

**SOUTHEAST FELLOWS INSTITUTE  
OF  
THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL**

Session I / September 29–30, 2022  
Charlotte, North Carolina

**VIRGINIA ASSET PROTECTION IN THE  
ESTATE PLANNING CONTEXT**



Katherine E. Ramsey  
Virginia Estate & Trust Law, PLC  
Richmond, Virginia

## I. THE GOLDEN RULE - KNOW YOUR CLIENT

### A. Existing vs. new?

1. Confirm identification
2. Current assets and liabilities
3. Solvency affidavit

### B. What is the client's goal?

1. Protect assets from one or more specific creditors?
  - i. Personal injury lawsuit
  - ii. Malpractice claim
  - iii. Divorce
  - iv. Business creditors
2. Protect assets from creditors generally (i.e., bankruptcy)?
3. Protect assets from possible future creditors vs. likely or known current creditors of client?
4. Protect assets from a beneficiary's creditors?

### C. Ethical obligations

1. Spouses<sup>1</sup>
  - i. Joint representation
  - ii. Asset transfers between spouses
  - iii. Joint debt / guarantors
  - iv. Divorce

---

<sup>1</sup> See Virginia Rule of Professional Conduct (RPC) 1.7 ([A] lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: (1) the representation of one client will be directly adverse to another client; or (2) there is significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.).

2. Client engaged in possible criminal or fraudulent activity<sup>2</sup>
  - i. There is a critical distinction between presenting an analysis of legal aspects of questionable conduct and recommending the means by which a crime or fraud might be committed with impunity. Virginia Rule 1.2(c), Comment 9.
  - ii. Trust your instincts – don't be afraid to say, "Sorry, I can't help you."
3. Virginia Fraudulent Transfers Statute (*see* Va. Code §§ 55.1-400 *et seq.*)
  - i. Any transfer made with the intent to delay, hinder, or defraud creditors is void. *See* Va. Code § 55.1-400.
  - ii. Regardless of the transferor's intent, any transfer made by an insolvent transferor (or a transferor who is rendered insolvent by the transfer) is void with respect to existing creditors, unless made for valuable consideration (other than in consideration of marriage). *See* Va. Code § 55.1-401.
  - iii. No statute of limitations applies (doctrine of laches only).
4. Fraudulent Transfers under the Federal Bankruptcy Act (11 U.S.C. § 548)
  - i. A bankruptcy trustee may generally void any transfer made within two (2) years before the **bankruptcy** petition is filed, if it was made (i) with the actual intent to hinder, delay or defraud any creditor or (ii) for less than reasonable compensation.
  - ii. Transfers made within ten (10) years before filing the petition may be voided if made to a self-settled **trust** for the benefit of the debtor with the actual intent to defraud creditors.

## **II. TENANTS BY THE ENTIRETY PROPERTY (Va. Code § 55.1-136).**

- A. "Tenants by the entirety" (TBE) is a special form of joint ownership reserved to married couples.

---

<sup>2</sup> A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law. Virginia Rule of Professional Conduct 1.2(c).

1. It is based upon the premise that the property is held by the spouses together, as a single owner.
  2. At the death of the first spouse, the property passes to the surviving spouse automatically by operation of law.
  3. Neither spouse may alienate his or her interest in TBE property without the other spouse's consent. In the case of TBE real estate, the transfer deed must be signed by both spouses as grantors. *See* Va. Code § 55.1-136(B).
- B. To create TBE property, the spouses must:
1. be married when they take title,
  2. take title jointly, under the same instrument and at the same time, and
  3. have identical interests in the property.
- C. TBE is available in Virginia for both real and personal property, but title must be expressly taken as "tenants by the entirety" or "tenants by the entirety." *See* Va. Code § 55.1-136(A).
- D. TBE property may be reached only by the spouses' joint creditors. This protection ends when the spouses are no longer married, whether by death or divorce.
- E. Although technically not TBE property, Virginia also protects property (and the proceeds from property) that was held as TBE before being conveyed by the spouses to one or more of their joint or separate revocable or irrevocable trusts.
1. This "TBE" creditor protection continues so long as:
    - i. The spouses remain married to each other;
    - ii. The former TBE property continues to be held in the trust(s); and
    - iii. The former TBE property "continues to be their property," such as where both spouses are current beneficiaries of one trust that holds the entire property, or where each spouse is a current beneficiary of a separate trust and the two separate trusts together hold the entire property, whether or not other persons are also current or future beneficiaries of the trust or trusts. *See* Va. Code § 55.1-136(C).

