By **Gideon Rothschild**

# Asset Protection Planning—20 Years Later

What's happened since the enactment of the first DAPT

This year marks the 20th anniversary of the first domestic asset protection trust (DAPT) legislation—in Alaska. Since that time, 17 states have enacted such legislation. Notwithstanding these tailwinds, we haven't had any favorable case law to provide the much sought-after certainty that clients seek. Not to be lost in all this is the ever-increasing emphasis that asset protection has garnered in the last decade—both positive and negative. Some critics believe that asset protection is either morally or legally a "race to the bottom." At the other end of the spectrum, many states that haven't enacted self-settled trust legislation have seen fit to enact other laws that provide enhanced protection from creditors. These include tenancy-by-entirety trusts, inter vivos qualified terminable interest property protections and statutes protecting inherited individual retirement accounts. Recently, New Hampshire became the first state to provide for non-charitable foundations, which are similar to those vehicles in use in civil law jurisdictions to provide confidentiality and protection from creditors.

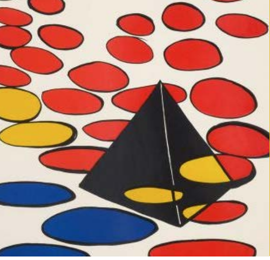
## ACTEC Symposium

Another notable development during this period was the formation of asset protection committees by both the American College of Trust and Estate Counsel (ACTEC) and the Real Property, Trust and Estate Law Section of the American Bar Association, demonstrating that this is an area warranting attention. Recently, in recognition of the 20-year anniversary of the first DAPT laws, ACTEC held a symposium, where I presented. This program covered three key developments in the area—DAPT legislation and developments therein, the use of non-self-settled trusts and other strategies for asset protection and the recent adoption of the Uniform Voidable Transactions Act (UVTA).

The ACTEC symposium included presentations on state and federal exemptions, planning with limited liability entities and planning with non-self-settled trusts. This latter topic deserves more attention from planners as it appears that often, the knee-jerk reaction for many clients seeking asset protection is to suggest a foreign or domestic self-settled trust. These structures may not work for most clients who reside in non-DAPT states, however, because courts in those states haven't yet ruled on their validity. Thus, I believe that clients should use these structures more sparingly, and planners should first consider all the other tools in their toolbox, in particular, those that won't offend the public policy in their home states.

These other strategies may be most appropriate for married clients when one spouse may be more vulnerable to creditor claims. For example, property can be transferred to the less vulnerable spouse, either outright or, more preferably, in trust. A planner can incorporate flexibility into the trust so that in the event of divorce or the grantor's spouse's death, the grantor can be added as a beneficiary through the exercise of a power of appointment or a third party's power to add the grantor. Alternatively, if the grantor gets remarried, a "floating spouse" provision could define "spouse" as the person to whom the grantor is married from time to time, thus providing access to the trust income or corpus indirectly. Other means of providing for the grantor spouse include providing for loans to the grantor and reimbursement for income taxes.

**Gideon Rothschild** is a partner at Moses & Singer LLP in New York City, where he co-chairs the Trusts and Estates and Asset Protection groups





## Tax-Saving Strategies

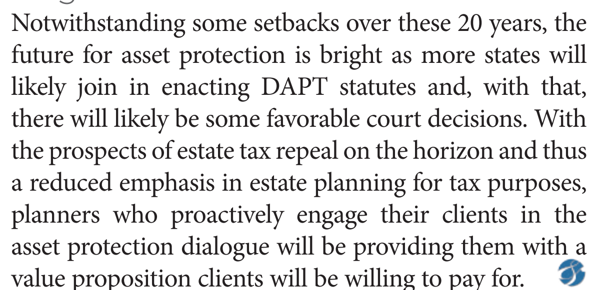
Incorporating tax-saving strategies, such as sales to grantor trusts or similar estate freeze techniques, into the planning would also demonstrate a purpose other than asset protection, which distinction may become more important with the passage of the UVTA, already enacted by 15 states. Although many commentators view the UVTA as not significantly modifying the law on fraudulent transfers, the Comments thereto have engendered much debate, particularly from the estate-planning bar. Foremost of these is the concern that Comment 8 to Section 4 suggests that a transfer to a DAPT by a resident of a non-DAPT state is a fraudulent transfer per se. As a result of lobbying efforts, some of the adopting states have omitted the Comments from the legislative history. It remains to be seen how the courts will interpret these in the future. Suffice it to say that demonstrating that a transfer has a purpose other than asset protection may, if challenged, provide the debtor with a sustainable defense.

## Early Implementation Needed

Given these developments, it becomes imperative that asset protection planning be implemented early on in the estate-planning process. All too often, clients seek counsel only after a claim has arisen, at which point it becomes too late to engage in effective (and ethical) planning. Planners need to do a better job educating clients on the need to protect assets from possible divorce and/or creditors and informing clients of the available options. This should include multi-generational planning, where applicable. That is, the planner needs to review what, if any, inheritance the client expects and how to protect it from possible future claims, as well as advising the client how best to make gifts or bequests to his heirs. In the overwhelming majority of situations reviewed, most dispositive instruments provide for outright distributions on attainment of certain ages and/or mandatory income or withdrawal rights. Even when retaining the assets in trust may not provide any tax benefit, leaving them outright may constitute malpractice if the beneficiary were to lose it all because the attorney failed to inform the client of the other benefits of trusts.

A recent divorce case in Connecticut demonstrates the importance of the foregoing. In *Ferri v. Powell-Ferri*,[1] the husband was a discretionary beneficiary of a trust settled by his father. He had an absolute power to withdraw 25 percent of the corpus at any time after attaining age 35, increasing to 100 percent after age 47. The trustee, without the husband's knowledge or consent, decanted the trust (which was governed by Massachusetts law) to eliminate the withdrawal power. The Connecticut appeals court, in reversing the lower courts, rejected the wife's argument that the trust was reachable because it was, in effect, self-settled and thus includible as a marital asset. (Connecticut is one of a minority of states that subject gifted and inherited property to equitable distribution.) The court further held that the decanting was a valid exercise of the trustee's discretion and the trust was therefore no longer available to the husband. Though some have criticized this decision as an outlier, it does demonstrate the need to avoid giving beneficiaries too much control, whether it be in the form of trustee, protector or granting withdrawal powers. This decision also demonstrates the efficacy of decanting a trust that may have "bad" strings attached.

## Bright Future



Notwithstanding some setbacks over these 20 years, the future for asset protection is bright as more states will likely join in enacting DAPT statutes and, with that, there will likely be some favorable court decisions. With the prospects of estate tax repeal on the horizon and thus a reduced emphasis in estate planning for tax purposes, planners who proactively engage their clients in the asset protection dialogue will be providing them with a value proposition clients will be willing to pay for.

## Endnote

1. *Ferri v. Powell-Ferri*, SC 19432 (Sup. Ct. Conn. 2017).