Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #200

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From: Steve Leimberg's Asset Protection Planning Newsletter
Subject: **Steve Oshins & the Hybrid Domestic Asset Protection Trust**

"After approximately 15 years since the first DAPT legislation passed, not a single DAPT has been tested all the way through the court system. Most likely this is because such a large supermajority believes that if tested the DAPT will work to protect its assets from a creditor of the settlor. However, despite the very high likelihood of protection, if there is a way to increase the odds of success even more, then such a strategy should be utilized whenever possible.

The Hybrid Domestic Asset Protection Trust ("Hybrid DAPT") is such a strategy, and it is very simple. The Hybrid DAPT is like a regular DAPT except that the settlor isn't an initial discretionary beneficiary of the trust, but can be added later."

We close this week **Steve Oshins'** commentary on a strategy he refers to as the "Hybrid Domestic Asset Protection Trust." According to Steve, the Hybrid DAPT puts the client in a significantly stronger position than with a traditional Domestic Asset Protection Trust. As he explains below, this strategy can be used with both an incomplete gift version and a completed gift version of the Domestic Asset Protection Trust.

Steven J. Oshins, Esq., AEP (Distinguished) is a member of the Law Offices of **Oshins & Associates, LLC** in Las Vegas, Nevada. Steve is a nationally known attorney who is listed in The Best Lawyers in America® and has been named one of the Top 100 Attorneys in Worth magazine. He was inducted into the NAEPC Estate Planning Hall of Fame® in 2011. He has written some of Nevada's most important estate planning and creditor protection laws, including the law making the charging order the exclusive remedy of a judgment creditor of a Nevada LLC and LP (in 2001, 2003 and 2011), the law changing the Nevada rule against perpetuities to 365 years (in 2005) and the law making Nevada the first and only state to allow a Restricted LLC and a Restricted LP creating larger valuation discounts than any other state allows (in 2009). He is also the author of the Annual Domestic Asset Protection Rankings at http://www.oshins.com/images/DAPT_Rankings.pdf. Steve can be reached at 702-341-6000, x2 or at soshins@oshins.com. His law firm's web site is http://www.oshins.com.

Before we get to Steve's commentary, members should take note of the fact that a new **60 Second Planner** by **Bob Keebler** was just posted to the **LISI** homepage. In his commentary, Bob reviews the May 4th opinion by the Ninth Circuit in Estate of Morgans, where the issue presented was whether Section 2035(b)'s gross-up rule applies in the case of a surviving spouse's deemed gift of a QTIP remainder. You don't need any special

equipment to listen- just click on this link.

Now, here is Steve Oshins' commentary:

EXECUTIVE SUMMARY:

Asset protection has become one of the hottest areas of law and has become the ideal complement to estate planning. Consequently, the Domestic Asset Protection Trust ("DAPT") has become one of the most popular asset protection tools in the planner's toolbox. As more states have enacted DAPT legislation, practitioners have started doing more DAPTs for their clients.

FACTS:

After approximately 15 years since the first DAPT legislation passed, not a single DAPT has been tested all the way through the court system. Most likely this is because such a large supermajority believes that if tested the DAPT will work to protect its assets from a creditor of the settlor. However, despite the very high likelihood of protection, if there is a way to increase the odds of success even more, then such a strategy should be utilized whenever possible.

The Hybrid Domestic Asset Protection Trust

The Hybrid Domestic Asset Protection Trust ("Hybrid DAPT") is a strategy that should increase the probability that the trust assets will be protected. And it is very simple. The Hybrid DAPT is just like a regular DAPT except that the settlor isn't an initial discretionary beneficiary of the trust, but can be added later. Thus, the trust is initially set up for the benefit of the settlor's spouse and descendants, for example, but not for the settlor. By not including the settlor as a beneficiary of the trust, the Hybrid DAPT is by definition a third-party trust and therefore almost certainly avoids the potential risk of uncertainty of a regular DAPT.

Especially where the settlor is married and has a strong, trusting relationship with his or her spouse, is there any good reason that the settler must have his or her name in the trust agreement as a beneficiary? It is very simple to indirectly access the trust assets through the spouse. And the trust agreement should define the "spouse" using a "floating spouse provision" that defines the spouse as the person the settlor is married to and living with from time to time. This gives the settlor the ability to access the trust assets through a subsequent spouse in the event of a divorce or the death of the settlor's spouse.

If the settlor has no spouse, then it becomes more difficult to access the assets. However, since a good asset protection planner will be sure to leave sufficient wealth outside of the client's asset protection trust, in most cases the settlor won't have to work through this issue anytime soon.

If the Settlor Is Added as a Beneficiary

In case the settlor needs to be a discretionary beneficiary of the Hybrid DAPT sometime in the future (i.e., if the settlor has no spouse or child that will "share" a distribution with the settlor and the settlor now needs a distribution), the trust agreement provides that the trust protector or independent trustee can add additional beneficiaries, including the settlor. However, if the settlor is added, then the Hybrid DAPT becomes a regular DAPT and thus risks that the law is still unsettled on DAPTs (even though most people believe that they work).

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What happens if the settlor suspects that a creditor attack may be forthcoming? Or what if the settlor is considering filing bankruptcy? In either case, **very far in advance of the problem occurring**, the settlor would ask the trust protector or independent trustee to remove him or her as a discretionary beneficiary.

