The Case for Nevada Trusts for Non-Resident Business Owners:
The NOST, NING, IDGT & BDIT

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Agenda

- Asset Protection Planning
  - The NOST
  - The Passport Trust™

- Income Tax Planning
  - The NING

- Income and Estate Tax Planning
  - The IDGT
  - The BDIT

Asset Protection Planning

- Asset Protection in Nevada
  - A Model Trust
  - California Candidates for Nevada Asset Protection Planning
- The Uniform Voidable Transactions Act
  - Good for Asset Protection Planning?
- Attacks from Creditors
  - Jurisdictional Hurdles
- Bringing a California Judgment to Nevada
  - Registering a Foreign Judgment
  - Full Faith and Credit
- The Ultimate Asset Protection Vehicle

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Asset Protection

"The long and short of this discussion is…the only means of enforcing a judgment against such a[n asset protection] trust may be to attack the creation of the trust as a fraudulent transfer.

Whether or not the post-transfer creditor will be successful will likely depend on whether the particular creditor was a contemplated creditor at the time of the transfer."

Bradley E.S. Fogel

St. Louis University School of Law Professor

Asset Protection

This type of planning should be done long before any distress event – trusts should be "old and cold."

Clients (and their attorneys) should not be attempting to do this type of planning in the middle of a financial crisis, or with an impending creditor attack.

Nevada Asset Protection

- A form of insurance.
- A process, not an event.
- Leveling of the playing field to:
  - Avoid a lawsuit altogether; or
  - Put the settlor in a better situation for negotiation with a creditor.

The Asset Protection Continuum

Expatriation

Qualified Retirement Plans

Offshore Asset Protection Trust

Third Party Trusts

Passport Trusts™

Limited Partnership
1% Domestic GP
99% Foreign LP in Trust

Domestic Asset Protection Trusts

Insurance

Limited Partnerships

Gifting

Corporation/LLC

Joint Ownership

Exemption Planning

Homestead

Issues/Limitations?

- Fraudulent Conveyance Statutes
- Voidable Transaction Statutes
- Bankruptcy Limitations

The Nevada
Domestic Asset Protection Trust

also known as the
Nevada On Shore Trust
(“NOST”)

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Jurisdiction Comparison –

9th Annual Domestic Asset Protection Trust State Rankings Chart											
Rank	State	Statute (50% weight)	State Income Tax (5% weight)	Uniform Voidable Transactions Act (12.5% weight)	Statute of Limitations (Future/ Preexisting Creditor) (5% weight)	Spouse/ Child Support Exception Creditors (Spouse 3%, Alimony 1%, Child Support 1% weight)	Preexisting Torts Exception Creditors/Other Exception Creditors (5% weight)	Ease of Use – New Affidavit of Solvency required for every new transfer? (7.5% weight)	Fraudulent Transfer Standard (5% weight)	Decanting State Ranking (5% weight)	Total Score
1	NV	§§166.010 to 166.170	No	No	2 Yrs./2 Yrs. or 0.5 Yr. Discovery	No	No	No Affidavit Required	Clear and convincing	Ranked #2	99
2	SD	§§55-16-1 to 16	No	No	2 Yrs./2 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Alimony; Child Support (only if indebted at time of transfer)	No	No Affidavit Required	Clear and convincing	Ranked #1	98
3	OH	Ch. 5816	No (except residents)	No	1.5 Yrs./1.5 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	No	Affidavit Required (with exceptions)	Clear and convincing	Ranked #6	85
4(tie)	MO	§456.5-505	No (except Missouri source income)	No	4 Yrs./4 Yrs. or 1 Yr. Discovery	Alimony; Child Support	State/U.S. to extent state/federal law provides	No Affidavit Required	Clear and convincing	Ranked #10 (tie)	84
4(tie)	TN	§§35-16-101 to 112	No (except dividends/ interest on residents)	No	2 Yrs./2 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	No	Affidavit Required	Clear and convincing	Ranked #3	84
6	DE	Tit. 12, §§3570-3576	No (except residents)	No	4 Yrs./4 Yrs. or 1 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts	No Affidavit Required	Clear and convincing	Ranked #5	83
7	AK	§34.40.110; §13.36.310	No	No	4 Yrs./4 Yrs. or 1 Yr. Discovery	Divorcing Spouse	No	Affidavit Required	Clear and convincing	Ranked #7 (tie)	82.5

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9	NH	§564-D:1-18	No (except dividends/ interest on residents)	No	4 Yrs./4 Yrs. or 1 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts	No Affidavit Required	Limited clear and convincing standard	Ranked #4	79
10	WY	§§4-10-502, 504, 506(c), 510-523	No	No	4 Yrs./4 Yrs. or 1 Yr. Discovery	Child Support	Property listed on app. to obtain credit – but only as to that lender	Affidavit Required	Clear and convincing	Ranked #10 (tie)	78.5
11	HI	§554G	No (except residents)	No	2 Yrs./2 Yrs. Pers. Injury; 6 Yrs. Contract	Divorcing Spouse; Alimony; Child Support	Preexisting Torts/ Certain Lenders/ Hawaii Tax	No Affidavit Required	Limited clear and convincing standard	None	77
12	MI	§§700.1041 to 700.10502	No (except residents)	Yes	2 Yrs./2 Yrs. or 1 Yr. Discovery	Divorcing Spouse	No	Affidavit Required (with exceptions)	Clear and convincing	Ranked #21 (tie)	75.5
13	MS	§§91-9-701 to 91-9-723	Yes	No	2 Yrs./2 Yrs. or 0.5 Yr. Discovery	Divorcing Spouse; Alimony; Child Support	Preexisting Torts, State/ Criminal Restitution/ Up to $1.5MM if no $1MM Umbrella Policy	Affidavit Required	Clear and convincing	None	72.5
14	UT	§25-6-13	Yes	Yes	None/2 Yrs. or 1 Yr. Discovery (also 120-day mailing/ publication option)	No	No	Affidavit Required	Missing clear and convincing standard	None	65
NR	OK	Tit. 31, §§10 to 18	No (except residents)	No	4 Yrs./4 Yrs. or 1 Yr. Discovery	Child Support	Must be majority Oklahoma assets	No Affidavit Required	Clear and convincing	None	NR
NR	VA	§64.2-745.1; §64.2-745.2	Yes	No	None/5 Yrs.	Child Support	Creditor who has provided services to protect trust/ U.S./city, etc.	No Affidavit Required	Clear and convincing	Ranked #14 (tie)	NR
NR	WV	§44D-5-503A; §44D-5-503B	No (except residents)	No	None/4 Yrs.	No	No	Affidavit Required	Missing clear and convincing standard	None	NR

*9th Annual Domestic Asset Protection Trust State Rankings Chart created in April 2018. Original State Rankings Chart created in April 2010.

*The Decanting State Ranking column is based on the 5th Annual Trust Decanting State Rankings Chart (Jan. 2018) at http://www.oshins.com/state-rankings-charts.

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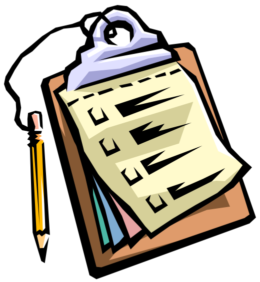
Requirements for a NOST



- At least one Trustee must be a qualified Nevada resident
    - This can be an individual resident, bank or a trust company with offices in Nevada
- Must be in writing
- Must be irrevocable
- Must not <u>require</u> distributions to Settlor, but distributions to Settlor are permitted if authorized by another Trustee

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Planning for California Residents

- To achieve the best protection:
  - The elapsed time from the last transfer of assets into the NOST and publication has been at least 2 years;
  - Only a portion of settlor's wealth was transferred into the NOST;
  - The settlor was solvent after the transfer of property into the NOST;
  - Settlor was current on all outstanding debts when the transfers were made;
  - Property in the NOST is best protected if it is capable of being physically located in Nevada and consists primarily of 'moveable' assets;
  - A trustee in Nevada approves any and all distributions to the settlor;
  - Have annual meetings with the Nevada Trustee.

- A well-constructed DAPT will either be upheld in its entirety or, if a dispute arises, it will put the Settlor in a better settlement position with creditors.
- A well planned Trust will have the following facts and provisions:
  - Designate Nevada as the governing jurisdiction;
  - Trust should cite estate planning, taxation and other advantages as reasons for creating the trust;
  - Trust administration, such as assistance in preparing tax returns and accountings, is performed by a Nevada Trustee with no substantive contacts with California;

- A well planned Trust (continued)
  - The settlor has no present or foreseeable creditor or judgment claims;
  - A Trust Protector is named with the power to replace the trustee and add or remove beneficiaries;
  - Follows NRS 166 for creating a valid self settled spendthrift trust;
  - Trust legal work is performed by Nevada counsel;
  - Trust is funded with 'movables' – separate from any California real estate.

California Uniform Voidable Transactions Act

- Adopted in California via SB 161 on July 15, 2015
- Effective as of January 1, 2016

- "Voidable Transfer" defined as:

  A transfer made by a debtor is voidable as to a present or future creditor if at the time the transfer occurred, the debtor made the transfer with "actual intent to hinder, delay or defraud any creditor" or did not receive reasonably equivalent value AND the debtor became insolvent due to such transfer. *See* Cal. Civ. Code § 3439, *et seq*.

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California Uniform Voidable Transactions Act

Choice of Law Provision, Cal. Civ. Code § 3439.10:

A claim in the nature of a claim under this chapter is *governed by the local law of the jurisdiction in which the debtor is located* when the transfer is made or the obligation is incurred.

