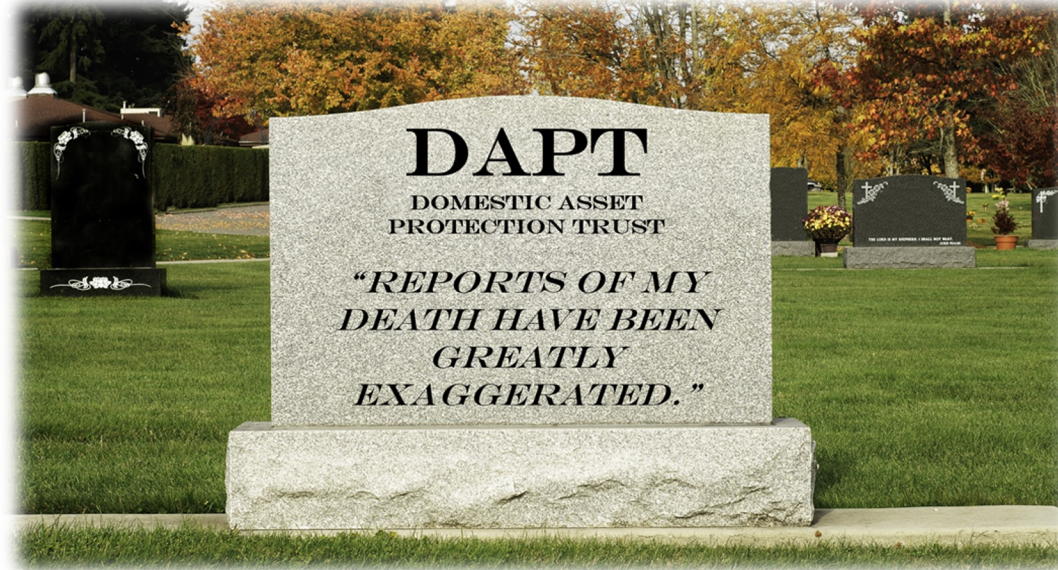




**Sioux Falls Estate Planning Council**

# **Self-Settled Trusts**



## **Reports of the Death of Self-Settled Trusts Has Been Exaggerated (& Additional Protection)**

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# Why Trusts? Because ...

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- They provide the greatest opportunities for
- Asset protection (if a spendthrift trust)
- Avoiding foolish dissipation of wealth (if a spendthrift trust)
- Reducing income taxation
- Reducing wealth transfer taxes

# Spendthrift Trusts

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- **Prevent (prohibit) the transfer or attachment of beneficial interests in trusts or the attachment of trust assets to satisfy claims against the beneficiary.**
- **Some states (e.g., NY) limit the spendthrift protection but in almost all it can be complete.**
- **Historically, however, a self-settled trust could not be a spendthrift one. Rather, the assets are permanently subject to the claims of the settlor's creditors. It was just a rule.**
- **Then began the offshore self-settled spendthrift trust industry—Bermuda, Cayman Island, Isle of Mann, Cook Islands, etc.**
- **These self-settled spendthrift trusts were regarded as so attractive.**
- **But not in America**

# Spendthrift and Self-Settled Trusts

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- **Restatement of Law(Third) of Trusts talks about self-settled trusts in the context of spendthrift trusts for which the settlor is a beneficiary, and expressly provides that “[a] restraint on the voluntary and involuntarily alienation of a beneficial interest retained by the settlor of a trust is invalid.” Restatement (Third) of Trusts §58-60 (2003), Section (2) comment f to Section 60. Likewise, the Uniform Trust Code provides that, if a settlor is the beneficiary of his or her own irrevocable trust, *his or her creditors can reach the maximum amount that can be distributed by the trustee to or for the settlor’s benefit.* UTC §505(2).**

# But Then Came the Alaska Trust Act in 1997...

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- Essentially, the Act provides that, unless the settlor was attempting to defraud a known creditor, creditors of the settlor cannot attach the trust assets or “confiscate” the settlor’s interest in the trust if the settlor’s interest is discretionary (in the exercise of a trustee other than the settlor).
- Delaware soon followed with legislation of its own
- Now 18 US states permit such “domestic asset protection trusts” or DAPTs as they are often called.
- Do they really “work?” Some cases, such as *In re Huber*, suggest they won’t if the settlor was trying to defraud a creditor.

