ASSET PROTECTION PLANNING AND DELAWARE ASSET PROTECTION TRUSTS

Asset protection planning is an important part of a comprehensive estate and financial plan addressing an individual's risks now and in the future. Proper asset protection planning requires time, consideration and knowledge to fully integrate the planning holistically and effectively.

Professionals such as physicians, attorneys and business owners are well aware of their common risks for liability and litigation. Many of these professionals face malpractice claims, breach of contract claims and personal injury claims, but there are a multitude of additional risks that professionals and employers confront. Employing household staff or serving as a volunteer board member of a charitable organization can leave one open to liability for the actions of others. Family members such as spouses, children and even pets can expose one to potential risks. In this current economic environment, those who are perceived to have deep pockets present an attractive litigation target.

Fulfilling the goals of those designing an estate and financial plan involves many considerations, such as the process of accumulating and growing assets, starting and growing a business, and maximizing estate and tax planning. A thorough estate and financial plan may also include planning for a wage earner's incapacity or death so children, spouses, business partners and others, who may be affected by disruptions caused by these unforeseen or untimely events, can continue to be supported.

Asset protection planning involves legal techniques and a body of statutory and common law dealing with protecting assets of individuals and business entities from disruptions due to the individual's or business owner's sickness, death, divorce, bankruptcy, exposure to civil money judgments and vulnerability to lawsuits. A holistic estate and financial plan includes asset protection planning.

FEDERAL AND STATE STATUTORY EXEMPTIONS AND INSURANCE

When planning for risk, it is best to start with the easiest and least expensive measures and work through all available options, weighing whether each measure can address each risk appropriately. The first level of protection recognizes state and federal laws that protect certain assets based on public policy concerns that favor leaving debtors enough assets to enable them to live and provide support for their dependents. Federal laws include protecting assets such as qualified retirement plans, educational savings plans and life insurance policies from bankruptcy claims.[1]

Many states have enacted statutes protecting life insurance, annuities, homesteads and retirement accounts from the claims of creditors. Each state's protections are different. For example, Florida has generous homestead exemptions.[2] Florida provides other unique protections such as an exemption for the wages of the head of a household,[3] and even an exemption for a hurricane savings account.[4]

1 11 USCS §§ 522 and 541
2 Fla. Stat. § 222.01
3 Fla. Stat. § 222.11
4 Fla. Stat. §§ 215.555 and 222.22

Florida also has protections for life insurance, protecting the cash value of life insurance from both the insured's and the beneficiary's creditors.[5] When using life insurance as an asset protection tool, you will want to know the specific protections afforded the owner, the insured and the beneficiary.[6]

In assessing a need for any particular type of insurance policy, a list of an individual's possible risk factors is important, starting with the most likely and the most costly. Most people are familiar with auto, medical and homeowner's insurance, but professionals and business owners should be considering a whole host of other types of insurance. For example, an umbrella policy to act as a catch-all for all kinds of liability can come at a fairly low cost and is a valuable policy to own.

TITLE TO ASSETS

The next level of planning begins with outlining how assets are currently titled. Are assets individually owned, in joint name with a spouse, or as tenants in common with someone else? When considering how assets are titled, it will be important to determine what forms of title are available. Some states are common-law states, some are community property states and some states allow a husband and wife (and in some states, civil union partners) to hold property as tenants by the entirety. Tenancy by the entirety is created between a husband and wife who together hold title to the whole property interest with rights of survivorship. This title gives some asset protection to the owners, since neither can sell an interest in the property without the consent of the other; and generally, the property cannot be attached by a creditor unless the creditor has a judgment against both owners. Some states, including Delaware, allow married couples to preserve the creditor-protected character of tenancy by the entirety property even when it is transferred to a trust.[7]

There are drawbacks to holding property in joint name. One drawback to transferring individually owned property into joint name with a spouse is that the transferee spouse now has rights to that property that may have otherwise been kept as separate, non-marital property. In the event of divorce, which is often a greater risk to someone's finances than a lawsuit by a third party, the transferred property is now divided one-half to each spouse. When transferring property into joint name with someone other than a spouse, the transferring person must understand whether or not the transfer will be considered a gift for gift tax purposes. Additionally, if the property is transferred into title as joint tenants with rights of survivorship, and if the joint owner survives the original owner, the property will be completely owned by the survivor. Such property will not become part of the original owner's estate to be divided according to the original owner's estate planning documents.