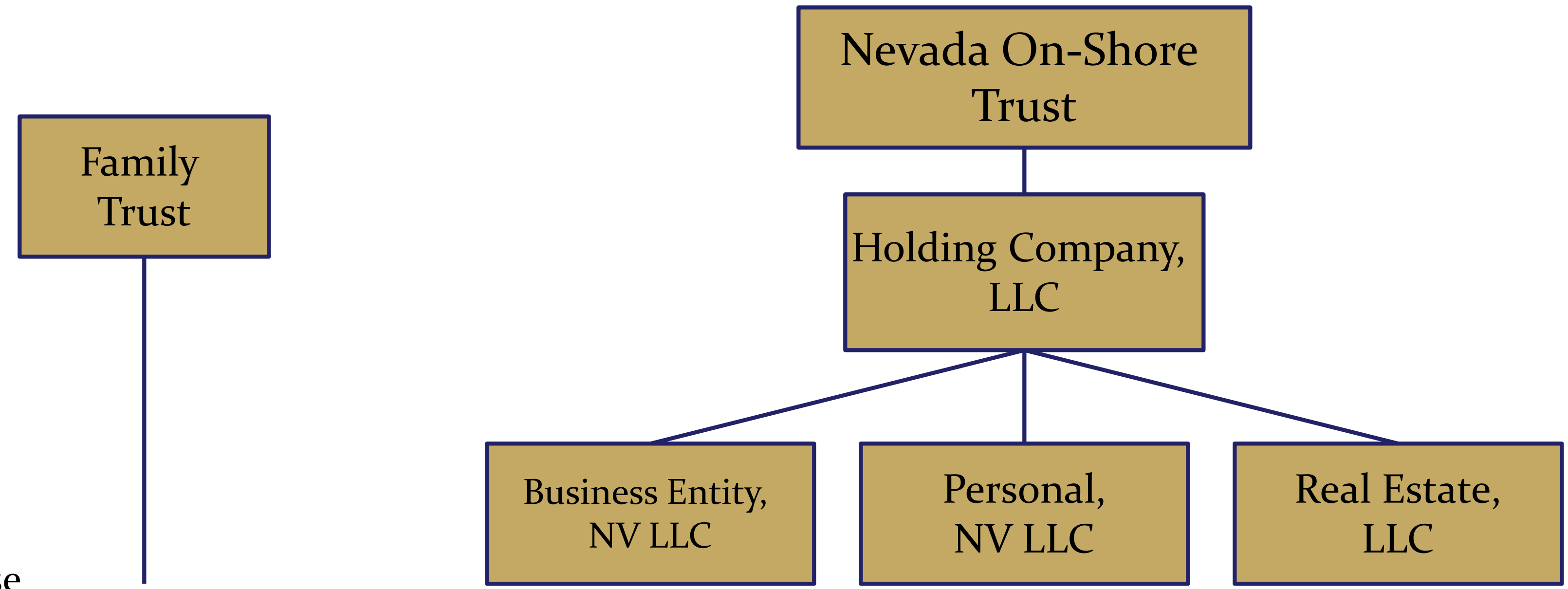
A debtor who is an individual is *located at the individual's principal residence.*

What does this mean for California residents setting up a NOST in Nevada?

Avoiding the UVTA

- Do planning before any creditor issues arise – if the action is brought 7 years after the transfer (in CA) it is barred by the statute of limitations.
- Don't make transfers that render the settlor insolvent.
- Keep the NOST assets separate from any California real property (fund the NOST with "movables").
- Maintain a substantial relationship with Nevada.

Typical Asset Protection Plan



Family Trust

House
Personal Checking Account
Cars
Personal Items

Business Entity, NV LLC

- Business Interests
- Active Business with value
- Investment Partnerships

Personal, NV LLC

- Savings & Investment Accounts
- Stock & Bonds
- Raw Land

Real Estate, LLC

- Income Producing Real Estate Interests
- Vacation Property

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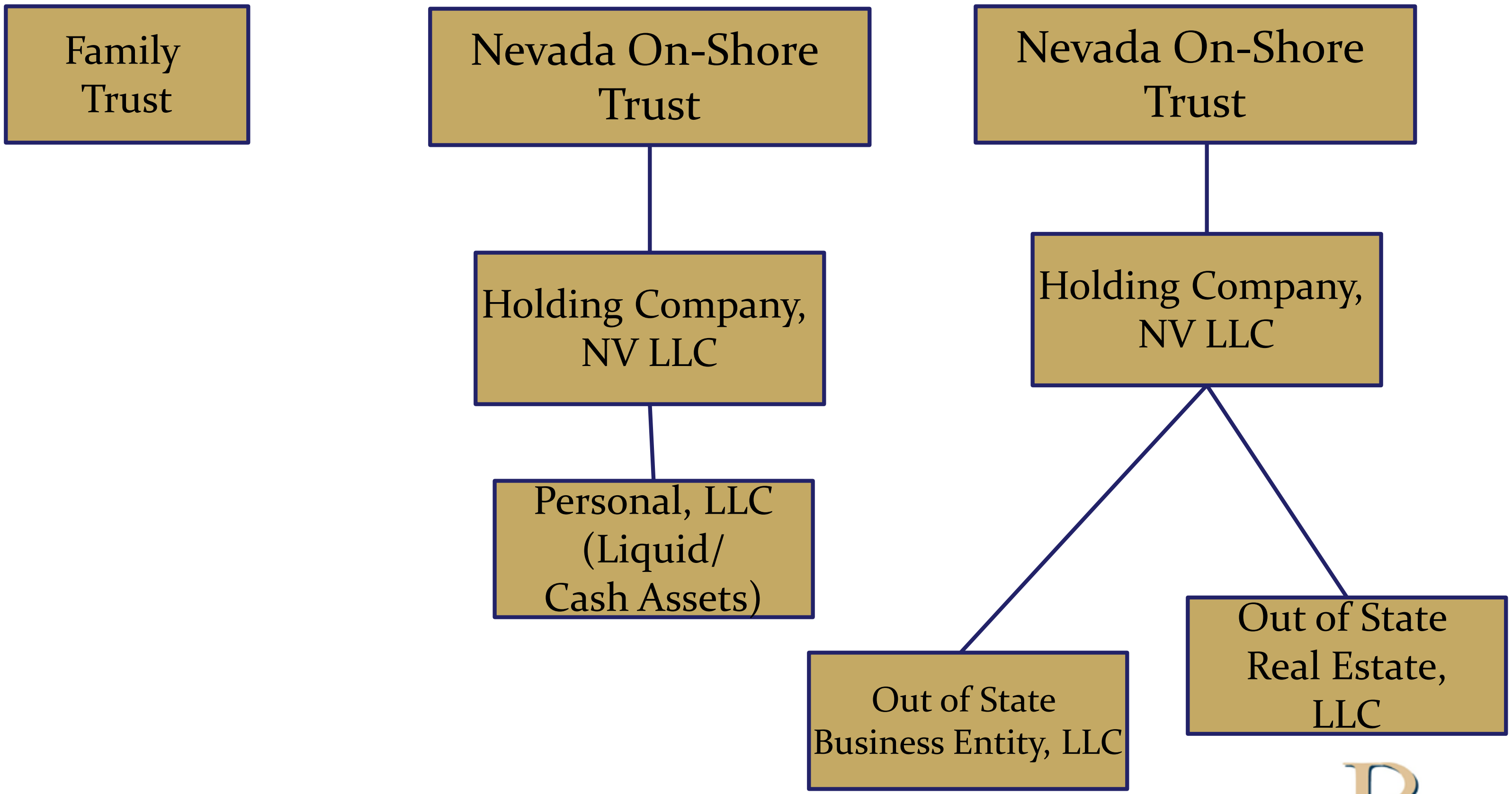
For The Best Protection…



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Avoid Bad Facts!

- *In re Huber,* 201 B.R. 685 (Bankr. W.D. May 17, 2013)
  - Client declared Bankruptcy after he transferred his assets;
  - Client started his asset protection planning after he had already been sued by multiple creditors and had outstanding judgements against him and thus his transfer of assets into the asset protection trust were fraudulent as they were meant to hinder, delay and/or defraud known creditors;
  - The transfers rendered the client insolvent;
  - No substantial ties to the asset protection state (Alaska) – as the attorney who drafted the Trust worked out of Washington, the signing of the Trust took place in Washington, and the client had no other connection to Alaska.

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Avoid Bad Facts!

- *Toni 1 Tr., by Tangwall v. Wacker,* 413 P.3d 1199 (Alaska 2018)
  - Client declared Bankruptcy after he transferred his assets;
  - Client's transfer of assets into the asset protection trust were fraudulent as they were meant to hinder, delay and/or defraud known creditors;
  - The Alaska court merely held that Alaska did not have exclusive jurisdiction over Alaska self-settled spendthrift trusts, and thus could not require that proceedings relating to the transfer of assets to an Alaska self-settled trust be brought before an Alaska court when other courts had jurisdiction over the assets and parties involved

Creditor Attacks

- Can a California court assert jurisdiction over a Nevada Trustee or Nevada Trust?
  - Real property located in California would be subject to a California court's *in rem* jurisdiction. If that real property is in a NOST with other assets, the court may try to use its long arm statutes to get jurisdiction over the NOST assets as well.
  - However, if the NOST is structured correctly, the California Court should *not* be able to assert jurisdiction over a Nevada Trustee, or the NOST.
  - The California Court would only be able to assert jurisdiction over the settlor, and a judgment rendered would be against the settlor, *individually*.

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Two Scenarios

1. Creditor gets a money judgment against a debtor, individually, in California, and brings the judgment to Nevada to collect.

2. Creditor gets a judgment against a debtor, individually, in California which provides that the transfer of assets to the NOST is void, and brings the judgment to Nevada to enforce.

Scenario 1:
Registration of Foreign Judgment

A court outside Nevada may grant a money judgment against a debtor, and the creditor may come to Nevada to collect on that judgment.

To collect, the creditor must register the judgment in Nevada, and the Nevada court will treat the foreign judgment as it would a domestic judgment. In that instance, Nevada's protections to a debtor apply, and NOST assets should be exempt from collection. *See* NRS 21.090.

Scenario 2:
Full Faith and Credit

Jurisdictions outside Nevada may not recognize the protection of a NOST and enter a judgment which states that the transfer of assets to the NOST is void– the creditor may bring that judgment to Nevada for enforcement.

But… Nevada may refuse to enforce the judgment voiding the transfer of assets to the NOST because the foreign court lacked jurisdiction over the NOST, and/or because the judgment was entered under laws 'contrary to Nevada's public policy.'