2. The creditor immunity for former TBE property held in trust may be waived by the trustee as to any specific creditor or any specifically described property, if expressly authorized under the trust instrument or by the written consent of both spouses. *See id.*
- F. In Virginia, spouses are jointly and severally liable for claims arising from either spouse's emergency medical care and immediate follow-up care in the hospital if they are living together at the time. *See Virginia Code § 8.01-220.2.*
1. As a result, the doctor/hospital is considered a joint creditor and may reach the couple's TBE property.
  2. However, if the spouses' principal residence is held as TBE, it is protected from such claims so long as it is not refinanced or transferred to new owners. *See id.*

### **III. SPENDTHRIFT TRUSTS**

- A. If a trust includes a valid spendthrift provision, the beneficiary may not transfer or anticipate any of his or her interest in the trust, nor may the beneficiary's creditors or assignees reach the assets before the trustee distributes them to the beneficiary. *See Va. Code § 64.2-743(C).*
- B. A spendthrift provision in a trust is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest. *Va. Code § 64.2-743(A).*
- C. No particular language is required as long as the trust terms make it clear the beneficiary's interest is to be held subject to a "spendthrift trust," or words of similar import. *See Va. Code § 64.2-743(B).* For example:
- To the extent permitted by law, neither the income nor the principal of the Trust Fund and its separate trusts or shares shall be liable for any beneficiary's debts; and no beneficiary may alienate or anticipate any portion of the income or principal except as expressly provided in this Agreement. I intend for every trust under this Agreement to be a spendthrift trust.*
- D. A spendthrift clause is not effective against certain exception creditors:
1. Any person to whom the beneficiary is legally required to pay child support,
  2. Any judgment creditor who has provided services for the protection of the beneficiary's interest in the trust,

3. The United States, or
  4. Virginia or any of its counties, cities and towns. *See* Va. Code §§ 64.2-744, 64.2-745(A).
- E. Note, spouses are not included in the list of exception creditors for spendthrift trusts, although a court may take the trust's existence and any past pattern of distributions made to or for the benefit of the beneficiary and spouse into account when awarding alimony/support or dividing the marital property.
- F. An exception creditor may obtain a court order attaching current or future distributions made to or for the benefit of the beneficiary. *See* Va. Code § 64.2-744(B), (D).
- G. To the extent a beneficiary's interest is not subject to a valid spendthrift provision or otherwise protected, a creditor or assignee may reach the interest, usually through attachment of present or future distributions to or for the benefit of the beneficiary. Va. Code § 64.2-742.
- H. Whether or not a trust contains a spendthrift provision:
1. A creditor or assignee of a beneficiary may reach any mandatory distribution if the trustee has not made the distribution within a reasonable time after it is due. Va. Code § 64.2-748(B).
  2. A creditor or assignee of a beneficiary may not compel an otherwise discretionary distribution, even if the trustee's exercise of discretion is subject to an ascertainable standard or the trustee has abused its discretion. *See* Va. Code §§ 64.2-746(B).
    - i. This is true even if the debtor beneficiary is the trustee, provided the distribution discretion is limited to an ascertainable standard. *See* Va. Code §§ 64.2-746(E).
    - ii. However, this rule does not protect the trust assets against child support claims. *See* Va. Code §§ 64.2-746(C).
    - iii. It also does not prevent the beneficiary from bringing an action against the trustee for abuse of discretion or failure to comply with any distribution standard. *See* Va. Code §§ 64.2-746(D).

#### **IV. VIRGINIA SELF-SETTLED SPENDTHRIFT TRUSTS**

- A. Generally speaking, a client's creditors can always reach the assets of a self-settled trust to the maximum extent those assets could be distributed to him or her

(or for his or her benefit), even if the trust contains a spendthrift provision. *See* Va. Code § 64.2-747(A)(2).

