

ASSET PROTECTION PLANNING

Robert F. Brogan, Esq., C.E.L.A.*, CAP

Brogan Law Group

3728 River Rd.

Point Pleasant, NJ 0842

732-701-9999

bob@broganelderlaw.com

* Certified as an Elder Law Attorney by the American Bar Association accredited
National Elder Law Foundation

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- The goal of asset protection is to shield assets from the reach of creditors, preferably before they are known to be creditors
- Asset protection structures include business and estate planning tools, such as limited liability companies, family limited partnerships, trusts and the like
- Asset protection planning should be legal and ethical
- An attorney is obligated to maintain integrity and not collude with a client who is engaging in fraud
- Asset protection plans should be used pro-actively at a point of solvency, without known creditors looming, or they risk being undone

- The term “asset protection” encompasses a number of planning and structuring mechanisms that may be implemented by a practitioner to minimize a client’s exposure to risk, but be mindful that some, such as Jay Adkisson warn that to refer to “asset protection” is to invite a fraudulent conveyance voidable transfer attack by future creditors.
- Solutions will be different, depending on:
 - The identity & location of the debtor— is it an entity or an individual – are they in a state with a DAPT statute?
 - The nature of the claim -- does the claim have priority, such as tax obligation, marital property?
 - The identity of the creditor -- a Bankruptcy Trustee, spouse, or child will have greater rights than a post-plan tort plaintiff.
 - The nature & location of the assets & debtor – LLC units, marital residence, C-Corp stock may all result in different outcomes when a creditor attempts to collect against them.

Threshold Questions to Consider

- Identity & location of the Debtor
 - Married or single (whose debt – is the couple in a community property state or were the assets accumulated in one); entity protection and exceptions
- Nature of Claim
 - Timing (how long before or after transfer to trust or re-titling did the interest of the claimant mature; prejudgment attachment issues; was obligation dischargeable in bankruptcy; consider the reach of Bankruptcy Trustee or the State's interest in protecting marital rights as between parties.
- Identity of Creditor
 - Creditor characteristics – location, likelihood of pursuing an attack of a difficult to unravel structure, persistence, size of claim in relation to Creditor's other assets, personal relationship versus stranger to defendant
- Nature of Assets
 - Liquid, real estate (location of res comes into play for choice of law concerns), residence (homestead & certain exemptions of equity in bankruptcy) easily made liquid, subject to seizure versus charging order

Debt Collection

- Who will be sued?
 - Both spouses; entity owners; community property issues in some states – may still be a factor, even if the divorce occurs in a non-community property state later.
- Where will the creditor sue?
 - Choice of law/Type of property (Real or Personal)
- Prejudgment attachment
- Collecting on judgments
 - Lien duration; writ of execution; writ of attachment; title to property
 - Assets subject to sale more valuable than those which only allow creditor to obtain income on distribution, e.g. C-corp stock versus LLC units.
- Debtor examination – review state law versus federal law implications
- Wage garnishment

Bankruptcy

- “[b]ecause bankruptcy cases are not diversity cases, the bankruptcy court is not required to apply local choice-of-law rules”
- Bankruptcy courts have national jurisdiction
- Thus they can render a valid judgment against the trustee or trust assets no matter where they are located in the United States

11 U.S. Code § 548 Fraudulent transfers and obligations

- This provision dominates all asset protection discussions & states

at (a) :

- **(1)** The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—**(A)** made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
- **(B)(i)** received less than a reasonably equivalent value in exchange for such transfer or obligation; and
- **(ii)(I)** was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
- **(II)** was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;
- **(III)** intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or
- **(IV)** made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

11 U.S. Code § 548 Fraudulent transfers and obligations (Cont.)

And states at (e):

- (1) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if—
 - (A) such transfer was made to a self-settled trust or similar device;
 - (B) such transfer was by the debtor;
 - (C) the debtor is a beneficiary of such trust or similar device; and
 - (D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was **or became**, on or after the date that such transfer was made, indebted. (emphasis added to get you considering “unknown and unforeseen” creditors may well be w/in the scope of this provision)

