Tennessee Further Solidifies Itself as a Top State for Trusts

For years, we have known that Tennessee has one of the most robust trust codes in the country. While this is surprisingly not one of the main topics at dinner tables nationwide, more than just Tennessee residents can share these incredible attributes. Due to new legislation Gov. Bill Lee signed into law on May 12, 2021, Tennessee has recently gotten even better!

For the readers that do not spend their weekends and vacations perusing the trust code, some of the best parts are: ease and flexibility of self-settled asset protection trusts, length of time trusts can exist, and state income tax provisions. And with the new legislation, it is even easier for preexisting trusts to be governed under Tennessee's Trust Code, even when the trust agreement provides for administration in a different state.

Self-Settled Asset Protection Trusts

Tennessee law provides for self-settled asset protection trusts, meaning that someone can create a trust, be a beneficiary of that trust, and the assets inside of the trust are protected from creditors if done correctly. The two most common self-settled asset protection trusts are the Tennessee Investment Services Trusts (TIST) and the Tenancy by the Entirety Trusts (TBE Trusts).

A TIST is an irrevocable trust created by you (the grantor) for your benefit while protecting the assets from most of your future creditors. One of the key requirements for a self-settled asset protection trust is that the trustee must be a "qualified trustee." A qualified trustee is either a trust company qualified to do business in Tennessee or a Tennessee resident that is not considered subordinate to you. So, even if you do not live in Tennessee, as long as the trustee is a "qualified trustee," you can create an asset protection trust and still be the beneficiary.

When initially funding a TIST, you must complete an affidavit that, among other things, discloses any known creditors and states that the transfer will not leave you insolvent. However, as part of last month's new legislation, subsequent transfers will not require such affidavit. Additionally, as a result of the new legislation and effective July 1, 2021, if a TIST is properly funded, it will be protected from the claims of most of your creditors after the later of 18 months or six months after the creditor discovers or reasonably should have discovered the transfer (this 18 month period is reduced from two years and tied with Ohio for the shortest statute of limitations in the country). One way to start the time on when a creditor should have reasonably known about the transfer is to record the affidavit with the Register of Deeds.

A TBE Trust is similar in concept to a TIST, but it is a trust created by a married couple. Under Tennessee law, property held jointly by spouses entails a degree of creditor protection against the claims of one spouse. Usually, spouses who execute a traditional Joint Revocable Trust lose this creditor protection. However, if you and your spouse (the grantors) create a TBE Trust, if drafted and funded correctly, the assets in your TBE Trust have the same creditor protection allotted to property held jointly by spouses. The new legislation tightened up this trust by specifying that jointly held property transferred to a TBE Trust would maintain the "tenancy by the entirety" status, so the creditors of only one spouse cannot attempt to satisfy their claims with the assets in the TBE Trust.

One key component to consider when trying to take advantage of this technique is the importance of complying with the statutory requirements and continued operation within the parameters of the code. Failure to comply with the statutory requirements or improper funding or administration of either trust could result in creditors being able to access trust assets. The improvements in the Tennessee Trust Code that have been made over the years is an intentional effort at encouraging growth in this area, so the rules and requirements are not burdensome. Still, you will want to make sure that the trust agreement is drafted correctly and that you have ongoing support from a long-term team of knowledgeable advisors as questions arise.

Length of Time of Trusts

Trusts created under Tennessee law can last for up to 360 years. Under most state laws, a trust is required to terminate after two or three generations. The benefit of a trust being allowed to continue for 360 years is two-fold. First, the assets within the trust will largely remain protected from the beneficiaries' creditors while remaining in the trust. This provides creditor protection of the assets for 360 years. Second, if properly prepared, the trust can avoid paying estate, gift, or generation-skipping transfer taxes (after the initial funding) for up to 360 years. A wealthy family or individual will be able to pass a large sum of assets to multiple generations while providing creditor protection and avoiding taxes on such assets.

Now, thanks to new legislation, this extended timeframe can be even more widespread. Historically, if a trust was created while there were not specific beneficiaries, it could only last for 90 years. Even if the beneficiaries are not immediately identifiable, the trust can continue for the full 360 years. This means that you could conceivably create a trust for the benefit of your unborn and unconceived children or grandchildren, fund it when estate exemption rates are higher (perhaps today's $11. 5M exemption) and before the exemption reduces (like it is scheduled to do in 2026), and the trust can continue for 360 years, instead of only 90.

State Income Tax Implications

With Tennessee no longer taxing investment income, Tennessee trusts will not incur Tennessee income tax. Of course, each state has its definition of what makes a trust's income taxable in that state. But for those states where "nexus" is defined as where the trust is administered or where the trustee is located, a Tennessee trust can potentially avoid any state income tax liability. Again, you want to make sure your advisor has a deep knowledge of the income tax implications of trusts, not only in Tennessee but also nationwide.

Additional Changes in New Legislation

The new legislation made further expansions to Tennessee's Trust Code. Among some of the other changes, this new law:

- Expands the decanting statute, allowing trust assets to be distributed directly to a different but similar trust to permit the remainder beneficiaries to become current beneficiaries. This provides more flexibility for trustees to be able to provide for the children of beneficiaries more easily;
- Includes explicit language specifically restricting a creditor's right to enforce a judgment against property interest over which a debtor transferred under a power of appointment. A power of appointment is a provision in some trust agreements that allows a beneficiary to direct assets to be distributed other than how the trust agreement states.
- Expands the uses of Nonjudicial Settlement Agreements (NJSA), which provides for trusts to be modified by agreement of all parties, without the time and expense of having the courts modify a trust. These expansions include (i) appointment, removal, or alteration of the powers and duties of a trust protector, and (ii) allowing an NJSA to be used to create a directed trust or otherwise deal with investment decisions; and
- Allows NJSAs to be executed by electronic signatures.

What Does This Mean?

Tennessee residents and residents of other states can all benefit from Tennessee's incredibly flexible trust laws. Regardless of their residency, an individual can create a trust for their benefit, which would be protected from creditors. Or a married couple can create a trust for their benefit, which would be protected from the creditors of one spouse. These assets could remain in trust for 360 years, providing creditor protection to descendants while avoiding Uncle Sam getting his share at the death of each generation. These trusts will not incur Tennessee income tax on the income generated by the trust, and out-of-state residents may be able to avoid income tax on the income generated by the trust – potentially subjecting the trust's income only to federal income tax.

Tennessee's recent amendments to the Trust Code, most of which become effective July 1, 2021, show its dedication to remaining one of the most favorable jurisdictions for trusts. If you are wondering what else makes Tennessee such an excellent state for trusts, we are here to help educate you and help ensure your estate plan is efficient and effective.

Whether you have a modest estate or millions, are a Tennessee resident, or resident of another state, Tennessee law could provide you a great benefit. Our team at Chambliss advises clients on these issues daily and can help you and your family with long-term planning. With a commitment to continuing estate planning sustainability in the firm, we will be here to guide you today, next year, and well into the future.

If you have any questions relating to Tennessee trusts or other estate and tax planning issues, please contact Shelton Chambers, Nick Nester, or another member of our Tax and Estate team.