Some people will transfer assets to family members with the idea that the assets will be protected from the transferor's creditors and that the family member will still take care of the transferor with those assets. This strategy often fails because these assets are not protected from the family member's creditors. *In re Woodworth*[8] involved a mother who transferred the bulk of her estate to her daughter in anticipation of needing to qualify for Medicaid. The court found this transfer suffered from many issues, including the fact that there is a Medicaid "look back" period for persons who transfer assets for less than fair market value. The court order in this case centered on Daughter's bankruptcy and the court concluded that Mother's assets transferred to Daughter were now subject to Daughter's bankruptcy proceeding and payable to the bankruptcy trustee. This case was a difficult lesson for Mother and highlights the old adage that "you get what you pay for," especially when it comes to good financial and legal advice.

5 Fla. Stat. § 222.14
6 As an example of the many considerations that should be addressed when planning with insurance, see *Using Life Insurance for Asset Protection — What Is Really Protected?* by Keith A. Herman, 68 J. Mo. B. 14 (Jan-Feb 2012)
7 12 Del. C. §§ 3334 and 3574(f)
8 *Meiburger v. LNDP&G Ultra Trust (In re Woodworth)*, 2013 Bankr. LEXIS 483 (Bankr. E.D. Va. Feb. 6, 2013)

ENTITY FORMATION

A higher level of protection can be found in creating a family limited partnership ("FLP") or limited liability company ("LLC"). The idea behind asset protection by using entities is the premise that any liability arising inside the entity must be satisfied by the assets owned by the entity; and the personal assets of the owners of the entity are not at risk. In order to get this protection, it is important for owners to follow corporate formalities and avoid using the entity's checkbook as their personal checkbook. Otherwise, the entity structure may be disregarded when a creditor brings an action against the owner or entity, possibly resulting in personal liability for the owner of such entity.

What many see as the greatest asset protection benefit of LLCs and FLPs is that several states have limited creditor remedies to a "charging order." A charging order only allows the creditor to receive distributions from the entity prior to the debtor receiving such distribution. The creditor is unable to force the sale of the underlying assets of the entity, access the entity's assets directly, force a distribution or a liquidation, or vote on any entity matter. The charging order protects the other "innocent" members or partners of the entity. Each state's laws regarding charging orders are different, and there are cases where the creditor was able to reach the assets of the entity because of a flaw in the structure. For example, the entity structure may not afford much protection if all of the partners of an FLP are debtors of a single creditor, or the LLC has a single member that is the debtor.

IRREVOCABLE TRUSTS

The simplest way to remove assets from the claims of creditors is to give them away with no expectation of further benefit from those assets, keeping in mind any "claw back" laws regarding gifts and fraudulent transfer rules. Many people decide to establish irrevocable trusts during their lifetimes to accomplish a wide variety of goals. For example, trusts can be created for the benefit of loved ones so that the beneficiaries can enjoy the trust assets during and after the lifetime of the settlor (person setting up the trust and making the initial transfer of assets to the trust). Goals may include providing for a beneficiary's education, support and health needs. Irrevocable trusts often set out specific ages or times that beneficiaries will receive distributions or defined needs that will be paid for by trust assets. Irrevocable trusts can provide for future generations, have provisions to protect the assets from the beneficiary's creditors, and also accomplish tax savings.

When the settlor does not want to completely part with the benefits of the assets put into the trust, then a more specific type of trust should be considered if the settlor also wants to protect the trust assets from the settlor's creditors. There are currently 14 states that have enacted laws that allow a person to create and transfer assets to a trust, where the settlor is a permissible beneficiary and the assets in the trust are protected from the settlor's creditors.[9] These trusts are often called "Self-Settled, Spendthrift Trusts" or "Asset Protection Trusts."