Voidable/Fraudulent Transfer Concerns You Must Consider

- Transfers by debtor that reduce the amount of assets reachable by a creditor
- Transfers involving *actual intent* to hinder, delay or defraud any creditors
 - Courts will look to Traditional Badges of Fraud
 - Business purpose / estate planning considerations outside of asset protection as sole objective - Make sure to articulate this in your Opinions to clients.
 - Present and future creditors, known versus the mere potentiality
 - e.g., a doctor moving assets as her practice grows in volume will look very different than if she moves assets shortly after a surgery where something went wrong, even though a law suit had not been filed yet. One who moves assets after being served looks even worse.
- Transfers involving *constructive fraud* – less than full consideration and in totality leaves debtor insolvent
- Potential Remedy / Good-faith exception but:
- Adkisson & others see virtually every APP as likely to satisfy the definition of a voidable fraudulent transfer if Asset Protection is the sole purpose, because it hinders or delays the ability of, not just known, but also unknown future creditors to collect against an asset.

Planning in Context of Marriage

- **Common law states** – separate property not liable for debts of other spouse; concept of marital property on and equitable distribution on divorce
- **Community property states** – liable for debts of either spouse
 - Exception of Nevada – **only debtor's share of CP liable for pre-marital debt**
- Community property – acquired during marriage, other than by gift or inheritance, analyze for tilting and commingling
- Determining nature of property – Keep in mind some assets have a mix of CP status depending on when it was purchased or added to in relation to the marriage.
- Potentially competing priorities, for example the added liability of exposing assets to the spouse's creditors if spouse is a practicing doctor, lawyer or other high risk profession may not be worth the full step up in basis through both lives, but may make sense after retirement when the liability decreases.

Entity Planning (or the Lack Thereof)

- Sole Proprietorship/General Partnership
 - Simple, inexpensive, but, no pain = no gain & here that means - **no protection**
- Corporation
 - Centralized management, limited liability for shareholder, but assets owned by corp. may be liquidated to satisfy corporate obligations to creditors.
- Limited Partnership
 - Limited liability for LPs
- LLC
 - Limited liability for all members. Enforcement may be limited to charging orders on distributions, so these are the most attractive tool in the belt for most planners
- LLP
 - Limited liability for all partners, except for malpractice by partner or malpractice by those over whom they directly supervise

Choice of Entity

- Non-tax factors
 - Economic flexibility – favors partnership type entities like LPs and LLCs – pass through entities for taxation purposes
 - State statutes, structure, close corporations, Series LLCs and LPs
 - Liability protection – favors partnership type entities
 - Entity provides liability shield; exceptions
 - Charging order protection;
 - Buy-out rights; poison pills
 - Single-member LLCs; reverse piercing the veil
- Alter Ego Theory
- Choice of Jurisdiction

Effect of One Entity Over Another

- A Judgment against a corporation attaches to the assets of the corporation.
- A Judgment against an LLC leaves the assets of the entity free and clear, but subjects the LLC to a charging order directing distributions to the creditor.
- Thus, formation under an LLC is advantageous.
- As we see an ongoing debate as to deduction under S-Corp filing under the new 26 USC 199A provisions, we may want to be advising LLC formation for the asset protection flexibility, but S-Corp election for the reporting of the taxation of the LLC. It's unchartered territory.

Planning with Trusts

- Trust – requires a settlor, a beneficiary, a trustee and trust property – It's relationship arrangement.
- Ownership of property is split – trustee has legal title, beneficiaries have equitable title
- Creditors can attach any asset that a person owns or can exercise control over for his own benefit.
- This is comparable to the imposition of taxation if I can exercise who has the beneficial enjoyment absent an ascertainable standard.

Planning with Trusts (Cont.)

- Trust should be irrevocable – if revocable, settlor deemed owner of trust assets
- Spendthrift provision – beneficiary prevented from anticipating distributions – some states impose presumption by statute but better practice is to specifically enumerate it as a one of grantor's purposes in creating the trust. e.g., **See Tannen v. Tannen NJ 208 N.J. 409 (2011)**
- Discretionary trust – trustee has discretion in making distributions, can exclude beneficiaries

Planning with Trusts(Cont.)

- Self-settled trust – settlor settles a trust for his own benefit
 - If more than one beneficiary, self-settled to the maximum potential extent of settlor's benefit
- No asset protection benefits to a self-settled trust traditionally at common law
- In all other respects, self-settled trusts are valid

Planning with Trusts (Cont.)

