Asset Protection Trusts

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Asset Protection Trusts: What Are They?

- Multiplicity of Meanings
- Broad Sense of the Term
  - Trusts that in a functional sense protect a beneficiary’s assets from his creditors, although not necessarily intended for that purpose
    - May include trusts with discretionary distribution provisions
    - May include trusts with spendthrift provisions
- Narrow Sense of the Term
  - Trusts created for the purpose of shielding a beneficiary’s assets from seizure by creditors
    - Foreign and Domestic Asset Protection Trusts (APT)
    - May include spendthrift trusts as well
Asset Protection Trusts: General Trust Law

- General Trust Law
  - “…the court may authorize a creditor or assignee of the beneficiary to reach the beneficiary’s interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means.” UTC § 501.
- Creditors can reach “the beneficiary’s interest,” not the trust property.
- Exceptions
  - Traditional
  - Non-Traditional

Asset Protection Trusts: The Varieties

- I. Trusts with Discretionary Distribution
- II. Spendthrift Trusts
- III. Self-Settled Trusts
  - A. In General
  - B. Asset Protection Trusts (SSAPT)
  - C. Foreign
  - D. Domestic (DAPT)
Asset Protection Trusts: Discretionary Trusts

**General Law:** Discretionary distribution trusts may grant flexibility to a trustee as to when, to whom, and how often to make distributions to a beneficiary.

"Whether or not trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if: (1) the discretion is expressed in the form of a standard of distribution; or (2) the trustee has abused the discretion." UTC § 504(b).

**Rationale:** If the beneficiary couldn't compel a distribution that was subject to the trustee's discretion, neither could his creditors standing in his shoes. See, e.g., Restatement (Second) of Trusts § 155 cmt (b).

**Exceptions:**

- Alimony and child support creditors may maintain a suit against trustee for an award or an "amount that is equitable" to the extent that trustee has "abused a discretion." UTC § 504(c).
- "[A] creditor or assignee of a beneficiary may reach a mandatory distribution of income or principal ... if the trustee has not made the distribution within a reasonable time after the designated distribution date." UTC § 506(b).

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Asset Protection Trusts: Discretionary Trusts

**Variations on the UTC Rules on Discretionary Trusts**

1. Some states that have enacted the UTC have omitted § 504 entirely. See, e.g., DC, Kansas, and Oregon.
   - Common law rules apply
   - Discretionary v. Support Trusts

2. Some states that have enacted the UTC have omitted alimony creditors from subsection (c) of § 504, resulting in child support creditors as the only exception to the general rule. See, e.g., Arizona, North Carolina, South Carolina, and Virginia.

3. Some states that have enacted the UTC have omitted subsection (c) of § 504, resulting in discretionary trusts being immune from all creditors. See, e.g., Arkansas, Florida, Maine, Missouri, Tennessee, and Wyoming.
Asset Protection Trusts: Spendthrift Trusts

- **Definition:** A trust that prevents a beneficiary from voluntarily or involuntarily alienating his equitable interest in the trust. UTC § 501; Restatement (Third) of Trusts § 58; but see Ohio Rev. Code § 5805.1(A).
- **History:**
  - England: Did not exist at common law; Still not allowable in England
  - United States
    - But see John Chipman Gray, Restraints on Alienation of Property § 262 (1883).
    - Now recognized in UTC § 501; Restatement (Third) of Trusts § 58.
- **How to Effectuate:** No “magic words”; “Spendthrift” or words “of similar import.” But see Del. Code Ann. tit. 12, § 3536(a); N.Y. Est. Powers & Trust Law § 7-1.5 (income).
- **Purpose:**
  - Adherence to and a result of the settlor’s dominion over the trust property

Asset Protection Trusts: Spendthrift Trusts

- **Limitations on Protection Afforded by Spendthrift Trusts**
  - Distributions made to Beneficiaries - UTC § 503(c)
  - Common exceptions
    - Alimony and child support creditors. UTC § 503; Restatement (Third) of Trusts § 59(a).
    - Creditors of services for protection of beneficiary’s interest (e.g., lawyer). UTC § 503(b)(2)
    - State and Federal Government (e.g., Tax liability) UTC § 503(b)(3).
Asset Protection Trusts: Spendthrift Trusts