Why might someone consider setting up an Asset Protection Trust ("APT")? These trusts are generally contemplated when there is a significant portion of someone's net worth that is not easily or adequately protected by other asset protection strategies. In 2012, with the threat of a significant reduction of the estate and gift tax exemption amount, individuals created these APTs to make large gifts they may not have otherwise considered since they were able to keep a string attached to those assets for their own benefit. APTs have also become popular as an alternative to a prenuptial agreement. Additionally, individuals who have received a large inheritance and want to save it and protect it for a rainy day are also good candidates for APT planning.

9 Alaska, Delaware, Hawaii, Missouri, New Hampshire, Nevada, Ohio, Rhode Island, Oklahoma, South Dakota, Tennessee, Utah, Virginia and Wyoming

ESTABLISHING AN ASSET PROTECTION TRUST

The APT is a fairly new estate planning tool, becoming popular after Delaware enacted one of the first domestic, Self-Settled, Spendthrift Trust statutes in 1997.[10] When considering an APT, a settlor should discuss expectations, risks, costs and planning objectives with a group of skilled legal and tax advisors who are experts in this type of planning. In order to properly set expectations, it is important to understand what is required to establish an APT.

It is critical to understand that an APT is a unique and specialized type of trust that should be drafted by an experienced legal practitioner. Simply stating that a trust is an asset protection trust or is a Delaware trust does not necessarily make it so.

A Delaware APT will require a transfer of assets to a trust that, under Delaware law, will be deemed a qualified disposition[11] and not a fraudulent transfer.[12] In order to establish an APT in Delaware, the trust must also be irrevocable; a qualified Delaware trustee must materially participate in the administration of the trust; Delaware law must govern the validity, construction and administration of the trust; and a spendthrift clause applicable to the settlor must be included in the document.[13] Although the settlor is a beneficiary of the trust, it is generally recommended that other discretionary beneficiaries are named to strengthen the planning aspects of the trust and give the settlor more flexibility as time goes on to allow for distributions to the settlor's loved ones.

Delaware's Qualified Dispositions in Trust Act ("DQDTA") is intended to prevent any action brought "for an attachment or other provisional remedy against property that is the subject of a qualified disposition" in trust, subject only to fraudulent conveyance laws.[14]

Delaware's laws allow a creditor four years to bring a claim after a transfer to the APT.[15] If the transfer was made with the actual intent to hinder, delay or defraud the creditor, the creditor with a claim that arose before the transfer has a year to bring a cause of action after the transfer to the trust was or could reasonably have been discovered.[16] Therefore, it is advisable for the transferor to make only one transfer to the APT to start the statute of limitations running. If subsequent transfers are made to the APT, the trustee will need to segregate these new assets and the statute will begin again as to each new transfer.[17]

HOW CREDITORS ATTACK ASSET PROTECTION TRUSTS

Successful APT attacks are based on fraudulent transfer claims and involve situations where there is plenty of evidence to show that the settlor transferred the bulk of his or her assets to the trust, or the settlor was aware of pending litigation, or the admitted purpose of the trust was to prevent creditors from reaching assets.[18] These cases are often referred to as "bad facts cases." If the transfer to the trust is a fraudulent transfer, the trust will not qualify as a Delaware APT, since one of the requirements of a valid Delaware APT is that the transfer of assets to the trust not be a fraudulent transfer.[19]

Avoid Fraudulent Transfers

When an individual is considering an APT, a skilled legal advisor will explain fraudulent transfer laws and perform due diligence with the client to establish that the transfer of assets to the APT is not a fraudulent transfer.

