White Paper

Argent FINANCIAL GROUP

Certain Provisions of the Tennessee Uniform Trust Act Affected by the 2021 Amendments

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Several significant and not-so-significant changes to Tennessee law relating to trusts and estates went into effect on July 1, 2021 (except where stated), after being passed by the state legislature and signed by Gov. Bill Lee. This summary is intended to serve as a reminder regarding certain administrative duties, powers and rules and the requirements and limitations affecting them. It will also point out the places where the new amendments have significant changes.

> The term "(amended)" will appear to indicate a specific statute affected by the 2021 amendments, but all the topics presented here reflect the updated law and include sections not yet accessible through online resources. I have broken this discussion into sections for easier consumption and included additional explanations to add context.

Requirements for Creation of a Trust

A trust is created only if:

1. The settlor has capacity to create a trust,
2. The settlor indicates an intention to create the trust,
3. The trust has a definite beneficiary (except for a charitable trust, a trust for the care of an animal or a trust for some other valid purpose that is funded in accordance with its intended use),
4. The trustee has duties to perform, and

   The same person is not the sole trustee and sole beneficiary. [Tenn. Code Ann. § 35-16-402(a) and § 35-16-409.]

Notwithstanding the requirement that the trustee has duties to perform, a passive trust is not terminable because it is passive. [Tenn. Code Ann. § 35-15-402(e) (amended).] The period of time that a trust created for a noncharitable purpose may be enforced has been increased from 90 years to 360 years. [Tenn. Code Ann. § 35-15-409(1) (amended).] These two amendments serve to allow the creation and funding of an irrevocable trust with no currently ascertainable beneficiaries that may now last 360 years and shelter estate tax-excluded assets for generations. For instance, a dynastic trust could be funded with my lifetime estate tax exemption for the benefit of my spouse and descendants, when I am currently unmarried with no children.

The Governing Trust Law Affecting Validity, Construction and Administration of the Trust

When specifically stated, the trust's terms control the jurisdiction's laws affecting the validity and construction of a trust. [Tenn. Code Ann. § 35-6-107(a) (amended to remove administration).]

- **The trust's terms control which jurisdiction's laws control the administration of the trust if:**
    1. The trustee is a resident in the designated jurisdiction,
    2. Its principal place of business is located there, or
    3. All or part of the trust administration occurs there.

- **A trust's administration occurs in a jurisdiction (a "resident trust"):**
    1. If some trust records are maintained there;
    2. If a fiduciary income tax return is wholly or partly prepared or arranged there;
    3. If some or all of the trust assets are located there, which may be in a checking account, time deposit, certificate of deposit, brokerage account, trust company fiduciary account or other similar account; or
    4. If some other substantive administrative activity takes place there. [Tenn. Code Ann. § 35-6-108(a) (amended).]

Tennessee law now governs the administration of a Tennessee resident trust, as defined above, unless the trust has a valid and controlling state jurisdiction provision or a court with proper jurisdiction issues an order that a different jurisdiction governs the trust's administration. [Tenn. Code Ann. § 35-6-108(b)(amended).] It has always been easy to meet this test, but the amendments greatly strengthen the connection that can be established. (Remember, if the trustee is a resident trustee in that state or its principal place of business is there, no other documentation or activity is necessary.)

Now a Tennessee trustee may register the trust with the Tennessee secretary of state definitively declaring it to be a resident trust. The registration is confidential and not subject to public inspection. However, the settlor, a trustee, trust advisor or trust protector for the trust may obtain a certified copy of the registration upon adequate proof of its appointment and payment of a fee. The trustee may cancel the trust registration by providing evidence it registered the trust in a different jurisdiction or that all the current beneficiaries agreed to its cancellation. If a trust has been registered elsewhere, that registration must be released by the other jurisdiction, or an instrument must be executed by the trustee and all current beneficiaries and filed with the Tennessee registration to be effective. [Tenn. Code Ann. § 35-15-1131 (amended, effective January 1, 2022).]