- B. However, Virginia allows a client to transfer assets to a “qualified self-settled spendthrift trust” (QST) and retain certain rights to receive future distributions from the trust at the discretion of an independent trustee, without exposing the client’s interest to creditor claims. *See* Va. Code § 64.2-745.1(A).
- C. The client’s creditors may not set aside the transfer under Virginia’s fraudulent transfers statute (discussed above) on the theory the transfer itself was intended to delay, hinder or defraud creditors. *See* Va. Code § 64.2-745.1(C).
  - 1. However, existing and future creditors may still set aside the transfer if they can show other evidence of actual intent to delay, hinder or defraud. *See* Va. Code §§ 55.1-400, 64.2-745.1(C).
  - 2. Existing creditors may also challenge the QST on the grounds that the client was insolvent at the time of the transfer (or that the transfer rendered him or her insolvent). *See* Va. Code §§ 55.1-401, 64.2-745.1(C).
  - 3. Creditors also have five (5) years from the date the QST was funded to bring an action to enforce a claim that existed at that time. *See* Va. Code § 64.2-745.1(D).
- D. In order to be recognized as a QST:
  - 1. The trust must be irrevocable and created during the settlor’s lifetime;
  - 2. The trust instrument must expressly incorporate Virginia law to govern the validity, construction and administration of the trust;<sup>3</sup> and it must include a spendthrift provision that restrains both voluntary and involuntary transfer of the settlor’s “qualified interest”;
  - 3. The trust must have at least one “qualified trustee” (who does not necessarily need to be an “independent qualified trustee”) at all times;
  - 4. At all times when distributions may be made by the independent qualified trustee to the settlor pursuant to the settlor’s qualified interest, there must be at least one other beneficiary to whom similar distributions may be made;<sup>4</sup> and

---

<sup>3</sup> If the administration of a trust is moved to Virginia and it otherwise meets the requirements for a QST, it thereafter will be treated as a QST under the statute. *See* Va. Code § 64.2-745.1(G).

<sup>4</sup> Presumably, the additional beneficiary prevents the trustee from abusing his or her distribution discretion in favor of the settlor.

5. The settlor may not have the right to veto trust distributions. *See* Va. Code § 64.2-745.2(A).
- E. Only the settlor’s “qualified interest” in the QST (i.e., the settlor’s right to receive distributions of income, principal, or both, in the sole discretion of an independent qualified trustee) is protected from creditor claims.
1. Mandatory distributions are not protected, nor are distributions made in the discretion of a non-independent qualified trustee.
  2. A settlor may have both a qualified interest, which is protected from creditors, and another interest, which is not protected, in the same trust.
- F. A beneficiary who has the right to withdraw his or her entire beneficial interest in the QST will be treated as its settlor to the extent of the entire interest once the withdrawal right lapses. *See* Va. Code § 64.2-745.2(E).
1. This provides creditor protection for the beneficiary’s entire interest rather than only for the portion that does not exceed the “five and five” power exclusion or gift tax annual exclusion.
- G. Trustees
1. A “qualified trustee” must (i) be a Virginia resident individual or a legal entity authorized to engage in trust business in Virginia and (ii) materially participate in the trust’s administration in Virginia.<sup>5</sup> The qualified trustee’s distribution authority cannot be subject to the direction of a third party (such as a trust protector or trust director) who would not also meet the requirements of a qualified trustee if he or she were a trustee. *See* Va. Code § 64.2-745.2(A).
  2. An “independent qualified trustee” (who alone may make discretionary distributions to the settlor) must be a qualified trustee who is not, and whose actions are not, subject to direction by: (i) an individual not residing in Virginia, (ii) an entity not authorized under Virginia law to engage in trust business within the state, (iii) the settlor, (iv) the settlor’s spouse, parent, issue, sibling, employee or subordinate employee,<sup>6</sup> (v) a business entity in which the settlor holds at least 30% of all voting

---

<sup>5</sup> Examples include maintaining or arranging for custody of at least some trust property within the state, maintaining at least a portion of the trust records in Virginia, or preparing or arranging for the preparation of the trust’s fiduciary income tax returns in Virginia.