10 10 71 Del. Laws, c. 159
11 12 Del. C. § 3570(7)
12 12 Del. C. § 3572(a)
13 12 Del. C.§ 3570(11)(c)
14 12 Del. C. § 3572(a)
15 12 Del. C. § 3572(b)(2)
16 6 Del. C. § 1309(1)
17 12 Del. C. § 3572(f)
18 *Kilker v. Stillman*, 2012 Cal. App. Unpub. LEXIS 8542 (Cal. App. 4th Dist. Nov. 26, 2012)
19 12 Del. C. § 3572(a)

Delaware has enacted the Uniform Fraudulent Transfer Act ("UFTA").[20] The UFTA has been widely adopted and currently only seven states have alternative fraudulent transfer laws.[21] In Delaware and UFTA states, a transfer of assets "with actual intent to hinder, delay or defraud any creditor" or a transfer of assets "without receiving a reasonably equivalent value," if done with the knowledge that remaining assets would be insufficient to carry on business or pay debts when due, is a fraudulent transfer whether the creditor's claim arose before or after the transfer was made.[22]

DUE DILIGENCE MAY INCLUDE:

- A statement of the settlor's profession or business and how long the settlor has been engaged in that endeavor
- An Affidavit of Solvency
- A statement of where the settlor's wealth derived
- All professional licenses held by the settlor and a statement about whether the settlor has been the subject of a disciplinary proceeding or whether a license was revoked or suspended
- A current financial statement of the settlor
- A list of all states and countries where the settlor has lived
- Federal and State income tax returns for the prior three years
- If an interest in a closely held business will be transferred to the APT, the governing documents, a current financial statement of the business, and Federal and State income tax returns for the prior three years for each entity
- A statement about any current or pending litigation or administrative proceedings and an estimate of the potential liability
- A list of all assets to be transferred, the value of each asset and how each is currently titled

To establish at the outset that the contemplated transfer to an APT is not a fraudulent transfer, the transferor should sign an Affidavit of Solvency that states that he or she is not insolvent and will not become insolvent after the transfer, is not currently in litigation and is not aware of any future litigation.

The affidavit generally sets out that the other factors to determine intent to hinder, delay or defraud any creditor are also not present. A thorough Affidavit of Solvency will include state specific statements based on the fraudulent transfer laws of the settlor's and the trustee's states of residence.

When considering an APT, it is important to address additional purposes for the planning, such as tax planning, planning as part of the overall estate plan, and specific planning to prepare for a defined goal such as business succession. Some courts do not like the idea of asset protection planning and have found that a transfer to an APT was a fraudulent transfer if the client is not educated about how the planning works and believes that the trust is simply a tool to avoid paying creditors.[23] A settlor should consider transferring an amount to the APT that would not substantially decrease the settlor's non-protected assets. Leaving some assets available to pay even unknown and unanticipated creditors bolsters a settlor's claim that the transfer to the APT was not a fraudulent transfer.

Due diligence paperwork should be dated prior to executing the trust document and kept with the trust document by the trustee. A corporate trustee will generally run a credit check and other "know your customer" checks regarding the settlor, the beneficiaries and the fiduciaries of the APT to make sure that statements reflected in the due diligence documents are true and that Anti-Money Laundering procedures are being followed.

A corporate trustee is required under federal law to take certain measures to combat money laundering and terrorist financing, so much of this due diligence will be required by a corporate trustee even if it is not initially performed by the attorney. Attorneys should consult the ABA Good Practices Guidance[24] and the ABA Formal Opinion 463[25] when performing due diligence for an APT.

20 6 Del. C. §§ 1301 et. seq.
21 States that have not enacted the UFTA: Alaska, Kentucky, Louisiana, New York, Maryland, South Carolina and Virginia
22 6 Del. C. § 1304(a)
23 Supra note 18
24 Resolution & Report 116, Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing. American Bar Association (2010)
25 ABA Comm. on Ethics & Prof'l Responsibility, Formal Op. 463 (2013)

Exception Creditors and Super Creditors

Some states with an APT statute provide for "exception creditors," or creditors who can defeat an APT. Delaware law reflects Delaware legislators' belief that there are certain creditors who should be protected for public policy reasons and that a transfer to an APT should not allow a person to avoid paying child support, a court ordered division of property, or alimony to a spouse who was married to the settlor at the time the trust was funded.[26] Another protected creditor in Delaware is someone who suffered a tort committed by the settlor prior to the transfer of assets to the trust, who suffers death, personal injury or property damage, if the claim is brought within the statutory period.[27] If an exception creditor has a claim against the settlor of a Delaware APT, that exception creditor can bring suit in Delaware and potentially reach the assets in the Delaware APT.