This new presumption that a trust administered in Tennessee is a resident trust and this new ability to affirmatively declare the situs of a Tennessee trust provides significant protection against a claim that the trust's principal place of administration is located somewhere else and that some other state law may apply. This is of particular import in relation to trusts with multiple trust advisors acting as fiduciaries created by a nonresident settlor to obtain Tennessee creditor protection not available in the settlor's or beneficiary's resident state or to create an income tax nongrantor trust specifically to avoid the settlor's resident state's income tax on capital gains.

A "Person" for purposes of the Tennessee Uniform Trust Act and the Tennessee Investment Services Act now means an individual, corporation, business trust, estate, trust or civil law equivalent of a trust, including a fideicomiso (which is when an asset is transferred, with title, along with instructions directing the recipient to convey that asset to or for the benefit of another), partnership, limited liability company, association, joint venture, government, governmental subdivision, agency or instrumentality, public corporation, or any other legal or commercial entity. [Tenn. Code Ann. § 35-16-102

(amended).] This greatly broadened definition of a person ensures that all these entities will qualify for the obligations, powers, duties and benefit the trust may accord to natural persons.

Duty to Keep Adequate Records and Inform and Report

Trustees are required to keep adequate records of their administration of the trust, keep trust property separate from their own property and keep separate shares in the trust properly designated as such even though such shares may be comingled for investment and tax reporting purposes. [Tenn. Code Ann. § 35-15-810(a)-(e).] However, if a trust is apportioned into separate shares for one or more beneficiaries, then those separate shares must be treated as separate trusts. [Tenn. Code Ann. § 35-15-810(f) (amended).] This amendment allows the beneficiaries of a separate share under a single trust agreement to access the default rights and protections previously only afforded to the beneficiaries of a specifically identified separate share trust.

- **Trustees are required to keep the current beneficiaries and any person holding a power of appointment over the trust reasonably informed. Trustees must send a notice to these same parties within 60 days of the funding of the trust or its acceptance as trustee that includes its contact information and a copy or abstract of the trust. The abstract must set out:**
    1. The number of beneficiaries,
    2. Whether distributions of income are mandatory or discretionary,
    3. Whether distributions of principal are permitted and, if so, for what purposes,
    4. An estimate of the current value of the trust from which distributions may be made, and
    5. An estimate of the income that may be distributable to the beneficiary.

A similar notice is also required upon the termination of the trust or any beneficiary's interest. [Tenn. Code Ann. § 35-15-813(a)-(c).]

These notice requirements may be waived by a beneficiary or curtailed or eliminated by the trust's terms. The trust may also give the settlor, a trust protector or trust advisor a power to direct the trustee in writing regarding all notices, what they may include and when they are to be sent, if at all. [Tenn. Code Ann. § 35-15-813(e)(1)-(2).]

When the settler, trust protector or trust advisor exercises a power to direct the trustee regarding notices, that directive remains in effect until revoked, or until the settlor, trust advisor or trust protector is dead, incapacitated or no longer serving in that capacity. If a person holds this power to direct the trustee regarding notices, this person may direct the trustee to instead send notices to a representative for the beneficiary. If no representative is identified, the trustee must send the notice to the settlor, the trust protector or trust advisor. [Tenn. Code Ann. § 35-15-813(e) and § 35-15-303 (amended).]

If the trustee is subject to written confidentiality restrictions with respect to a trust asset, the trustee may require the beneficiary eligible for such notices to also agree to the confidentiality restrictions. [Tenn. Code Ann. § 35-15-813(g) (amended).]

Any excluded fiduciary designated by the terms of the trust must be kept reasonably informed regarding any specific duty or function of the responsible fiduciary and of any other material information the excluded fiduciary would normally be required to disclose to the beneficiaries so that the excluded fiduciary may perform its duties.

