The Asset Protection Planning Continuum:

Practical Steps for Estate Planning Lawyers and Other Professionals

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A KEY ESTATE PLANNING GUIDE

Law Easy

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The Asset Protection Planning Continuum

What is Asset Protection Planning?

What is Asset Protection Planning

- Asset protection is simply planning steps to minimize the risks to client's assets and financial health that a range of risks might pose. These risks might include the costs of a lawsuit, malpractice claim for clients who are professionals, the financial impact of divorce, suits relating to a client serving on a charitable board.
- Asset protection is not limited to costly trusts set up in foreign jurisdictions ("FAPTs").
- While FAPTs might be part of the asset protection tool-kit it is not the focus of asset protection for most clients.

The Asset Protection Planning Continuum

Who Should or Should Not Pursue Asset Protection Planning?

Who Should Pursue Asset Protection Planning

- For every client, better asset protection is almost always an advisable goal.
- Asset protection should not be reserved only for wealthy entrepreneurs and surgeons.
- Every client does and should undertake asset protection planning. The issue is only to what extent planning should be done.

Who Should Not Undertake Asset Protection Planning

- Any client where the transfers or other actions could be a fraudulent conveyance, render the client insolvent, etc.

The Asset Protection Planning Continuum

How Might Practitioners Protect Themselves

Before Proceeding…

- Set a firm policy to perform some due diligence on every client, e.g., google and other searches.
- Obtain a balance sheet for every client and have the client sign it confirming that all planning depends on the accuracy of that data.
- Consider a policy for LexisNexis or other searches.
- Obtain a solvency affidavit before consummating transfers.
- Have the client’s financial adviser/wealth manager complete financial forecasts corroborating that the contemplated transfers will leave the client with sufficient resources and cash flow to meet anticipated expenses.
- Consider whether hiring a forensic accountant or other expert to perform investigative analysis is appropriate.

The Asset Protection Planning Continuum

Asset Protection Planning Continuum

Asset Protection Planning Continuum

- Viewing asset protection as a planning continuum will help advisers who have not specialized in this area become more comfortable making it a part of their regular planning repertoire.
- It will also help clients who may not view themselves as needing significant or costly protections better understand how and why they should undertake some asset protection steps.

Asset Protection Planning Continuum

- How far each client will move on the asset protection continuum will depend on the:
  - Client's perception of risk exposure.
  - The costs and complexity of planning.
  - Client's perception of the costs/benefit trade off of each additional step up the planning continuum.
- For estate planners, CPAs, attorneys, wealth advisers, insurance consultants, etc. understanding the asset planning continuum, and how to use it to build awareness and advise every client as to appropriate asset protection planning steps, should be a vital part of the estate and financial planning process.

Asset Protection Planning Continuum

- **Low End**:
  - For many clients, relatively simple and low cost steps might suffice to enhance their asset protection.
  - Buying an adequate homeowners and auto insurance policy is asset protection. Determining the size of the deductible and the maximum level of coverage (e.g., whether an excess liability policy is purchased) is asset protection planning at the simplest level.
  - Convert an IRA to a Roth IRA.
  - Change title to assets.

Asset Protection Planning Continuum

- **<u>Mid-Range</u>**:
  - Moving forward up the asset protection might involve creating an irrevocable life insurance trust (“ILIT”) to protect the cash value of the life insurance (assuming it is not protected under state law) and the death proceeds.
  - Setting up a limited liability company (“LLC”) to own a rental property or a home based business.
  - These are generally common planning tools that most advisers are quite familiar with but which clients often neglect absent professional guidance (or if they have addressed these items often in a woefully inadequate an unprofessional manner).

Asset Protection Planning Continuum

- **Higher End**:
  - Higher on the asset protection continuum might include the creation of more sophisticated irrevocable trusts such as non-reciprocal spousal lifetime access trusts (“SLATs”). As clients move up the asset protection continuum the irrevocable trusts on the higher end may be formed in a trust friendly jurisdiction (e.g., Alaska, Delaware, Nevada or South Dakota) in contrast to trusts lower on the spectrum that may be formed in the client’s home state with a family member trustee.
  - QPRTs.
  - While lower on the planning spectrum a client may have formed an LLC to own a real estate rental property as the planning moves up the spectrum those LLCs might be formed in a jurisdiction with better creditor protection laws and more likely with be fractionalized between various owners including irrevocable trusts.

