



TRUSTS AND ESTATES LAW

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Planning With Asset Protection Trusts

When planning for asset protection, one must be mindful of several areas of the law. For example, the law regarding fraudulent conveyances cannot be ignored. Other areas, such as trusts and trustees, bankruptcy, choice of law, taxation, and the U.S. Constitution also must be considered.

Trusts and Trustees

Many asset protection plans involve the use of trusts. An APT (asset protection trust) can be domestic (DAPT) or foreign (FAPT). Traditionally, these trusts can be used to benefit the grantor's family, rather than the grantor himself or herself. To benefit his or his family may be the very goal of the debtor/grantor. If the transfer is not a fraudulent conveyance as noted below then the funding of the APT solely for the benefit of the debtor/grantor's family should be respected. If the debtor/grantor retains no interest in the transferred assets, they should be protected.

However, when an individual wishes to retain some interest in the trust, it is known as a self-settled asset protection trust,

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and the protection of the transferred assets is less certain. A DAPT is an APT formed under the laws of a U.S. state; an FAPT is an APT formed under the laws of a foreign nation. An FAPT affords more protection than a DAPT in a few key ways, primarily in limiting the ability of a creditor to discover the FAPT's assets. For example, some grantors wish to retain as much interest in the APT assets as possible. This desire will necessitate the use of a state's law other than that of New York, since New York law does not provide protection against the grantor's creditors when the grantor retains access to the assets in the APT after the transfer.

There are currently 10 states that have passed laws permitting self-settled APTs: Alaska, Delaware, Nevada, Rhode Island, Utah, Oklahoma, Missouri, South Dakota, Wyoming and Tennessee. A New York domiciliary may create a DAPT under one of the state's laws that permit it. An independent trustee who is a resident of the DAPT's state (and not a New York resident) will provide some important

protection. In particular, claims made later in New York will permit a judgment against the debtor's assets. Enforcing that New York judgment may present some difficulty in the DAPT state. One obstacle will be the jurisdiction of the domiciliary state over the trustee in the DAPT state under the Full Faith and Credit Clause of the U.S. Constitution.

Retaining flexibility in an APT is very attractive to many grantors, since direct grantor control of the assets will not protect the APT's assets. Some of the provisions that are generally permitted are as follows:

1. *Trust protector.* An APT may provide for an independent person (trust protector) to have certain powers over the trustees. Depending upon the jurisdiction of the APT, the APT may provide for a power to appoint a successor trustee, if the post is vacant, a power to appoint a cotrustee to act with a current trustee, a power to remove a current trustee, and many other powers. A trust protector may be very useful to oversee the administration of a trust from a position outside of the day-to-day activities, and act in the beneficiaries' best interest in the event the trust protector believes exercising his or her power will accomplish the goals of the APT. The trust protector review may be many years after the APT was created, when the relationships between the trustee and beneficiaries may have changed.
2. *Flee clause.* If the law of the particular

state or foreign country under which the APT was created has changed, or with FAPTs, if the political instability of the foreign country becomes worrisome for the trust parties, the APT agreement can provide for the trustee's ability to change the situs of the trust, to move the assets, and/or to change the trustees. This flexibility will permit the trust to move from one state or country to another and to have the new state or country's laws apply to the trust, which will be favorable to the APT's purpose, to further the intent of the grantor.

3. *Income and/or principal.* At the trustee's discretion, the grantor may receive income and/or principal from the trust's assets. The trustee's discretion can be very broad, or perhaps a standard can be applied to the trustee's discretion.

4. *Income distributions.* The grantor may receive income distributions currently from the trust. If the trust requires income distributions to the grantor, the income is subject to his or her creditors' claims.

5. *Testamentary power of appointment.* The grantor may retain a testamentary power of appointment, permitting him or her to decide who the ultimate beneficiaries shall be.

6. *Spendthrift clause.* The APT should have a spendthrift clause, to protect the grantor's interest in the trust, to the extent he or she has an interest. The purpose of a spendthrift provision is to prevent a beneficiary, whether it is a grantor or not, from transferring, selling or otherwise alienating his or her interest in the trust. If the beneficiary had the ability to transfer his or her interest, then the beneficiary's creditors could force the beneficiary to invoke this ability, thereby gaining access to the assets of the trust. Since the main idea of the trust is to protect the assets, a spendthrift clause will prohibit such a transfer and the

creditors will not have access to the trust's assets.

Fraudulent Conveyances

While creating the APT is one matter, funding it is quite another. There is a substantial hurdle to overcome before the benefits of an APT can be realized. That hurdle is the law of fraudulent conveyances. Without satisfying the constraints of the law in this area, the transfer will be deemed void and no protection can be afforded to a debtor/grantor looking to plan for the protection of his or her assets.

In New York, the law of fraudulent

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conveyances is codified in the Debtor and Creditor Law §276, which states, "Every conveyance made and every obligation incurred with actual intent, as distinguished from intent presumed in law, to hinder, delay, or defraud either present or future creditors, is fraudulent as to both present and future creditors."

While one may not transfer his or her assets to another person or entity with the intent to defraud creditors, one can plan ahead without violating Debtor and Creditor Law §276. For example, one can create and fund a trust for the benefit of his or her family at a time when he or she has no current or future creditors. Certainly, if a claim exists against the debtor, a transfer by the debtor will be a fraudulent conveyance. Further, if a potential creditor has not yet brought a claim against the debtor for the debtor's act or omission for which the debtor will bear liability, then a transfer by the debtor will

also be a fraudulent conveyance. However, in the event one has no existing claims and no reason to foresee any claims, then some planning may be appropriate.

Part of this analysis includes comparing the debtor's assets to his or her liabilities at the time of a transfer in question. If immediately after the transfer, the debtor has sufficient assets to pay his or her debts, then the debtor cannot be said to have had intent to defraud his or her creditors.

Estate Tax and APTs

An APT may be includible in the grantor's gross estate under Internal Revenue Code §2036(a)(1). While the APT is often established to ultimately benefit the grantor's descendants, the grantor will usually want to retain an interest as a discretionary beneficiary. The Internal Revenue Service often views an APT with much scrutiny since the grantor may have retained an interest in the APT prohibited under §2036. Certainly, any assets actually distributed to the grantor that are held by him or her at the date of the grantor's death will be includible in his or her estate. However, whether the assets inside the APT will be includible in the grantor's estate will turn on the following two factors: (1) There is an understanding between the grantor and the trustee that the trustee will make distributions to the grantor; or (2) Creditors of the grantor/debtor can reach the grantor's interest in the trust, namely the discretionary interest. Thus, in order to avoid inclusion, neither of the above factors can be satisfied.

Conclusion

As noted above, with some careful advance planning, an asset protection trust can be used as part of an estate plan.

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