No failure to provide this information will affect the limitation on the liability of any excluded fiduciary. [Tenn. Code Ann. § 35-15-813(h) (amended).]

Modification of Tennessee Trusts by Court Order or by Nonjudicial Settlement Agreement

Any one of the settlors, trustee and beneficiaries may bring an action in court to modify an irrevocable trust and, if they all consent, the modification may even be against a material purpose of the trust. [Tenn. Code Ann. § 35-15-411(a).] Following the settlor's death, the beneficiaries may modify the trust if the trustee and all beneficiaries consent, and the modification is not inconsistent with a material purpose of the trust. [Tenn. Code Ann. § 35-15-411(b)&(c).] If one or more beneficiaries disagree with a proposed modification, the court may still order the modification if the court finds that it would not be against a material purpose of the trust and that the objecting party or parties will be adequately protected. [Tenn. Code Ann. § 35-15-411(g).]

A modification may also be effectuated, without court approval, through a nonjudicial settlement agreement among the settlor, the trustee and the qualified beneficiaries with respect to any trust matter even if it may violate a material purpose of the trust. However, a nonjudicial settlement agreement between the trustee and qualified beneficiaries, executed after the settlor's death, is valid only to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the court. [Tenn. Code Ann. §§ 35-15-111(a)&(b) and -411(a).]

The execution of a modification, termination or settlement agreement pursuant to Tenn. Code Ann. § 35-15-111, § 35-15-411, or § 35-15-412 is considered a transaction for purposes of Tenn. Code Ann. § 47-10-103. [Tenn. Code Ann. § 35-15-1102 (amended).] This amendment has the effect of permitting the execution of nonjudicial settlement agreements by electronic signature or digital execution.

Matters that may be resolved by a nonjudicial settlement agreement include, but are not limited to:

1. The interpretation or construction of the terms of the trust;
2. The approval of a trustee's report or accounting;
3. Directing the trustee to refrain from performing a particular act;
4. Granting a trustee any necessary or desirable power;
5. The resignation or appointment of a trustee;

6. The determination of a trustee's compensation;
7. The transfer of a trust's principal place of administration;
8. The liability of a trustee for an action relating to the trust;
9. The extent or waiver of bond for a trustee;
10. The governing law of the trust;
11. The criteria for distribution to a beneficiary where the trustee is given discretion;
12. The resignation, appointment and establishment of the powers and duties of trust protectors or trust advisors; and
13. The powers for approval of an investment decision, delegation, policy, plan or program. [Tenn. Code Ann. § 35-15-111(c) (amended).]

The last two items listed above are additions under the amendment that clarify and ratify purposes for which I am sure the nonjudicial settlement agreement has been applied many times.

Any qualified beneficiary or trustee may request the court to approve a nonjudicial settlement agreement, to determine whether the representation of the qualified parties was adequate, and to determine whether the agreement contains terms and conditions the court could have properly approved. [Tenn. Code Ann. § 35-15-111(d).]

- **However, no modification, termination, combination or division of a trust is allowed that:**
  1. Results in the trust not qualifying for the federal or state marital or charitable income, gift, estate or inheritance tax deduction if the trust would have otherwise qualified;
  2. Results in the trust being subject to the federal or state generation-skipping transfer tax if the trust would not have otherwise been subject to the generation-skipping transfer tax; or
     Results in an overall increase in federal or state estate, inheritance, gift or generation-skipping transfer taxes. [Tenn. Code Ann. § 35-15-410(d).]

Modification of Tennessee Trusts by Trustee's Discretion to Invade Trust Principal (Decanting)

A trustee that is given a discretionary power to distribute the principal or income to or for the benefit of one or more of the trust beneficiaries of an irrevocable trust may appoint ("decant") part of all the trust assets to a trust that may be under a different trust instrument already in existence, may be under a new trust instrument that the trustee creates, or may even be the original trust instrument that the trustee has modified, any of which may even be in another jurisdiction. [Tenn. Code Ann. § 35-15-816(b)(27) (amended).]

