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Asset Protection Jurisdictions Compared

Fine-tuning the DAPT, with Steve Oshins

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Since 1997, 13 states have enacted laws permitting self-settled trusts. Including Colorado, which has had a highly questionable statute on its books since long before the other states, there are a total of 14 states with some form of domestic asset protection trust (DAPT) laws. Each of these DAPT jurisdictions has taken its own approach, and there are critical variations.

"Creditors have better memories than debtors"

—Benjamin Franklin

To some extent, the 14 states have jockeyed for competitive edge to position themselves as attractive havens for trust funds. Here, we have consulted Nevada attorney Steve Oshins, an authority on the subject, to consider the best DAPT jurisdictions, as well as a new "Hybrid DAPT" approach that enhances the asset protection

Presented With Our Compliments

Our Litigious Society

By one poll, three in ten businesses have been sued or threatened with a lawsuit in the last five years. A lawyer can expect to be sued at least once during a career—more depending on the type of practice. Nursing homes experience a steady stream of lawsuits, the majority of which are settled; nursing home clients going forward have to pick up the expense in higher fees.

Anyone with assets can expect to be sued. For physicians, the combination of injured people, risky surgeries, and wealthy physicians results in staggering statistics. Three quarters of physicians in low-risk specialties face malpractice claims, and virtually all physicians in high-risk specialties face claims during their careers. A 2011 study of 40,000 doctors that was published in the New England Journal of Medicine revealed the following.

1) 7.4% of all physicians have a malpractice claim each year.

2) By age 45, 36% of physicians, generally, will have encountered their first claim. For the higher risk specialties, that number shoots up to 88%.

3) By age 65, very few physicians have not been sued. As many as 75% of physicians with low-risk specialties will have been sued by age 65; approximately 99% of physicians with high-risk specialties will have had malpractice suits by that age.

Offshore Asset Protection

A completed gift or a gift in trust can put assets out of harm's way, so long as the transfer takes place before litigation, is irrevocable, and is undertaken without any fraudulent intent. But this approach divests the grantor of beneficial use and control of assets. However, the completed gift approach is more closely associated with estate planning techniques as opposed to pure asset protection and for many years, asset protection had focused beyond our nation's borders.

The offshore option has worked for some people and purposes, but there are certainly shortcomings. There are rules to research and inconveniences for each jurisdiction. Generally, by the time people go to the trouble of moving assets into a foreign trust, they are often so deep in trouble of some kind that the transfer will be deemed fraudulent. At first blush, a debtor transferring assets to a jurisdiction like St. Vincents in the West Indies might feel reassured that creditors will be forced to prove a transfer was fraudulent by a high burden of proof (beyond a reasonable doubt) and will have a one-year statute of limitations that begins to run from the time of the transfer.

Making matters worse, a body of law has been developing that may undermine the offshore approach. In *Dexia Credit Local v. Rogan,* 2009 WL 648634 (N.D. ILL. 2009), for example, an offshore trust from the Bahamas was disregarded when the court determined that a choice of law provision would violate Illinois public policy against self-settled trusts.

The Best DAPT States

In the late 1990s, a number of domestic jurisdictions, such as Alaska, Delaware, and Nevada, began developing laws that made these states domestic financial havens with beneficial tax laws and more favorable asset protection rules. Establishing statutes to permit self-settled trusts has allowed many people to establish their asset protection trusts in these domestic havens.

In a 2010 article written by reporter Ashlea Ebeling, *Forbes* magazine provided letter grades for the 12 domestic jurisdictions that permitted self-settled trusts at the time the article was written. Leading that list was Nevada, which was the only state to receive an A+.

Context is critical. A trust set up in a particular state has to contend with that state's income tax, as well as the other laws of that state. As a starting point, states that have no income tax have an advantage. Virginia, which joins the DAPT list as of July 1, 2012, has an income tax.

The statute of limitations for preexisting and future creditors is also relevant. Nevada and South Dakota have two-year limits, while states such as Alaska and Delaware have four-year standards. There is a tolling period for preexisting creditors. The shorter the period, the sooner the trust assets are protected.

Most of the DAPT states have carved out exceptions for alimony, child support, and certain torts. Nevada stands alone in not permitting any exceptions.

The Definitive Chart

For the past three years, the definitive DAPT chart comparing jurisdictions has been developed and maintained by Nevada attorney Steve Oshins.

The chart provides instant comparisons of the statutes of limitation and exceptions applicable to each of the DAPT states. There is also a numerical grading based on a weighting of the various categories.

We have obtained permission to reprint the Oshins DAPT chart here. Mr. Oshins also answered questions about the chart, as well as a new "Hybrid" variation he has developed for the DAPT.

Interview with Steve Oshins

Q: So far there are 14 jurisdictions that have adopted some form of DAPT. Is this now a trend that will gather momentum in another 36 states, or have we arrived at a plateau?

A: It's probably similar to what we have seen over the years with states modifying their perpetuities laws. I expect that we will see a few more of the more progressive states enact DAPT statutes, but I doubt we will see very many more states enact these laws. All of the states that I would expect to enact DAPT laws have already done so.

Q: Some people will always consider domestic trust havens as inferior to offshore trusts. Which option do you think is more protective?