- DAPTs – referring to the 1997 and later trust legislation in Alaska, Nevada, Tennessee, etc.
 - Legislation which allows self-settled trusts as a creditor shield – a growing minority of states
 - Trusts need to comply with specific requirements
- Choice of law; Fraudulent Conveyance, Bankruptcy clawback, Full Faith and Credit clause, & Marital Rights are the key issues

Foreign Trusts

- Foreign trust – any trust governed by the laws of a foreign country
- Looking for jurisdictions with trust laws favorable to settlors and beneficiaries
- Jurisdiction features – self-settled trusts are effective, favorable fraudulent transfer laws, does not recognize foreign judgments
- There are favored jurisdictions

Foreign Trusts (Cont.)

- Issues to consider:
 - Choice of jurisdiction
 - Location of assets
 - Time of funding
 - Choice of trustee
 - Contempt
 - Defense
 - Anderson case
- Using LLCs to regain control

Foreign Trusts (Cont.)

- Tax treatment of foreign trusts
 - Every trust is a “foreign trust” for tax purposes, unless meets the court test and the control test
 - Court test and control test
 - Grantor status
- Reporting requirements
 - Forms 3520 and 3520-A
 - Penalties

Changing International Landscapes

- United States courts have been consistently hostile to offshore trusts
- Congress and the President have been equally hostile the last few years towards citizens holding assets out of the country
- IRS now getting disclosure cooperation from nations traditionally protective of private financial information e.g. Switzerland (w/UBS)

Domestic Asset Protection Trust

- Pre-existing creditors versus non pre-existing creditors
- Fraudulent conveyance/Voidable Transfers laws – transfer with the intent to hinder, defraud or delay
- Which Restatement a State has adopted may influence the outcome
- Status of Creditor will most assuredly influence the outcome, e.g., anticipate a Bankruptcy Trustee within ten years of transfer will have sweeping authority and a spouse or children are likely to also have a greater ability to get at Trust assets more so than an unrelated party
- But, after ten years, the Bankruptcy Trustee will not have such preference, and depending on which state law applies, the interests of the spouse may be limited to varying extents.

Restatement approach

- Section 156 of the Restatement (Second) of Trusts states that a spendthrift provision in a self-settled trust is invalid as to claims made by the settlor's creditors

UTC APPROACH

- Section 505 of the Uniform Trust Code provides that in the case of a self-settled discretionary trust, the settlors, creditors may reach the maximum amount that the trustee *could* pay to the settlor, regardless of whether the trustee actually distributes the money or whether the trust contains spendthrift provision

DAPT Basic Requirements

- Alaska enacted the first domestic APT statute in 1997
- Each state's statute requires that:
 - At least one trustee be located in the host state
 - The trust instrument invoke the host state's law
 - Part of the trust res be held within the host state
 - Part of the trust administration occur in the host state

Onshore Versus Offshore Protection

- There are several advantages of domestic APTs over foreign APTs
 - Settlor can avoid the uncertainties of transferring property to a jurisdiction that has a different language, political system, legal structure, and currency
 - Another advantage of domestic trusts is that they allow the settlor to avoid the foreign trust reporting requirements imposed by the Internal Revenue Code (I.R.C. 6048)

A Moral View Versus Legal View

- The most common argument against DAPTs is that allowing settlors to protect assets from claims of their creditors impairs their moral duty to pay their debts and to refrain from reckless conduct
 - Stewart E. Sterk, *Asset Protection Trusts: Trust Law's Race to the Bottom?* 85 CORNELL L. REV. 1035, 1040-41 (2000)

- Beneficiaries of gifts that are *not* placed in a spendthrift trust may be punished for the donor's failure to plan
- Similarly, when a court creates a trust with a personal injury award, that trust often will be self-settled and therefore be subject to creditor claims, but may have statutory protections. **See 42 USC 1396(p)(d)(4)(a)**
- The APT merely allows people to do for themselves what they already may do for others

- An APT may potentially remove the trust assets from the settlor's estate while still allowing the trustee to make discretionary distributions to the settlor if the settlor later requires some of those assets
- The settlor must make a completed gift of the property to the trust
- Settlers make completed gifts when they have given up “dominion and control” of the assets
 - Treas. Reg 25.2511-2(b) (2006)

The Ideal Settlor

- “The ‘best candidate’ for a domestic asset protection trust is a client who:
 1. Has no current creditor problems (or has assets in excess of what is needed to cover existing and foreseeable claims);
 2. Has a general concern about future claims by creditors;
 3. Has assets that will not be needed to meet the current and foreseeable living expenses; and
 4. Will not want frequent access to the assets being protected”

Richard Nenno, Wilmington Trust Company

- I would respectfully add...5) Who also has objectively valid reasons, other than just asset protection, for the planning that is implemented, e.g tax reduction or asset management.

