

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
 - ▶ “[W]hether 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).

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
 - ▶ Born in the United States in *Broadway Nat. Bank v. Adams*, 133 Mass. 170 (1882).
 - ▶ 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).
 - ▶ Georgia: Ga. Code Ann. § 53-12-80(d)(3)
 - ▶ Mississippi : *Sligh v. First Nat. Bank*, 704 So. 2d 1020 (Miss. 1997), legislatively overruled
 - ▶ Louisiana: La. Rev. Stat. Ann. 9:2005 (legislatively repealed)

Asset Protection Trusts: Spendthrift Trusts

- ▶ Limitations on Protection Afforded by Spendthrift Trusts
 - ▶ ...
 - ▶ Outlier Jurisdictions
 - ▶ Under prior law, North Carolina did not recognize “spendthrift” trusts. As of 2006, North Carolina adopted the UTC and now recognizes spendthrift trusts, which “represents a major change in North Carolina law.” See N.C. Gen. Stat. Ann. § 36C-5-502 North Carolina cmt.
 - ▶ Arkansas, Kansas, Maine, Minnesota and Alaska: No exceptions for any creditors! See, e.g., Me Rev. Stat. Ann. tit 18-B, 503
- ▶ 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
 - ▶ *In re Brooks*, 217 B.R. 98 (Bankr. D. Conn. 1998)
 - ▶ *FTC v. Affordable Media, LLC*, 179 F.3d 1228 (9th Cir. 1999)
 - ▶ *In re Olson*, 2018 WL 2059648 (C.D. Cal. 2018)
 - ▶ *Smagin v. Yegiazaryan*, 2017 WL 6551106 (W.D. Cal. 2017)

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 a protective as foreign APT, they are usually cheaper and have few 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

Asset Protection Trusts: Domestic Self-Settled Asset Protection Trusts

- ▶ 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
 - ▶ *Battley v. Mortensen*, 2011 WL 5025288 (Bankr. D. C. Alaska 2011)
 - ▶ *In re Reuter*, 499 B.R. 655 (Bankr. W.D. Mo. 2013)
 - ▶ *Huber v. Huber*, 493 B.R. 798 (Bankr. W.D. Wash. 2013)
 - ▶ *TrustCo Bank v. Matthews*, 2015 WL 295373 (Del. Ch. 2015)
 - ▶ *Dahl v. Dahl*, 2015 WL 5098249 (Utah 2015)
 - ▶ *Klabacka v. Nelson*, 133 Nev. Adv. Op. 24 (May 25, 2017)
 - ▶ *Toni 1 Trust v. Wacker*, 2018 WL 1125033 (Alaska 2018)

Helpful Sources

- ▶ Kevin D. Millard, *Rights of a Trust Beneficiary's Creditors Under the Uniform Trust Code*, 34 ACTEC Journal 58 (2008).
- ▶ Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?*, 85 Cornell L. Rev. 1035 (2000).
- ▶ Alan Newman, *The Rights of Creditors of Beneficiaries under the Uniform Trust Code: An Examination of the Compromise*, 69 Tenn. L. Rev. 771 (2002).
- ▶ Eleventh Annual ACTEC Comparison of the Domestic Asset Protection Trust Statutes 2017 (ed. David G. Shaftel).
- ▶ Steve Oshins, 10th Annual Domestic Asset Protection Trust State Rankings Chart (2019).
- ▶ Bogert, *Trusts and Trustees* § 222, §§ 1123-1140
- ▶ Robert H. Sitkoff and Jesse Dukeminier, *Wills, Trusts, and Estates* 695-724 (10th ed. 2017)

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