A: At this point, it is still unclear whether a DAPT is more protective than an offshore asset protection trust. Both of these options are a nine out of ten, in my opinion in terms of protection. The offshore option has in nearly every circumstance scared the creditors away, while the DAPT, albeit probably in many less circumstances, has scared the creditors away every time. However, the only type of trust that is nearly a 10 out of 10 in degree of protection is a trust in which the grantor is not a discretionary beneficiary. This is the reason that I came up with the Hybrid DAPT idea.

Q: Among the domestic states, there are upper "A" level states, such as Alaska, Delaware, Nevada, and South Dakota, and second-tier "B" states, such as New Hampshire, Rhode Island, and Tennessee. Is there a big difference?

A: The first-tier states – Alaska, Delaware, Nevada, and South Dakota – get nearly all of the out-of-state business. The second-tier states have excellent DAPT laws, but they fall a little short and thus tend to be good for residents of those states, but there's just too much competition at the top. Delaware is a wildcard state. Its laws aren't as protective as the laws of the other so-called first-tier states and are very similar to those of New Hampshire, Rhode Island, and Tennessee. But Delaware tends to get grouped with the first tier because it is so heavily marketed and thus gets a very high percentage of the DAPT business.

Q: You've developed a twist on the regular DAPT that you call a Hybrid DAPT, in which the grantor is not initially a discretionary beneficiary but can be added as one later by an independent trustee or trust protector. In what context do you see this as being the most beneficial?

A: This is something that I came up with years ago and have been using for quite some time. I finally gave it the name "Hybrid DAPT" recently and wrote an article on the technique and got an amazing response.

It's a very simple concept. Basically, the concept is that there is no good reason to include the grantor as a discretionary beneficiary, especially if the grantor won't need any distributions from the trust anytime soon. This is especially true if the grantor's spouse is a beneficiary and thus can receive distributions that can be "shared" with the grantor. Therefore, the initial trust document is nothing more than a third-party trust where the grantor is not a beneficiary and thus has a higher probability of protection and should be much more intimidating to a prospective creditor of the grantor.

Only if the grantor actually needs a distribution would the independent trustee or trust protector add the grantor in as a discretionary beneficiary under a provision we build into the trust agreement allowing this. With most DAPTs, because the grantor generally leaves sufficient cash flow out of the DAPT, it would take both a cash flow problem and the grantor to have no spouse to whom a distribution could be given for the grantor to need to be added into the trust as a beneficiary. Thus, this is a Hybrid DAPT because it starts as a third-party trust and then can be converted into a DAPT at a later date. So the bottom line is that, in my opinion, most DAPTs should be set up as Hybrid DAPTs.

Q: Does the clawback statute in the 2005 Bankruptcy Act have any effect on the Hybrid DAPT?

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

That being said, 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. One of the requirements of §548(e) is that the debtor must be a beneficiary of the trust. Unless the grantor is added as a discretionary beneficiary of the Hybrid DAPT, this requirement doesn't exist.

Q: Your DAPT State Rankings Chart has become a great resource that I frequently consult. How has your chart been received by the asset protection community?

A: It has been extremely well-received. I initially put it together three years ago because I found that there was no one-page comparison of the DAPT jurisdictions in our industry. I decided that our industry needed a chart that shows the material differences among the DAPT jurisdictions in an easy-to-read format. I am glad that you use it as a resource.

In this year's version of the chart, for the first time ever, I decided to not only rank the states, but also to assign numerical scores to each state. The numerical scores help show the degree of differences among the states and help break them into tiers.

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 (30% weight)	REPUTATION FRAUDULENT TRANSFER STANDARD Other Adjustments (10% weight)	TOTAL SCORE
1	A+	Nevada	No	2 Years	2 Years or 0.5 Years from discovery	No	No	Significant	100
2	A-	South Dakota	No	2 Years (as of 7/1/12)	2 Years or 0.5 Years from discovery	Divorcing Spouse; Alimony; Child Support	No	Significant	92
3	A	Alaska	No	4 Years	4 Years or 1 Year from discovery	Divorcing Spouse	No	Significant	90
4	A-	Delaware	No (except residents)	4 Years	4 Years or 1 Year from discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts	Significant	82
5	B	Tennessee	No (except dividends/ interest on residents)	4 Years	4 Years or 1 Year from discovery	Divorcing Spouse; Alimony; Child Support	No	High/Missing clear and convincing evidence standard	79
6	B	Rhode Island	No	4 Years	4 Years or 1 Year from discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts	Medium	73
7	B-	New Hampshire	No (except dividends/ interest on residents)	4 Years	4 Years or 1 Year from discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts	High/ Limited clear and convincing evidence standard	71
8	N/A	Hawaii	No (except residents)	2 Years	2 Years Personal Injury; 6 Years 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 Years	4 Years or 1 Year from 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 Years	4 Years or 1 Year from discovery	Divorcing Spouse; Alimony; Child Support	State/U.S. to extent state/federal law provides	Low	58
11	C	Utah	No (except Utah source income)	3 Years	3 Years or 1 Year from discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts; Numerous	Low	55
12	N/A	Virgina (as of 7/1/12)	Yes	None	5 Years	Child Support	Creditor who has provided services to protect trust; U.S., city, etc.	Low	52
13	C-	Oklahoma	Yes	4 Years	4 Years or 1 Year from discovery	Child Support	Protection limited to $1,000,000	Low	37
14	D	Colorado	Yes	4 Years	4 Years or 1 Year from 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.