In addition to Delaware's exception creditors, other creditors, who may be deemed "super creditors," can challenge an APT under any state's laws. Those super creditors are the Internal Revenue Service,[28] the Securities and Exchange Commission and the Federal Trade Commission. Furthermore, although APTs are protected under section 541 of the Bankruptcy Code, the Federal Bankruptcy Courts have a 10-year statute of limitations under section 548(e) to challenge APTs if the APT was made with the actual intent to evade creditors.[29]

Defeating an APT Choice of Law Provision

An APT can be an effective tool to protect someone from frivolous lawsuits, since many "good-facts" cases settle before trial. Nevertheless, only 14 states have enacted legislation that recognizes Self-Settled, Spendthrift Trusts. There are many other states that either do not recognize Self-Settled, Spendthrift Trusts or even find such trusts void for public policy reasons.

If a creditor can bring a claim against the settlor or the trustee in one of these states, the APT is at risk and the assets in the trust may become available to satisfy a judgment claim. The importance of understanding how a court outside of Delaware can assert jurisdiction, regarding a Delaware APT cannot be overlooked when making choices for how to draft and fund a Delaware APT.

If the creditor does not qualify as an exception creditor or a super creditor, the creditor may file suit against the debtor where the creditor believes the suit will be successful. A court in a jurisdiction outside of Delaware must determine which state's law to apply. In a Delaware APT, the trust must have a choice of law provision stating that Delaware law shall govern the validity, construction and administration of the trust.[30] In a state with APT law, the court will presumably apply Delaware's APT law and not find the trust void for public policy reasons as long as there is no evidence of fraudulent transfer.

Courts in non-APT states may decline to apply the trust law of a foreign jurisdiction selected by the settlor if doing so would harm creditors or other third parties.[31] The typical reasoning behind this position follows the understanding that in contracts, the creditor and debtor are both parties to the agreement incorporating the choice of law provision; as opposed to a trust, where the creditor is not a party to the trust document and should not necessarily be held to the choice of law provision chosen by the settlor. When there is a conflict of laws between the choice of law stated in the APT and the law where the court is located, many state and federal courts apply the Restatement of the Law, Second, Conflict of Laws, ("the Restatement") that favors respecting choice of law provisions in a trust agreement.[32] Nevertheless, section 270(a) of the Restatement gives courts a two-part process to defeat a settlor's choice of law provision.

26 12 Del. C. § 3573(1)
27 12 Del. C. § 3573(2)
28 *United States v. Cohen*, 930 F. Supp. 2d 962 (C.D. Ill. 2013), Where the court found the defendant did not follow corporate formalities and the entity was acting as his nominee, the property held by the entity was exposed to Federal tax liens against the defendant. The IRS has been clever enough to get to the assets of an offshore asset protection trust, even though the U.S. court had no jurisdiction over the foreign trustee in a recent case (*United States v. Grant*, 2013 U.S. Dist. LEXIS 57262 (S.D. Fla. 2013)) where the U.S. beneficiary had the power to change trustees. Since the courts did have jurisdiction over the beneficiary, she was ordered to replace the foreign trustee with a domestic trustee that would be within the jurisdictional reach of the court.
29 11 USCS §§ 541(c)(2) & 548(e)
30 12 Del. C. § 3570(11)(a)
31 *Battley v. Mortensen*, 2011 Bankr. LEXIS 5560 (Bankr. D. Alaska, May 26, 2011); *Waldron v. Huber* (*In re Huber*), 493 B.R. 798 (Bankr. W.D. Wash. 2013)
32 Restat 2d of Conflict of Laws, Introductory Note & § 270

The first part involves determining if the chosen state has a "substantial relation" to the trust, and the second part involves reviewing the choice of law provisions in the trust to determine whether the application of the chosen law violates a "strong public policy of the state" that has the most "significant relationship" to the trust.