Counsel's Due Diligence

- First do a solvency analysis of the client
- Then fund the trust with only a portion of the leftover assets so that the transfer does not render the settlor insolvent
- Make sure that settlors understand they will not have access to the trust assets whenever they wish
- Suggest that the trustor should include other beneficiaries in addition to himself
- Get an Affidavit of Solvency at the time of the funding
- You don't want to be a defendant from whom a creditor seeks to collect "fraudulently transferred" assets

Additional Positive Reasons for Implementing a DAPT Planning Structure

- The rise of domestic APTs should allow substantial amounts of assets to be invested in the United States rather than being transferred to the foreign trustees of offshore trusts
- In addition to the estate tax benefits a settlor can gain from an APT, he may also receive state income & capital gains tax benefits, a definitively non-fraudulent and alternatively legitimate reason for planning. Note however potential limitations – PA, NY & NJ all try to minimize the effectiveness of these
- Settlers can only avoid this tax liability if the trustee may only distribute income to them with the consent of an “adverse party” (I.R.C.677(a)(1))

How far, if at all, does the protection extend?

- Full Faith and Credit Clause
 - The Constitution requires all states to give “Full Faith and Credit” to judgments rendered by the courts of other states (U.S. CONST art IV 1)

Several commentators argue that the Full Faith and Credit Clause will not provide protection when the defendant in their jurisdiction is before the Court or the assets which purport on paper to exist in the hands of a DAPT Trustee were put there by a defendant who resides in a non-DAPT state court’s jurisdiction.

Full Faith and Credit Clause

- The Full Faith and Credit Clause does not require the APT state to enforce a judgment if the non-APT forum did not have jurisdiction over either the trust assets or the trustee
- To prevent a non-APT court from having jurisdiction, the trustee should be a resident of the APT state or a corporation doing business only in the APT state (so that it does not have “minimum contacts” with the forum state), and the trustee should hold all trust assets within the APT state (so that a non-APT court cannot have *in rem* jurisdiction over trust assets)

Contracts Clause

- The Contracts Clause prohibits states from enacting laws that impair the obligation of contracts (U.S. CONST art.1 10)
- These laws will be subject to the “strict scrutiny” standard of review and thus must be narrowly tailored to further compelling government interest
- APTs, however, should not be vulnerable under this provision because the clause prohibits impairment of *existing* contracts, and most APTs have an exception that allows creditors existing at the time of the trust is created to bring claims within a certain number of years

Supremacy Clause/Bankruptcy Law

- Section 541(c)(2) of the Bankruptcy Code provides that “[a] restriction on the transfer of the beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title” (U.S.C. 542(c)(2)) (2006)

Where will the Suit/Battle Take Place?

- Creditors May Sue Outside the APT State
 - Another state's courts may have jurisdiction over the trustee or the trust assets, depending on where they are located
 - Corporate trustees may be subject to the jurisdiction of any state in which they do business depending on the extent of contacts with the jurisdiction – evolving jurisprudence on this point of late

To Play Chicken or Go on the Attack?

- There are at least two ways for trustees to avoid having out-of-state courts enter judgments enforceable against the Trust assets

Trustee's Option 1

- They can refuse to appear in the out-of-state court
 - If they do not appear, however, the out-of-state court will enter a default judgment against them, but an APT state court may later refuse to enforce the judgment against trust assets because it may decide that the out-of-state court did not have jurisdiction over the trustee

Trustee's Option 2

- The trustee's second option is to take an offensive posture and **bring a declaratory judgment action in the APT state**
 - The APT state will use its own law to uphold the trust, and the Full Faith and Credit Clause will then require other states to uphold that judgment
 - They will most likely have jurisdiction over the trust assets, since all APT statutes require at least some of the assets to be held within the APT state
 - If the trustee sends notice of the proceeding to the creditor and gives him an opportunity to come defend his position, the creditor can still be bound by the judgment of the APT state.

Does a DAPT Work?