Asset Protection Planning Continuum

- **<u>Highest End</u>**:
  - On the highest end of the asset protection continuum clients might create an asset protection trusts (“APTs”) either domestically, domestic asset protection trusts (“DAPTs”) or foreign asset protection trusts (“FAPTs”) funded with a tier of entities planned, structured and operated to provide further layers of protection.

Asset Protection Planning Continuum

- The sequence of the asset planning continuum is not rigid. Depending on the nuances of a particular application of an irrevocable trust it may appropriately be much lower, or higher, on the spectrum.
- Focusing more attention on these alternative asset protection planning techniques will enable practitioners to offer a wider variety of more cost effective asset protection techniques to a wider array of clients. This will provide benefit to clients and help practitioners expand their practices by creating a new driver.

Asset Protection Planning Continuum

- A spousal lifetime access trust ("SLAT") in which one spouse creates a trust for the benefit of the other, can vary significantly in how protective it is depending on a number of factors such as: what state it is formed in, what distribution provisions are provided for, whether an independent institutional trustee is named or the beneficiary spouse, and so on.
- Nonetheless, the continuum will provide a useful analogy to guide many clients to pursue more asset protection planning. It will hopefully provide practitioners who do not specialize a useful model to gain more comfort with asset protection planning.
- As practitioners proceed up the planning continuum if they reach a level of planning that is appropriate for a particular client but beyond their skill set they can partner with other advisers to provide that level of planning.

The Asset Protection Planning Continuum

Insurance Coverage

Insurance Review

The first step on the asset protection continuum is a review of the client's insurance coverage:

- Property and casualty coverage is an essential first line of defense from storms, theft, and other risks. Asset protection should be viewed in a broad context. It is not uncommon to find a physician terrified of malpractice claims pursuing a complex self-settled trust while his or her basic homeowners or schedule property is inadequate.
- Liability coverage to the extent feasible is also a key protective step. This is something all clients should undertake.

Insurance Review

- Liability coverage includes liability on appropriate business and professional policies, homeowners and auto and, if appropriate both personal and professional umbrella or excess liability insurance.
- Is insurance coverage in place for each significant asset?
- Is insurance coverage in place for each activity or risk that could cause liability.
- Few practitioners will have the expertise to determine specifically which coverage level, but most practitioners will have the ability to spot some issues and direct clients to retain insurance consultants to review details. It is surprising how many clients, even those with significant wealth, have inadequate or no personal excess liability coverage.

Common Insurance Oversights

- No or inadequate personal excess liability (umbrella) policy. Many clients have never had their liability coverage reviewed. A surprising number of clients simply are lacking this type of coverage which could expose most or all of their assets to claims. In some instances, e.g., when the client has different insurance companies providing underlying homeowners and the umbrella policy, there are gaps between underlying coverage and the umbrella.
- Insurance for a rental or family use property is sometimes inappropriate underwritten as a primary residence coverage.

Common Insurance Oversights

- **Example**: Mom and dad ow a condominium in the city which daughter lives in. When they purchased the condominium it was erroneously insured as their residence. It may be more appropriate to have the parents own a landlord policy and their daughter a renter's policy to assure proper coverage.
- Old coverage. It is not uncommon to find that clients have old property, casualty or liability coverage that was simply never updated.
  - They may have had a home business and when they closed it the rider for it was never cancelled.
  - More dangerously, the client started a home based business and never discussed with their insurance agent what coverage might be necessary to insure the additional risks that provides.
  - Values of coverage may be very out of date.
  - When it the last time the client had collectibles appraised to assure that there is sufficient coverage?

Common Insurance Oversights

- Does the client have home health aides? Are they covered with appropriate workers' compensation coverage? Employment practices coverage?
- If the client is a professional have they acquire reasonable/sufficient policy limits? What about other coverage? Business interruption insurance? Business excess liability?
- What about disability and long term care coverage? While these are not considered part of asset protection planning they should be since asset protection planning should encompass all risks. If a client is disabled and has to draw down assets for living expenses because of not having disability insurance that will jeopardize the value of those assets no different then a claim.
- For every client, confirming that they have had a recent review of all property, casualty and liability coverage should be a part of every asset protection plan.