The exact subsections for the amended Tenn. Code Ann. § 35-15-816(b)(27) cannot be determined since the published statutes have not been updated yet and this section was replaced in its entirety. It is also notable that under the prior version of 816(b)(27) there was a comment that stated: "The fact that the trustee has a power does not imply a duty that the power must be exercised." I do not know if a similar comment is included with the 2021 amendment. Therefore, I cannot confirm that the trustee has no duty to consider exercising its power to decant a trust if it would be in the best interests of the beneficiaries.

- **The terms of the second trust may be different from the original trust in any way, even if the modification violates a material purpose of the original trust, as long as (the asterisk denotes an amended or new provision):**

    1. The second trust only benefits one or more of the same beneficiaries (but not necessarily all of them*),
    2. Does not accelerate a future beneficial interest to a current one while the settlor is alive (but may do so if the settlor is deceased*),
    3. Does not prevent a qualification for a tax deduction or reduce a deduction that was allowed under the original trust,
    4. Does not adversely affect a Sub-S Election,
    5. Does not allow the trustee make distributions to himself or herself if such power was not included in the original trust (*),
    6. Does not include a less restrictive ascertainable standard for the trustee as a beneficiary than under the original trust (but may alter the ascertainable standard for the beneficiaries if the trustee is not a beneficiary*),
    7. Does not alter a requirement in the original trust that the trustee only make distributions to itself with the consent of a co-trustee or a person holding an adverse interest (*),
    8. Does not allow the trustee the discretion to make distributions that would discharge the trustee's legal support obligations if the original trust included this limitation (*), and

       Any power of appointment it confers upon a beneficiary of the original trust precludes any exercise that would extend the permissible period of the rule against perpetuities that apply to the trust.

       [Tenn. Code Ann. § 35-15-816(b)(27) (amended).]

Therefore, now a decanting may omit current income beneficiaries but not add new ones. After the settlor's death, it may accelerate a remainder beneficiary to a current income beneficiary.

Any modification should be exercised through a written instrument that describes the purpose of the modification, how it complies with the statute, how it notices the affected parties or includes their executed consents, references or includes the terms to be changed or added, and includes an attachment of the amendments or the entire new trust agreement. The appointment or agreement will usually include the written consent and the indemnification of the trust beneficiaries.

The Duty to Allocate Receipts and Disbursements Between Income and Principal

The proper allocation of receipts between income and principal is essential to the proper administration of a trust or estate. There are no amendments to this section, but I include it for context in relation to other changes. The Tennessee Uniform Principal and Income Act ("the act") defines income as any receipts that a fiduciary receives as a current return from a principal asset. Principal is defined as any property held in the trust estate for distribution to a remainder beneficiary when the trust terminates. (Tenn. Code Ann. § 35-6-102.)

The paramount fiduciary duty is to allocate a receipt or disbursement between income and principal and to exercise a power to adjust between income and principal impartially, based on what is fair and reasonable to all the beneficiaries, unless the trust's terms intentionally favor one or more beneficiaries. [Tenn. Code Ann. § 35-6-103(b).]

The trustee's power and duty to allocate a receipt or disbursement between income and principal is entirely controlled by the terms of the trust instrument even if those terms conflict with the act. In the absence of direction in the trust, the act controls. If a situation arises wherein a receipt or disbursement is not addressed by the trust's terms or the act, then the trustee must add the receipt or charge the disbursement to principal. [Tenn. Code Ann. § 35-6-103(a)(1)-(4).]

The Default Rules for Receipts and Disbursements Between Income and Principal

For purposes of Tenn. Code Ann. § 35-6-401, an "entity" is defined as any corporation, LLC, RIA, REIT, common trust fund, or other organization, but not if it is another trust estate, a business entity operated by the trustee, or an asset-backed security (whose receipts are either allocated to principal or must be apportioned between income and principal - see Tenn. Code Ann. §§ 35-6-402, -403 and -415 for the applicable rules for these receipts). [Tenn. Code Ann. § 35-6-401(a).]