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Creditor Exceptions to a NOST: None.

Recently emphasized by the Nevada Supreme Court in *Klabacka v. Nelson* (May 2017)

But what creditors *may* still be protected:

- Secured Creditors
- IRS
- Bankruptcy creditors if the Trust was funded within 10 years

  (*Mortensen* case and 11 U.S.C. 548(e))

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If clients want even more protection than a DAPT offers if a distress event were to occur, the Passport Trust™ may be the answer

PASSPORT TRUST

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The Passport Trust™

Combining the simplicity and comfort of on-shore domestic asset protection with the potential of moving off-shore when needed.

Offshore Trusts

- Laws of the foreign jurisdiction will apply to the trust and the enforceability of the trust's spendthrift clause.

- Due to the difference between creditor laws in the U.S. and foreign jurisdictions, a foreign jurisdiction does not have to enforce a U.S. court's judgement against assets held in that foreign jurisdiction.

Offshore Trusts

- Creditor has the burden of proving a fraudulent conveyance
- The creditor's burden of proof is the criminal standard of "beyond a reasonable doubt" (Cook Islands)
- For existing creditors, the statute of limitations begins running on the date of the transfer, not on the date the transfer was discovered (Cook Islands)

“Passport” Provisions

- NOSTs have been successfully re-domiciled in other jurisdictions, including offshore jurisdictions such as the Cook Islands and Nevis.
- Usually no new waiting period (tolled transfer date) in the new jurisdiction.
- Lowers entry cost into serious asset protection planning.
- Allows you to begin with a NOST and “start the clock” on the waiting period and later convert to an offshore trust for the best of both worlds if there is a distress event.

Better to Start On Shore

- States must afford Full Faith and Credit to the laws and judgments of sister states – they have no obligation to honor the laws or judgments of a foreign jurisdiction.
- Better chance of protecting U.S. real estate and business interests.

Drafting Tips:

- Settlor can be the "Investment Trustee" and control investment of trust assets.
- Set in place a "Distribution Trustee" to authorize distributions to the Settlor.
- Use a Trust Consultant for removing and replacing Trustees.
- Appoint an Offshore "Special Trustee" who can act when/if situs is changed.
- Allow for change of situs/domicile of trust.
- Settlor may possess a "power of appointment" to change beneficiaries of the trust.

Income Tax Planning

- The NING
  - Set up and Administration
- Why NINGs are Ideal for California Clients
  - California Taxation of Trusts
- Advantages/Disadvantages

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Current Tax Landscape

- Individual and trust federal income tax rates in the highest tax bracket are 39.6%. In addition, California rates are as high as 13.3% - and clients can no longer claim a deduction on their federal returns for state income taxes paid

- With current estate tax rates of 40%, many clients are interested in creating plans that evolve around income tax savings during their lifetimes rather than estate tax savings at their deaths

The NING
Nevada Incomplete Non-Grantor Trust

"Incomplete" for gift tax purposes – anything contributed to this trust by the Grantor will be included in the Grantor's estate for estate tax purposes.

"Complete" for income tax purposes – the trust is designed to be a separate taxpayer from the Grantor and a resident of Nevada.

NINGs must be carefully structured to allow the Grantor sufficient control to keep contributions to the NING from being treated as completed gifts, but insufficient control to require that the Grantor be treated as the owner of the NING’s income.

To Ensure an Incomplete Gift:

- Grantor retains a special lifetime power of appointment limited by ascertainable standard – health, education, support and maintenance (only available in Nevada).
- Grantor also retains a limited testamentary power of appointment. (Can appoint the trust estate to anyone other than himself, his estate, his creditors, or creditors of his estate).

Establishing the NING as a Separate Taxpayer

- The NING must avoid Grantor Trust status under IRC § 671 *et seq.* to be its own taxpayer, and does so through the use of an Independent Trustee and Distribution Committee:
  - Any distributions of NING income must be made with the approval or consent of a distribution committee containing "adverse parties." *See* IRC § 672(a).
  - An "Adverse Party" is defined as any person who has a substantial beneficial interest in a trust, which would be adversely affected by the exercise or non-exercise of the power of the Grantor possesses respecting the trust. *Id.* Children, grandchildren, or other remainder beneficiaries in a NING would be considered 'adverse parties'.
- The NING must be considered a 'resident' of Nevada, and accomplishes this through the use of a Nevada trustee.

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PLR 201310002

- In the above Private Letter Ruling, the IRS approved a NING where the Grantor retained a lifetime special power of appointment with a health, education, maintenance and support standard.
- The NING was held to be a non-grantor trust for income tax purposes and that the transfers were incomplete for gift tax purposes.
- However, this result is currently only available in Nevada, due to its asset protection statute (NRS 166) that allows a settlor to retain a lifetime power of appointment that satisfies Treasury Regulations without subjecting the trust assets to claims of creditors.

NINGs are Ideal for California Clients

By establishing and funding properly drafted NING, California residents can avoid the 13.3% state tax on income generated by the assets in the NING

Caution: Avoid Step Transactions

If the asset contributed to a NING is a business interest in anticipation of a sale, certain time restrictions apply to avoid the transfer and sale of the business being considered a Step Transaction

California Taxation of Trusts

The California income tax rules regarding trusts looks at three main determinations:

1. Source of Trust Income;
2. Residence of Trustees; and
3. Residence of Trust Beneficiaries.

Cal. Rev. & Tax Code § 17743

Source of Trust Income

- If a trust's income is California sourced (i.e., rental income generated from California real property, income received from a business operated in California), it will be subject to California tax.
- Thus, a NING should be funded with intangible property that can be 'moved' to and administered in Nevada – such as shares in a corporation or membership interests in an LLC

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Residence of Trustees

- If all of a trust's trustees reside in Nevada, the trust income will not be subject to California tax.
- If there are both resident and non-resident trustees, trust income will be taxed based on the percentage of resident to non-resident trustees. For example, if there were 1 California trustee and 1 Nevada trustee, 50% of the trust's income would be subject to California tax.

NINGs Avoid California Tax By:

- Being comprised of intangible assets that can be ‘moved’ and administered in Nevada (passes the California-sourced income test);
- Having the only Trustee be a Nevada resident (passes the resident trustee test); and
- Having only contingent beneficiaries – distributions are made in the complete discretion of the Trustee (passes the resident non-contingent beneficiary test).

However…

If distributions of income are made to a beneficiary who lives in California, the amount that is distributed to that beneficiary must be reported on that beneficiary's California income tax return.

California justifies this result by stating that once the income is distributed, the beneficiary's interest as to the amount of the distribution is no longer contingent.

NING Advantages

- Assets in a NING receive a step-up in basis at the Grantor's death;
- The Grantor can be a beneficiary of a NING;
- Transfers to a NING will not use up a Grantor's applicable exclusion amount or annual gift amount;
- A NING established as a separate taxpayer in Nevada is not subject to income taxes in the Grantor's home state (as long as certain requirements are met);
- For additional control of NING assets, the NING can be created in conjunction with an LLC, of which the Grantor can serve as Manager;
- In Nevada, NING assets will be protected against creditors of the Grantor and other beneficiaries as permitted by NRS 166.

NING Disadvantages

- If distributions are made to the Grantor or NING beneficiaries while they are residents of California, tax benefits may be lost as California will tax those distributions;
- California may impose substantial penalties if a NING is funded with assets that are certain or even highly likely to be sold shortly after the creation of the trust (the creation and funding of the NING will be considered a step transaction).

Income and Estate Tax Planning

- The IDGT
  - Set up and Administration
  - Advantages/Disadvantages
- The BDIT
  - Set up and Administration
  - Advantages/Disadvantages
- An IDGT or BDIT Installment Sale

The IDGT
Intentionally Defective Grantor Trust

"Incomplete" for income tax purposes – the Grantor retains enough control over the IDGT to have the IDGT qualify as a Grantor Trust for income tax purposes.

"Complete" for estate tax purposes – anything contributed to an IDGT by the Grantor will be excluded from the Grantor's estate for estate tax purposes.

When to use an IDGT

- When the client has high-basis assets and is looking to transfer those assets outside his or her estate for estate tax purposes.
  – A 'high-basis' situation could include an asset recently bought, or a second-death situation where a community property asset received a double step up in basis.

Advantages of an IDGT

- The IDGT will continue for multiple generations without being subject to federal estate tax.
- Gifts or sales to an IDGT do not trigger capital gains or capital losses.
- Payment of income taxes on behalf of the IDGT are additional 'gifts' to the IDGT beneficiaries that do not use up the annual exclusion amount or lifetime exemption amount for gift or estate tax purposes.
- Utilizing an IDGT with an installment sale and a family LLC, the assets transferred from the Grantor's estate can be transferred at a discounted value for lack of marketability and control under IRC § 2704.

Disadvantages of an IDGT

- Client cannot be a beneficiary of the IDGT.
- Creditor protection is only available for the trust beneficiaries, not the Grantor.
- Grantor, as Trustee, may manage trust assets but cannot enjoy the use or benefit of trust assets.

The BDIT
Beneficiary Defective Inheritor's Trust

Set up by a third party for the benefit of a Primary Beneficiary.

The Primary Beneficiary will be treated as "Grantor" for income tax purposes.

The assets in the BDIT will not be included in the Primary Beneficiary's estate for estate tax purposes.

Setting up the BDIT

1. Third Party (typically a family member of the Client) funds the BDIT with an irrevocable gift of $5,000.
2. The BDIT is set up for the benefit of the Client and the Client's descendants.
3. The Client is given the power to withdraw the $5,000 trust corpus through a *Crummey* Power.
4. The Client does not exercise that power of withdrawal, and because he does not exercise that power, he becomes the 'Grantor' for income tax purposes.
5. Thereafter, the growth in the value of the BDIT's assets will be excluded from the Client's gross estate without estate or gift tax cost.

