

DILENDORF
LAW FIRM

Domestic Asset Protection Trusts

Five State-Based Trusts
To Consider And **Why**



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A blue-tinted background image featuring a silhouette of the Statue of Liberty, with its torch and crown visible against a lighter blue sky.

What Is A Domestic Asset Protection Trust (DAPT)?

Individuals who wish to protect their assets and property from the impact of civil judgments, creditors, and divorce may look to a trust as a way to accomplish this. A solid asset protection plan is also important to have in place due to the increasingly litigious environment caused by COVID-19.

The Domestic Asset Protection Trust (DAPT) refers to the fact that this trust is established in the United States. However, only seventeen states have these trust statutes on the books, each with a slightly different format. It is important to learn the differences between state laws to determine the most advantageous state for establishing a DAPT.

The DAPT is often used to safeguard the grantor's (trust maker's or settlor's) property, while providing a fairly flexible distribution structure for trust beneficiaries. It is especially useful for individuals and business owners who may be at risk for potential legal claims against their property.

A domestic asset-protection trust is an irrevocable and self-settled trust, which means the grantor is allowed to be a beneficiary, with access to the funds in the trust. When properly structured, these funds will be out of reach for most creditors, with the exceptions of child support, alimony, and specific "exception creditors," which vary by state. While asset protection is the primary goal, a DAPT offers other benefits, such as savings on state income taxes when the trust is established in a no-income-tax state.

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What Kinds Of Assets Are Included In A Domestic Asset Protection Trust?

A DAPT is only beneficial to the grantor when it is funded with assets. Typically, trust assets include:

- + **cash,**
- + **securities,**
- + **limited liability companies (LLCs),**
- + **real estate,**
- + **business assets**

(inventory, intellectual property, and equipment), as well as recreational assets such as boats and aircraft.

An asset protection attorney will analyze each asset based on its effect on taxation, legal protection, business growth potential, and future distributions to beneficiaries. As a result, the planning process involved in an asset transfer is a critical part of the process.



Who Is Eligible For A DAPT?

For many Americans who have equity in their homes, stock and mutual fund portfolios, or even sizeable bank accounts, a DAPT may be the most affordable alternative to the complex and costly business entity or offshore trust. Some other good candidates for this type of asset protection vehicle might include professionals with liability concerns, such as lawyers, doctors, high-risk professionals, and other individuals of high net worth. However, it is important to plan ahead when considering an asset protection trust.

The best protection available in these trusts occurs when the structure is set up in advance of any creditor issues.

This is because of the mandatory statutory waiting period enforced by each state before the assets are protected. A fraudulent transfer may also be a concern if the property is transferred into the trust after a creditor threatens action or after a lawsuit is filed. Each of the seventeen states where a DAPT is available has its own waiting period, which is in force from the date the asset is transferred and dictates when it becomes protected from potential claims. These statutes of limitations are different depending on whether it is from a preexisting or non-preexisting creditor. One of the ancillary benefits of a domestic asset protection trust is its ability to stifle most plaintiffs from pursuing a claim, but they are even more effective when combined with an additional legal barrier within a well-crafted asset protection plan. For example, by adding one or more Limited Liability Companies (LLCs), one can limit a creditor's ability to pursue assets in the trust to the LLC member's share of distributions.



How Is A DAPT Set Up?

A well-structured DAPT shields the assets in the trust from creditors' claims against the grantor, making it an attractive estate planning tool for professionals in high-risk occupations, such as doctors, attorneys, and business owners. An attorney can recommend the proper structure and jurisdiction for a domestic asset protection trust.

A DAPT is a self-settled trust, where the grantor, or settler, is also a trust beneficiary.

In such a structure, the grantor must pay taxes on income generated by the trust, and the trust's assets are excluded from the grantor's estate. Because it includes a spendthrift clause, the trust limits both voluntary and involuntary transfer of a beneficiary's interest in the trust assets. Once the trust jurisdiction and structure are determined, an asset protection lawyer will analyze the grantor's assets and make recommendations about which ones should be transferred into the trust. It is important to keep in mind that each state has its own statute of limitations after which protection begins, usually between two and four years after the assets are transferred into the trust.



What Is The Difference Between State DAPTs?

Each of the seventeen states offering domestic asset protection trusts has its own rules, but there are several commonalities. For instance, most states require the trust to be administered in the state where it was formed, by a state resident or corporate fiduciary. Each state also has statutes concerning fraudulent transfers, most of which make it more difficult to prove a transfer was fraudulent.

It is important to keep in mind that if another state gains jurisdiction over a DAPT or its assets, that state could pierce its “corporate veil of protection” by applying its own law.