- **The trustee will allocate to income money received from an entity in which the trust holds an interest except:**
  1. When the receipt is in property other than money,
  2. When it is in exchange for an interest in the entity,
  3. When it is received in "partial liquidation" or total liquidation of the entity, or
  4. When it is from an RIA or REIT as a capital gain dividend. [Tenn. Code Ann. § 35-6-401(c).]

A receipt is a "partial liquidation" when the entity indicates it is a distribution in partial liquidation or when the total amount of the receipt is greater than 20% of the entity's gross assets as shown by its year-end financial statements or by an attestation by an officer immediately preceding the initial receipt. [Tenn. Code Ann. § 35-6-401(d) (amended).] This amendment simply added the officer's attestation option to allow for more privacy but also hold the entity responsible for identifying a partial liquidation.

■ **The trustee will disburse from income for all ordinary expenses incurred in connection with the administration, management or preservation of trust property, including:**

1. Interest,
2. Ordinary repairs,
3. Regularly recurring taxes assessed against principal, unless the tax is assessed on receipts allocated to principal (even if the taxing authority calls it an income tax),
4. Any tax on receipts allocated to income,
5. Expenses of a judicial proceeding primarily concerning income,
6. Insurance premiums covering the loss of a principal asset or the loss of income from or use of the asset, and
7. May transfer to principal a reasonable amount of net cash receipts from a principal asset that is subject to depreciation unless such asset is used or available for use by a beneficiary. [Tenn. Code Ann. § 35-6-501(3)-(4), § 35-6--503(b).]

■ **These special rules apply to income taxes. A tax required to be paid by a trustee:**

1. Based on receipts allocated to income must be paid from income.
2. Based on receipts allocated to principal must be paid from principal, even if the tax is called an income tax by the taxing authority,
3. That is a regularly recurring tax assessed against principal must be paid from income, unless the tax is assessed on receipts allocated to principal (even if the taxing authority calls it an income tax), and
4. A tax on the trust's share of an entity's taxable income must be paid:
    a. From income to the extent that receipts from the entity are allocated only to income,
    b. From principal to the extent that receipts from the entity are allocated only to principal,
    c. Proportionately from principal and income to the extent that receipts from the entity are allocated to both income and principal, and
    d. From principal to the extent that the tax exceeds the total receipts from the entity.

The trustee must adjust income or principal receipts to the extent that the trust's taxes are reduced because the trust receives a deduction for payments made to a beneficiary. (Tenn. Code Ann. § 35-6-505.)

■ **The trustee will disburse from principal for:**

1. All of the trustee's compensation calculated on principal,
2. Payments on the principal of a trust debt,
3. Expenses of a judicial proceeding primarily concerning principal, including a proceeding to construe the trust or to protect the trust or its property,

4. Insurance premiums for policies for which the trust is owner and beneficiary other than those covering the loss of a principal asset or the loss of income from or use of the asset,
5. Estate, inheritance and other transfer taxes, including penalties, apportioned to the trust,
6. Disbursements related to any environmental matter, and
7. An amount equal to any income paid to a creditor in reduction of a principal balance on an encumbered principal asset that requires income from that asset to be paid to the creditor must be transferred to income. [Tenn. Code Ann. § 35-6-502(a)-(b).]

■ **The trustee may transfer from income to principal to reimburse principal or provide a reserve for future principal disbursements to the extent that an amount chargeable to income was paid from principal because the amount is:**

1. Unusually large, including extraordinary repairs;
2. For a capital improvement to or construction of a principal asset, including special assessments;
3. To prepare property for rental use, including tenant allowances, leasehold improvements, and broker's commissions;
4. In periodic payments on an obligation secured by a principal asset to the extent that the amount transferred from income to principal for depreciation is less than the periodic payments; or
5. Equal to any income paid to a creditor in reduction of a principal balance on an encumbered principal asset that requires income from that asset to be paid to the creditor must be transferred to income. (Tenn. Code Ann. § 35-6-504.)