# Why Did I Draft the Alaska Trust Act?

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- **Not to help people hinder, delay or defraud creditors**
- **It was to provide psychological comfort in doing lifetime estate planning.**
- **An example.**
- **But then came the Wacker Case.**

# Tony 1 Trust v. Wacker (AK Sup Ct Mar. 2018)

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- **After both Montana and the US Bankruptcy Courts entered default judgments on a lawsuit claiming that the transfers to an Alaska trust were fraudulent, the trustee commenced an action in Alaska courts seeking a judgment that the decisions in Montana and the US Bankruptcy Court were essentially void because Alaska Statute 34.40.110 provides that any court proceeding relating to transfers to self-settled Alaska trusts must be determined exclusively by Alaska courts. The Alaska Supreme Court refused to so rule.**
- **Some have contended that the decision is the death knell for self-settled trusts created in any DAPT state by a resident of a non-DAPT state. But the truth is far different.**

# Background of Self-Settled Trusts

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- **Self-Settled Trusts.** Whenever Someone Creates a Trust from Which He or She *May Receive Distributions in the Discretion of the Trustee* Is a Self-Settled Trust—That Is, a Trust One Has Created (or “Settled” as the English Say) for One’s Self. That Is Not Per Se Sinful.
- **IRAs Are Self-Settled Trusts**
- **Before 1997 (the Alaska Trust Act), Creditors of the Settlor Throughout the US Could Attach the Assets in a Self-Settled Trust Regardless of Why Created or When the Claim Arose. It Was Just a Rule.**
- **Now about 18 States Allow DAPTs**



# Distinction to Fraudulent Transfers

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- **All states basically void, or make voidable, fraudulent transfers. The identity of the transferee does not matter (family member, friend, trust, LLC). It is the intention of the transferor that counts (whether to hinder, delay or defraud creditors).**
- **And even though most fraudulent transfer claims are made under state law, the US Bankruptcy Code was amended in 2005 to add additional restrictions. US Bankruptcy Code Section 548(e) provides that a transfer to a *self-settled trust* (or similar device) may be set aside if it occurred within ten years of the filing of the petition for bankruptcy and was made “with an actual intent to hinder, delay or defraud” a creditor.**

# Fraudulent Transfer Acts

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- **Uniform Fraudulent Conveyance Act (Alaska)**
- **Uniform Fraudulent Transfers Act (Most States)**
- **The Uniform Voidable Transfers Act (“UVTA”) at Section 4, Comment 8, makes mention that a transfer to a self-settled domestic asset protection trust (DAPT) is voidable if the transferor’s home state does not have DAPT legislation. (Several states have adopted the UVTA)**

# Contrast to Self-Settled Trusts

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- **Self-settled trusts are clearly different than fraudulent transfers. Nearly everyone in America takes some action to avoid future claims that might otherwise arise.**
  - **Prenuptial Agreements and Pre-Marriage Trusts to Avoid Right of Election or Marital Property Divorce Claims (revocable trust in some states may defeat elective share)**
  - **Acquiring Homestead Property – e.g. FL**
  - **Tenants by entirety -- e.g. NJ for real estate, PA for even intangibles**
  - **IRAs and Qualified Plans**
  - **Using Limited Liability Business Entities**
  - **Life Insurance (in Most States)**

# Legitimate Reasons for a Self-Settled Trust

- **Good Estate Planning Especially in Light of the Temporary Increase in the Wealth Transfer Exemptions**
- **The Magic of Compounding**
- **What If the Settlor Wants Access to the Gifted/Sold Assets?**
  - **Self-Settled Trusts?**
  - **Non-Reciprocal SLATs?**