- This is the \$64K question for which you will get vastly differing opinions/answers... **what you won't get is certainty.**
- A DAPT should work for a resident of the DAPT state outside of a bankruptcy or marital situation.
- Does it work for a resident of a non-DAPT state who sets it up under the laws of a DAPT state? Experts differ significantly on their conclusions.
- A number of commentators believe it works and a dearth of case law, suggests it works more than it doesn't.
- To quote Steve Oshins, “If almost all potential creditors have been frustrated to the point where they choose to either settle the dispute or go away altogether, doesn't this mean that almost EVERY DAPT has worked?”

Bad Facts Lead to Bad Results: *But Such Cases Should Not Equate to Binding Precedent*

- Since the first DAPT statute in 1997, there have been few cases, and those which garnered much attention were based on egregious facts.
 - *In re Huber*, 2013 Bankr. LEXIS 2038, May 17, 2013 – discussed in the next slide in detail
 - *Dahl v. Dahl* (which as noted above – arguably- is not truly a DAPT case)
 - *Battley v. Mortensen*, Adv. D.Alaska, No. A09-90036-DMD (2011) An interesting case in as much as the Grantor funded the Trust while solvent, drafted it w/o Legal Counsel, but then also filed a Ch. 7 bankruptcy petition pro se 4 years after the transfer into the trust, but within the 10 years of having created it.
 - *Respectfully, I submit that these anomalies, while putting us all on guard, are distinguishable to an effective extent such that DPAT planning should remain alive & well.*

In re Huber

- *In re Huber*, 2013 Bankr. LEXIS 2038, May 17, 2013
 - Donald Huber was a real estate investor
 - The real estate market was precipitously crashing and Huber had numerous personal guarantees putting him under the preverbal guillotine with a fraying rope holding the blade at bay.
 - He set up an Alaska DAPT and transferred \$10,000, a 99% LLC interest (holding more than 25 different LLC interests), and other assets, thereby leaving himself insolvent
- Not Unsurprisingly, the Trust assets were not protected
 - Blatant fraudulent conveyance
 - Filed for bankruptcy: 10-year clawback per Sec 549€ allowed the Trustee to seize it all.
 - Choice of law issue with him as a Washington resident was at issue, but on these facts the Court had little reason to want to respect his plan.

Dahl v. Dahl

- *Dahl v. Dahl, 2015 UT 23 is principally a case of over-aggressive draftsmanship combined with the pre-dominance of marital rights, rather than being a “DAPT’s don’t work” case.*
- *Contrast the Supreme Court result with the App. Div. result. (Perhaps in a less contentious non-marital matter a settlement could have been achieved.)* Fourth District Court, Utah County, State of Utah, Civil No. 090402989, November 1, 2011
 - Charles and Kim Dahl were Utah residents
 - Charles and Kim set up a Nevada DAPT and transferred his residence (with Kim jointly transferring the residence) and a 97% LLC membership interest (holding brokerage assets) to the DAPT
 - Charles and Kim divorced &, as is frequently the case, it was ugly.
- Trust Assets were not protected but the crux was that the Trust was deemed **revocable**. Kim won on appeal because the Court interpreted that the trust authority she retained made it revocable by her.
 - the App. Div. had quoted from *Innerlight v. Matrix Group, LLC, 2009 UT31*, noting that choice of law and choice of forum provisions contained in contracts and legal documents are enforceable. [Emphasis added.] but **the Supreme Court of Utah deemed Utah’s interest in protecting marital rights required application of Utah law.** If the trust were not deemed revocable, it could have concluded otherwise, which is why I submit this is a case about drafting & the interests courts will have in preserving marital property rights.
 - A valid Asset Protection trust must be irrevocable. This scrivener tried to give the clients freedom to have it both ways, which does not work.

Statutory Exception Creditors

While a state may favor protection of debtors over protection of creditors, the vast majority of states, which have passed DAPT statutes, provide for certain classes of creditors whose claims cannot be protected by the Trust.

- The majority of DAPT states have a least one statutory exception creditor
 - Such as divorcing spouses & marital children owed support
 - Such as pre-existing tort creditors

Nevada & Utah are the only states with no statutory exception creditors.

Third-Party Irrevocable Trusts

- Third-Party Irrevocable Trusts are irrevocable trusts in which the grantor is not a beneficiary
- Grantor retains the power to fire and hire trustees
- Using a “floating spouse” provision
- If grantor loses his assets, his spouse can take care of him
- We know from repeated interpretations by various courts that a Third Party Irrevocable Trust works to protect its assets from creditors of the beneficiaries

Third Party Irrevocable Trusts (Cont.)