<sup>6</sup> The distinction between employee and subordinate employee for this purpose is not clear.

interests, or (vi) a subordinate employee of a business entity in which the settlor is an executive. *Id.*

3. If a qualified trustee or independent qualified trustee ceases to serve for any reason, the position must be filled by an eligible successor designated pursuant to the trust agreement or, if none, by an eligible person designated by all of the qualified beneficiaries of the trust, or otherwise by an eligible person appointed by the court pursuant to its statutory authority. *See* Va. Code § 64.2-745.2(B), (C).

H. A Virginia QST is most useful for a client who wants to make large gifts for tax purposes while retaining the possibility of benefiting from the assets in the future if needed. Given the 5-year “look-back” period and the “actual intent to defraud” exception, clients with significant creditor concerns will most likely continue to seek the greater protection available in more established “haven” states or off-shore jurisdictions.

I. Virginia Code § 64.2-747(B) confirms that:

1. The holder of a presently exercisable power of withdrawal is treated as the settlor of a revocable trust to the extent of the property subject to the power. Upon the lapse, release or waiver of the power, the holder will be treated as the settlor to the extent the property’s value exceeds the greater of the “5&5” amount and the annual exclusion amount (or twice the annual exclusion amount, if the donor was married at the time the property subject to the power was transferred to the trust).
2. The settlor’s contingent remainder interest in a lifetime marital deduction trust he or she created for his or her spouse will not cause the trust to be considered a self-settled trust following the spouse’s death.

## V. LIFE INSURANCE

A. All benefits from a life insurance policy or annuity issued in Virginia, including the cash surrender value, death benefit and settlement proceeds, are generally protected from the creditors of:

1. The owner or insured,
2. The spouse (or intended spouse) or the owner or insured,
3. A dependent child of the owner or insured,
4. Anyone else who is dependent on the owner or insured, or

5. The purchaser of the policy or annuity contract. *See* Va. Code § 38.2-3122(A), (B).
- B. The protection is available whether or not the owner, insured, purchaser or annuitant (or his or her estate) is also a beneficiary under the policy or annuity, or the individual has the right to change the beneficiary. *See* Va. Code § 38.2-3122(B)(2), (F).
- C. However, any premiums or other amounts paid with the intent to defraud creditors, together with interest thereon, are not protected and inure to the benefit of creditors from the policy or annuity proceeds. *See* Va. Code § 38.2-3122(D).
- D. Similarly, the exemption is not available for any life insurance policy or annuity issued within 6 months before the protected person filed for bankruptcy or was declared insolvent. *See* Va. Code § 38.2-3122(E).
- E. This statutory protection can be waived as to any policy “taken out, made, or assigned in writing for the benefit of the creditor.” *See* Va. Code § 38.2-3122(C).
- F. Although estate planners are usually not qualified to give insurance advice, advisors should discuss with clients the need for adequate liability (and where applicable, malpractice and D&O) insurance coverage, including umbrella coverage.

## **VI. RETIREMENT BENEFITS**

- A. In bankruptcy
  1. Under Virginia law, an individual’s interest under any qualified retirement plan, whether as a participant, beneficiary, contingent annuitant, alternate payee or otherwise, is protected from his or her creditors in bankruptcy to the same extent as under federal law. *See* Va. Code § 34-34(B).
    - i. The protection does not extend to claims for child or spousal support. *See* Va. Code § 34-34(C).
  2. Federal bankruptcy law exempts qualified employer plans, individual retirement accounts and the like from creditor claims in the hands of the participant. *See* 11 U.S. Code § 522(b)(2), (b)(3)(C), (d)(12),
    - i. Federal bankruptcy protection for IRAs and Roth IRAs is capped at \$1,512,350 (for 2022, 2023 and 2024). *See* 11 U.S.C. 522(n), 87 Fed. Reg. 6625 (2/4/2022).

