or the obligation was or reasonably could have been discovered if the claim arose before the qualified disposition was made or (2) within two years after the qualified disposition was made if the claim arose concurrent with or after the qualified disposition.[39]

## Conclusion

Michigan's new Qualified Dispositions in Trust Act and amendments to the Uniform Fraudulent Transfer Act offer many benefits to those who want to form domestic asset protection trusts and shield their assets from creditors. At the same time, however, there are numerous mechanisms to protect creditors and impose limitations on DAPT protections. Regardless of which side of a DAPT you are on, it is important to understand the intricacies of the act and the UFTA and closely monitor judicial interpretation of this new legislation. ■

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## ENDNOTES

1. MCL 700.1041 *et seq.* and MCL 566.31 *et seq.*
2. Senate Legislative Analysis, SB 597 and HB 5504 (December 27, 2016) <https://www.legislature.mi.gov/documents/2015-2016/billanalysis/Senate/pdf/2015-SFA-0597-N.pdf>. All websites cited in this article were accessed February 6, 2018.
3. Senate Legislative Analysis, SB 597 (S-1) and SB 598 (March 30, 2016) <https://www.legislature.mi.gov/documents/2015-2016/billanalysis/senate/pdf/2015-SFA-0597-U.pdf>.
4. *Id.*
5. MCL 700.1042(p).
6. *Id.*
7. MCL 700.1042(g).
8. *Id.*
9. MCL 700.1042(r).
10. *Id.*
11. MCL 700.1042(r)(i)–(iii).
12. MCL 700.1042(aa).
13. MCL 700.1042(y).
14. MCL 700.1046(2).
15. MCL 700.1046(1), MCL 700.1046(3), and MCL 700.1046(5).
16. MCL 700.1045(2) and MCL 700.1047.
17. MCL 700.1045(2)(a). The burden of proof described in Section 5(2)(a) of the act is a significant departure from the traditional burden of proof described in Section 4(3) of UFTA, which requires proof by a preponderance of the evidence.
18. MCL 700.1045(3)(b).
19. MCL 700.1045(3)(a).
20. For example, Alaska, Delaware, Missouri, New Hampshire, Oklahoma, Rhode Island, and Wyoming each have a four-year statute of limitations period for future creditor actions. On the other side of the spectrum, Ohio has an 18-month statute of limitations period for future creditor actions. With the exception of Virginia, statute of limitation periods range from 18 months to four years after the qualified disposition was made or the obligation was incurred and from six months to one year after the date of discovery. Virginia uses an older style of fraudulent conveyance statute that does not follow the UFTA, so it does not mention a specific date of discovery rule and uses a blanket five-year statute of limitations period.
21. MCL 700.1045(7).
22. MCL 700.1045(10).
23. MCL 700.1045(11).
24. MCL 700.1045(12).
25. MCL 700.1047(1).
26. MCL 700.1047(7).
27. MCL 700.1047(2)(a).
28. *Id.*
29. MCL 700.1047(2)(b).
30. MCL 700.1047(3).
31. *Id.*
32. MCL 700.1049(1).
33. MCL 700.1049(2).
34. *Id.*
35. MCL 700.1049(3).
36. *Id.*
37. MCL 700.1049(4).
38. MCL 566.34 is also referred to as section 4 of the UFTA. As discussed, the act mandates that a creditor can only maintain an action against a qualified trust under sections 4 or 5 of the UFTA.
39. MCL 700.1045(3)(a)–(b).