- Limitations on Protection Afforded by Spendthrift Trusts
  - ...
  - Less Common Exceptions
    - Necessities Supplied to Beneficiaries: Restatement (Third) of Trusts § 59(b).
    - Station-in-Life Exception: N.Y. Est. Powers & Trust Law § 7-3.4
    - Some Tort Creditors. Restatement (Third) of Trusts § 59 cmt (a)(2).
      - Mississippi: Sligh v. First Nat. Bank, 704 So. 2d 1020 (Miss. 1997), legislatively overruled

- Outlier Jurisdictions

- N.B.: Spendthrift trusts ARE excluded from the debtor’s bankruptcy estate. 11 U.S.C. § 541(c)(2).
Asset Protection Trusts: Self-Settled Trusts

- **What is it?**
  - A trust created by the settlor of which the settlor is a beneficiary
  - A trust that insulates the assets of settlor/beneficiary from creditors
- **Traditional law**
  - **Revocable Trusts**
    - “During the lifetime of the settlor, the property of a revocable trust is subject to claims of the settlor’s creditors.” UTC § 505(a)(1).
    - “After the death of a settlor, … the property of a trust that was revocable at the settlor’s death is subject to claims of the settlor’s creditors….” UTC § 505(a)(3).
  - **Irrevocable Trusts**
    - “[A] creditor of the settlor may reach the maximum amount that can be distributed to or for the settlor’s benefit.” UTC § 505(a)(2).

Asset Protection Trusts: Self-Settled Asset Protection Trusts

- **Modern Developments**
  - A significant minority of trusts jurisdictions, foreign and domestic, have begun to abrogate the general rule allowing a creditor to seize the interest of a beneficiary who is also the settlor of the trust.
- **Fraudulent Transfers**
  - Abrogate traditional law
  - Liberalize existing laws
Asset Protection Trusts: Foreign Self-Settled Asset Protection Trusts

- **Popular Jurisdictions**
  - Bahamas, Barbados, Bermuda, Cayman Islands, Cook Islands, Gibraltar, Guernsey, Isle of Man, Jersey, Nevis, Turks & Caicos, etc.

- **Some Common Characteristics**
  - Apply only to non-resident settlors
  - Very liberal laws as to fraudulent transfers combined with short statute of limitation periods
  - Foreign judgments are unenforceable

- **Some Cases**
  - FTC v. Affordable Media, LLC, 179 F.3d 1228 (9th Cir. 1999)
  - In re Olson, 2018 WL 2059648 (C.D. Cal. 2018)

Asset Protection Trusts: Domestic Self-Settled Asset Protection Trusts

- **Origin:** Alaska in 1997
- **Currently:** 17 States
  - Alaska; Delaware; Hawaii; Michigan; Mississippi; Missouri; Nevada; Oklahoma; Ohio; Rhode Island; South Dakota; Tennessee; Utah; Virginia; West Virginia; Wyoming
- **Most recent additions:** Mississippi (2014); West Virginia (2016); Michigan (2017)
- **Legislation has been proposed in Florida and Georgia (vetoed by Governor in 2018)**
- **Although DAPT tend not to be as protective as foreign APT, they are usually cheaper and have fewer political issues than foreign APTs**
Asset Protection Trusts: Domestic Self-Settled Asset Protection Trusts

Typical Requirements:
- Trust must be administered in relevant state by an in-state trustee
- Transfer into the trust cannot be fraudulent, but most states have liberalized existing law and impose a “clear and convincing” standard of proof
- Few, if any, exception creditors
  - Child Support and/or Alimony are the most common
  - Pre-existing Tort Creditors is the next most common
  - Some states have no exception creditors. See, e.g., Nevada, Utah, and W. Virginia

Outstanding Questions
- Conflicts of Law Issues:
  - Whose law applies? Forum state or the law specified in the trust?
    - Validity based upon public policy issues
    - Fraudulent Transfer Issues
- Jurisdictional Issues
  - Trust Property
  - Trustee
  - Settlor
  - Federal Bankruptcy Law
Asset Protection Trusts: Domestic Self-Settled Asset Protection Trusts

Cases Applying DAPT Statutes
- In re Reuter, 499 B.R. 655 (Bankr. W.D. Mo. 2013)
- TrustCo Bank v. Matthews, 2015 WL 295373 (Del. Ch. 2015)

Helpful Sources
- Steve Oshins, 10th Annual Domestic Asset Protection Trust State Rankings Chart (2019).
- Bogert, Trusts and Trustees § 222, §§ 1123-1140
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