This comes into play when a DAPT trust owns land in a non-DAPT state, in which a court in the non-DAPT state could get jurisdiction over the assets and satisfy a judgment through seizure of the property.

It is important to obtain protections of the state law governing the trust, since each state has its own set of rules. For example, according to the Constitution, when another jurisdiction issues a valid judgment the DAPT state must give that judgment its full faith and credit. However, the mechanics of how this applies to an asset protection trust have not yet been fully resolved by the United States Supreme Court.

Wyoming Domestic Asset Protection Trust

While commonly known as a “domestic asset protection trust,” the asset structure used in Wyoming is technically a “qualified spendthrift trust.” The name is significant because some of the key characteristics are based on a lifetime, rather than a post-mortem, asset protection strategy.

While offering many of the standard benefits seen in other state-based funds, Wyoming’s DAPT offers several unique benefits too. Here is what one can expect from a qualified spendthrift trust when it is established in the state of Wyoming:

- +** The creator, or settlor, of the trust can also be the sole beneficiary
- +** The settlor retains control and authority over the investments in the trust, as an “investment advisor” and may veto decisions made by the person responsible for managing its assets, known as the trustee.

Another important aspect of a DAPT is its ability to insulate the trust’s assets from creditors. A Wyoming based DAPT can protect assets in most circumstances, but there are a few exceptions.

1. Child support orders may remain enforceable against the assets in the trust.
2. If the assets in the trusts were specifically included in application to obtain or maintain credit, a creditor may be able to pursue these assets in a lawsuit.
3. If the assets transferred into the fund are in violation of Wyoming’s Uniform Fraudulent Conveyance Act.
4. Creditors may be able to attach the assets in a DAPT in a bankruptcy proceeding if it can be proven that assets were transferred in an attempt to defraud.

A blue-tinted photograph of an Alaskan landscape. In the foreground, two reindeer are visible, one on the right and one partially on the left. The background features snow-capped mountains under a clear sky.

SUMMARY OF STATE TRUSTS OFFERED BY DILENDORF LAW FIRM

Alaska Domestic Asset Protection Trusts

Alaska was the first state to allow for self-settled spendthrift trusts and offers some of the best statutes for both the settlor and other trust beneficiaries. A self-settled trust allows the grantor to avoid being subjected to creditor claims by creating an irrevocable trust, while also being a discretionary beneficiary. In addition, some assets in such a trust may be excluded from the taxable estate of the grantor, even if they are a trust beneficiary.

Unlike other states' DAPT laws, Alaska has no special group, or "class" of creditors, which means creditors must prove "actual fraud" instead of constructive fraud, before assets from the trust can be attached in a judgment.

Additionally, Alaska's DAPT has a provision stating that a beneficiary of a discretionary trust does not have a "clear property right in his or her beneficial interest", but rather has a mere expectancy. As a result, creditors of a trust beneficiary have no legal right to attach or compel the trustee to provide a distribution.

An Alaska DAPT allows trust beneficiaries to realize extraordinary year-on-year returns, which are compound-free from state and local income tax. Alaska also has no estate tax, no gift tax, and no tax on intangibles, and it also allows an individual whose Individual Retirement Account (IRA) is not protected from creditors under the laws of his or her own state to utilize Alaska law to provide such protection. As long as an IRA is in the form of a trust that is governed by Alaska law, it is protected by this statute.

Many other aspects of Alaska's domestic asset protection trusts may be beneficial to an individual seeking flexible asset protection with minimal taxation.

Dilendorf Law Firm helps clients determine the best state jurisdiction for establishing a DAPT.

Delaware Domestic Asset Protection Trusts

A Delaware DAPT is considered one of the most desirable asset protection strategies, and like other state-specific trusts it is available to individuals from every other state and territory of the United States. A qualified trustee who resides in Delaware must also be appointed, or one may use a Delaware trust company as an alternative.

Once the Delaware DAPT is established and assets are transferred into it, the grantor and beneficiaries must wait for the four-year statute of limitations to pass before they are protected. However, there are some limitations to the type of creditor protection allowed by law, including spousal support, child support, taxes, and some tort creditors.

A Delaware DAPT has many benefits, including:

- + A grantor in a Delaware DAPT may assign his or herself as a discretionary beneficiary of the trust, in order to get assets back in the event of an emergency
- + A reduction in federal transfer tax will occur if the grantor makes a gift that incurs gift tax, lives at least three years after making the gift, and his estate must pay estate tax. However, if the gift is made through a Delaware asset protection trust the transfer taxes may be avoided entirely.
- + Similarly, if a grantor's state of residence imposes an inheritance tax, he or she may be able to reduce that by making a gift before their death. However, if the gift is made through a Delaware DAPT it is possible to get the funds back, if needed.
- + Grantors may also use a type of Delaware DAPT known as the Delaware Incomplete Non-Grantor Trust, also known as a DING, to avoid paying income tax on the trust's capital gains and undistributed ordinary income, which may be imposed by a state without the federal grantor-trust statutes.