The Asset Protection Planning Continuum

Title to and Nature of Assets

Nature and Type of Assets

- The nature and ownership (title) to assets can have important asset protection ramifications.
- Keep assets in the name of the spouse who does not have significant creditor liability. This is often referred to as the “poor person’s asset protection plan.” It often incurs no cost, but the protection provided may prove inadequate. The tales of the supposed non-risk spouse being sued for an automobile accident and losing the family wealth are legion. So while this might provide some protection, it should rarely be relied on.

Title Assets in Non-Risk Spouse's Name

- If the non-risk spouse dies and his or her will does not assure that the assets pass into an appropriately protective trust for the surviving at risk spouse, any protection may be lost.
- In most states, assets acquired from earnings and growth in value during the marriage will be shared equally upon divorce, even when those assets have been kept in the name of one spouse or the other.
- A prenuptial or postnuptial agreement can be entered into to assure the spouse without assets that the spouse with assets will divide these equally in the event of a divorce, and leave them for the benefit of the surviving spouse in the event of death.

Retitle to Low Risk Spouse

- **Example**: Where one spouse is a neurosurgeon and the other is a school teacher, it superficially has appeal to put the bulk of otherwise unprotected assets under the school teacher's name, or under a revocable trust that will not protect from creditors but will protect the assets from guardianship and probate if the school teacher dies or becomes incapacitated. But if the school teacher dies without appropriate trust planning the assets will pass back to the neurosurgeon unprotected. If the simplistic approach is used the school teacher spouse's will or revocable trust should include appropriately protective trusts to be funded on his or her death to protect the surviving neurosurgeon spouse. Liability insurance should be reviewed to assure that the school teacher is sufficient protected in the event of possible claims. But in all events, this should be viewed as the minimum of a plan and perhaps at most a temporary first step on the planning spectrum.

Tenants by the Entirety

- Tenancy by the entireties property ownership, depending on state law, may provide a meaningful measure of protection. While a relatively few states provide that the creditor of one spouse cannot reach tenancy by the entireties property, which is a special form of ownership that only exists between married couples, the bankruptcy law will recognize tenancy by the entireties with respect to jointly owned real estate that is located in a tenancy by the entireties state, such as Michigan, Florida and Delaware.
- Caution should be exercised as a “last minute” transfer into tenancy by the entireties where a creditor already exists could be set aside pursuant to the fraudulent transfer rules that apply in the jurisdiction where the debtor lives.

Foreign Accounts and Entities

- It is difficult for a creditor to reach foreign assets because many jurisdictions do not recognize U.S. judgments, and would require a completely new jury trial in the jurisdiction itself before a judgment would be given that would enable a creditor to attach an account in that jurisdiction. The same can apply with respect to stock owned in a foreign company where the stock certificate is also held in that foreign jurisdiction.
- Foreign planning can be fraught with a significant number of traps for the unwary, which could include having a judge put a debtor into jail on contempt of court charges if the judge has the authority to order the debtor to bring the assets back to the jurisdiction where the court is sitting, or the debtor has transferred the assets at the last minute in a “fraudulent transfer.”

The Asset Protection Planning Continuum

Roth IRA Conversion

Roth IRA Conversion

- Converting an IRA to a Roth IRA and paying the income tax triggered from unprotected assets may be a useful and easy to implement asset protection step.
- If state law protects both the IRA and the post-conversion Roth IRA the conversion will use up liquid assets held outside the protection of the IRAs, e.g., funds in a brokerage account, to pay the income tax triggered on the conversion. The result will be full post tax dollars protected by the Roth IRA rather than merely pre-tax dollars protected in the regular IRA.
- Roth IRAs have no mandatory distribution rules for the plan holder so dollars will not have to be removed from that protective structure as they eventually will from a regular IRA.

