

Legislative update

FAMILY WEALTH PRESERVATION TRUST ACT

By
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If you haven't looked at asset protection recently, now is the time to review your plans and take action if appropriate. The Federal Bankruptcy Reform Act of 2005 significantly reduces the relief available to certain individuals, particularly those who enjoy high incomes.

Coincidentally, the Oklahoma Family Wealth Preservation Trust Act (FWPT) has been clarified and strengthened. I will give a brief overview of the highlights of these two acts as well as discuss a new Oklahoma tax benefit that enhances the Family Wealth Preservation Trust Act.

AN AMENDED ACT

Effective June 8, 2005, the governor signed into law an amended version of the Family Wealth Preservation Trust Act passed last year at this time. The law remains unique in that it uses the bankruptcy exemption laws and allows the grantor to create a revocable trust to protect against his or her creditors. No other asset protection trust, foreign or domestic, allows the grantor to retain the right to revoke.

Individuals can now create an Oklahoma trust consisting of a **majority** of Oklahoma assets that protects up to one million dollars (plus income or growth) from creditors. This trust must benefit only the grantor's parents, spouse's parents, spouse, children, adopted children, step-children, grandchildren or fund a trust for the benefit of one or more of these individuals or to a charity. Since this is an individual exemption, a married couple could create two trusts, one for each grantor spouse, and thus shelter up to two million dollars.

In return for the exemption, a majority of the assets must be invested in Oklahoma assets, the trust must be

subject to the taxation laws of Oklahoma and have an Oklahoma trust company or bank as trustee or co-trustee.

What are "Oklahoma-based assets"? These would include not only Oklahoma-based company stocks and bonds but also Oklahoma municipal bonds, real estate, bank CDs and many other Oklahoma related investments. Since only a majority of the assets must be Oklahoma based assets, an individual can now hold a majority of the account in fixed income assets such as Oklahoma municipal bonds and a diversified equity portfolio in the remaining portion of the account. The new law allows trustees to better diversify the trust portfolio.

The Oklahoma corporate trustee requirement is consistent with the trustee provisions for IRAs, for example. The legislators wanted to encourage strict compliance with the provisions and intent of the act with regulated professional trustees.

The act also requires that asset protection trust income be taxable in Oklahoma. From a tax standpoint, this is a grantor trust so all of the trust income is included on the grantor's individual income tax return just as it is with a standard revocable trust.

The amended act removes the presumption of fraud provision contained in the original statute. The act therefore falls within the existing fraudulent transfer rules.

BANKRUPTCY REFORM

The Federal Bankruptcy Reform Act of 2005, generally effective in October of this year, made dramatic and sweeping changes to the bankruptcy code, especially with regard to "high income" debtors.

Analyzing the reform act from a strictly "high income" perspective reveals several new challenges. Under the old bankruptcy code, a snapshot of the debtor's financial condition on the date of bankruptcy determined the ultimate outcome, e.g. if debt exceeds assets, relief can be granted. The



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reform act creates a “means” test that determines if a debtor can repay the debt from future income. If monthly income exceeds state median income, the repayment must be made or the bankruptcy will be dismissed.

Take, for example, the business executive who has made an effort to protect his assets with various exemptions but is a “high income” individual. High income is defined as having income exceeding the state median income. The U.S. Census Bureau shows Oklahoma median income for the three year period 2001-2003 was \$36,733. One day the hypothetical business executive is involved in an auto accident. He was talking on his cell phone at the time and was found negligent. Judgment was rendered against him in the amount of ten million dollars to pay for the care of the now disabled passenger in the other vehicle.

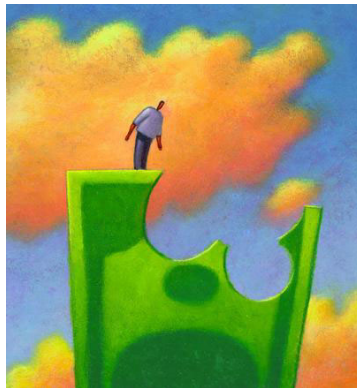
His auto insurance policy paid the one million dollar limit. It would appear that to the extent the business executive’s income exceeded \$36,733 annually, he would be required to make payments on the judgment in the amount of that excess income. These payments would apparently continue for five years. Current planning should review the impact of a significant drop in income and how those dollars might be covered by exempt assets.

NEW CODE LIMITS HOMESTEAD EXEMPTIONS

The new bankruptcy code also places limits on homestead exemptions. Under Oklahoma law, your personal residence is exempt in an unlimited amount. The new Federal law, which overrides state law, provides a ten

One long-time fear of mine is that family-owned oil and gas operators and service companies could have a serious and costly accident... especially one that gets the attention of the Environmental Protection Agency (EPA). EPA has demonstrated that they can go after the family members personally even if they operate the properties in a corporation. Attorneys that specialize in oil field risk and EPA matters say the entire family wealth could be at risk. I strongly recommend the Oklahoma Family Wealth Preservation Trust Act to family-owned oil and gas operators and service companies.

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year lookback period to determine if nonexempt assets funded the residence and there was an intent to defraud.

Further, the law provides that any interest acquired within 1,215 days before the bankruptcy filing is NOT protected by the state exemption to the extent it exceeds \$125,000. To prevent “exemption shopping,” the new law imposes a two year residency requirement (formerly six months) to take advantage of the particular state’s exemption rules.

The new bankruptcy code allows a Bankruptcy Trustee to avoid (basically undo) a transfer to an asset protection trust anytime within ten years where the debtor is a beneficiary and there is “actual intent” to avoid debt. Why else would you do an asset protection trust?

All of the domestic protection trusts, except Oklahoma, in the United States, e.g. Alaska, Delaware, etc., allow the debtor to be a beneficiary. Because the debtor cannot be a beneficiary of the FWPT, this ten year lookback provision does not apply.

OKLAHOMA TAX RELIEF

Oklahoma passed a statute last year providing that taxpayers may exclude capital gains realized from the sale of real or tangible Oklahoma property held at least five years or stock or ownership interests in Oklahoma properties held at least three years.

This relief is available to all taxpayers, not just Family Wealth Preservation Trusts, but it does provide some additional incentive to consider the FWPT. That act became effective for sales after December 31, 2004.

Feel free to call me with any questions you may have or to set up a meeting to review your current plan and how the Family Wealth Preservation Trust might fit in.

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