- Commonly used in Special Needs Planning to circumvent the need to include a Medicaid Payback provision in a first party trust.
- Useful tools to preserve assets passing down to children and protect those assets from the children's potential creditors, particularly their potential "future ex-spouses."
- Be conscious of potential attacks in terms of step-transactions, but there is guidance in case law to rebut such attacks.

Hybrid DAPT

- A “Hybrid DAPT” is a Third-Party Irrevocable Trust that can be turned into a DAPT – developed by Steve Oshins and Jonathon Blattmachr
- Does the grantor really need to see his name in the trust agreement as a discretionary beneficiary?
 - Assuming a good relationship with spouse, a trust for spouse and descendants isn’t much different than a DAPT, but addresses UTC Section 505 problems.
 - Give Trust Protector the power to add the grantor or remove the grantor as a permissible beneficiary
 - So long as the arrangement is not a pure two-step transaction and truly voluntary, this third party arrangement will likely withstand attack.

Hybrid DAPT (Cont.)

- If grantor is sued, Hybrid DAPT avoid the uncertain outcome of a regular DAPT
 - Since first DAPT statute in 1997, only a few reported cases have cropped up arguably because most of the creditors generally either go away or settle
 - But let's stack the odds even more in our client's favor
- If using a Completed Gift DAPT, this avoids the estate tax issue – Need we still be concerned with the Estate Tax – 1/1/2026 ??

Hybrid DAPT (Cont.)

- May Avoid the 10-year clawback if the grantor goes through bankruptcy.
 - *Battley v. Mortensen* (Alaska, 2011) – DAPT assets would have been protected using a Hybrid DAPT
 - *The cases where the DAPT have not worked arose in the bankruptcy or marital context and with egregious facts. If you represent a genuinely solvent client at the time of transfer, with no potential claims pending and they do not need to file bankruptcy for ten years thereafter, the assets within the Hybrid DAPT should be protected.*

Dynasty Trust

- A “Dynasty Trust” is an irrevocable trust that is not subject to estate taxes for as long as state law allows
- It can also be drafted to be protected from creditors and divorcing spouses
- Rule against perpetuities limitation – check state law
- This is likely to become customary planning in our industry.
- More and more children are marrying later in life, have larger student debt loads, and a poorer job prospect than prior generations, thus the 30, 35, 40 distribution models of the past do not provide protection against these & other problems modern heirs face.
- The Dynasty Trust should be the centerpiece of nearly EVERY plan!

Tier 1 Dynasty Trust States

- These states are generally considered the Tier 1 states (listed in alphabetical order)
 - Nevada
 - South Dakota
 - Tennessee
 - Alaska
- To use one of these state's laws, add a co-trustee (or for the most protection, sole trustee) from that state
- A trust in perpetuity, or as near to perpetuity as State law will allow, provides future generations protection from the largest most common creditor problem child-heirs face in the modern era - **DIVORCE**

Steve Oshins Hierarchy of Type of Trusts

- Discretionary trust = Best
- Support trust = Second Best
- Simple trust (mandatory income distributions) = Bad
- Staggered distribution trust = Horrible
- As noted above 30, 35, 40 should not be the goal or model for planners in 2016 – On this I agree with Steve 100%
- How I usually explain it to clients is that “Sometimes the best way to insure that someone receives the beneficial enjoyment of something is best served by not putting that something directly in their name.”

Discretionary Trust

- Discretionary Trust
 - “Sole and absolute discretion”
 - “Unreviewable by a court of law”
 - Doesn’t have to rely on a spendthrift provision
 - Allows for a disinterested Trustee to have tremendous flexibility
 - A naturally preferable way for protection but may be disfavored by beneficiaries

Support Trust

- What is it?
- Most are health, education, maintenance and support
- Relies on spendthrift provision
- Can Exception creditors attach
- Will they withstand attack from a variety of creditors including governmental creditors, such as Medicaid? The answer will frequently rest on who or what is the creditor seeking to pierce the assets of the trust.