Purchasing an Asset with a BDIT

1. Once the Client becomes 'Grantor' for income tax purposes, he can either invest in a new business with the funds in the BDIT or sell an asset (typically a start-up business or low basis asset owned by the Client individually) to the BDIT.
2. The sale of an asset by the Client to the BDIT would be ignored for income tax purposes because the buyer (the BDIT) and the seller (the Client) are considered the same person for income tax purposes.
3. This kind of sale is typically accomplished through the use of a promissory note issued by the BDIT to the Client to purchase the asset, with the remainder beneficiaries as guarantors of the BDIT's debt.

When a BDIT makes sense:

- The Client has a start-up business or low-basis asset that is expected to explode in value, and the Client wants to remove that asset from his estate for estate tax purposes but maintain control, use and enjoyment of the asset.

- The Client does not live in a state that recognizes self-settled spendthrift trusts and wishes to benefit from the BDIT's spendthrift clause as well as protect the assets from potential claims of a spouse in marital dissolution or separation.

BDIT Advantages

- As a third-party spendthrift trust, the BDIT's assets are protected from the Primary Beneficiary's creditors (even in states like California that do not allow self-settled spendthrift trusts);
- Any increase in value of the asset owned by the BDIT will be outside of the Primary Beneficiary's estate for estate tax purposes;
- Unlike the IDGT, the Primary Beneficiary can exercise control over the BDIT's assets as Trustee.

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BDIT Disadvantages

- The Primary Beneficiary must have a relative (or other party) willing to provide the initial funding for the BDIT as an absolute and irrevocable gift to the Primary Beneficiary;
- Formalities must be adhered to for the BDIT structure to be effective, the lack of which may make transactions between the BDIT and Primary Beneficiary suspect;
- It is a common view that under IDGT or BDIT transactions that involve an installment sale, the trust must have its own assets equal to at least 10% of the amount of the debt as evidence that the obligation from the Trustee to the Grantor is a bona fide indebtedness rather than an equity interest in the BDIT. Typically, the seed gift of $5,000 is not enough to purchase an asset nor satisfy the 10% rule, so the remainder beneficiaries may be required to personally guarantee the note or the beneficiaries may need to loan money to the BDIT, otherwise the desired tax benefits will not be attained.

IDGT v. BDIT

IDGT	BDIT
Client (Grantor) cannot be a beneficiary	Client (Primary Beneficiary) can be a beneficiary
Creditor protection available for beneficiaries, but not for Client	Creditor protection available for Client and other beneficiaries
Client treated as owner for income tax purposes	Client treated as owner for income tax purposes
Trust assets are not included in the Client's estate for estate tax purposes	Trust assets are not included in the Client's estate for estate tax purposes
Client as Trustee retains control of assets, but not use and enjoyment	Client as the Trustee, and as primary beneficiary, retains control, use and enjoyment of BDIT assets

THANK YOU!

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NEVADA ASSET PROTECTION FOR CALIFORNIA RESIDENTS

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Introduction

More and more clients are seeking asset protection as jury awards and the number of frivolous lawsuits continue to increase, in order to preserve their hard-earned assets to pass on to future generations. Such asset protection is available in various forms, including limited liability companies, corporations, homesteads, qualified retirement plans, offshore trusts and domestic asset protection trusts. As of the date of this article, 18 states have adopted some form of Domestic Asset Protection Trust ("DAPT") statute[1]. Such statutes are not solely for the benefit of the residents of those 18 DAPT states. California has not yet passed a DAPT statute, however, many residents of California can still enjoy many of the protections DAPT states afford as long as certain conditions are met. This article discusses and explores the requirements of implementing a successful asset protection plan in such a situation, in which a California resident (a non-DAPT jurisdiction) sets up a Nevada DAPT. This article will show that a Nevada DAPT, structured as outlined below for a California resident, should provide a real benefit to the settlor by either (1) being upheld in its entirety if challenged, or (2), if a dispute arises, lead to an attractive settlement.[2]

First, the California resident must be a good candidate for a Nevada DAPT. To be a 'good candidate' the California resident should not have any impending litigation or creditor issues, and have other reasons for setting up the trust, which may include tax reasons – using up a lifetime exemption, taking advantage of Nevada's income tax laws, gifting assets to reduce an estate for estate tax purposes; or other reasons such as pre-marital planning, protecting beneficiaries (other than him or herself) against potential ex-spouses, their creditors, etc. It is important for the drafting attorney to perform due diligence on the client to ensure that they are a qualified applicant and are not engaging in this type of planning to hinder, delay, or defraud known creditors.

In our example, we will assume that the California resident's DAPT is in compliance with the Nevada DAPT statute and possesses the circumstantial factors described below.

<u>Compliance with Applicable Nevada Statutes:</u>

Nevada Revised Statute ("NRS") Chapter 166, also known as the Spendthrift Trust Act of Nevada, requires that in order to be a valid spendthrift trust, the trust must be (1) in writing, (2) the settlor must manifest an intent to create such a trust, (3) irrevocable, and (4) at least one trustee must be a Nevada resident, (5) not require that any part of the trust's income or principal be distributed to the settlor, and (6) not be intended to hinder, delay or defraud known creditors. *See generally* NRS §166.

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[1] *See* Steven J. Oshins, "8th Annual Domestic Asset Protection Trust State Rankings Chart" (April 2017) (States with some form of DAPT Statute: Alaska, Colorado, Delaware, Hawaii, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia and Wyoming).

[2] Thomas E. Greene III, "Structuring Self-Settled Trusts for Non-Resident Settlors," Trusts & Estates, 29-35 (November 2016).

Circumstantial Factors

In addition to complying with the Spendthrift Trust Act of Nevada, the model Nevada DAPT in our example will also be surrounded by the following circumstances:

1. Settlor transfers only a portion of his or her wealth into the DAPT;
2. Settlor has no outstanding claims, lawsuits, or judgments when transfers are made to the DAPT;
3. All of the property owned by the DAPT can be physically located in Nevada and consists primarily of 'moveable' assets, such as marketable securities, bonds, and cash equivalents;
4. A trustee who resides in Nevada (who has minimal contact with California) approves all distributions to the settlor, and preferably actually manages and preserves the assets, limiting the control of the settlor over the DAPT;
5. The DAPT is drafted by competent Nevada counsel and is executed in the state of Nevada.

The trust should meet the above requirements and also contain a "spendthrift clause" which generally prohibits the assignment, alienation, acceleration and anticipation of any interest of the beneficiary under the trust by the voluntary or involuntary act of the beneficiary, or by operation of law or any process at all.[3]

Under Nevada law, when a trust is structured according to the above, "a person may not bring an action with respect to a transfer of property to a DAPT (1) if the person is a creditor when the transfer is made, unless the action is commenced within 2 years after the transfer is made or 6 months after the person discovers or reasonably should have discovered the transfer, whichever is later; [or] (2) if the person becomes a creditor after the transfer is made, unless the action is commenced within 2 years after the transfer is made." NRS §166.170.

While engaging in such planning does not prevent an attack from creditors, in such a situation where the DAPT complies with NRS §166 and the above facts surround the creation and administration of the DAPT, the DAPT should either be upheld in its entirety, or should at least put the settlor in a better settlement position in relation to those creditors.

Attacks from California Creditors

A California creditor may attempt to attack the DAPT in our example through the relatively new Uniform Voidable Transactions Act (the "UVTA").

[3] The following is an example of a spendthrift clause: "The beneficiary shall have no power or capacity to make any disposition whatever of any of the income by his or her order, voluntary or involuntary, and whether made upon the order or direction of any court or courts, whether of bankruptcy or otherwise; nor shall the interest of the beneficiary be subject to any process of attachment issued against the beneficiary, or to be taken in execution under any form of legal process directed against the beneficiary or against the trustee, or the trust estate…The trustee of a spendthrift trust is required to disregard and defeat every assignment or other act, voluntary or involuntary, that is attempted contrary to the provisions of this chapter." *See* NRS §166.120.

The California Uniform Voidable Transactions Act

The UVTA was adopted in California on July 2, 2015 and made effective as California Civil Code Section 3439, *et. seq*., on January 1, 2016. The UVTA revised and replaced the Uniform Fraudulent Transfers Act, and while discussing all the changes and potential implications of the UVTA is beyond the scope of this article, one of the relevant changes affecting our topic is the Choice of Law provision, which provides that a claim under the UVTA is governed by the local law of the jurisdiction in which the debtor is located when the transfer is made or the obligation is incurred. If the debtor is an individual, they are considered to be located at the individual's principal residence. Cal. Civ. Code §3439.10. This section was meant to clarify the historical ambiguity of which state's law was to apply in a conflict of laws situation. As California's law expressly states that if the UVTA applies, California self-settled spendthrift trusts, as to the settlor, are invalid and assets in such a trust are accessible to those creditors.[4] Of course a creditor would want California law to apply, not Nevada law.

In light of the passage of the UVTA and its choice of law provision, some practitioners have taken the position that asset protection planning for residents of a non-DAPT state is now futile.[5] For California residents, it has been suggested that any asset protection planning engaged in would be per se void, as California by statute does not recognize self-settled spendthrift trusts.[6] That is exactly why many California residents seek to avail themselves of Nevada's DAPT laws. However, in order for the UVTA's choice of law provision to be controlling and dictate a court's choice of law, BOTH the domicile state and the DAPT state must have adopted the UVTA. The UVTA was introduced as Assembly Bill 420 in the 78th Session of the Nevada Legislature in March of 2015 but the bill was dead on arrival. No vote was ever taken, and because no vote was taken within the time period allotted, pursuant to Joint Standing Rule 14.3.2, no further action was allowed to be taken on the bill and it is unlikely that it will ever be passed by the Nevada legislature. Thus, as the UVTA was not adopted by the Nevada legislature, a Nevada court would still have to engage in its own conflict of laws analysis in determining whether to apply California's law if an action is brought in Nevada under the UVTA.[7]

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[4] *See generally* California Civil Code §3439; *see also* Cal. Prob. Code §15304.

[5] *See* Al W. King III, "Tips From the Pros: Be Aware of the Uniform Voidable Transactions Act," wealthmanagement.com (Sep. 21, 2016); *see also* George D. Karibjanian, "The Uniform Voidable Transactions Act Will Affect Your Practice," Trusts & Estates, 17 - 21 (May 2016).

