# Use of Asset Protection Trusts in Lieu of or in Conjunction with Prenuptial Agreements

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## I. Protecting Assets Brought into Marriage

A. In the absence of proper premarital planning, a spouse in a dissolving marriage may be entitled to an equitable distribution of property brought to the marriage, which could include business interests, gifts, inheritances, employment income, and other assets held prior to the marriage.

B. Traditionally, men and women concerned about protecting assets brought to the marriage from future spouses in the event of a divorce use prenuptial agreements.

C. Although prenuptial agreements serve a certain purpose, there are many personal and legal issues that deter couples from executing them.

D. Due to the potential issues and problems surrounding prenuptial agreements (discussed below), many practitioners have turned to alternatives to protecting assets obtained prior to marriage such as a Domestic Asset Protection Trusts.

## II. What is a Domestic Asset Protection Trust ("DAPT")?

A. The concept of asset protection has exploded over the past 20 years and has evolved into a compelling component of prudent estate, business and pre-marital planning.

B. Prior to 1996, clients were forced to go "off shore" for asset protection trusts.

   i) Generally, off shore asset protection trusts divests the grantor of beneficial use and control of trust assets.

   ii) Because of tightening regulations and expenses associated with establishing and maintaining off shore asset protections trusts, many states passed legislation creating DAPTs.

C. DAPTs are trusts that protect assets from creditors, which include by definition a future spouse.

D. A DAPT, a self-settled trust, allows the settlor to name himself or herself as a potential beneficiary.

E. DAPTs are effective against a settlor's future spouse and other creditors provided the trust settlement and funding occurs prior to marriage and does not violate applicable fraudulent transfer law (see discussion of fraudulent conveyance discussed below).

F. DAPTs are a formidable strategy that legally shields assets from third party liability (including spouses in a divorce proceeding) while permitting settlors to retain some control over trust assets and enjoy a discretionary beneficiary interest during their lifetime. Examples of assets held in DAPTs are as follows:

   i) Investible Assets

   ii) Real Estate

   iii) Closely Held Stock

   iv) LLC/Partnership Interest

   v) Non-traditional trust assets (artwork, automobiles, collectables)

G. Prior to marriage, a spouse can establish a DAPT that is fully discretionary, receive financial benefit from the trust as needed during the life of the trust AND protect those assets from a spousal claim in a divorce proceeding.

H. Pennsylvania does NOT have a DAPT statute.

I. Alaska established the first DAPT in 1996, followed by Delaware in 1997. Today there are 14 states that have passed asset protection statutes:

| | |
|---|---|
| Nevada | South Dakota |
| Alaska | Delaware |
| Tennessee | Rhode Island |
| New Hampshire | Hawaii |
| Wyoming | Missouri |
| Utah | Virginia |
| Oklahoma | Colorado |

J. States are continually changing their DAPT statutes in an attempt to become the most attractive jurisdiction for asset protection. Therefore, it is vitally important for practitioners to understand the nuances among asset protections states, identify the leading jurisdictions, and stay current with changes.

K. **South Dakota**, **Delaware**, **Nevada**, and **Alaska** are consistently recognized as having the most robust and powerful DAPT statutes in the nation.[1]

## III. Factors that Determine the Best Asset Protection States[2]

A. Taxation

i) States considered to have the best DAPT do not impose state income tax upon the trust.

ii) The following states do not impose state income tax upon the trust.

| | |
|---|---|
| Nevada | South Dakota |
| Alaska | Delaware |
| Tennessee | Rhode Island |
| New Hampshire | Hawaii |
| Wyoming | Utah |

B. Fraudulent Conveyance/Statute of Limitation—(very important issue)

i) If there is a current claim pending or the settlor has reason to believe that a specific claim is going to be filed, the transfer of assets into a DAPT is considered to be fraudulent and the assets will not enjoy creditor protection.

ii) However, if assets are transferred because of the possibility of a future claim (like a potential divorce), the transfer is not considered to be fraudulent and the assets will be protected only IF a claim is brought outside the timeframe outlined in the state's fraudulent conveyance statute.

