



FERRIS FINANCIAL, LLC

HELPING YOU PLAN, PROTECT & PROSPER



Situation and Objectives

- ◆ Individual has a general concern about potential future creditor claims.
- ◆ Individual is not currently subject to any pending lawsuits, or the threat of any claim by a creditor.
- ◆ Individual has assets that are not needed to meet his/her living expenses, or for business purposes.

Concept

A Domestic Asset Protection Trust (DAPT) is an irrevocable trust created by the grantor in which the grantor is a permissible beneficiary. Normally, if a trust is "self-settled," the grantor's creditors are able to access trust assets. However, 17 states have enacted laws in varying forms that allow a grantor to be a beneficiary of a discretionary trust he/she creates, and to varying degrees the assets are protected from creditors. The states are:

- Alaska
- Delaware
- Hawaii
- Michigan
- Mississippi
- Missouri
- Nevada
- New Hampshire
- Ohio
- Oklahoma
- Rhode Island
- South Dakota
- Tennessee
- Utah
- Virginia
- West Virginia
- Wyoming

The various state laws primarily differ as to: (1) the statute of limitation period – the time within which a creditor can make a claim; (2) exempt creditors such as divorcing spouses; and (3) what constitutes a fraudulent conveyance.

- ◆ **Requirements:** The trust document states that the trust will be governed by the laws of the state in which the trust will be located. The trust must contain a spendthrift provision, which prevents the beneficiary from assigning or transferring his/her interest to other parties. The transfer of assets to the trust cannot defraud any existing creditor, and the grantor must confirm his/her solvency both before and after the creation of the trust. Generally, some of the trust assets must be located in the governing state; and at least one Trustee should reside in the state. The distribution trustee should be an independent party, i.e., one not related to the grantor; and distributions can only be made to the grantor at the trustee’s discretion. In addition, there can be no express or implied arrangement between the grantor and the trustee regarding distributions.

To achieve the intended DAPT benefits, it may be prudent to: Establish and document a reasonable estate planning or business purpose for making the asset transfer to the DAPT, such as investment purposes, estate planning purposes, or personal and/or family planning purposes; name additional beneficiaries, such as spouse and children; and maintain sufficient assets outside of the DAPT for all living expenses.

- ◆ **Potential Benefits:** After the running of the statute of limitations, which varies from 2 to 4 years, the trust assets should be protected from future creditors; however, the efficacy of DAPTs where multiple jurisdictions may be involved has not been tested in the courts. The independent trustee can make discretionary distributions to the grantor and the other beneficiaries.



Insights and Caveats

The first DAPT statute was created by Alaska in 1997. A Private Letter Ruling 200944002, September 30, 2009, (which is binding only to the parties involved), held that an Alaskan DAPT created by an Alaska resident was a completed gift; however, the IRS declined to rule on whether the trust’s assets would be includible in the grantor’s estate under Internal Revenue Code Section 2036. Additionally, Section 548(e) of The Bankruptcy Act of 2005 allows a transfer to a “self-settled trust or similar device” to be set aside if made up to 10 years before the bankruptcy filing, providing perhaps the greatest risk to such arrangements.

Several recent court cases have resulted in defeat for DAPTs that were established with clear intent to defraud creditors. Other important issues surrounding DAPTs, including the ability to avoid estate tax, as well full faith and credit disputes, have yet to be definitely addressed. As such, it is critical to work with qualified planning counsel to determine whether a DAPT is appropriate, and to determine the trust situs.

Potential creditor arguments might include: that the law of the grantor's residence should apply rather than the trust situs, that the transfer was a fraudulent conveyance, or that the grantor and the trustee had an implied agreement to distribute assets to the grantor. For non-residents of the DAPT state, commentators have suggested appointing a Trust Protector with power to remove the grantor as a beneficiary; or using a third party trust, i.e., one that benefits a third party such as the spouse, rather than the grantor.



FERRIS FINANCIAL, LLC

HELPING YOU PLAN, PROTECT & PROSPER



Ferris Financial, LLC

Matthew Ferris*, MBA

150 E. Mound Street, Suite 301, Columbus, OH 43215

Phone: (614)227-7090

msferris@ferris-financial.com

*Registered Representative offering securities through NYLIFE Securities LLC, Member FINRA/SIPC, a Licensed Insurance Agency, (150 E. Mound Street, Suite 301, Columbus, OH 43215). Financial Adviser offering investment advisory services through Eagle Strategies LLC, a Registered Investment Adviser. Member Agent of The Nautilus Group®, a service of New York Life Insurance Company. Ferris Financial, LLC is not owned or operated by New York Life Insurance Company or its affiliates.

This tax-related discussion reflects an understanding of generally applicable rules and was prepared to assist in the promotion or marketing of the transactions or matters addressed in this material. It is not intended (and cannot be used by any taxpayer) for the purpose of avoiding any IRS penalties that may be imposed upon the taxpayer. Ferris Financial, LLC as well as New York Life Insurance Company, its agents and employees may not give legal, tax or accounting advice. Please consult your own professional advisors before making any decisions.

This information was produced by New York Life Insurance Company and provided as a courtesy by Matthew Ferris. © 2016 New York Life Insurance Company. All rights reserved. SMRU 497908 (exp. 2.28.2021)

Matthew Ferris CA Insurance License Number 0K38071