■ **The trustee will disburse half from income and half from principal for:**

1. The regular compensation of the trustee and of any person providing investment advisory or custodial services to the trustee, and
2. All expenses for accountings, judicial proceedings or other matters that involve both the income and principal. [Tenn. Code Ann. § 35-6-501(1)-(2).]

If the trustee determines that charging part or all fiduciary compensation to principal is impracticable due to insufficient principal cash and readily marketable intangible personal property, or is inadvisable because of the nature of the assets, then it may pay part or all of the compensation from income, subject to the prohibitions under Tenn. Code Ann. § 35-6-104(c), with no requirement to reimburse to income from principal. [Tenn. Code Ann. § 35-6-502(a)(1) (amended).] This amendment clarifies and ratifies the trustee's power to allocate receipts and disbursements between income and principal and to adjust between income and principal. (Tenn. Code Ann. § 35-6-104.)

These requirements for disbursements from income and/or principal are unrelated to the deductibility of expenses, such as trustee fees, on a fiduciary income tax return. The Tax Cut and Jobs Act states under Sections 67(e)(1) and 67(g) that investment-related costs and fees are not deductible. It limits the deductibility of tax preparation fees to nongrantor

trust and estates, including costs relating to preparation and filing estate and generation-skipping transfer tax returns, fiduciary income tax returns, and the decedent's final individual income tax return. But the costs for preparing all other tax returns (for example, gift tax returns) are not deductible.

Trustee compensation under a nongrantor trust or an estate is only deductible on the fiduciary income tax return to the extent that it relates to purely administrative services and the portion relating to investment services is not deductible. The trustee, or the fiduciary directing the trustee regarding income tax filings, is responsible for a reasonable determination as to the appropriate ratio the trustee's compensation must be divided between administrative and investment services. The trustee has no duty to decouple its fees on its published fee schedule between administrative and investment services.

The Power to Adjust Between Income and Principal

The trustee has a power to adjust between income and principal in accordance with the act's requirements and limitations, even if the trust's terms limit that power unless it is clear from the trust's terms that the settlor intended to deny the trustee the power to adjust. [Tenn. Code Ann. § 35-6-104(f).] There is no requirement that the trust actually confer a power to adjust to the trustee for the trustee to have the power to adjust. The power to adjust is a default power that may be curtailed by the trust's terms.

A trustee has no duty to make an adjustment and shall not be held liable for not considering an adjustment or for choosing not to make an adjustment. [Tenn. Code Ann. § 35-6-104(a) and -104(f)-(g).]

The trustee may adjust between income and principal when:

1. It complies with the prudent investor rules,
2. The trust includes a power to distribute income to a beneficiary, and
3. The trustee determines that adhering to the trust's terms or the act's default rules for allocating receipts and disbursement between income and principal would not be fair and reasonable under the circumstances. [Tenn. Code Ann. § 35-6-104(a).]

In making an adjustment between income and principal, the trustee may consider any circumstances affecting its decision, including but not limited to:

1. The nature, purpose and duration of the trust,
2. The settlor's intent,
3. The beneficiary's needs,
4. The preservation of capital,
5. The type of assets and any affect the adjustment may have on those assets,
6. Any trust's terms limiting the trustee's power to invade principal or accumulate income,

7. The current economic conditions, and
8. Any anticipated tax consequences. [Tenn. Code Ann. § 35-6-104(b).]

The trustee may not make an adjustment between income and principal:

1. That disqualifies the trust for a tax deduction or adversely affects a gift tax exclusion that would be otherwise be allowed,
2. That alters a fixed annuity or fractional interest,
3. That changes an amount set aside for a charitable purpose,
4. That causes a person to be treated as an income tax owner of all or part of the trust or to be subject to gift or estate tax inclusion for all or part of the trust,
5. If the trustee is a beneficiary of the trust, or
6. If the trustee may receive a direct or indirect benefit from the adjustment. [Tenn. Code Ann. § 35-6-104(c).]