[1] See ***Domestic Asset Protection Trusts: Which Jurisdictions Are the Most Effective to Set Up This Powerful Tool?*** *Mark Metric & Daniel G. Worthington, Trust and Estates Magazine, January, 2013.*
[2] See Appendix A – ***3rd Annual Domestic Asset Protection Trust State Rankings Chart*** *Steve Oshins, Oshins & Associates, LLC.*

iii) South Dakota and Nevada have the shortest fraudulent conveyance tatutes at two (2) years. Therefore, creditor protection attaches after two (2) years.

iv) All other asset protection states have a four (4) year fraudulent conveyance statute.

C. Spouse/Child Support Exception

i) Nevada is the only asset protection state that does not carve out an exception for claims of spousal and child support. All other asset protection states refuse to allow a spouse to use a DAPT to shield assets relative to claims for spousal and child support.

ii) This is a very controversial exception that raises compelling public policy issues.

D. Privacy Provisions

i) South Dakota is the only DAPT state that has a total privacy seal forever on the existence of a trust, its provisions, or beneficiaries.

ii) There is no seal or privacy provision relative to trusts in Pennsylvania.

iii) Delaware only seals this information for three (3) years.

IV. **DAPT vs. Prenuptial Agreements**

A. DAPT

i) A soon to be married individual can establish a DAPT in a state permitting such trusts (do not need to be a resident of that state) and, upon the dissolution of the marriage, shield those assets from any equitable distribution.

ii) This technique is very appealing to many individuals who would like to protect their assets from their future spouse or the widely unpredictable discretion of a judge, and would like to do so quietly and without the complexity and expense associated with preparing and negotiating a prenuptial agreement.

B. Prenuptial Agreements

i) Due to stringent validity requirements of prenuptial agreements in most states, they must be drafted carefully and, if not, are open to challenges and may be held invalid.

ii) Generally, each party should be represented by independent counsel to avoid any accusations of duress or coercion.

iii) In many states, the agreement must be fair at the time of execution and enforcement. Therefore, the determination of "fairness" often falls into the hands of judges or juries in a divorce proceeding. (Note: In 1990 the Pennsylvania Supreme Court abandoned inquiry into the fairness aspect of a prenuptial agreement)

iv) In many states, it is not uncommon for prenuptial agreements to be completely disregarded in a divorce proceeding.

v) Asking one's future spouse to enter into prenuptial may cause difficulty in a blossoming relationship.

vi) The requirement of full financial disclosure can and often does deter couples from the execution of a prenuptial agreement.

vii) With roughly half of the marriages ending in divorce, prenuptial agreements have become an important component of pre-marital planning. However, based upon nuances in state law and the myriad of attacks brought by spouses, there are no guarantees that the prenuptial approach alone will provide the expected protection.

C. Advantages of DAPTs

i) *No Disclosure Requirement*. Unlike a prenuptial agreement, there is no asset disclosure requirement. Therefore, the existence of the assets or the trust never needs to be revealed to an intending spouse.

ii) *No Timing Requirement*. The trust can be established, signed, and funded moments before the wedding.

iii) No executed agreements, contracts or need for acquiescence of the intended spouse.

iv) The DAPT approach avoids uncomfortable and potentially confrontational conversations.

v) Utilizing DAPTs reduces the chances of a successful attack resulting in the equitable distribution of property brought to the marriage.

## V. Valid and Effective Domestic Asset Protection Trusts

A. Criteria for Establishing a DAPT:

i) The DAPT trust must be irrevocable.

ii) A trustee must be appointed with the discretion to administer the trust and make discretionary distributions.

iii) A trustee must be appointed that is a resident of the jurisdiction in which the trust in formed.

iv) The trust must contain a spendthrift clause, which restricts the transferability of a beneficiary's interest in the trust property, whether involuntary, before the trustee actually distributes property to the beneficiary.

v) The trust must be established and funded prior to marriage.

vi) The trust must be properly administered in accordance with trust language and applicable state laws.

vii) Proper trust administration, accounting, and record keeping are essential for protection of assets in a DAPT.

