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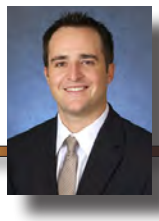
Practical Issues in Forming a Domestic Asset Protection Trust for a Non-Resident



By: Brad H. Milhauser, Esq.

Over the last several years, our firm has made a concerted effort to bolster our asset protection planning practice. Not only have our existing clients become more concerned with asset protection planning, but we are receiving more referrals from professional advisors regarding their clients' concerns with protecting wealth.

Although we are fortunate that we practice in a debtor-friendly state such as Florida, we continue to avail our clients with laws from jurisdictions that are even more favorable under certain circumstances. Homestead exemptions and statutory exemptions only protect certain asset classes. When our clients seek to shield assets which require sophisticated planning and attention, we feel it is our duty to seek protection under jurisdictions that offer increased protection outside of a client's home state.

This article will offer practical guidance and suggestions when representing clients in establishing a Domestic Asset Protection Trust (DAPT) under the law of a state in which they do not reside.

Perhaps the most frequently cited law against the use of a DAPT for a non-resident of the DAPT jurisdiction is the Full Faith and Credit clause in the United States Constitution. The clause stands for the proposition that the courts of one state must recognize judgments rendered in another state. In the asset protection context, if a Florida resident client establishes a DAPT in Nevada, a judgment entered in a Florida court against the client may be enforced against the client in Nevada.

As a practical matter, a creditor would attempt to join the Trustee of the DAPT by bringing a fraudulent transfer action and joining the Nevada Trustee as a transferee. The Florida court would then have jurisdiction over the Trustee and the Florida order may be enforceable in Nevada. This argument, however, is made under the presumption that the creditor will be successful in its attempt to join the Nevada Trustee. By choosing the right trustee, the careful practitioner can greatly reduce the risk that a Trustee will be subject to jurisdiction in the client's home state.

We recommend selecting a Trustee that is chartered only in the state where the DAPT is located and that such Trustee has few contacts, if any, with the client's home state. It is important to interview multiple Trustees prior to appointing one in a DAPT. The attorney should have a solid understanding of the contacts and the business presence that the Trustee has in the client's home state. Issues to address with the Trustee include but are not limited to (i) offices maintained by the Trustee outside of the DAPT state, (ii) advertising or business generation efforts outside of the DAPT state, (iii) prior experience in serving as Trustee of a DAPT, and (iv) information regarding parent or subsidiary companies that may operate in other states. By choosing a Trustee that has minimal contacts with a client's home state, a practitioner can reduce the risk that a Trustee would be subject to the home state's jurisdiction.

It is rarely advisable to transfer real estate located in a client's home state to a DAPT located in another jurisdiction. A court will have in rem jurisdiction over real estate located within its borders. Some practitioners advocate turning the real estate into an intangible asset by contributing it to a limited liability entity such as a partnership or LLC, however, the viability of that technique is questionable. Further, if the property in question is related to income-producing activity in the home state, the limited liability entity will be required to apply for qualification to transact business in the home state and submit to jurisdiction there.

For every entity that we establish outside of a client's home state, we retain local counsel to review the transaction for compliance with state law. Not only will this avoid an unauthorized practice of law issue against the

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attorney, but counsel in these jurisdictions are likely more familiar with laws in their states, they are better acquainted with the court system, and will have a better perspective on the strength of the asset protection technique.

We layer each of our DAPTs with a limited liability entity such as a LLC. The LLC adds an additional hurdle for a creditor due to the charging order remedy. For practitioners and clients that are concerned about whether the DAPT will stand up in a court of law, the LLC component is an important obstacle that will have to be overcome if the DAPT is defeated. Further, in some instances, we try to mitigate the risk of relying too heavily on one jurisdiction. For instance, if we establish a Nevada DAPT, we may layer it with a Delaware LLC. This may cause the court to turn to Delaware LLC law after the Nevada DAPT was successfully defeated. This long process may frustrate a creditor to the point of inducing a favorable settlement for our client.

When implementing an asset protection plan, we integrate it with the client's estate plan in such a way to validate it for other purposes such as tax planning or business succession planning purposes. In DAPT jurisdictions such as Alaska, the common law rule against perpetuities has been abolished. Thus, establishing a DAPT in Alaska makes sense from a GST tax standpoint because a grantor can create a GST exempt trust which can grow free of GST tax for generations. Further, in Alaska, some practitioners rely on Private Letter Ruling 200944002, which may allow a client to establish a Alaska DAPT and treat the transfer to the DAPT as a completed gift, thereby eliminating the DAPT assets from the client's gross estate for estate tax purposes. This will allow appreciation on the DAPT property to accumulate outside of the client's estate.

Where appropriate we try to encourage clients to establish a third-party DAPT which is established for the benefit of the client's family. The law on third-party DAPTs is certainly more defined and tested than a first-party DAPT of which the client is a discretionary beneficiary. If the client is not married or is in a troubled marriage, a third-party DAPT may not be ideal.

Our approach to asset protection planning is simple: we strive to position our clients so that they are unattractive targets for lawsuits and thereby force favorable settlements. It is just as important, however for a client to understand our approach and never leave our office with the mindset that their asset protection plan is made of Teflon. As lawyers, we can never guarantee results. If we stay focused on our asset protection approach, rather than attempting to create structures that are too complex for clients, judges, or juries to understand, then we are more likely to succeed in protecting wealth by forcing settlements that are favorable to our clients.

About the Author:
Brad H. Milhauser is an attorney with Ellis Law Group, P.L., in Boca Raton, Florida and he practices in the areas of sophisticated estate planning, wealth preservation and asset protection, and business succession planning. Brad holds an LL.M. in Estate Planning from the University of Miami.