[6] Cal. Prob. Code §15304.

[7] In the Official Comments to the UVTA's choice of law provision, the commentators specifically address the scenario of a non-DAPT settlor establishing a trust in a DAPT state. Official Comment 8 provides:

> "Because the laws of different jurisdictions differ in their tolerance of particular creditor-thwarting devices, choice of law considerations may be important in interpreting [the UVTA] as in force in a given jurisdiction. For example, the language of the [UVTA] historically has been interpreted to render voidable a transfer to a self-settled spendthrift trust. Suppose that jurisdiction X, in which this Act is in force, also has in force a statute permitting an individual to establish a self-settled spendthrift trust and transfer assets thereto, subject to stated conditions. If an individual Debtor whose principal residence in X establishes such a trust and transfers assets thereto, then under Section 10 of this Act the voidable transfer law of X applies to that transfer. That transfer cannot be considered voidable in itself under the [UVTA] as in force in X, for the legislature of X, having authorized the establishment of such trusts, must have expected them to be used. Other facts might still render the transfer voidable under X's enactment of [the UVTA]). By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has not legislation validating such trusts, and if the Debtor establishes such a trust under the law of X and transfers assets to it, then the result would be different. Under Section 10 of this Act, the voidable transfer law of y

If a creditor brought an action against a settlor in California under the UVTA in order to reach assets held in a Nevada DAPT, the creditor would have to overcome several hurdles. In our scenario, the DAPT trustee and assets are all in Nevada and the settlor had no intent to hinder, delay or defraud this creditor bringing the action. The creditor would likely attempt to name the Trustee of the DAPT as a party to the action, however, the first major hurdle would be to get the California court to assert jurisdiction over the Nevada DAPT. If the California court did not assert jurisdiction over the Nevada DAPT, typically the creditor would have to get a judgment against the settlor, individually, and then seek to enforce that judgment against the trust in Nevada.

It is important to note here that if the UVTA applies, real property located in California, even if transferred to a DAPT, would most likely be susceptible to a creditor judgment in California as California courts have "in rem jurisdiction" over such property. In that situation a California court might argue that by virtue of some property of the DAPT being located in California, the court has jurisdiction over the entire DAPT. Ideally, the California real property would be transferred into an LLC, which would be owned by a separate DAPT other than the DAPT that holds all the 'moveable' assets. Thus, to reach any 'moveable' assets in the second DAPT that owns all the moveables, a creditor would have to first obtain jurisdiction over the Nevada trustee. If the creditor is successful in a California court, then the creditor would either (1) register its money judgment in against the DAPT in Nevada, or (2) seek enforcement of the judgment rendering a transfer to the DAPT void in Nevada.

Ideally, the DAPT created in the above scenario would fall outside the UVTA. A DAPT should fall outside the scope of the UVTA if the UVTA statute of limitations has expired, the transfer of assets was not made to hinder, delay or defraud known creditors, and the transfer did not render the settlor insolvent.[8]

Jurisdiction of a California Court over a Nevada DAPT

Generally, a California court may exercise jurisdiction over a trust on any basis permitted by Section 410.10 of the California Code of Civil Procedure, which states that "a court of this state may exercise jurisdiction on any basis not inconsistent with the Constitution of this state or of the United States." The purpose of §410.010 is to provide plenary power over property located within the state and limited power over property and trusts located outside of California.

Exercising jurisdiction over out-of-state property (and trusts) is limited to instances where a foreign defendant "has certain minimum contacts [with the state] such that the maintenance of the suit does not offend traditional notions of fair play or substantial justice."[9] Such contact may include an analysis of factors including: (1) presence, (2) domicile, (3) residence, (4) nationality or citizenship, (5) consent, (6) appearance in an action, (7) doing business in the state, (8) an act done in the state, (9) causing an effect in the state by an act done elsewhere, (10) ownership, use or possession of a thing in the state, (11) other relationships to the state which make the exercise

would apply to the transfer. If Y follows the historical interpretation of the above section [which renders voidable a transfer to a self-settled spendthrift trust], the transfer would be voidable under [the UVTA] as in force in Y."

[8] See Cal. Civ. Code §3439.09, *et seq*.
[9] *Int'l Shoe Co. v. State of Wash., Office of Unemployment Comp. & Placement*, 326 U.S. 310, 316 (1945).

of juridical jurisdiction reasonable.[10] Under the model DAPT outlined above, when the trustee is in Nevada, all the property is located in Nevada, and the Nevada DAPT does not own California real property, there would likely be insufficient contact with California to justify a court exercising jurisdiction over the DAPT. Consequently, California courts would be unable to claim jurisdiction over a DAPT.

If the creditor names the Trustee in the original action, the Trustee can appear specially to assert lack of jurisdiction of the California Court to challenge the court's jurisdiction by a motion to quash service of summons within the designated time period.[11] A special appearance to challenge jurisdiction does not constitute a 'general appearance' that would typically allow a court to assume jurisdiction over a party.

Assuming, arguendo, that the Trustee was unsuccessful in challenging jurisdiction and a California court awarded the creditor a judgment against the settlor and the DAPT, the creditor would still have to go to Nevada to enforce the judgment (as all the assets in the DAPT in our scenario are physically located in Nevada).

If the California court did not assume jurisdiction over the DAPT, the creditor would have to bring a completely new action in Nevada to get to the property in the DAPT.

Bringing a California Judgment to Nevada

In order to have a valid foreign judgment in Nevada, the out of state judgment creditor must follow the statutory procedure for registering a foreign judgment in Nevada. In order to bring a judgment obtained in a foreign jurisdiction to bear in a different jurisdiction, a multi-step procedure involving both federal and state law must be followed. First, the clerk of the original court must execute a "Certification of Judgment for Registration in Another District" pursuant to 28 U.S.C. §1963, which states:

> "A judgment in an action for the recovery of money or property entered in any court of appeals, district court, bankruptcy court, or in the Court of International Trade may be registered by filing a certified copy of the judgment in any other district…when the judgment has become final by appeal or expiration of the time for appeal or when ordered by the court that entered the judgment for good cause shown… A judgment so registered shall have the same effect as a judgment of the district court of the district where registered and may be enforced in like manner."

When a judgment is registered in the foreign state pursuant to 28 U.S.C. § 1963, the judgment is controlled by Rule 69 of the Federal Rules of Civil Procedure, which provides: "The procedure on execution, and proceedings supplementary to and in aid of the judgment and in proceedings on and in aid of execution shall be in accordance with the practice and procedure of the state in which the district court is held." Once a judgment is registered in Nevada (from any other jurisdiction) pursuant to 28 U.S.C. § 1963, and according to Federal Rule of Civil Procedure 69, that judgment would be governed and interpreted under Nevada law.

Under Nevada law, the judgment creditor, upon registering the foreign judgment, must: file an affidavit, promptly give notice to the judgment debtor, and verify to the court that the notice was

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[10] *Id*.; See also Conflict of Laws Restatement (Second) Section 27.
[11] Cal. Rule Civ. Proc. §418.10.

given. NRS § 17.360. It is important to note here, that unless the Nevada Trustee is named in the original action in the foreign jurisdiction, a judgment against the settlor individually will not be enforceable against the Trustee. In this case, a separate action must be brought to enforce the judgment against the Trustee.

The affidavit must set forth the name and last known post office address of the judgment debtor and the judgment creditor and also must include a statement that the foreign judgment is valid and enforceable, and the extent to which it has been satisfied.[12]

Upon registration of a foreign judgment, a judgment creditor is able to pursue their judgment on the debtor in Nevada. Again, if the DAPT is not named as a party in the original action, this judgment is NOT ENFORCEABLE as against the DAPT. In this instance the attorney for the DAPT would bring a motion to quash the judgment for lack of jurisdiction, and a Nevada court would likely dismiss the creditor's claim against the DAPT. As to the settlor, a district court "may order any property of the judgment debtor not exempt from execution…to be applied toward the satisfaction of the judgment." NRS §21.320. The exemptions from execution are those exemptions that the Nevada legislature has deemed exempt, NOT the exemptions that are allowed under the foreign jurisdiction's laws. Under Nevada law, pursuant to NRS §21.090, interests in self settled spendthrift trusts are exempt from attachment.

Additionally, the Nevada Spendthrift Trusts Act provides strong protections against creditor's claims. A DAPT prohibits the assignment, alienation, acceleration and anticipation of any interest of a beneficiary under the trust by the voluntary or involuntary act of the beneficiary, or by operation of law or any process. NRS §166.120. Payments and distributions by the Nevada trustee are made only to the beneficiary, who specifically can be the settlor. NRS §166.110. The Trustee of a DAPT is required to disregard and defeat every assignment or other act, voluntary or involuntary, that is attempted contrary to the provisions of the Nevada Spendthrift Trust Act. If the DAPT meets all the requirements of the statute and is modeled after the DAPT provisions outlined earlier in this article, under Nevada law a judgment creditor may not execute a judgment against any property in a DAPT.

Judgment Against the DAPT Trustee

<u>Full Faith and Credit</u>.

Article IV of the United States Constitution states that "full faith and credit shall be given in each State to the Public Acts, Records, and Judicial Proceedings of every other State."[13]

However, if a California court erroneously asserted jurisdiction over the DAPT, a Nevada court does not have to enforce such a judgment under the Full Faith and Credit clause of the Constitution, as it is invalid on its face. The United States Supreme Court has held that states have no obligation to give full faith and credit to an invalid judgment offensive to the Due Process Clause of the 14th Amendment. *Hanson v. Denckla*, 357 U.S. 235 (1958).