In May 2013, the U.S. Bankruptcy Court in *In re Huber* held that Alaska did not have a substantial relation to an Alaska APT established by the debtor with an Alaska trustee, and that Washington did have a significant relationship to the trust.[33] The court came to its decision based on the following factors: 1) the settlor was not domiciled in Alaska; 2) the bulk of the assets were not located in Alaska; 3) the beneficiaries were not domiciled in Alaska; 4) the debtor resided in Washington; 5) virtually all the property transferred to the trust was located in Washington; and 6) the attorney who prepared the trust documents and transferred the assets to the trust was located in Washington. The court then determined that Washington has a strong public policy against APTs because Washington state law provides that Self-Settled Trusts are void as against existing or future creditors. The court then applied Washington law to find that the debtor's transfers to the Alaska APT were void and made the assets of the APT available to the bankruptcy trustee.

Establishing Jurisdiction

Where an APT has been created by a settlor who resides in a non-APT state, and the settlor is then sued in the settlor's non-APT state of residence or files for bankruptcy in the non-APT state, the court of the non-APT state has *in personam* jurisdiction over the settlor. Once the settlor's liability is established, there must be an enforcement action against the trustee, since the trustee has legal title to the trust property. Without *in personam* jurisdiction over a trustee, a judgment affecting trust assets in a Delaware APT would violate the *Due Process Clause of the Constitution*.

In *Hanson v. Denkla*, the United States Supreme Court held that a Delaware court was not compelled to give full faith and credit to the judgment of a Florida court that lacked jurisdiction over the Delaware trustee.[34]

Courts in some recent cases have found clever ways to get to the assets in APTs even when they could not assert *in personam* jurisdiction over the trustee. When real property is located in a particular state, that state's courts will have *in rem* jurisdiction over the real estate.[35] This jurisdiction is based on the location of the property in the state, rather than on the location or residence of a particular person, such as the trustee.

In *Rush University Medical Center v. Sessions*,[36] the Supreme Court of Illinois found the Self-Settled, Spendthrift Trust fraudulent and *per se* void under Illinois common law, asserted *in rem* jurisdiction over the Illinois real estate that was held in an offshore APT, and ordered the trustee to pay an irrevocable pledge the settlor had made to a charity prior to his death. The reason why this case is so remarkable is that the settlor of the offshore APT established this trust in the Cook Islands and designated the law of that jurisdiction to control the trust. The Illinois court obviously had no jurisdiction over the Cook Islands trustee, but because there was property located in Illinois in this offshore APT, the Illinois courts could exert *in rem* jurisdiction over those assets.

One way to avoid holding real estate directly in an APT is to place the non-Delaware real estate in a Delaware LLC, thereby turning the real property interest into an intangible property interest. Most corporate trustees will not hold real estate directly in a trust. Additionally, Delaware's rule against perpetuities states that real property may only be held in trust for 110 years.[37] Nevertheless, Delaware has abolished its rule against perpetuities as to all other assets held in trust.

33 *Waldron v. Huber* (*In re Huber*), 493 B.R. 798 (Bankr. W.D. Wash. May 17, 2013)
34 *Hanson v. Denckla*, 357 US 235 (U.S. 1958)
35 *Shaffer v. Heitner*, 433 U.S. 186 (U.S. 1977)
36 *Rush Univ. Med. Ctr. v. Sessions*, 2012 IL 112906 (Ill. 2012)
37 25 Del. C. § 503(b)

Clearly, it is important to consider the type of assets that will be transferred to the Delaware APT. As previously discussed, real estate is a particularly tricky asset to hold in an APT.

The problems become heightened when that real estate is the settlor's primary residence. A primary residence is probably the worst asset to transfer to an APT, not only because of the jurisdictional issues, but also because the settlor will be directly benefiting from the asset. An APT is meant to serve as "a rainy day fund" and not hold assets that the settlor currently uses. For example, typical APTs do not have mandatory income distributions to the settlor. Additionally, with residential real estate, it is likely that a court in the state where the real estate is located will find that the trust is merely the *alter ego* of the settlor and disregard the trust and its protections.

