ASSET PROTECTION PLANNING

There are currently more than a dozen states that have enacted laws that allow a person to create and transfer assets to a trust, where the settlor is also a permissible beneficiary and the transferred assets in the trust may be protected from certain creditors of the settlor. These trusts are often called "self-settled, spendthrift trusts" or "asset protection trusts."

Asset Protection Trusts

Why might someone consider setting up an Asset Protection Trust ("APT")? These trusts are generally contemplated when there is a significant portion of someone's net worth that is not easily or adequately protected by other asset protection strategies. APTs have also become popular as a component of prenuptial planning. Depending on the tax laws of an individual's state, some people are able to avoid the bite of state income tax on the sale of a business in an APT. Additionally, individuals who have received a large inheritance or who wish to save and protect assets for future generations are also good candidates for APT planning.

When considering an APT, it is important to address additional purposes for the planning, such as tax planning, planning as part of the overall estate plan, and specific planning to prepare for a defined goal such as business succession. Some courts do not like the idea of asset protection planning. One court found that a transfer to an APT was a fraudulent transfer because the client was not educated about how the planning worked and believed that the trust was simply a tool to avoid paying creditors.[1] A settlor should evaluate his or her individual circumstances when evaluating which state's laws to use in establishing an APT. A settlor should consider transferring an amount to the APT that would not substantially decrease his or her non-protected assets. Leaving some assets available to pay even unknown and unanticipated creditors bolsters an individual's claim that the transfer to the APT was not a fraudulent transfer.

It is important to consider the type of assets that will be transferred to an APT. An APT is meant to serve as "a rainy day fund" and not hold assets that the settlor currently uses. For example, typical APTs do not have mandatory income distributions and do not hold real estate. Many APTs hold Limited Liability Company ("LLC") interests that in turn can hold a variety of assets, including real estate, that are managed by the manager of the LLC and not the trustee.

"Due diligence paperwork" (net worth statements, tax returns, corporate documents, etc.) should be completed and dated prior to executing the APT document. Further, states may require certain affidavits and other documents be filed with the state to document the transfer of assets into an APT. This paperwork is then kept with the trust document by the trustee. Use of a corporate trustee is highly recommended, since these trusts are complex estate planning tools and have a heightened opportunity for scrutiny. Therefore, use of a corporate trustee helps confirm that the trust is properly administered and may also be necessary in order to establish the proper location for the trust to employ the state's APT laws.

1 *Kilker v. Stillman*, 2012 Cal. App. Unpub. LEXIS 8542 (Cal. App. 4th Dist. Nov. 26, 2012)

An APT can be an effective tool to provide protection for professionals (i.e., doctors and lawyers), business owners, officers, directors, and other individuals with substantial assets from frivolous lawsuits, since many claims against APTs will settle before trial. It should also be noted that not every state has enacted legislation allowing for self-settled, spendthrift trusts. There are many other states that either do not recognize self-settled, spendthrift trusts or even find such trusts void for public policy reasons. If a creditor can bring a claim against the individual who set up the trust or the trustee in one of these states, the APT is at risk and the assets in the trust may become available to satisfy a judgment claim. Asset protection planning is a growing field in professional practices. As more states enact APT legislation, it may become more difficult for creditors to breach these trusts.

Planning Gone Wrong

When considering an APT, keep in mind how it will be administered. In *Battley v. Mortensen*, the grantor alleged that his Alaska APT was formed to preserve a piece of land for his children[2]. However, the grantor used trust assets to make stock market investments and a car loan to a friend. The court concluded that these actions had no relationship to the trust's purpose and defeated the APT. This case highlights the reason why a corporate trustee may be the appropriate choice to administer an APT. Unsophisticated trustees and advisors can cause a lot of problems for the APT administration and can open an individual serving as a trustee or advisor to personal liability. An APT can be a great addition to an individual's overall estate plan since APTs can provide flexibility in planning and protections that are not otherwise available using more traditional techniques.

2 *Battley v. Mortensen*, Adv. D. Alaska. No. A09-90036-DMD (May 26, 2011)

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INV WM PDF 0916-091-372104

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