In *Hanson*, a Florida court assumed jurisdiction over a Delaware Trustee of several Delaware trusts established by a Pennsylvania settlor by virtue of the settlor being domiciled in Florida at the date of her death. The Supreme Court held that the Florida court erred in holding that it had

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[12] *See Kabana, Inc. v. Best Opal, Inc.*, 2007 WL 556958 (D. Nev. Feb. 15, 2007).
[13] U.S. Const. Art. IV, §1.

jurisdiction over the non-resident corporate trustee defendant, as no trust property was located in Florida and the Trustee did not have enough contacts with Florida to meet the minimal contacts requirement as set forth in *International Shoe* because the trust company had no office in Florida, the Trust company transacted no business in Florida, none of the trust assets had ever been held or administered in Florida, and there was no evidence that the trust company solicited business in Florida.[14]

If a creditor who has been successful in California subsequently brings an action or seeks to enforce the California judgment in Nevada under the UVTA, a Nevada court would engage in a choice of laws analysis. The creditor would push for the court to apply California law, and likely cite *In re Huber* as persuasive authority despite it being a Bankruptcy Court case. *In re Huber* is often used by critics of DAPTS for non-DAPT jurisdiction residents. However, critics that cite *Huber* as a case-in-point that DAPTS do not work for non-DAPT residents fail to mention the 'bad' facts:

- The debtor was aware of the 'gathering storm clouds' of creditor trouble – he had actually already been sued by multiple creditors and had outstanding judgments against him.
- His principal goal, as stated in an email to his estate planning attorney was to "protect…[his] assets from [his] creditors."
- The transfers into the trust were fraudulent – at the time assets were transferred into the trust there were existing judgments and threatened litigation.
- The debtor transferred substantially all of his property (about 70%) into the Trust, essentially rendering him insolvent.
- Actual intent to hinder, delay, and defraud known creditors was found due to the timing of the trust's creation, the facts surrounding its creation, the timing of asset transfers support a finding of motive other than estate planning: that of asset protection at the expense of his creditors.
- There were no substantial ties to the DAPT state (Alaska) – the only asset transferred to Alaska was a $10,000 cd which was a nominal amount compared to the total amount of assets transferred into the trust.
- The estate planning attorney who drafted the trust worked out of Washington, the signing of the Trust took place in Washington.

The court, in its analysis, dove into the facts surrounding the creation of the Trust and ultimately concluded that the transfers to the asset protection trust were fraudulent, and thus void. Understanding *Huber* leads us to conclude that had the facts been different (a proper DAPT with no fraudulent intent by the settlor and sufficient contacts with the DAPT state) a court would uphold such a DAPT for a non-resident. The court looks at specific facts to determine which state law applies. It has also been argued that the court in *Huber* used the wrong Conflict of Laws Restatement section to come to its conclusion.[15]

Thomas E. Greene quoted Barry S. Engel in his commentary that:

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[14] *Hanson v. Denckla*, 357 U.S. 235 (1958) quoting *Int'l Shoe Co. v. State of Wash., Office of Unemployment Comp. & Placement*, 326 U.S. 310, 316 (1945).

[15] Thomas E. Greene III, LISI Asset Protection Planning Newsletter #328 (August 17, 2016) at http://www.leimbergservices.com.

> "[T]he Court misapplied [Conflict of Laws] Restatement §270 and instead, should have relied on Restatement §273…the Court resolved the wrong question. Restatement §270 speaks to the 'validity' of the trust, but validity is not the issue, as trusts are inherently valid contracts…rather, the relevant question is 'whether the [valid] trust will be enforceable as against the creditors of that person." [16]

Further, Greene cited Nenno & Sullivan to elaborate on distinguishing the two sections. They argue that, since trusts are inherently valid, the purpose of § 270 in determining the validity of trust matters are confined to issues such as violating the rule against perpetuities or the rule against accumulations. They state that in contrast § 273 deals specifically in determining a creditor's ability to reach trust assets. This interpretation makes perfect sense and sufficiently clarifies the confusion between the two sections. As further illustrated by Greene, it makes a big difference which section is applied because the provisions in § 273 allow greater deference to be given to the choice of law provision in the trust:

> "The title of [Conflict of Laws] Restatement (Second) §273 'Restraints on Alienation of Beneficiaries' Interests,' is prima facie evidence of the [above argument]. Paraphrased, §273 states that whether a creditor may be assigned a beneficiaries' interest is determined by the governing law designated in the trust, 'and otherwise,' by the law of the state to which the administration of the trust is most substantially related. The words 'and otherwise' are crucial, because, in this context, they can only be interpreted to mean the state law designated to govern the trust will prevail in enforcement cases and, only if there is no designation, will substantial relationship factors even come into play….[Thus] the terms of a trust instrument designating the trust state's law to govern, when combined with the trust state's law enforcing the trust's provisions against creditors, present a difficult to refute argument demanding that the state court enforce the trust's terms."[17]

Here, in our scenario, the DAPT would name Nevada as the governing jurisdiction and the Nevada Court would apply its own laws regarding claims against the settlor. In our example, the chances of the creditor succeeding are very slim, as the Nevada Supreme Court recently upheld the validity of properly constructed DAPTs and the protections against creditors they provide.[18]

In *Nelson v. Klabacka,* the Nevada Supreme Court issued a ruling upholding the protections afforded by a DAPT. In this case a husband and wife had executed a transmutation of property (separate property agreement) and then placed their individual property in separate DAPTs, with the intent to occasionally "level off the trusts" to equalize their value. Upon divorce, the wife added the husband's DAPT as a necessary party and sought to collect from it alimony, child support, attorney fees, expert fees, and additional assets to equalize her trust's value. Because there was ample evidence that the parties intended to continue to use the property of both trusts as community property the District Court found that the wife had a continued interest in the assets and could thus reach them. However, because the separate property agreement was clear and unambiguous on its face, the Supreme Court properly denied the consideration of extrinsic

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[16] *Id*.
[17] *Id*.
[18] *Klabacka v. Nelson*, 133 Nev., Advance Opinion 24 (May 25, 2017).

evidence and held the separate property agreements and DAPTS to be valid, thus eliminating any rights the wife would have held in the husband's DAPT.

As the requirements for a valid DAPT under NRS §166 were satisfied and the trust was not created to defraud a *known* creditor at the time assets were transferred into the trust, the Supreme Court held the trust to be valid. The Supreme Court held that, pursuant to Nevada Law and the specific bar under NRS §166.120(2), it could not order the Trustee to make a distribution to a discretionary beneficiary (the husband) to satisfy his personal obligations.

Finally, although DAPT laws in South Dakota, Wyoming, Florida, and others specifically allow assets to be reached to satisfy child and spousal support, Nevada statutes explicitly protect beneficiaries from these personal obligations. The Court even analyzed its legislative history to further support this conclusion, and quoted Michael Sjuggerd in *Defeating the Self-Settled Spendthrift Trust in Bankruptcy* that the key difference between Nevada DAPTs is that Nevada "abandoned the interests of child-and spousal-support creditors, as well as involuntary tort creditors." Because the husband's child-and spousal-support obligations were not known at the time the trust was created and the obligations were personal, the Court held that the DAPT could not be made to pay such obligations as a valid spendthrift trust.

Another case that critics of DAPTs for non-DAPT jurisdiction residents cite is *Dahl v. Dahl*.[19] In this case, a Nevada DAPT was at issue during divorce proceedings in Utah. The choice of law provision in the trust mandated that it should be governed according to Nevada law, to which the Utah Supreme Court said they would ordinarily adhere to. However, the Utah Court reasoned that in this instance, due to Utah's strong public policy regarding equitable distribution of marital assets, the Court would use its own laws to interpret the trust. The Court held that, under Utah law, the trust was revocable, and that the wife as a settlor of the trust had a right to revoke the portion of the trust that was funded with her property.

It should be emphasized that the only assets the "creditor" was able to reach were the assets that she had placed into the trust herself and had property rights to. Further, she was only entitled to her equitable share of those assets, not their entire value. Therefore, unless a creditor placed its own assets in a debtor's trust this case gives them no argument that it could lay claim to any property held in a Nevada DAPT. Further, this policy exception is extremely narrow, and only applies if the creditor is a divorcing spouse in Utah. Because this holding only allowed a return of a wife's property rights under an extremely narrow exception it is clear that the majority of DAPTs would be unaffected by this holding and that DAPTs are still alive and well.

Enforcement of Judgment Rendering Transaction Voidable

There are two scenarios in which a creditor can attempt to reach a debtor/settlor's assets: either the creditor obtains a money judgment against the settlor, or the creditor obtains a judgment which states the settlor's transfer of assets into a DAPT was void. Under both scenarios, despite having obtained a judgment against the settlor, the creditor must now seek to enforce it against the DAPT in Nevada, as it is the Trustee who holds the assets which are physically located in Nevada.

As discussed previously, the United States Supreme Court has stated that the full faith and credit clause does not compel "a state to substitute the statutes of other states for its own statutes

[19] *Dahl v. Dahl*, 2015 UT 79 (2015).

dealing with a subject matter concerning which it is competent to legislate."[20] A state such as California would use the UVTA choice of law provisions to determine which laws apply, while Nevada, who has not enacted the UVTA, would use the Restatement 2d Conflict of Laws analysis. If California had determined under their UVTA choice of law provision that their local laws shall apply to invalidate a trust, and that judgment is brought to Nevada, who has specifically rejected the UVTA, then Nevada will be even less likely to give credit to that judgment. This is because Nevada is not required to substitute its Conflict of Laws analysis for that of another state who adopted the UVTA. Further, because Nevada has specifically rejected the UVTA when it was presented to the legislature it is clear they will not be eager to give effect to its provisions. Had a California judgment still used the Conflict of Laws analysis under the Restatement 2d, as they would have done prior to the UVTA, Nevada may have been forced to give full effect to the analysis since the Nevada Court would have undergone the same analysis. By enacting a different choice of laws provision under the UVTA, California has effectively distanced itself from the Conflict of Laws rules of Nevada, which supports the position that Nevada need not give full faith and credit to a judgment of a California court under certain circumstances.

