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## Is a Domestic Asset Protection Trust a Legitimate Estate Planning Tool?

Although he was writing about using irrevocable trusts for tax planning, Judge Learned Hand's famous opinion over 60 years ago applies as well today to using trusts for asset protection planning:

Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.

If the law allows for using a Domestic Asset Protection Trust ("DAPT") as an estate planning tool, a person legitimately may establish a DAPT if they follow the law permitting a DAPT, and owe no duty to avoid using a DAPT merely because currently unidentified creditors may wish in the future to gain access to the assets in the DAPT to satisfy a future judgment.

Generally, a person may establish a trust for the benefit of third persons and protect the assets in that trust from the claims of most creditors of the "settlor" or "donor" if the settlor retains no economic interest in the trust. Settlers also may shield those trust assets from the claims by most creditors of the third-party beneficiaries if the trust instrument includes a spendthrift clause that precludes a beneficiary, as well as the beneficiary's creditors, from demanding the trustee make distributions. Many states include in their spendthrift statutes exceptions for certain classes of debts, such as child support and alimony. South Dakota and some other states have limited such exceptions for third-party trusts.

Every state has adopted some type of "fraudulent conveyances" or "voidable transfers" statute. Such state laws prohibit persons from giving assets to another person or a trust for less than adequate and fair consideration if the person intended in making the gift to avoid paying known or reasonably anticipated creditors. The United States Bankruptcy Code provides a national rule that any transfer made in the two years prior to filing a bankruptcy petition, with actual intent to defraud or delay creditors, or generally for less than "a reasonably equivalent value," is voidable by the bankruptcy trustee. The common law of trusts, and statutes in most states, provide that, if persons establish a trust under the laws of that state and retain the benefits of the trust property for themselves, the creditors of such persons may satisfy a judgment by attaching the assets of that "grantor trust."

South Dakota and a handful of other states have adopted statutes that facilitate the creation of "Domestic Asset Protection Trusts." Under the laws of those select states, spendthrift provisions in properly drafted trusts that are established without intent to defraud existing or reasonably anticipated creditors are effective not only against the creditors of third-party beneficiaries, but against the creditors of the trust settlor, if the trust has been drafted and administered in compliance with the state's DAPT statutes. South Dakota law creates a legitimate legal opportunity for a person to establish a Domestic Asset Protection Trust for their own benefit, provided the trust complies with South Dakota law, including:

- the trust instrument must expressly provide that the trust is governed by South Dakota law;
- the trust instrument must include a spendthrift provision compliant with South Dakota law;
- the settlor must be solvent when they establish the trust and when they transfer the assets;
- the trust must be administered in compliance with South Dakota law and the trust instrument;
- the trust at all times must have at least one trustee who is either a South Dakota resident, a federally chartered bank with trust powers and its headquarters in South Dakota, or a trust company chartered under and regulated by the laws of South Dakota, such as **First Trust Company**

*This summary is not legal advice. Consult with your attorney prior to establishing a DAPT.*