In *US v. Evseroff*,[38] the court pierced an APT finding that the settlor had such control of the property that the trust was not *bona fide*. In this case, the settlor had transferred his residence to the trust, but the trust did not book payments the settlor made in lieu of rent as income; the trust did not assume the mortgage or claim the mortgage interest deduction; the trust did not claim the deduction for real estate taxes and was not the named beneficiary of the flood and fire insurance policies. This case highlights the importance of following corporate and trust formalities.

QUESTIONS TO ASK YOUR CORPORATE TRUSTEE

- Does your company only have offices in Delaware and conduct administration in Delaware or do you have offices in other jurisdictions where administration is conducted? Many national banks will have established a limited purpose trust company in Delaware to manage and administer all Delaware trusts. Those that are functioning under their national charter may expose the trust to other jurisdictions.
- Are all corporate trustee board meetings for your company conducted in Delaware?
- Are assets for Delaware trusts custodied in Delaware?
- Can your company function as a full trustee, as well as a directed trustee?

The alter ego cases generally involve defendants who established APTs and exerted control over the trust and committed some wrong that resulted in an unjust loss to the creditor. The alter ego approach is basically a reverse veil-piercing technique traditionally used to pierce corporate entities. This technique, as it relates to trusts, is meant to hold the trust liable for the obligations of the settlor. Once an alter ego relationship is established, both the alter ego (the settlor) and the APT (and trustee as legal owner of the APT assets) will be subject to the jurisdiction of the court in the non-APT state as long as the settlor is subject to that court's jurisdiction.[39]

Nexus is Important

Many people establishing a Delaware APT also want to take advantage of Delaware's other beneficial trust laws, such as Delaware's direction trust statute. Delaware's direction trust statute allows a settlor to name a Delaware trustee and also name specialized advisors who can take on discrete responsibilities that only expose them to liability for their own actions and not the actions of any of the other advisors or the trustee. This open architecture in naming fiduciaries is unlike naming co-trustees who are responsible for monitoring what the other co-trustees are doing and can be liable for co-trustees' misconduct.

If a settlor wants to name an investment advisor or other advisors, who are not Delaware residents for a Delaware APT, the residence of those advisors should be considered. In an effort to keep as many ties to Delaware as possible, some planners will establish a Delaware LLC to manage the trust. The investment advisors outside of Delaware may be named as the managers of the Delaware LLC. If this planning is contemplated, it is important to keep in mind that all corporate formalities should be observed and that corporate meetings should take place in Delaware. Most corporate trustees will provide office space to conduct these meetings. Keeping the trust's most significant contacts in Delaware is important. If fiduciaries located in non-APT state jurisdictions are important to the planning, incorporating this technique will make it more difficult for a non-APT state court to exert jurisdiction over the fiduciary.

38 *United States v. Evseroff*, 2012 U.S. Dist. LEXIS 60344 (E.D.N.Y. 2012)
39 *Matijkiw v. Strauss*, 2011 DC Super LEXIS 13 (D.C. Super. Ct. 2011)

NEW APT TECHNIQUES

One technique that is becoming popular for APT planning is to avoid naming the settlor as an initial beneficiary, but to allow a trust protector to add the settlor later as a beneficiary if needed. This technique is sometimes called a "springing APT." This basic concept of later springing the settlor into a beneficiary position could also be accomplished by simply giving one of the current discretionary beneficiaries a lifetime or testamentary power to appoint assets to the settlor; or by setting up certain triggers to spring the settlor into a beneficiary position, such as after a number of years or after the spouse dies or divorces the settlor. All of these techniques represent only some available options and may have tax consequences.

This advanced planning and all Delaware APT drafting options should be discussed with a Delaware estate planning attorney.

Although the DQDTA allows the settlor flexibility in planning, a conservative approach to APT planning will likely result in the best shot at success. For example, although the DQDTA allows the settlor to act as the investment advisor of his or her own APT,[40] the settlor may want to consider foregoing this option, and instead name a Delaware investment advisor or allow the Delaware trustee to act as full fiduciary for the APT. Naming himself or herself or a close family member as investment advisor may open the door for scrutiny based on nominee or alter ego theories. It may also expose an APT to attack in states that have not adopted APT legislation, or expose the APT to state income taxes that might not otherwise apply if the settlor had not named himself or herself or a family member as a fiduciary.[41] Think of asset protection and control of assets as opposite sides of a see-saw. The more control the settlor maintains over the assets, the less protection he or she can expect from the planning.