The Asset Protection Planning Continuum

State Exemptions

State Exemptions

- Most planners are aware that each state has certain creditor "exemptions" that will provide protection for "exempt assets" that are purchased before a creditor problem arises, or with the proceeds from other exempt assets. Every advisor should be familiar with the exemption laws of his or her state if those are material. Some states, like Florida, have exemption rules that are extremely favorable to debtors, and can include protection of an unlimited or high homestead value, the cash value of life insurance policies, annuity contracts, IRAs, pension accounts, tenancy by the entireties assets owned by a married couple, 529 College Savings Plan accounts, Health Savings Account, and other categories of assets.

State Exemptions

- **<u>Example</u>**: Move to Florida and buy a big home. Florida is one of the few states to have an unlimited homestead exemption, and the Florida Constitution's homestead protection trumps its fraudulent transfer law, meaning that a debtor with a judgment against him could move to Florida and buy a big house and not be pushed out of the house even if this was an intentional "fraudulent transfer" of previously owned non-exempt assets. It is noteworthy that the 2005 Bankruptcy Act provides that home equity that is attributable to a fraudulent transfer made within ten years before the filing of a bankruptcy can be lost if the debtor ends up in bankruptcy, but it normally takes three creditors to require a debtor to be in bankruptcy if the debtor has at least twelve legitimate creditors.

State Exemptions

- Other states, like Nevada, have very limited creditor protection exemptions, and in some situations the only exemptions that can be relied upon are those provided under Section 522 of the Bankruptcy Code, which are somewhat limited but include certain real and personal property, retirement funds and homestead.
- If the client’s state has meaningful exemptions this might be a relatively simple and inexpensive planning step to retitle or purchase additional protected assets to provide incremental protection.

The Asset Protection Planning Continuum

Simpler Irrevocable Trusts

Simple Irrevocable Trust Basics

- The use of irrevocable trusts is the foundation for many asset protection plans. Protective trusts should be used at each phase of planning.
- A typical irrevocable life insurance trust ("ILIT") or trust for children or other heirs, can provide asset protection benefits.
- Parents should bequeath assets into long term trust for heirs rather than make outright bequests. If benefactors for the client make all gift or testamentary transfers into protective long term trusts for the client the client may be able to have access too, and meaningful control over, those assets, without exposing them to his or her creditors, divorce or other predators. Some commentators refer to these protective yet flexible trusts as beneficiary controlled trusts.

Simple Irrevocable Trust Basics

- Spouses and partners should gift and bequeath assets to each other only in protective long-term trusts. Caution should be exercised when spouses (and even other family members) plan to address the reciprocal trust doctrine. While this is a tax doctrine that may enable the IRS to unravel planning, it may also permit a creditor to challenge contributions made by one spouse as having been made by the other spouse when both spouses are funding similar trusts for one another within a relatively short period of time. Many practical steps can be taken to lessen this type of challenge by forming the trusts in different jurisdictions, naming different beneficiaries, using different trustees, varying the terms, not signing the trusts at the same time, funding the trusts with different assets, and so forth.
- Single individuals may have few options other than funding a trust that they themselves are a beneficiary. See discussion of self-settled domestic asset protection trusts ("DAPTs") below.

Structure Irrevocable Trusts Better

- One of the common issues with trusts is that the distribution provisions are structured in a manner that characterizes them as “support trusts.” This gives the trustee the power to pay trust income to provide for the health education maintenance and support (“HEMS”) of the beneficiary. A support trust is somewhat protective of beneficiary’s interests because the beneficiary is only entitled to distributions for his or her support. A spendthrift provision should be included.
- A support trust is not as protective as may be desired because the distributions to maintain support may be reached, and depending on state law put the trust at risk in the event of the beneficiary’s divorce.

Structure Irrevocable Trusts Better

- A preferable approach is to structure trust distribution provisions as a discretionary trust. Distributions are made only in the discretion of trustee. The creditors of a beneficiary of a discretionary trust should not be able to compel the trustee to pay. The interest of the beneficiary does not qualify as a property right so even preferred creditors like spouses may be prevented access. However, it may not provide protection in some jurisdictions from what might be characterized as "super creditors."
- Ideally, an independent trustee other than the beneficiary should be named.
- Traditional trusts often distributed assets at specified ages and ended at some specified age, e.g. one-third at age 25, one-half of what remains at 30 and the balance at 35. These mandated distributions and terminations undermine the protection of these trusts from an asset protection perspective.