# Estate Taxation and Self-Settled Trusts

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- **Irrevocable Trust Included in Settlor's Estate If Applicable Local Law Allows Settlor's Creditor's Access to the Trust. Rev. Rul. 2004-64**
- **But Not If Creditors Cannot Attach Under Applicable Local Law. Rev. Rul. 76-103, Rev. Rul. 2004-64, German, 7 Ct. Cl. 641 (1985) PLR 9332006 (not precedent) and PLR 200944002 (not precedent)**
- **What If Home State Allows Creditor to Attach (Uniform Voidable Transfers Act)?**
- **Key: Can Settlor Merely “Relegate” the Creditors to the Trust Per Rev. Rul. 76-103?**

# Other Legitimate Reasons for Self-Settled Trusts

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- **ING Trusts: What They Are; What They May Do: State Income Tax Avoidance, Greater Deduction(s) under Sections 199A and 164.**
- **Salty SLATs**
  - **Need for Adverse Party**
  - **Gift In? Gift out?**
- **Income tax savings are an independent (non-asset protection) reason for creating non-grantor trusts**

# Avoid Being a Self-Settled Trust

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- **Restatement (Second) of Trusts, Section 156(2) (1959) provides in relevant part “[w]here a person creates for his own benefit, a trust for support or a discretionary trust, his transferee or creditors can reach *the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.*” (Emphasis added.)**
  - **What about a Hybrid DAPT? (Allow the Grantor to Be Added as a Beneficiary; After 10 Years; only if no spouse)**
  - **What About a Trust Where Distributions to the Settlor Can Only Be Made by the Exercise of a Special Power of Appointment Held by a Non-Fiduciary? (A *Collateral* Power of Appointment). See O’Connor, Gans & Blattmachr, “SPATs: A Flexible Asset Protection Alternative to DAPTs,” Estate Planning (Feb. 2019)**

# Is Wacker Just a Case of Bad Facts Make Bad Law?

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- **Are Bad FLP cases Viewed Differently than Bad DAPT Cases?**
- **Rush University Case.**
- **Wacker: The court did not hold that Alaska law would allow the creditors of the grantor access to the trust's assets. And that is the key. If the trust is located in a jurisdiction, such as Alaska, Nevada or Delaware, which does not automatically and permanently subject trust assets to the claims of the grantor's creditors, it may well be upheld.**
- **It depends upon many factors as discussed in detail in Rothschild, Rubin & Blattmachr, "Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch," 32 Vanderbilt J. Transnational Law 1549 (1999).**
- **Governing Law (Restatement (second) Conflict of Laws, Sec. 270/273) on Governing Law vs. Sec. 6 on Validity**



# Is There a Better or More Certain Trust Form?

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- **And could it even work in a jurisdiction like New Jersey which is not a DAPT state?**
  - **Back to the definition of a self-settled trust: attachable to the extent the trustee could make distributions to the settlor**
  - **Don't make the settlor an immediate beneficiary but allow him or her to be added as a beneficiary later**
  - **Better yet: prohibit any distribution of property to or for the settlor from the trust but grant someone a non-fiduciary special power of appointment to appoint assets to or for the benefit of any descendant of the settlor's mother or grandmother**
  - **Who should hold the special power. Some suggestions**
  - **Get the February issue of Estate Planning**

# Why You Should Consider a SPAT Soon

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- **Use of the Temporary Exemption**
- **The very scary S. 309**
- **INGs**

# Summary and Conclusions

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- **Asset Protection Planning Is a Common Occurrence**
- **Self-Settled Trusts Can Be Used for Many Legitimate Purposes Where Asset Protection Is Merely a Necessary Consequence of Their Use, Not the Primary Reason for Their Use**
- **Don't Use a Self-Settled Trust as the Primary Tool for Asset Protection; Rather, Acquire Exempt Assets and take other steps**
- **Self-Settled Domestic Asset Protection Trusts May Serve Legitimate (Non-Fraudulent Transfer) Purposes and, Therefore, Are Alive and Well**
- **A SPAT Is the Better Choice But Create It in a DAPT state**