OPPORTUNITIES FOR DELAWARE APT PLANNING

Although a Delaware APT may not be an appropriate solution for every client, it can be a great addition to an individual's overall estate plan. APTs can provide flexibility in planning and protections that are not otherwise available using more traditional techniques. Individuals who may want to consider Delaware APT planning include:

- Those who want to make a large gift to family members and use estate and gift tax exemptions, but do not feel comfortable doing so without the possibility of getting to some of the funds, if needed, in the future to deal with unexpected circumstances;
- Those who want to get the benefits of a prenuptial plan without the hassle of disclosing assets to a future spouse, negotiating an agreement and dealing with the myriad emotional issues that crop up around these discussions. The assets transferred to the Delaware APT prior to marriage may be protected from divorce settlements with a future spouse. Also, those who have already gone through a divorce and have children may want to consider this planning to protect assets for the existing family, should any subsequent marriages also end in divorce;
- Those who expect to receive a substantial inheritance and want to put a portion away as a "rainy day fund";
- Individuals and couples in high risk professions or people who are perceived to have deep pockets and are exposed to litigation and are not adequately protected using other techniques;
- Those considering transferring a family business to the next generation but want to avoid children's ex-spouses and others from causing disruptions to the business by trying to get an interest in the business. An APT may not only lend protections from these risks, but also help to organize family planning and structure transition of the business, while also providing the opportunity for significant tax planning; and
- Those who own tenancy by the entireties property and want to preserve the protections of that title, yet still plan with that property in a trust.

40 12 Del. C. § 3570(8)(d)
41 For example, California will tax a trust if a fiduciary is located in California. *Cal Rev & Tax Code § 17742*

THINGS TO KEEP IN MIND WHEN CONSIDERING AN APT FOR A CLIENT

- If the client is a resident of a non-APT state or the trust will have any ties to a non-APT state, understand the limitations of this planning. Try to have as many ties to Delaware and eliminate ties to other jurisdictions, especially non-APT jurisdictions.
- Consider bolstering your planning with additional protective measures such as setting up Delaware LLCs.
- Consider using a Delaware attorney to act as co-counsel.
- Consider naming a Delaware corporate trustee as the sole trustee and incorporate advisors for flexibility and control rather than naming co-trustees.
- Consider funding the trust with liquid assets that can be easily custodied in Delaware.
- Make sure you perform due diligence before drafting an APT.
- Make sure you consider any income tax or transfer tax issues.

CONCLUSION

When discussing asset protection with a client, outline all of the client's concerns, possible risks and their likelihood of occurring, and craft a comprehensive plan using a variety of asset protection techniques. If an asset protection trust is part of that plan, take control of the planning and educate the client about conservative choices, rather than what might be technically allowed. It is important to choose your asset protection trust clients carefully and perform due diligence. It will also be prudent to keep up to date on the latest statutory changes in asset protection laws, debtor creditor laws and fraudulent transfer laws.

A good network of other sophisticated professionals to lend their expertise to making sure your client's plans are successful will prove invaluable. While drafting the trust, keep in mind how it will be administered. In *Battley v. Mortensen*, Mortensen alleged that his Alaska APT was formed to preserve a piece of land for his children.[42] Instead, he used trust assets to make stock market investments and a car loan to a friend. The court concluded that these actions had no relationship to the trust's purpose and defeated the APT. This case highlights another reason why a corporate trustee is the best choice to administer an APT. Unsophisticated trustees and advisors can cause a lot of problems for the APT planning. Although APT planning can be challenging, spending the time to do it right can be rewarding for the client and the planner.

42 *Battley v. Mortensen*, 2011 Bankr. LEXIS 5560 (May 26, 2011)

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