The trustee may adjust between principal and income to offset the shifting of economic interests or tax benefits between income and remainder beneficiaries which arise from:

1. The trustee's elections and decisions regarding tax matters,
2. Any tax imposed on the trust or a beneficiary as a result of a transaction or distribution from an estate or trust, or
3. The trust's or estate's interest in an entity whose taxable income, whether or not distributed, is includable in the taxable income of the estate, trust or a beneficiary. [Tenn. Code Ann. § 35-6-506(a).]

However, if the amount of an estate tax marital deduction or charitable contribution deduction is reduced because a fiduciary deducts an amount paid from principal for income tax purposes instead of deducting it for estate tax purposes, and as a result the estate taxes paid from principal are increased and income taxes paid by an estate, trust or beneficiary are decreased, then each estate, trust or beneficiary that benefits from the decrease in income tax must reimburse the principal from which the increase in estate tax is paid.

1. That total reimbursement must equal the increase in the estate tax to the extent that the principal used to pay the increase would have qualified for a marital deduction or charitable contribution deduction but for the payment.
2. The proportionate share of the reimbursement for each estate, trust or beneficiary whose income taxes are reduced must be the same as its proportionate share of the total decrease in income tax.
3. The estate or trust must reimburse principal from income. [Tenn. Code Ann. § 35-6-506(b).]

Creditor Protection Afforded a Spendthrift Trust Under the Tennessee Uniform Trust Act

Unless prohibited under the act, a court may authorize a creditor to invade a beneficiary's trust and charge against all present or future distributions. (Tenn. Code Ann. § 35-15-501.)

A spendthrift provision is valid to restrain all voluntary and involuntary transfers of a beneficiary's interest, including a discretionary interest, even if the beneficiary is also a trustee or other fiduciary, simply by stating that the interest is held subject to a "spendthrift trust," or words of similar import. (Tenn. Code Ann. § 35-15-502 and § 35-15-504.) However, a spendthrift provision is unenforceable against claims brought by the State of Tennessee. (Tenn. Code Ann. § 35-15-503.)

A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision. A creditor may not reach or force a distribution of a beneficiary's interest if the trust includes a spendthrift provision. (Tenn. Code Ann. § 35-15-502.)

Whether or not the terms of a trust contain a spendthrift provision, during the lifetime of the settlor, the property of a revocable trust is subject to the settlor's creditor's claims. A creditor may reach the maximum amount the trustee may distribute to or for the settlor's benefit — but not more than the settlor's actual contribution to the trust. [Tenn. Code Ann. § 35-15-505(a)(1)-(2).]

It is notable that Tenn. Code Ann. § 35-16-104(b)(1)'s amendment (see below) to reduce the limitation period from 24 to 18 months applies specifically to qualified dispositions in trust under the Tennessee Investment Services Trust Act. There is no similar reduction to 18 months in the amendments for spendthrift trusts under the Tennessee Uniform Trust Act controlling other irrevocable trusts. [Tenn. Code Ann. § 35-15-505(g).]

A person is not considered the settlor or deemed settlor of an irrevocable inter vivos trust by virtue of being the settlor's spouse at the time property is transferred to the trust, regardless of a subsequent dissolution of the marriage. [Tenn. Code Ann. § 35-15-505(h) (amended).] Prior law provided that property transferred to an irrevocable inter vivos trust is no longer held by the husband and wife as tenants by the entirety, but this amendment dictates that property transferred to such trust will be tenancy by the entirety property held by the spouses. [Tenn. Code Ann. § 35-15-510(i) (amended).] These amendments have the effect of limiting a creditor from pursuing a collection action against a non-debtor spouse personally or by attacking the spendthrift trust.

