

# To Preserve Wealth, Consider a Domestic Asset Protection Trust

No matter how much effort you put into designing your estate plan, it won't do you much good if you have few or no assets to share with the next generation. That's why estate planning and asset protection planning often go hand-in-hand.

The most effective way to protect your assets is to transfer them to your children or other family members, either outright or in trust, with no strings attached. So long as the transfer isn't a fraudulent conveyance -- that is, a transfer intended to delay or defraud known creditors -- creditors won't be able to reach the assets. But if you wish to retain some control over your wealth, consider an asset protection trust.

For affluent families with significant liability concerns, foreign asset protection trusts offer protection against creditors' claims. But if you prefer to avoid the complexity and expense of a foreign asset protection trust, consider a domestic asset protection trust ("DAPT") instead.

## What's a DAPT?

A DAPT is an irrevocable, spendthrift trust established in one of the states that currently authorize this trust type (including Alaska, Colorado, Delaware, Hawaii, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia and Wyoming). Unlike trusts in other jurisdictions, a DAPT offers creditor protection even if you're a discretionary beneficiary of the trust.

To take advantage of a DAPT, you don't necessarily have to live in one of the previously listed states. But, as a general rule, to set up a trust in another state you'll need to locate some or all of the trust assets there and engage a bank or trust company in the state to administer the trust.

DAPT protection varies from state to state, so it's important to shop around. For example, different jurisdictions have different statute of limitations periods, which determine how long you'll have to wait until full asset protection kicks in. (During the limitations period, creditors can challenge transfers to the trust.) Also, most of the DAPT laws contain exceptions for certain types of creditors, such as divorcing spouses, child support creditors and pre-existing tort creditors.

Typically, DAPTs are incomplete gift trusts, which give you some flexibility to change beneficiaries or otherwise control the disposition of the assets. But it's also possible to structure a DAPT as a completed gift trust, thereby removing the assets (and any future appreciation of those assets) from your taxable estate.

## What Are the Disadvantages?

The main disadvantage of a DAPT is the uncertainty over whether it will withstand a court challenge. Although they've been around since 1997, DAPTs have not been frequently tested in the courts.

Most experts agree that if you live in one of the states with a DAPT statute, a properly designed and funded DAPT will be effective. But there's some doubt regarding trusts established by non-residents. It's uncertain whether courts in non-DAPT states will recognize other states' DAPT statutes or whether the U.S. Constitution's Full Faith and Credit Clause requires courts in DAPT states to enforce out-of-state judgments against a DAPT.

Two court cases raised concerns about DAPTs. In one, a federal bankruptcy court applied federal rather than Alaska law to invalidate a transfer to an Alaska DAPT. And in the other case, the Illinois Supreme Court permitted creditors to seize Illinois property that had been transferred to a foreign asset protection trust.

The court found that under Illinois law, a foreign asset protection trust (and, arguably, a DAPT) is fraudulent *per se*.

A potentially safer option might be the "hybrid DAPT," which starts out as a third-party trust but gives the trustee the option of adding you as a discretionary beneficiary at a later date.

## **Worth the Risk**

If you're looking for a relatively simple asset protection tool, a DAPT is worth the risk. Despite the uncertainty, a DAPT may create a strong deterrent to creditors and improves the odds that your assets will remain intact. Please consult with us about whether this, or another type of trust, would be best in your situation.

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