Support Trust Exception Creditors

- Exception creditors – Restatement Second of Trusts
 - Alimony or child support
 - Necessary services or supplied rendered to the beneficiary (such as medical services)
 - A claim by the U.S. or a state to satisfy a claim against a beneficiary (such as a tax lien)
 - Services rendered and materials furnished that preserve or benefit the beneficiary interest in the trust (such as attorneys' fees to protect a trust)

Staggered Distribution Trust

- Nearly every trust you typically see is drafted as a staggered distribution trust A “staggered distribution trust” is a trust that makes mandatory distributions to the beneficiary as staggered ages, e.g., 30, 35, 40
- This subjects the trust assets to potential estate taxes, creditors and divorcing spouses as the beneficiaries age.
- In a society that routinely sees divorce rates in excess of 50% are we leaving our clients hard-earned legacies exposed to being lost some day to a former son-in-law or daughter-in-law? How can that be called sound estate planning?

Beneficiary Controlled Trust

- Rather than make mandatory staggered distributions, why not just pick an age to give the beneficiary control subject to ascertainable standards or simply the ability to name the Trustee?
- Very few attorneys understand this which is why nearly every trust has the same drafting error
- Once the client understands that the trust can be drafted as a beneficiary controlled trust, there is no reason to ever terminate the trust
- Perhaps use ascertainable standards for additional flexibility but be aware in some states like NY, that authority may be attachable.

Beneficiary Controlled Trust - Design

- Primary beneficiary can be a trustee
- Primary beneficiary can be the sole trustee with limitations to the ascertainable standard of health, education, maintenance and support
- Primary beneficiary can be the investment trustee with friendly distribution trustee
- Primary beneficiary can fire/hire trustees
 - Rev. Rul. 95-58
- Primary beneficiary can access income and principal
 - Principal for HEMS if beneficiary is distribution trustee
- Primary beneficiary can have non-general power of appointment
- Elect out of prudent man/person standard

Getting Cash Flow Without Being a Beneficiary

- Assume grantor sets up Hybrid DAPT for benefit of spouse and descendants
- Ways to access cash flow?
 - Distribution to spouse who may later voluntarily share it with grantor
 - Sell investment portfolio (stocks/bonds, etc.) to Hybrid DAPT for promissory note
 - So Hybrid DAPT can get cash flow by paying down promissory note
 - Sell other assets to Hybrid DAPT for promissory note
 - Loan money to the grantor for promissory note

PLR 20131002 – The Road Map for a DING/NING

- Retained Powers and Rights of Grantor
 - Grantor is a discretionary beneficiary of trust during his lifetime
 - Grantor has lifetime power to appoint to beneficiaries (other than himself) limited to an ascertainable standard in a non-fiduciary capacity
 - Grantor has testamentary power to appoint anyone other than his estate, his creditors or the creditors of his estate
 - Grantor may appoint and fire investment advisors for the Trust (which is a directed trust)
 - Grantor may fire and hire trustees

PLR 201310002 – The Road Map (cont.)

- Distribution Committee
 - Directs trustees as to all distributions during lifetime of Grantor
 - Trustee cannot otherwise make any distributions or transfers
 - Operates either by majority plus Grantor or unanimously without Grantor
 - Consists of four members
 - Must always have at least two members
 - Member who predeceased Grantor not replaced unless there would be fewer than two members remaining
 - All members are beneficiaries both during Grantor's lifetime and, in the event he does not exercise his powers of appointment, following his death
 - See additional clarification in 2014-10006

LLC/LLP & Double LLC Structure

- Nevada law makes the “charging order” the exclusive remedy of a judgment creditor
- A “charging order” is a lien
- So a creditor can only get a lien on the LLC membership interest (or LP interest) and can’t force a distribution
- Does the creditor pay the income taxes?
- Rev. Rul. 77-137 – voluntary assignment
- Charging order – involuntary
- Owner vs. lien holder – who pays the tax?
- A good asset protection structure will frustrate the creditors into settling for pennies on the dollar or going away altogether.

Equitable Remedies

- Pick a state where the charging order is the exclusive remedy
- Pick a state where no equitable remedies can apply
 - Reverse veil piercing – opposite of veil piercing
 - Constructive trust – unjust enrichment
 - Resulting trust – entity holding on behalf of
 - Alter ego – no business purpose / personal assets

Charging Order Which State Law?