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# 3rd Annual Domestic Asset Protection Trust State Rankings Chart

| Rank | 2010 Forbes Letter Grade | State | State Income Tax (10% weight) | Statute of Limitations (Future Creditor) (10% weight) | Statute of Limitations (Preexisting Creditor) (10% weight) | Spouse/ Child Support Exception Creditors (30% weight) | Preexisting Torts Exception Creditors/Other Exception Creditors (30% weight) | Reputation/ Fraudulent Transfer Standard/Other Adjustments (10% weight) | Total Score |
|---|---|---|---|---|---|---|---|---|---|
| 1 | A+ | Nevada | No | 2 Yrs. | 2 Yrs. or 0.5 Yr. Discovery | No | No | Significant | 100 |
| 2 | A- | South Dakota | No | 2 Yrs. (as of 7/1/12) | 2 Yrs. or 0.5 Yr. Discovery (as of 7/1/12) | Divorcing Spouse; Alimony; Child Support | No | Significant | 92 |
| 3 | A | Alaska | No | 4 Yrs. | 4 Yrs. or 1 Yr. Discovery | Divorcing Spouse | No | Significant | 90 |
| 4 | A- | Delaware | No (except residents) | 4 Yrs. | 4 Yrs. or 1 Yr. Discovery | Divorcing Spouse; Alimony; Child Support | Preexisting Torts | Significant | 82 |
| 5 | B | Tennessee | No (except dividends/ interest on residents) | 4 Yrs. | 4 Yrs. or 1 Yr. Discovery | Divorcing Spouse; Alimony; Child Support | No | High/Missing clear and convincing evidence standard | 79 |
| 6 | B | Rhode Island | No | 4 Yrs. | 4 Yrs. or 1 Yr. Discovery | Divorcing Souse; Alimony; Child Support | Preexisting Torts | Medium | 73 |
| 7 | B- | New Hampshire | No (except dividends/ interest on residents) | 4 Yrs. | 4 Yrs. or 1 Yr. Discovery | Divorcing Spouse; Alimony; Child Support | Preexisting Torts | High/ Limited clear and convincing evidence standard | 71 |
| 8 | N/A | Hawaii | No (except residents) | 2 Yrs. | 2 Yrs. Pers. Injury; 6 Yrs. Contract | Divorcing Spouse; Alimony; Child Support | Preexisting Torts, Certain Lenders, Hawaii Tax | Low/Limited clear and convincing evidence standard | 65 |
| 9 | C | Wyoming | No | 4 Yrs. | 4 Yrs. or 1 Yr. Discovery | Child Support | Property listed on app. to obtain credit (makes difficult to use) | High/ Missing clear and convincing evidence standard | 61 |
| 10 | C- | Missouri | No (except Missouri source income) | 4 Yrs. | 4 Yrs. or 1 Yr. Discovery | Alimony; Child Support | State/U.S. to extent state/federal law provides | Low | 58 |
| 11 | C | Utah | No (except Utah source income) | 3 Yrs. | 3 Yrs. or 1 Yr. Discovery | Divorcing Spouse; Alimony; Child Support | Preexisting Torts/Numerous | Low | 55 |
| 12 | N/A | Virginia (as of 7/1/12) | Yes | None | 5 Yrs. | Child Support | Creditor who has provided services to protect trust; U.S., city, etc. | Low | 53 |
| 13 | C- | Oklahoma | Yes | 4 Yrs. | 4 Yrs. or 1 Yr. Discovery | Child Support | Protection limited to $1,000,000 | Low | 37 |
| 14 | D | Colorado | Yes | 4 Yrs. | 4 Yrs. or 1 Yr. Discovery | Not clear if protection from any creditor | Not clear if protection from any creditor | Low | 32 |

3rd Annual Domestic Asset Protection Trust State Rankings Chart created in April 2012. Original State Rankings Chart created in April 2010.


**Steve Oshins** is a member of the Law Offices of Oshins & Associates, LLC in Las Vegas, Nevada. He is rated AV by the *Martindale-Hubbell Law Directory* and is listed in *The Best Lawyers in America*®. He was inducted into the NAEPC Estate Planning Hall of Fame® in 2011 and has been named one of the Top 100 Attorneys in *Worth*. He can be reached at 702-341-6000, ext. 2 or soshins@oshins.com. His law firm's website is www.oshins.com.