3. Inherited accounts are not protected in bankruptcy. *See Clark v. Rameker*, 573 U.S. 122 (2014).

B. Outside bankruptcy

1. Employee Retirement Income Security Act of 1974 (ERISA) Plans
  - i. ERISA governs employer-sponsored plans such as 401(k) and 403(b) plans, pension plans, profit-sharing plans and other defined benefit and defined contribution plans.
  - ii. Federal law generally protects ERISA plans from the participant's creditors due to the anti-alienation provisions required under the Internal Revenue Code. *See* 26 CFR § 1.401(a)-13(b)(1), *Patterson v. Shumate*, 504 U.S. 753 (1992).
  - iii. The protection is not absolute, however.
    - a. ERISA plan assets may be reached by the IRS or divided and awarded to a spouse by a court pursuant to a qualified domestic relations order.
    - b. Certain ERISA plans are not protected by the anti-alienation clause. These include SIMPLE IRAs and SEPs.
2. Individual Retirement Accounts / Roth IRAs
  - a. Retirement arrangements that are not subject to ERISA's anti-alienation provisions are protected outside of bankruptcy only to the extent provided by state law.
  - b. Virginia exempts IRAs and Roth IRAs from creditor claims to the same extent permitted by federal bankruptcy law. Va. Code § 34-34. *See* above.

## VII. 529 PLANS; ABLE SAVINGS ACCOUNTS

Generally speaking, Virginia 529 savings accounts, prepaid tuition contracts and ABLE savings accounts are exempt from the creditor claims (including, in the case of an ABLE savings account, clawback for Medicaid benefits provided by Virginia to the beneficiary) of any purchaser, contributor or beneficiary. *See* Va. Code § 23.1-707(G)(1), (I).

## VIII. LIMITED LIABILITY COMPANIES / LIMITED LIABILITY PARTNERSHIPS

### A. Limited Liability Companies

1. As a general rule, the member of an LLC is not personally liable for the company's debts solely by reason of his or her membership. *See* Va. Code § 13.1-1019.
  - i. However, a member may be held personally liable by third parties for his or her own torts (negligence, fraud, etc.), even if carried out through an LLC.
  - ii. A member's personal liability to the LLC or its members for damages from any act or omission is limited to \$100,000, unless the articles or operating agreement provide otherwise or the member engaged in willful misconduct or a knowing violation of the criminal law. *See* Va. Code § 13.1-1025.
2. A third-party creditor or assignee of an LLC member may only ask a court for a charging order against the member's transferable interest in the LLC, in which case it may receive the distributions, if any, to which the member would otherwise be entitled to in respect of the charged interest. *See* Va. Code § 13.1-1041.1(A), (D).

### B. Limited Liability Partnerships

1. A general partner in a general partnership (GP) or limited partnership (LP) is personally liable for the partnership's debts. *See* Va. Code §§ 50-73.96(A), 50-73.29(B); *see also* Va. Code § 50-73.97(D).
  - i. Of course, a limited partner is not similarly liable for the LP's debts (unless he or she is also a general partner or otherwise participates in the control of the business). *See* Va. Code § 50-73.24(A).
2. A GP or LP (and by extension, its general partners) is liable for any damages caused by a partner's actionable conduct, if the partner was acting in the ordinary course of business or with authority of the partnership. *See* Va. Code §§ 50-73.29, 50-73.75, 50-73.95.
3. However, if a GP or LP registers as a "limited liability partnership," a general partner will not be liable for the partnership's liabilities. *See* Va. Code §§ 50-73.96(C), 50-73.78.

- i. The registration is made by filing with the Virginia State Corporation Commission the appropriate form (Statement of Registration as a Virginia Registered Limited Liability Partnership) signed by any one or more general partners. *See* Va. Code §§ 50-73.132, 50-73.78(A).
  - ii. The registration must be approved by the partners required to amend the partnership agreement.
  - iii. In the case of a GP, if a “Statement of Partnership Authority” was previously filed in the clerk’s office for any jurisdiction in which the GP owns real property, the Statement of Registration as a Virginia Registered Limited Liability Partnership should be similarly recorded.
4. A partner’s creditors may only obtain a charging order against his or her transferable interest in the partnership. *See* Va. Code §§ 50-73.46:1, 50-73.108.

## **IX. VIRGINIA BANKRUPTCY EXEMPTIONS**

The homestead and other exemptions offered under Virginia’s bankruptcy laws are very limited. *See, e.g.,* Va. Code §§ 34-4 *et seq.* They offer significantly less protection than comparable federal law. Therefore, they are not covered in this outline.