Fix Existing Trust that is Not Optimal for Asset Protection

If a trust is identified that is less than optimal from an asset protection perspective, there may be options to modify the trust to enhance the asset protection benefits of the trust:

- Modify the trust by actions of a trustee or trust protector if permitted under the governing instrument.
- Decanting the trust into a new trust that has better administrative and distribution provisions.
- Merge the existing trust into a new trust that has better administrative and distribution provisions.
- Effect a non-judicial modification pursuant to state statute if the settlor is alive and all beneficiaries are of age or can be represented virtually.

The Asset Protection Planning Continuum

Qualified Personal Residence Trusts (QPRTs)

QPRTs

- A Qualified Personal Residence Trust ("QPRT") is a technique whereby a taxpayer gifts his or her home to a special trust reserving the right to live in the home rent-free for a fixed number of years (the "QPRT term"). Upon the expiration of the QPRT term, the children (or a trust for their benefit, often a grantor trust) will own the home. The parent may continue to live in the residence after the QPRT term pursuant to a fair market lease arrangement.
- The estate planning advantage of a QPRT, assuming a taxable estate, is that the technique can be used to leverage the gift of a taxpayer's personal residence out of his or her taxable estate. The leverage is in part due to the fact that the parent/donor retains the right to live in the house rent-free for a fixed number of years.

QPRTs

- That retained right delays the beneficiary's receipt of the residence and reduces the value of the gift of the home on a present value basis. Often QPRTs represented an acceptable form of gift because clients could retain their liquid assets intact to cover living expenses. For most moderate wealth clients, there may be no tax benefit from QPRTS with a $5 million inflation adjusted exemptions.
- Why give up the basis step-up at death if the client's estate won't be taxable? A QPRT, however, might provide some measure of asset protection planning benefits since it transforms an outright equity interest in the home into a mere term of years' interest that should not be particularly valuable to a creditor.

Alternatives to QPRTs

- If the client is married and lives in a state that provides for tenants by the entirety protection for a home, e.g. New Jersey, practitioners must weigh the possible benefits and limitations of that protection versus the benefits, restrictions and income tax consequences of a QPRT.
- If the state provides a valuable homestead exemption, e.g., Florida, using a QPRT might reduce protection.
- If the client is single a QPRT may be useful, simpler and perhaps safer than transferring the house to a limited liability company which would be held in whole or part by a self-settled DAPT.

QPRT Implementation

- Husband and wife jointly own a personal residence. The deed is re-titled to tenants in common so that each spouse owns a one-half interest in the home.
- Create a separate QPRT trust for each of husband and wife.
- The home is appraised with consideration to possible fractional interest discounts.
- Each of husband and wife gift their one-half interest in the home to their respective QPRT.
- If either spouse outlives the term of their QPRT the 50% interest in the home is transferred to a remainder trust for the children. By using a grantor trust at the “back end” if the parents wish to continue living in the home the rent they pay to the trust would be disregarded for income tax.

The Asset Protection Planning Continuum

Spousal Lifetime Access Trust (SLAT)

SLAT

- Spousal lifetime access trusts (SLATs) can provide a valuable asset protection benefit for married couples.
- With SLATs each spouse creates a trust for the benefit of the other spouse that may include other sprinkle beneficiaries. The couple can effectively move significant assets into trusts yet continue to access all of those assets. The risks of SLATs include premature death which can be insured against, and the possibility of divorce. How might divorce impact a SLAT plan if one of the premises of the plan is that each spouse might indirectly benefit from the assets of the trust they create through the distributions to their spouse. Divorce would undermine that access.

SLAT

- SLATs are almost always structured as grantor trusts so that the income is taxed to the settlor. This will result in the clients paying income tax on income earned in the SLAT thereby reducing their estate and accelerating the growth of assets inside the SLATs. This is also a valuable asset protection benefit as the protections will be enhanced each time the clients/grantors make income tax payments to cover SLAT income. The power of this grantor trust tax burn on the clients' estates can be powerful. Even a moderate gift by a married couple both age 65 to two non-reciprocal spousal lifetime access trusts ("SLATs") can shift over the duration of the couple's life a substantial portion of their wealth outside their taxable and creditor-reachable estate.

