Commentary on Domestic Asset Protection Trusts

ALEXANDER A. BOVE JR., EDITOR

Background

For several hundred years the law in this country has provided that if a person established a trust for her own benefit, then that person's creditors could reach the trust assets to the maximum extent of the person's beneficial interest, despite the fact that the trust might be irrevocable or that distributions to the person might be only at the discretion of the trustee. This is called the "self-settled spendthrift trust" rule. To hold to the contrary would seem to be against public policy.

For instance, if a person (the "settlor") transferred her assets to another with instructions to pay out whatever she requests or appears to need, and if, at the same time, her creditors were prohibited from reaching the trust assets to satisfy her legitimate debts, one could justifiably argue that this is clearly against public policy, and if such a practice became widespread, ultimately no one would risk dealing with others unless they paid up front.

Sometime in the '60s, U.S. estate planners began to learn about offshore jurisdictions that allowed individuals to establish a trust for their own benefit but offered protection of the trust assets from the individual's creditors. In other words, the settlors of such trusts and their families could enjoy unlimited benefits from the cash and investments they transferred to the trust, but their legitimate creditors could not reach the assets. This was something just not allowed in the United States. As the "word" caught on, billions of U.S. dollars and investments began to pour out of the United States and into the offshore accounts held by such trusts. In time, U.S. banks and trust companies, and investment houses and investment advisors—and, of course, U.S. attorneys—began to feel the effect, and concerted lobbying began for our states to adopt trust laws that abandoned the well-established self-settled spendthrift trust law, allowing a person to establish a trust for his own benefit while protecting trust assets from his creditors.

Birth of the DAPT

The first state to do so was Alaska in 1997, followed that same year by Delaware, and eventually followed by 17 more states, as explained in this volume. Since all of these trusts have in common the protection of the trust assets from the settlor's creditors, they are generally referred to as asset protection trusts (APTs), and since they are domestic (here in the United States) as opposed to offshore, they are generally referred to as domestic asset protection trusts (DAPTs). Interestingly, while the 19 states that presently allow persons to create a DAPT all have certain requirements in common

(e.g., the trust must be irrevocable,[1] have a local trustee, have some assets in the state, and have a spendthrift clause), at the same time there are many differences and peculiarities that make the selection of a DAPT state a procedure that requires knowledge and investigation of the laws of the individual states, the special features, if any, and the state's own background and familiarity with the subject matter. For example, some of the states, such as Wyoming and Mississippi, require the settlors to provide evidence of a million-dollar (or higher) umbrella policy to have a qualified DAPT in that state. Most others require the settlor to execute an affidavit of solvency, disclosing any claims, potential or expected.

Limited Time to Sue

One of the most important considerations in selecting a DAPT is the period of limitations (POL) on creditor's claims, which is typically based on the principle of fraudulent transfer. For decades, the POL across the United States has been four years and remains that in most states. The DAPT states, however, recognized that a shorter POL would attract more trust business in that state, and so the game of POL limbo (how low can you go?) began. While most of the states retained the four-year period (five years for Virginia), a few of the states (e.g., Utah, South Dakota, Nevada, and Tennessee) shortened their POL to two years, then Ohio beat them all with an 18-month POL. Whether the shorter POL is truly a protection, however, remains to be seen, because the dispute over which POL applies—that of the settlor's domicile or that of the DAPT state—remains unresolved. In addition, the recently promulgated Uniform Voidable Transfer Act (UVTA) suggests it will be the latter, and further, the UVTA suggests, according to many commentators, that the very act of transferring assets to an APT is by itself evidence of a fraudulent (voidable) transfer. Nevertheless, the fact remains that a shorter POL at the very least poses another obstacle for a creditor to overcome.

Speaking of periods of limitations, a special rule applies if the settlor of a DAPT (or any APT) files bankruptcy. In that case, the trustee in bankruptcy has a ten-year POL within which to claim that the settlor's transfer to the APT was fraudulent. This is thoroughly discussed in our chapter on bankruptcy by Attorney Anne J. White.

Drafting the DAPT

Despite the wealth of information in our volume on the requirements of and limitations on a DAPT, we must note that except for the comment that follows here, we have not offered any advice on drafting the trust, other than, of course, a recitation of the provisions required under each state's trust law in order for the trust to provide the desired creditor protection. Accordingly, I felt it would be appropriate to make one exception.

As noted at the onset, the primary attraction of the offshore APT was that a person could establish her own self-settled trust that could protect the trust assets from her creditors, something not heretofore available in the United States. But there were a few other attractive features that became standard in virtually all offshore APTs. One of those was and is the so-called "flee" clause. The typical flee clause provided that if the trustee had cause to believe that the trust might be under attack and that the trust or its assets might in any way be jeopardized by such suspected actions, the

1. With the exception of Oklahoma.

trust could quickly be moved (similar to a decanting) to another jurisdiction and the trustee would be held harmless for doing so. The aggressive creditor, then, would find itself gearing up to sue the trust in state A, only to find that the trust had moved to state D.

In short, drafters of a DAPT might benefit from a review of the provisions commonly used in an offshore APT.

The Ultimate Question

Perhaps the central outstanding question when considering the protection offered by a DAPT is whether a judgment issued from the home state of the settlor can be enforced against the settlor's DAPT in another state, under the Full Faith and Credit Clause of Article IV of the U.S. Constitution. This concern has been discussed repeatedly, including in this volume in our chapter on attacking and defending a DAPT by attorney David Shaftel. That is, fraudulent transfer aside, may a judgment creditor of a Florida settlor of a Delaware DAPT enforce the Florida court judgment against the settlor's trust in Delaware? The defense argument seems to be that the Florida judgment is against the settlor, personally, and is not enforceable against the trust over which the settlor has no rights. Although there have been no cases directly on this point, a recent South Dakota case[2] involved a California judgment order against a California trust that was re-sitused to South Dakota. The plaintiff argued that the Full Faith and Credit Clause should allow the California judgment to be enforced against the South Dakota trust. The trust was not a DAPT and thus the holding, which did not allow full faith and credit to the California judgment, was not a resolution of the DAPT question. Nevertheless, the case quickly garnered the attention of just about every asset protection lawyer in the country, who felt this was at least a step in the right direction.

Whether this national trend in the states to adopt DAPTs will spread is not really the question, as more states are considering such legislation, regardless of the unresolved full faith and credit issue. And there is also little question that not every state will end up with a DAPT. Some states, e.g., Massachusetts, are so conservative that such a law is highly unlikely to get anywhere, unless a textbook case on full faith and credit makes its way to the U.S. Supreme Court, holding that the DAPT may not be breached at least on that argument. The outcome of such a case either will spark new life into the DAPT to the point where virtually every state will offer one, or will effectively impose a death warrant on the DAPT, period.

2. *In re* Cleopatra Cameron Gift Tr., 931 N.W.2d 244 (S.D. 2019).