- *New Times Media, LLC v. Bay Guardian Company, Inc.* (May 11, 2010)
 - Delaware LLCs
 - Charging order issued in California court
- *American Institutional Partners, LLC v. Fairstar Resources, Ltd.* (March 31, 2011)
 - Delaware LLCs
 - Charging order issued in Utah court
- *U.S. v. Wilhite*, 2017 WL 5517410 (D.Colo., Nov. 17, 2017) Colorado Charging Order yielding to Federal Fair Debt Collection restitution action by the feds.
- See Jay D. Adkisson, “Charging Orders: The Peculiar Mechanism,” 61 S.D. L. Rev. 440 (2016)
- See also Rev. Rul. 77-137 and *Evans v. Commissioner*

Increasing the Odds

- Increasing the odds of success
 - Since first DAPT statute in 1997, other than a few isolated bankruptcy and family law cases (most of which have horrible or distinguishable facts), there is limited case law involving these planning structures
 - There is reason to believe then that the DAPT structure provides some protection, particularly from a settlement negotiation perspective
 - Assuming no fraudulent intent, it is prudent to stack the odds in our clients' favor as much as possible
 - Therefore, consider using a Hybrid DAPT rather than a regular DAPT in almost all cases and you increase the likelihood of favorable outcomes down the road.

A Caution to Consider Tennessee over Nevada or South Dakota as the DAPT Situs

- A grantor placing assets into a Nevada or a South Dakota DAPT **is not** required to execute an Affidavit confirming that they remain solvent post-transfer. In contrast, a Tennessee grantor **is** required to sign such an Affidavit, confirming their post-transfer solvency, with each contribution of new assets into the DAPT.
- As a result, attorneys assisting a client with moving assets into a DAPT in either NV or SD are at a much higher risk of being named a defendant in an action by a client's creditors for conspiracy to engage in a fraudulent transfer.
- Almost by definition, an insolvent client at that point would not have funds outside of the trust to satisfy claims, *so going after the lawyer may be a primary way for the creditor to get paid on a viable claim in Nevada or South Dakota.*
- The Attorney's malpractice coverage may be the lone remaining source available to make a plaintiff whole...not an advisable position for the attorneys who will be helping clients become aware of the availability of DAPTs as a vehicle to protect assets for future generations.

Robert F. Brogan, Esq., C.E.L.A.*, CAP

- Bob Brogan is President of the Brogan Law Group, a boutique practice focused exclusively on elder law, special needs planning and asset protection. Bob primarily concentrates on Medicaid Planning, Special Needs Planning, Asset Protection, as well as Estate & Trust Planning and Administration. * Certified as an Elder Law Attorney by the ABA-accredited National Elder Law Foundation, Bob has held leadership positions in the Elder and Special Needs field at the National and State level.
- Bob is a Director on the Board of Directors of the Special Needs Alliance, for which he also serves as Co-Chair of the Public Policy Committee. Bob served as a Director on the Board of Directors of the National Academy of Elder Law Attorneys (NAELA). Bob also served as Chapter President of NJNAELA. He was Chair of the Elder and Disability Law Section of the New Jersey State Bar Association. Bob is a member of the Council of Advanced Practitioners (CAP), an invitation-only Council comprised of innovators in the profession guiding the future of Elder and Special Needs Law. Bob served as Chair of the Ocean County Bar Association Elder Law Committee. He is admitted to practice in the Superior Courts of New Jersey, the Federal District Court of New Jersey and the United States Third Circuit Court of Appeals.
- Bob has been selected for inclusion in Super Lawyers Magazine's 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016 and 2017 Editions, and has received an A-V Preeminent Peer Review rating from Martindale-Hubbell. He was selected by the NAELA President to Chair the ABLE Act Task Force. Bob also served as a Board Member on the NAELA Senior Rights PAC and on the NAELA Grassroots Advocacy Committee and served on the NAELA Public Policy Committee Steering Committee. The New Jersey State Bar Association has twice awarded him the Legislative Service Award for his lobbying efforts in the fields of elder law and special needs. Bob was also an adjunct Professor of Law at the Georgetown University Law Center.
- Bob received his B.A., with high honors in journalism, from Rutgers College, where he was also an Eagleton Institute Associate in the political science department. He received his J.D. from Rutgers Law School-Camden, where he participated in the Rutgers Elder Law Clinic, providing legal representation to impoverished seniors in Camden County. He began his legal career as a judicial clerk for the Honorable William H. Huber, Presiding Judge of the Chancery Division, General Equity Part, of the Superior Court of New Jersey in Toms River. Bob is pursuing an LL.M in Tax at Villanova University's Charles Widger School of Law.
- Bob's proudest accomplishment is his role as the happily married father of eight wonderful home-schooled children.