SLAT/ILIT

- Non-reciprocal SLATs are a common planning technique. These trusts are more robust versions of more traditional irrevocable life insurance trusts (“ILITs”). In fact, properly structured (e.g., with a separate insurance trustee and appropriate insurance provisions) SLATs can hold life insurance and in many instances may be used in that context to eliminate old ILITs simplifying and improving the client’s planning.

The Asset Protection Planning Continuum

Beneficiary Defective Irrevocable Trusts (BDITs)

BDITs

- Beneficiary Defective Irrevocable Trusts (" BDITs") may provide valuable asset protection benefits.
- The BDIT is an irrevocable trust that uses the common Crummey power to allow someone other than a third party benefactor (such as a client's parent) who establishes the trust for the client and his or her family to be treated as the owner of the trust property for income tax purposes.
- The client for whom the BDIT was created can be treated as the owner of the trust for income tax purposes only (i.e. the BDIT is a grantor trust as to the client not the actual settlor). \
- The settlor, e.g., the client's parent, establishes the trust and makes a $5,000 gift to the trust. The client as beneficiary has the right to withdraw that cash gift using the Crummey power, lapsing power of withdrawal, but does not do so.

BDITs

- As a result of the client holding a right of withdrawal under a Crummey power, Code Section 678 treats the client as the owner of the trust property for income tax purposes. This tax characterization is vital to the planning applications.
- The client never makes any gratuitous transfers to the BDIT. The trust is intentionally designed so that it is not a grantor trust as to the settlor. This will enable the client, as deemed owner of the trust property for income tax purposes, to sell appreciated assets to the BDIT without triggering income tax consequences. Some practitioners believe that because the client is not the settlor of the trust the BDIT is superior to a self-settled DAPT discussed below. Once the BDIT is established the client transfers appreciating assets to the BDIT via a nontaxable note sale similar to the traditional note sale to a defective grantor trust.

BDITs

- Why go through these additional machinations to differentiate the BDIT from the DAPT which would permit the same type of sale? Proponents of BDITs argue that a drawback to the DAPT is that the client is the person establishing the trust and making transfers to it. Because the client is the one making the transfers to the DAPT, his or her control over the transferred assets must be substantially limited if the desired estate tax benefits are to be achieved.
- Because the client will not make any gratuitous transfers to the BDIT, the assets inside the BDIT are, according to many practitioners who use the technique, more secure from claimants than the assets held in a DAPT. The BDIT is an approach that enables the client to be in substantial control of the transferred wealth.

The Asset Protection Planning Continuum

Entities, Contractual Relationships and Other Steps

Entities and Relationships

- Prudent use of limited liability companies ("LLCs") and other limited liability entities (corporations, S Corporations, limited partnerships, limited liability partnerships, etc.).
- Re-characterize relationships, such as by making employees into independent contractors and outsourcing risky activities to third parties.

Entities and Relationships

- **<u>Example</u>**: A judgment holder could levy upon all stocks and bonds owned by a debtor. However, before any claim arose the client transferred assets to an LLC. The client/debtor owns 95% of the LLC and the remaining 5% of the membership interests are owned by her parents, or a trust for her children. In most states the creditor cannot reach into the LLC, but generally will only instead receive a charging order which gives the creditor the right to receive 95% of any distributions, but only if and when there would be a distribution. The courts will normally not have any power to require distributions, so creditors typically negotiate favorable settlements when their only avenue is to receive a charging order.

Entity Restructure

- Move assets out into a separate leasing or licensing entity that can have an arm's-length relationship with the operating entity, if this will not trigger material taxes. It may be possible for a business entity taxed as an S corporation or a C corporation to avoid taxes being incurred upon separation by entering into what is known as a new Parent F reorganization, whereby a new company will own the existing operating company and a new "brother/sister company" that can receive valuable assets from the operating company without triggering income taxes.