As mentioned previously, an exception to the Full Faith and Credit Clause exists if enforcing another state's judgment would violate the policy of that state.[21]

Much has been debated about this policy argument, but the real question is how a Nevada court would react to it. In 2011 the Supreme Court of Nevada was presented with this argument to enforce a California judgment in *Donlan v. State*.[22] Here, a California judgment terminated its requirement for a defendant to register in another state as a sex offender, and the defendant subsequently filed with Nevada to conform to the amended judgment under the Full Faith and Credit clause. Nevada refused to honor the judgment, stating that California "lacks power to dictate the means by which [Nevada] can protect its public."[23] The Nevada Court refused to substitute its laws for conflicting California laws dealing with the same issue which violated Nevada policy in which Nevada was competent to legislate.[24] Specifically, the Nevada Court quoted the United States Supreme Court: "the full faith and credit clause does not require one state to substitute for its own statute, applicable to persons and events within it, the conflicting statute of another state, even though the statute is of controlling force in the courts of the state of its enactment."[25]

Using the same line of reasoning as *Donlan*, because Nevada statutes protect property within Nevada which is controlled by a Nevada Trustee held within a Nevada Trust, the Nevada courts would be under no obligation to allow laws of another state (California) to mandate how disputes regarding such property should be resolved.

Thus, it is clear that the Nevada Supreme Court recognizes this policy argument against the Full Faith and Credit Clause and is not afraid to use it to support its policies and legislation. Further,

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[20] *Pacific Ins. Co. v. Industrial Accident Comm'n*., 306 U.S. 493(1939).
[21] *Id.;* see also *Baker v. General Motors Corp.*, 522 U.S. 222 (1998).
[22] *Donlan v. State*, 127 Nev. 143 (2011).
[23] *Rosin v. Monkin* 599 F .3d 574, 577 (7th Cir. 2010)
[24] *Nevada v. Hall*, 440 U.S. at 421-22, 99 (1979); *Pacific Ins. Co. v. Industrial Accident Comm'n* 306 U.S. 493, 502 (1939); see also *Baker v. General Motors Corp.*, 522 U.S. 222 (1998).
[25] *Pacific Ins. Co. v. Industrial Accident Comm'n* 306 U.S. 493, 502 (1939).

it is clear in the recent *Nelson* case, discussed herein, that Nevada has a strong public policy of supporting properly formed DAPTS and will protect the assets in such trusts from attachment by creditors.

Conclusion

Based on the above analysis, Nevada asset protection planning is still a viable option for eligible California residents, as engaging in such planning (following the model trust provisions and under the right circumstances) would benefit a settlor in the event of a creditor attack as the DAPT would either be upheld in its entirety or at least put the settlor in a better settlement position in relation to that creditor.

For clients who want even more protection and peace of mind that their legacies will be preserved to pass on to future generations, we recommend the Passport Trust™.

<u>The Ultimate Asset Protection Vehicle – the Passport Trust™</u>

Clients that come into our office looking for asset protection in the form of a domestic asset protection trust ("DAPT") often ask us what additional protections an offshore trust could offer them. Some of those additional protections include a shorter statute of limitations for creditors to attack assets after the assets have been transferred in to the trust, a higher standard of proof that creditors must meet to undo a transfer into an offshore trust, and the fact that the creditor must go to the foreign jurisdiction to pursue their claims and bring an entirely new cause of action. After reviewing these benefits, many clients are anxious to set up an offshore trust, but that excitement wants considerably when we discuss the high set up costs and maintenance fees, the formalities and complexities that must be adhered to in order to enjoy those extra protections, and the need for an offshore trustee.

To obtain the additional protections for our clients, but reduce the upfront costs and eliminate the need for the appointment of an immediate offshore trustee and the more stringent formalities of an offshore trust, JEFFREY BURR, LTD. has created the Passport Trust™. The Passport Trust™ is an asset protection vehicle that combines the flexibility and simplicity of a DAPT with the advantages of an offshore jurisdiction's additional protections against creditors, if the need arises.

A Passport Trust™ includes "passport" provisions in the trust agreement that enable a DAPT to be redomiciled in a foreign non-US jurisdiction such as the Cook Islands if there is ever a distress event. Typically, there will be no new waiting period for creditor claims in the offshore jurisdiction – the original transfer date of assets into the DAPT will also be used as the transfer date for purposes of the Cook Island's rules regarding creditor claims.

Passport Trusts™ lower the entry cost to obtain the additional protections an offshore jurisdiction can provide by allowing clients to begin with a DAPT and 'start the clock' on the state and offshore waiting period for protection from creditor claims and later convert to an offshore trust, if necessary, for the best of both worlds.

The Passport Trust™ begins as a DAPT with all the protections that Nevada's self-settled spendthrift law provides, but includes a special passport provision that enables the Trustee to move the trust's domicile to a foreign jurisdiction. In conjunction with this passport provision, application will be made to a foreign trust company (SouthPAC) upon the creation of the DAPT to pre-approve the DAPT for redomiciliation. The foreign trust company shares in the due diligence regarding the creation of the trust. As a result of their early involvement, the foreign trust company agrees to serve as a special trustee, dormant and waiting with 'open arms' to receive the trust assets if a distress event occurs. If a distress event does not occur, clients enjoy the flexibility and simplicity of a DAPT with the comfort of knowing that their assets are protected in the event of a lawsuit or other misfortune, and will pass that protection on to their children.

<u>Advantages of Beginning with a DAPT</u>

There are other advantages to starting out with a DAPT in Nevada. They are as follows:

1. Greater Flexibility. The Spendthrift Trust Act of Nevada statute (the "Act") is very flexibly constructed to allow the Settlor the following powers:
    a. The Act allows the Settlor to be an Investment Trustee of the Trust. This is true even if the Settlor is a nonresident of Nevada.
    b. In all cases where the Settlor is also a trustee, the Act requires that another person or entity have discretion over the right to make distributions to or for the benefit of the Settlor. This person or entity is often referred to as a "Distribution Trustee" or "Administrative Trustee." The Settlor has the first right to select who the Distribution Trustee will be. Thereafter, a Trust Advisor can remove and replace the Distribution Trustee. The Settlor, however, can make all decisions regarding the investments of the Trust and can even make distributions to other beneficiaries of the Trust.
    c. If the Settlor chooses to not serve as the investment trustee, the Act gives the Settlor a veto power to veto any proposed distribution by the Trustee of the Trust. So if for jurisdictional reasons or otherwise a Settlor doesn't serve as Trustee, the Settlor still has power over proposed distributions by the Trustee.
    d. An alternative to the Settlor serving as Investment Trustee is to have a Nevada resident or Trust Company serve as Trustee and have the Trust form a Nevada LLC with the Settlor as the Manager of the LLC. This allows the Settlor to manage the assets of the Trust.
    e. The Settlor retains a lifetime and testamentary power of appointment to direct the disposition of Trust property during the Settlor's lifetime or at the Settlor's death. Because the DAPT is irrevocable, it cannot be amended by the Settlor. However, the Settlor can, in effect, amend or change the dispositive provisions of the Trust through the exercise of his or her power of appointment. Of course, the Settlor's power to appoint excludes the power to appoint to the Settlor, the Settlor's creditors, the Settlor's estate and creditors of the estate.
    f. The Trust Advisor will have the power to make administrative changes to the Trust to cause the Trust to be current and relevant in the event of new statutory changes or due to judicial decisions.
    g. The Trust Advisor can also be given the power to add or remove beneficiaries from the Trust.
    h. Most DAPTs are drafted to cause the Trust to be a grantor trust for income tax purposes. This causes all income and deductions to be reported on the Settlor's

income tax return and alleviates the need to file a separate tax return for the DAPT.

i. In effect, except for a need to have a separate Nevada Distribution Trustee, the DAPT is substantially similar to a revocable living trust in terms of flexibility but provides additional protection from creditors that a revocable trust does not provide.

2. Full faith and credit should be given to a DAPT by sister states. Upon occurrence of a distress event, the DAPT Trust Advisor will have the option of defending the DAPT in state court or can move the jurisdiction to the Cook Islands. By having an option, the Trust Advisor can consider all relevant facts and circumstances. If the Trust one is trying to protect is not drafted pursuant to a self-settled spendthrift trust statute, the only option is to seek to move the jurisdiction offshore.

   Moving the Trust to an offshore jurisdiction may be an easy decision when the Trust has mainly cash, bonds and marketable securities, but what if the Trust owns real estate? It is commonly agreed that ownership of real estate in an asset protection trust, even if the real estate is in an LLC is problematic. If an action is brought in a non-DAPT state where real estate is located then the court may seek to exercise *in rem* jurisdiction over the real estate. Plus, the Trust owning real estate or business assets in a non-DAPT state may cause the Trust, and all its other assets, to be subjected to the jurisdiction of that state.

   The solution is to form two separate Trusts. One Trust will hold moveables such as cash, stocks and marketable securities, and the other Trust will own real estate and vulnerable business assets.

   The moveables Trust can be easily redomiciled to the Cook Islands and receive additional protection if necessary.

   All is not lost, however, for the real estate/business Trust if the facts are right and relevant formalities are met, there is still a fighting chance that the Trust will be held valid under the Full Faith and Credit Clause. If these assets are held in a non-DAPT Trust then no such argument can be made. Even if the real estate/business DAPT is vulnerable, the creditor still has to jump through a lot of extra hoops to reach the Trust assets. This could result in a favorable settlement with the Trust and/or Settlor.

It may be argued that a settlor is better off with a DAPT than an offshore right away, as settlors could be held in contempt of court for failing to pay a judgment from an offshore trust.[26] It is better to have a DAPT come up in a California court, where courts are bound by the Full Faith & Credit Clause of the United States Constitution to honor Nevada's laws. States have no

[26] *FTC v. Affordable Media, LLC,* 179 F.3d 1228 (9th Cir. 1999) (Debtor jailed for refusing to repatriate assets); *U.S. v Plath*, 2003 WL 23138778 (U.S. Dist. Ct., So. Dist. Fla. 2003) (Debtor held in contempt for refusing to obey court order to disclose details about offshore accounts despite the fact that there was no fraudulent transfer); see also *Eulich v. U.S.*, 2004 WL 1844821 (U.S. Dist. Ct., N.D. Tex. 2004) (Debtor found in contempt, threatened with fines and jail time until assets repatriated); *SEC v. Solow*, 682 F.Supp.2d 1312 (2010) (Debtor jailed for contempt of court for refusing to repatriate assets).

obligation to honor the law of foreign jurisdictions, just as foreign jurisdictions have no obligation to honor judgments from a US court.

