

The Estate Planning Advisor

By Richard J. Shapiro

Give Yourself the Gift of Asset Protection

In my last column I described how you can establish protective trusts for your spouse, children or other loved-ones that will afford them access to the trust assets for their needs and wants, but at the same time shield those assets from their creditors. That leads to the logical question, “can I use trusts to protect my assets from my own creditors?”

The quick answer is yes, but there are certain caveats. As a fundamental principle, you cannot shield your assets from any existing creditors, whether or not a lawsuit has been commenced or a judgment has been entered. If, however, you do not have any existing creditors and have no reason to believe a lawsuit will be filed against you, there are a number of planning tools available that can help protect your assets from unanticipated future creditors.

It is a common misconception that a standard *revocable* trust offers asset protection. Revocable trusts are important and useful planning tools, but they provide *no* asset protection. With a revocable trust, the trustmaker retains full access to the assets, so the trustmaker’s creditors retain the same right to access. However, an *irrevocable* income only trust, commonly used for Medicaid planning, does allow the trustmaker to shield the principal from any future creditors, since the trustmaker has made an irrevocable gift of the principal assets funded into the trust.

There are many people who would prefer to have greater access to all of their assets, both income and principal, while enhancing their creditor protection. Under the laws of New York and most other states, it is not possible to create a creditor protected irrevocable trust that would permit the trustmaker to be a beneficiary of both trust income and principal. But there are now nine states, most prominently Alaska, Delaware and Nevada, which have passed legislation allowing a person – including an individual residing in another state -- to establish what are known as domestic asset protection trusts (“DAPT”). DAPT’s are irrevocable trusts in which the trustmaker can remain a beneficiary and yet be protected against creditor claims. These trusts may have the additional bonus of allowing the assets funded into the trust to be considered lifetime gifts, with the appreciation of the assets excluded from the trustmaker’s taxable estate. A potential disadvantage of DAPT’s is that there have been no cases testing whether a judgment obtained in one state (e.g., New York) can be enforced against a DAPT created in another state (e.g., Alaska, Delaware or Nevada) under the “Full Faith and Credit” clause of the U.S. Constitution.

While no asset protection strategy can be deemed “bulletproof,” the foreign asset protection trust (“FAPT”) provides the greatest protection of assets against the claims of future creditors. FAPT’s are similar in structure to DAPT’s, but because they are created in foreign jurisdictions that are not subject to the Full Faith and Credit clause of the U.S. Constitution (e.g., Nevis, the Cook Islands, or the Bahamas), they are widely considered to provide a higher level of asset protection than a DAPT. In addition, foreign nations

typically impose more stringent burdens of proof, shorter statutes of limitation and other legal hurdles that tend to discourage a judgment creditor from pursuing their claim (and will often lead to a settlement more favorable to the judgment debtor). Disadvantages of FAPT's include the higher cost to create and maintain them, and some people may be uncomfortable dealing with a foreign jurisdiction.

Asset protection is a legitimate and valuable part of the planning process. Keep in mind, however, that the time to protect your assets is while the "waters are calm" – that is, *before* an actual or likely creditor claim has arisen. At that point, engaging in any of the above-described asset protection strategies might be deemed invalid under the doctrine of "fraudulent conveyance," and might subject both you and your professional advisor to civil, and possibly even criminal, sanctions.

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