No creditor or assignee may reach property transferred from a spendthrift trust pursuant to a power of appointment exercised by a decedent unless the power of appointment was actually exercised in favor of the decedent or the decedent's estate. [Tenn. Code Ann. § 35-15-509(3) (amended).]

Creditor Protection Afforded Under the Tennessee Investment Services Trust Act

The Tennessee Investment Services Trust Act ("the act") at Tenn. Code Ann. § 35-16-104, prohibits any action brought at law or equity to attach property transferred to an irrevocable investment services trust as a qualified disposition as defined in the act, unless the action comports with the Tennessee Uniform Fraudulent Transfer Act at Tenn. Code Ann. § 66-3-3, and, in the case of a creditor whose claim arose after a qualified disposition, unless the qualified disposition was also made with actual intent to defraud that specific creditor.

A "qualified disposition" means a disposition by or from a transferor with or without consideration, to an investment services trust, administered by a qualified trustee. [Tenn. Code Ann. § 35-16-102(11) (amended to remove the requirement that a qualified affidavit is required).]

A "qualified trustee" means a natural person who is a Tennessee resident (excluding the transferor) or any entity authorized to act as a trustee under Tennessee law subject to supervision by the TDFI, the FDIC, the Comptroller of the Currency, the Office of Thrift Supervision or other successor agency and the trust meets the requirements as a Tennessee resident trust. [Tenn. Code Ann. § 35-16-102(12).]

A "qualified affidavit" means a sworn affidavit signed by the transferor before a disposition of assets to an investment services trust. If a trustee transfers a qualified disposition in further trust, then the original transferor must sign the qualified affidavit. [Tenn. Code Ann. § 35-16-102(10).] The settlor's execution of a qualified affidavit is no longer required for creditor protections under the act to apply; however, a qualified affidavit creates a rebuttable presumption that the assets disclosed in the affidavit were a qualified disposition to the trust on the date the affidavit was executed. However, for any asset not listed on a qualified affidavit, the transferor bears the burden of proving the date the asset was transferred. [Tenn. Code Ann. § 35-16-104 (amended to add the rebuttable presumption).]

I must emphasize the importance of obtaining the protections afforded by the rebuttable presumption granted through the qualified affidavit. Conclusively proving the date of the qualified disposition is essential to the application of the time limitations a purported creditor must meet to bring a successful action for collection against trust assets. A qualified affidavit is only effective if it states state that:

1. The transferor has full right, title and authority to transfer the assets to the trust,
2. The transfer of the assets to the trust will not render the transferor insolvent,
3. The transferor does not intend to defraud a creditor by transferring the assets to the trust,
4. The transferor does not have any pending or threatened court actions against the transferor, except for those court actions identified by the transferor on an attachment to the affidavit,
5. The transferor is not involved in any administrative proceedings, except for those administrative proceedings identified on an attachment to the affidavit,
6. The transferor does not contemplate filing for relief under the federal bankruptcy code, and
7. The assets being transferred to the trust were not derived from unlawful activities. (Tenn. Code Ann. § 35-16-103.)

For creditor claims that exist prior to a qualified disposition of property to an investment services trust, a person must bring a claim that the qualified disposition was a fraudulent conveyance within the later of 18 months after the qualified disposition is made to the trust or six months after the person discovers or reasonably should have discovered the qualified disposition. For creditor claims that arise after a qualified disposition of property to a spendthrift trust, a person must bring a claim that the qualified disposition was a fraudulent conveyance within 18 months of the time the qualified disposition is made. The person bringing such action must prove by clear and convincing evidence that the settlor's qualified disposition to the trust was made with the intent to defraud that specific creditor. [Tenn. Code Ann. § 35-16-104(b)(1) (amended to reduce the limitations period from 24 to 18 months).]

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