3. The Passport Trust™ Offers These Benefits:

    The Passport Trust appears to have a great degree of flexibility and an easy and quick path to redomiciliation to an offshore jurisdiction if necessary. A Passport Trust™ begins as a DAPT and does not require approval as a foreign trust in order to have the special offshore trust to pre-qualify the Trust and allow the holding period of the Trust to also meet the holding period of the offshore jurisdiction.

    In addition, it is our opinion that because the Passport Trust™ is statutorily authorized as an asset protection vehicle, a court is less likely to find a Settlor of a DAPT in contempt as a result of the removal of the asset to an offshore jurisdiction than it would a settlor of a foreign trust. The Nevada statute, for example, specifically allows for the Trustee of a DAPT to transfer the assets of the DAPT into another irrevocable trust and allows the Transferee Trust to use the holding period of the Transferor Trust for purposes of creditor claims.

The Passport Trust™ is the preeminent asset protection vehicle as it combines the simplicity and flexibility of a DAPT with the ultimate strength and protections afforded by an offshore jurisdiction, providing clients with ease of mind that their assets will be preserved and protected under both domestic and foreign asset protection laws.

PASSPORT TRUST

THE NEVADA PASSPORT TRUST™

BY

JEFFREY ◆ BURR

ESTATE PLANNING & PROBATE ATTORNEYS

Introduction

Clients who come into our office looking for asset protection in the form of a domestic asset protection trust ("DAPT") often ask us what additional protections an offshore trust could offer them. Some of those additional protections include a shorter statute of limitations for creditors to attack assets after the assets have been transferred into the trust, a higher standard of proof that creditors must meet to undo a transfer into an offshore trust, and the fact that the creditor must go to the foreign jurisdiction to pursue their claims and bring an entirely new cause of action. After reviewing these benefits, many clients are anxious to set up an offshore trust, but that excitement wanes considerably we discuss the high set up costs and maintenance fees, the formalities and complexities that must be adhered to in order to enjoy those extra protections, and the need for an offshore trustee.

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A Passport Trust™ includes "passport" provisions in the trust agreement that enable a DAPT to be redomiciled in a foreign non-US jurisdiction such as the Cook Islands if there is ever a distress event. Typically, there will be no new waiting period for creditor claims in the offshore jurisdiction – the original transfer date of assets into the DAPT will also be used as the transfer date for purposes of the Cook Island's rules regarding creditor claims.

Passport Trusts™ lower the entry cost to obtain the additional protections an offshore jurisdiction can provide by allowing clients to begin with a DAPT and 'start the clock' on the state and offshore waiting period for protection from creditor claims and later convert to an offshore trust, if necessary, for the best of both worlds.

The Passport Trust™ begins as a DAPT with all the protections that Nevada's self-settled spendthrift law provides, but includes a special passport provision that enables the Trustee to move the trust's domicile to a foreign jurisdiction. In conjunction with this passport provision, application will be made to a foreign trust company (SouthPAC) upon the creation of the DAPT to pre-approve the DAPT for redomiciliation. The foreign trust company shares in the due diligence regarding the creation of the trust. As a result of their early involvement, the foreign trust company agrees to serve as a special trustee, dormant and waiting with 'open arms' to receive the trust assets if a distress event occurs. If a distress event does not occur, clients enjoy the flexibility and simplicity of a DAPT with the comfort of knowing that their assets are protected in the event of a lawsuit or other misfortune, and will pass that protection on to their children.

JEFFREY BURR
ESTATE PLANNING & PROBATE ATTORNEYS

Advantages of Beginning with a DAPT

There are other advantages to starting out with a DAPT in Nevada. They are as follows:

1 **Greater Flexibility. The Spendthrift Trust Act of Nevada statute (the "Act") is very flexibly constructed to allow the Settlor the following powers:**

a. The Act allows the Settlor to be an Investment Trustee of the Trust. This is true even if the Settlor is a nonresident of Nevada.

b. In all cases where the Settlor is also a trustee, the Act requires that another person or entity have discretion over the right to make distributions to or for the benefit of the Settlor. This person or entity is often referred to as a "Distribution Trustee" or "Administrative Trustee." The Settlor has the first right to select who the Distribution Trustee will be. Thereafter, a Trust Advisor can remove and replace the Distribution Trustee. The Settlor, however, can make all decisions regarding the investments of the Trust and can even make distributions to other beneficiaries of the Trust.

c. If the Settlor chooses to not serve as the Investment Trustee, the Act gives the Settlor a veto power to veto any proposed distribution by the Trustee of the Trust. So, if for jurisdictional reasons or otherwise a Settlor doesn't serve as Trustee, the Settlor still has power over proposed distributions by the Trustee.

d. An alternative to the Settlor serving as Investment Trustee is to have a Nevada resident or Trust Company serve as Trustee and have the Trust form a Nevada LLC with the Settlor as the Manager of the LLC. This allows the Settlor to manage the assets of the Trust.

e. The Settlor retains a lifetime and testamentary power of appointment to direct the disposition of Trust property during the Settlor's lifetime or at the Settlor's death. Because the DAPT is irrevocable, it cannot be amended by the Settlor. However, the Settlor can, in effect, amend or change the dispositive provisions of the Trust through the exercise of his or her power of appointment. Of course, the Settlor's power to appoint excludes the power to appoint to the Settlor, the Settlor's creditors, the Settlor's estate and creditors of the estate.

f. The Trust Advisor will have the power to make administrative changes to the Trust to cause the Trust to be current and relevant in the event of new statutory changes or due to judicial decisions.

g. The Trust Advisor can also be given the power to add or remove beneficiaries from the Trust.

h. Most DAPTs are drafted to cause the Trust to be a grantor trust for income tax purposes. This causes all income and deductions to be reported on the Settlor's income tax return and alleviates the need to file a separate tax return for the DAPT.

i. In effect, except for a need to have a separate Nevada Distribution Trustee, the DAPT is substantially similar to a revocable living trust in terms of flexibility, but provides additional protection from creditors that a revocable trust does not provide.

2 Full Faith and Credit Should be Given to a DAPT by Sister States. Upon occurrence of a distress event, the DAPT Trust Advisor will have the option of defending the DAPT in state court or can move the jurisdiction to the Cook Islands. By having an option, the Trust Advisor can consider all relevant facts and circumstances. If the Trust one is trying to protect is not drafted pursuant to a self-settled spendthrift trust statute, the only option is to seek to move the jurisdiction offshore.

Moving the Trust to an offshore jurisdiction may be an easy decision when the Trust has mainly cash, bonds and marketable securities, but what if the Trust owns real estate? It is commonly agreed that ownership of real estate in an asset protection trust, even if the real estate is in an LLC, is problematic. If an action is brought in a non-DAPT state where real estate is located, then the court may seek to exercise *in rem* jurisdiction over the real estate. Plus, the Trust owning real estate or business assets in a non-DAPT state may cause the Trust, and all its other assets, to be subjected to the jurisdiction of that state.

The solution is to form two separate Trusts. One Trust will hold moveables such as cash, stocks and marketable securities, and the other Trust will own real estate and vulnerable business assets.

The moveables Trust can be easily redomiciled to the Cook Islands and receive additional protection, if necessary.

All is not lost, however, for the real estate/business Trust; if the facts are right and relevant formalities are met, there is still a fighting chance that the Trust will be held valid under the Full Faith and Credit Clause. If these assets are held in a non-DAPT Trust, then no such argument can be made. Even if the real estate/business DAPT is vulnerable, the creditor still has to jump through a lot of extra hoops to reach the Trust assets. This could result in a favorable settlement with the Trust and/or Settlor.

3 The Passport Trust™ Offers These Benefits: The Passport Trust appears to have a great degree of flexibility and an easy and quick path to redomiciliation to an offshore jurisdiction, if necessary. A Passport Trust™ begins as a DAPT and does not require approval as a foreign trust in order to have the special offshore trust to pre-qualify the Trust and allow the holding period of the Trust to also meet the holding period of the offshore jurisdiction.

In addition, it is our opinion that because the Passport Trust™ is statutorily authorized as an asset protection vehicle, a court is less likely to find a Settlor of a DAPT in contempt as a result of the removal of the asset to an offshore jurisdiction than it would a Settlor of a foreign trust. The Nevada statute, for example, specifically allows for the Trustee of a DAPT to transfer the assets of the DAPT into another irrevocable trust and allows the Transferee Trust to use the holding period of the Transferor Trust for purposes of creditor claims.

PASSPORT TRUST

The Passport Trust™ is the preeminent asset protection vehicle as it combines the simplicity and flexibility of a DAPT with the ultimate strength and protections afforded by an offshore jurisdiction, providing clients with ease of mind that their assets will be preserved and protected under both domestic and foreign asset protection laws.

In Summary, the Passport Trust™ Offers These Benefits:

- The client has the advantage of starting "on-shore," where they have more flexibility and can essentially manage Trust assets until and unless a distress event occurs and the assets are moved offshore.
- The "Passport" provision enables clients, if they need it, to transfer assets seamlessly to one of the oldest and most tested asset protection jurisdictions – the Cook Islands, with one of the most trusted foreign trust companies – SouthPAC.
- The client receives the protections afforded by Nevada as soon as the statutory time period has elapsed from the date of transfer into the Trust, and the Cook Islands will accept that original transfer date for purposes of their protective laws as well.
- The initial set-up cost and annual maintenance fees are very reasonable because clients start with a Nevada trust, thus minimizing set-up costs in a foreign jurisdiction and foreign trustee fees.
- A client does not have to be a resident of Nevada to enjoy the benefits of a Passport Trust™, as long as they have a Nevada resident person or business entity serve as one of the Trustees.
- For the majority of clients, the Trust assets in a Passport Trust™ will never be moved offshore, so they will enjoy the benefit of their assets throughout their lifetimes with flexibility and the comfort of knowing that their assets are protected in the event of a lawsuit or other misfortune, and will pass that protection on to their children.