An asset protection attorney from Dilendorf Law Firm will offer guidance to ensure that a DAPT is the best approach to satisfy a client's unique objectives.

Nevada Domestic Asset Protection Trust

In the state of Nevada, a DAPT is also referred to as a self-settled spendthrift trust and is known as one of the more powerful asset protection and estate planning methods available.

While many of the benefits of a Nevada DAPT overlap with those of other states, the Nevada self-settled spendthrift trust statutes offer unique features that may appeal to certain investors. For example, the statutes allow a grantor to create an irrevocable trust into which he or she will transfer assets, while remaining a beneficiary of said trust.

Some advantages of a Nevada DAPT include:

- + Most states tax the income of trusts, but Nevada does not.
- + Most states require a three to four-year statute of limitations to establish protection of transferred assets in the trust, but Nevada's is only two years.
- + Only two states offer zero exception creditors, including divorcing spouses, and Nevada is one of them.
- + Nevada allows the grantor, or settlor, to appoint an independent financial advisor to manage the assets in the trust, which is also known as a directed trust.
- + Nevada has no rules against perpetuities, meaning the state allows for perpetual, or dynasty, trusts. The state allows the creation of a trust that continues for up to 365 years, thereby minimizing the transfer taxes that may otherwise be assessed.
- + Nevada also offers one of the best decanting statutes, providing an effective means to accommodate changing family needs and dealing with outdated trust provisions.
- + The trust no-contest clause afforded in Nevada helps to eliminate challenges to trust provisions and beneficiaries.
- + Nevada offers some of the most flexible and protective limited liability and limited partnership laws.
- + Nevada's trust laws provide the highest level of confidentiality to settlors and trust beneficiaries.

New Hampshire Domestic Asset Protection Trust

Since its inception in 2009, the New Hampshire DAPT continues to gain credibility. Because the state's progressive tax code is frequently revised to remain at the forefront of state trust laws, it is often cited as the main reason New Hampshire is chosen by individuals and families.

Like most states, New Hampshire requires a four-year waiting period after assets are transferred into the trust before they are fully protected against creditors' claims. Exceptions to this protection would include court orders for alimony, child support, civil judgments, personal injury, and death.

New Hampshire has also narrowed the class of creditors who can access the assets held in irrevocable DAPTs. While these trusts cannot protect against every state or federal claim against a beneficiary, the only creditors that may attach assets in the trust are those that existed at the time the trust was established, as well as the "exception creditors" mentioned above.

One of the bedrock principles of New Hampshire's Trust Code is the sanctity of the grantor's intent in creating the trust, so that when disputes arise the expressed intent cannot be overridden. While all fiduciaries must act in good faith according to the terms of the trust and in the interest of its beneficiaries, the grantor's intent is of paramount importance.

All grantors in a New Hampshire DAPT receive creditor protection, whether they live in New Hampshire or out of state, but for grantors outside of New Hampshire, the state's trust laws afford significant tax advantages. For example, while New Hampshire imposes taxes on dividends and interest income for state residents, it does not impose a capital gains tax. It also exempts out-of-state beneficiaries from paying New Hampshire taxes on the ultimate distribution of trust assets.

How An Asset Protection Expert Can Help?

An expert specializing in asset protection should be able to summarize trust options depending on your geography, assets and goals. An asset protection expert also knows which state trusts may be most advantageous in your situation with regard to taxation, duration of statutory waiting periods, control and available structures.

In addition to preparing the legal framework for a domestic asset protection trust, an experienced asset protection attorney may assist in the selection of a trustee to hold the property in trust. This could be a trusted individual, an institutional trustee or an organization.

While the trustee receives payment for acting in a professional capacity, he or she does not benefit from the assets in the trust. These assets are managed by the trustee for the purpose of the designated beneficiaries, who directly benefit from the trust's assets. An asset protection lawyer will prepare detailed instructions in the trust deed about the administration of the trust, including irrevocability, timing and manner of distributions, events of deaths of grantor or beneficiaries, election/termination of trustees, trust protector and advisers, and other similar issues essential for the trust's intended operations and legal protections.

Individuals considering various options for optimizing estate/gift/income tax treatment and protecting assets from creditors' and other legal claims will benefit from professional guidance of an asset protection expert.

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