Entity Restructure

- Have the company owe shareholders pursuant to loans, or indebtedness to others. A legitimate creditor can be given a lien against entity assets in the same way that a bank normally takes a mortgage lien against a house.
- Liens given against physical assets and also intangible assets like accounts receivable are normally "perfected" by the filing of UCC-1 Financing Statements in the state where the assets are maintained. Consider factoring accounts receivable to an entity owned for the primary benefit of family members in the next generation, to help with estate tax planning, and also pare down the balance sheet.

The Asset Protection Planning Continuum

Domestic Asset Protection Trusts (DAPTs)

DAPT

- Many state courts have held that self-settled trusts are accessible to creditors. There is precedent in New York and New Jersey that a self-settled trust is void as against public policy. But there are no cases analyzing the application of this with respect to a self-settled trust state, like Alaska, Delaware, South Dakota or Nevada. If your client lives in one of the states permitting self-settled trusts, then your client can likely use a DAPT. If your client, however, does not reside in one of those states, then there may be an issue, but how much of an issue remains unclear for several reasons.

DAPT

- Courts have remained critical of DAPTs, because judges are generally unfamiliar with how these trusts work, and often have an unfavorable attitude when the law of a jurisdiction outside of the judge's reach and command are used to protect assets that may have significant relationships with the jurisdiction where the judge is located.
- In the 2013 Bankruptcy Court decision of *Huber*, a bankruptcy judge in Washington State held that Washington State law, in lieu of the protective Alaska law, applied where the debtor had established an Alaska LLC and placed Washington State real estate into the LLC, and then transferred the ownership of the LLC to an Alaska Creditor Protection Trust.

DAPT

- A key issue for DAPTs is whether protection provided by these trusts will be afforded to settlors not residing in those states? What protection, if any, is available for someone residing in a non-DAPT state that creates a DAPT in a state permitting such trusts?
- The Restatement of Conflicts of Law Section 273 concerning restraints on alienation of trust interests creates a further issue for DAPTs. This provides that the local law of the state in which the settlor has manifested an intention for the trust to be governed should control. But Section 270 of the Restatement provides that an inter-vivos trust is valid under the local law of the state designated, provided that application of its law does not violate a strong public policy of a state which has the most significant interest in the trust. This could imply that the non-DAPT state may successfully maintain that a DAPT created by its resident to escape creditors in its jurisdiction violates a strong public policy of that state.

DAPT

- This interpretation could obviate the benefits of a DAPT for a resident of a non-DAPT jurisdiction. The Uniform Voidable Transactions Act raises further concerns. Section 4 comment 2. Might make a DAPT voidable per se for a non-DAPT resident.
- **Example**: A resident of New Jersey (which does not permit self-settled trusts) creates a DAPT in Alaska (the first state to permit self-settled trusts), New Jersey courts may permit creditors to reach that trust as being void per se.

Hybrid DAPT Sample Clause

- The Grantor appoints NAME as the Designator. During the Grantor's lifetime, the Designator, shall have the power, exercisable at any time and from time to time in a non-fiduciary capacity, and without the approval or consent of any person in a fiduciary capacity, to add as additional beneficiaries hereunder any person who is a descendant of Grantor’s grandparents who is not already designated herein as Beneficiary. Further, the Designator may at any time remove any person so added by written notice to the General Trustee, so that from the date of such written notification that added descendant of Grantor’s grandparents shall cease being a beneficiary hereunder. The Grantor directs that this power is not assignable. In the event that NAME dies before the Grantor dies, the successor Designator shall be such individual (other than the Grantor, any person acting as a Trustee under this instrument) whom NAME shall have designated by an instrument in writing.

Conclusion and Additional Information

Conclusion

Conclusion

- Although asset protection trusts are a valuable asset protection technique, it is important for clients and practitioners to know that there are other less expensive and less complex mechanisms that can be put into in place to provide valuable creditor protection. In many situations a combination of such methods, which may also include the use of an asset protection trusts may also be considered. The asset protection continuum introduced in this article will hopefully help practitioners guide all clients through a range of asset protection planning that will help each client achieve a level of protection that is appropriate for that client's circumstances and budget.

Additional information

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A KEY ESTATE PLANNING GUIDE

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