§548(e) of the 2005 Bankruptcy Act

It is extremely unlikely that a DAPT settlor will file for bankruptcy, especially if the settlor has an "old and cold" DAPT that is past the applicable state's statute of limitations period. In fact, of the hundreds of DAPTs created by the author, not one of those clients has gone through bankruptcy.

However, in maintaining the philosophy of this commentarythat it is important to build into the structure every safeguard available, it is interesting to note that the Hybrid DAPT most likely does not fit the definition required by §548(e) of the 2005 Bankruptcy Act that would otherwise potentially claw back the assets of a traditional DAPT. The requirements of §548(e) are as follows:

> (1) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if—
>
> (A) such transfer was made to a self-settled trust or similar device;
> (B) such transfer was by the debtor;
> (C) **the debtor is a beneficiary of such trust or similar device** [emphasis added]; and
> (D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.

Unless the settlor is added as a discretionary beneficiary of the Hybrid DAPT, Subsection (C) doesn't apply. Also, arguably Subsection (A) doesn't apply either since the Hybrid DAPT isn't a "self-settled trust or similar device" at the time the provisions are applied.

The Completed Gift Hybrid DAPT

Most DAPTs are designed as Incomplete Gift DAPTs where the sole objective is asset protection. However, many DAPTs are designed as Completed Gift DAPTs where the settlor is a discretionary beneficiary of a

trust designed with the following attributes:

(i) It's a completed gift for gift tax purposes,
(ii) The settlor is a discretionary beneficiary,
(iii) The trust assets are protected from the settlor's beneficiaries, and
(iv) The trust assets are outside of the settlor's estate for estate tax purposes at the settlor's death.

The Completed Gift DAPT strategy was approved by the Service in PLR 200944002 where a resident of a DAPT jurisdiction established the DAPT using the laws of that DAPT jurisdiction.

However, with respect to a resident of a non-DAPT jurisdiction, although

However, with respect to a resident of a non-DAPT jurisdiction, although most practitioners are comfortable that this strategy works, whether the trust assets are open to creditors of the settlor is still uncertain, since it is unclear which state law will apply for creditor purposes. The DAPT will be includible in the settlor's estate at death if the trust assets are open to the settlor's creditors. If this were the case, this would occur under IRC §2036(a)(1) since the settlor would be treated as retaining the ability to run up creditor debts which can be paid out of the trust at the settlor's death.

IRC § 2036(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which the decedent has retained for life or for any period not ascertainable without reference to the decedent's death or for any period that does not in fact end before death the possession or enjoyment of, or the right to the income from, the property.

The Completed Gift DAPT reduces this risk significantly since the settlor isn't a discretionary beneficiary of the trust and, thus, it isn't a self-settled trust. In an ideal scenario, the settlor will never need to be added as a discretionary beneficiary by the trust protector or independent trustee. However, if the settlor does need to be added at a later date, since the Completed Gift Hybrid DAPT also gives the trust protector or independent trustee the power to remove beneficiaries, as long as the settlor is removed as a discretionary beneficiary more than three years prior to death, there is no estate tax inclusion since IRC §2035 (the three-year contemplation of death rule) won't apply.

Down and Dirty

To this date, there is still no case law saying that a DAPT does or does not work to shield the assets from the creditors of a settlor who is a resident of a non-DAPT jurisdiction. Although all the cases have settled, or the creditors have decided not to sue, the estate or asset protection planner must still consider how to plan if the law does go the wrong way. Unfortunately, although there will ultimately be case law, whether good or bad, unless the case law goes through the appeal process and is ultimately decided by the highest court, we still won't have any certainty. So it is prudent to plan for this uncertainty.

If the settlor has set up a Hybrid DAPT, whether as an Incomplete Gift Hybrid DAPT or as a Completed Gift Hybrid DAPT, if the settlor wants to be sure to preserve a portion of the Hybrid DAPT's assets if the settlor is being added in as a discretionary beneficiary, the trustee can split the Hybrid DAPT into two separate trusts and the trust protector or independent trustee can add the settlor as a discretionary beneficiary of only one of the two trusts so as not to taint the other trust.

For example, if there are $10 million of assets in the Hybrid DAPT, the trustee might divide the trust into two trusts – the "Clean Hybrid DAPT" which doesn't include the settlor as a discretionary beneficiary and has $8 million of assets, and the "Dirty Hybrid DAPT" which includes the settlor as a discretionary beneficiary and has $2 million of assets. Thus, the risk has been transferred away from the Clean Hybrid DAPT to the Dirty Hybrid DAPT (which, again, should be protected, but is potentially being sacrificed in the interests of not tainting the assets in the Clean Hybrid DAPT). This is nothing more than a risk management decision.

COMMENT:

It is imperative that the asset protection planner create a plan with the highest probability of success. In most cases, it is possible to significantly increase the protection by simply using a Hybrid DAPT rather than a traditional DAPT. This commentary describes this structure, and also creates a further structure where the Hybrid DAPT can be divided into a Clean Hybrid DAPT and a Dirty Hybrid DAPT, so that even if the Dirty Hybrid DAPT is unsuccessful, it doesn't taint the Clean Hybrid DAPT.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Steve Oshins

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CITES:

PLR 200944002; Oshins & Keebler on Mortensen: "No, the Sky Isn't Falling for DAPTs!", Asset Protection Newsletter #186 (Oct. 31, 2011); Battley v. Mortensen, Adv. D.Alaska, No. A09-90036-DMD, May 26, 2011 (Original Memorandum) and July 18, 2011 (Memorandum Denying Motion For Reconsideration).