The Hybrid Domestic Asset Protection Trust: A Third-Party Trust that can turn into a Self-Settled Trust

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Domestic Asset Protection Trust

A DAPT is a U.S. asset protection trust in which the trust grantor is a permissible beneficiary.
Domestic Asset Protection Trust
Fifteen States Allow DAPTs

1.5-Year Statute of Limitations

- Ohio

2-Year Statute of Limitations

- Nevada
- South Dakota
- Hawaii
- Utah
Domestic Asset Protection Trust
Fifteen States Allow DAPT:

4-Year Statute of Limitations
All other states \textbf{EXCEPT}

5-Year Statute of Limitations

\textbf{VIRGINIA}
Domestic Asset Protection Trust

- Pre-existing creditors versus non pre-existing creditors
- Fraudulent conveyance laws—transfer with the intent to hinder, defraud or delay
Statutory Exception Creditors

Thirteen of fifteen states have statutory exception creditors

- Such as divorcing spouses
- Such as pre-existing tort creditors
Statutory Exception Creditors

Nevada and Utah = only states with no statutory exception creditors
## The Big Four Asset Protection Trust States: Nevada Ranked #1

<table>
<thead>
<tr>
<th>Ranking/Forbes Grade</th>
<th>State</th>
<th>Statute of Limitations?</th>
<th>Available to Spouse Creditor?</th>
<th>Available to Pre-existing Tort Creditor?</th>
<th>State Income Tax?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/A+</td>
<td><strong>Nevada</strong></td>
<td>2 Years</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>2/A-</td>
<td>South Dakota</td>
<td>2 Years</td>
<td>Yes <em>(alimony, child support too if debt at time of transfer)</em></td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>3/A</td>
<td>Alaska</td>
<td>4 Years</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>4/A-</td>
<td>Delaware</td>
<td>4 Years</td>
<td>Yes <em>(alimony, child support too)</em></td>
<td>Yes</td>
<td>No <em>(Just on Residents)</em></td>
</tr>
</tbody>
</table>
Nevada Asset Protection Trust Powers

- Grantor can be an investment trustee per NRS 166.040.3
- Grantor cannot be distribution trustee per NRS 166.040.2(b)
- At least one trustee must be Nevada natural person, trust company or bank per NRS 166.015.2
- Grantor can retain power to fire and hire trustees per NRS 166.040.3
- Grantor can retain veto power and testamentary POA per NRS 166.040.2(a)
Does a DAPT Work?

A DAPT definitely works for a resident of the DAPT state.

Does it work for a resident of a non-DAPT state who sets it up under the laws of a DAPT state?

- Very large majority believe it works
- Since first DAPT statute in 1997, only two cases
  - *Dahl v. Dahl*, Fourth Judicial District Court, Utah County, State of Utah, Civil No. 090402989, November 1, 2011
Charles and Kim Dahl were Utah residents

Charles set up a Nevada DAPT and transferred his residence (with Kim jointly transferring the residence) and a 97% LLC membership interest (holding brokerage assets) to the DAPT

Charles and Kim divorced

Trust assets were protected

Charles won on Summary Judgment

“As noted by the Court in Innerlight v. Matrix Group, LLC, 2009 UT 31, choice of law and choice of forum provisions contained in contracts and legal documents are enforceable.” [Emphasis added.]
Donald Huber was a real estate investor

The real estate market was crashing and Huber had numerous personal guarantees

He set up an Alaska DAPT and transferred in $10,000, a 99% LLC interest (holding more than 25 different LLC interests), and other assets, thereby leaving himself insolvent

Trust assets were not protected

Blatant fraudulent conveyance

Filed for bankruptcy: 10-year clawback per Sec. 548(e)

Choice of law issue: Washington resident (bad WA statute/ Mastro case was WA resident)
Does a DAPT Work?

If almost all potential creditors have been frustrated to the point where they choose to either settle the dispute or go away altogether, doesn’t this mean that almost EVERY DAPT has worked?
Third-Party Irrevocable Trusts

Third-Party Irrevocable Trusts are irrevocable trusts in which the grantor is not a beneficiary.

Grantor retains the power to fire and hire trustees.

Use a “floating spouse” provision.
Third-Party Irrevocable Trusts

- If grantor loses his assets, his spouse can take care of him.

- We know for a fact that a Third-Party Irrevocable Trust works to protect its assets from creditors of the beneficiaries.
Which Would You Rather?

Even if you aren’t a beneficiary, from a pure asset protection standpoint, which would you rather?
Which Would You Rather?

Option 1: $10M net worth

- If you’re sued and the judgment is for more than $10M, you’re broke
Which Would You Rather?

Option 2: $10M net worth

- Transfer $2M to irrevocable trust for spouse and descendants, so you now have $8M
- If you’re sued and the judgment is for more than $8M, you’re broke, but you can indirectly live off of the $2M irrevocable trust
Which Would You Rather?

$10M net worth

- Transferred $2M to discretionary trust for spouse and descendants
- Have $8M left
What if you get divorced?

- $2M in discretionary trust is not part of marital estate, so only the $8M is part of the marital estate
- Therefore, the marital division doesn’t include the $2M
- However, you can indirectly access the $2M in the future through your next spouse (floating spouse) or your children
A “Hybrid DAPT” is a Third-Party Irrevocable Trust that can be turned into a DAPT

- Concept applies to incomplete gift or completed gift

Does the grantor really need to see his name in the trust agreement as a discretionary beneficiary?

- Assuming a good relationship with spouse, a trust for spouse and descendants isn’t much different than a DAPT
- Give Trust Protector the power to add the grantor or remove the grantor as a permissible beneficiary
Hybrid DAPT

Avoids the 10-year clawback if the grantor goes through bankruptcy

- *Battley v. Mortensen* (Alaska, 2011) — DAPT assets would have been protected using a Hybrid DAPT
Hybrid DAPT

If grantor is sued, Hybrid DAPT avoids the uncertain outcome of a regular DAPT

- Since first DAPT statute in 1997, only two cases since the creditors generally either go away or settle
- But let’s stack the odds even more in our client’s favor
Getting Cash Flow Without Being a Beneficiary

Assume grantor sets up Hybrid DAPT for benefit of spouse and descendants
Getting Cash Flow Without Being a Beneficiary

Ways to access cash flow?

- Distribution to spouse who shares it with grantor
- Sell investment portfolio (stocks/bonds, etc.) to Hybrid DAPT for promissory note
  - So Hybrid DAPT can get cash flow to grantor by paying down promissory note
- Sell other assets to Hybrid DAPT for promissory note
- Have trust loan money to the grantor for promissory note
Only after consideration of all of the above options, last resort is to ask Trust Protector to add grantor as a beneficiary.
Down and Dirty
Splitting the Trust

Another option is to have the trustee split the Hybrid DAPT into two separate trusts

- Trust A = Clean Trust: Still a Hybrid DAPT
- Trust B = Dirty Trust: Grantor is added in as a discretionary beneficiary and multiple distributions are made to him without hesitation

We know the Clean Trust still works

The Dirty Trust might not work, but at least we protected the Clean Trust assets
Grantor’s Hybrid DAPT has $5 million of assets

- Grantor wants some distributions

Let’s not “taint” the entire $5 million trust

- **If no current creditor issues:** Trustee splits the Hybrid DAPT into two trusts: Trust A (the Clean Trust) with $4 million and Trust B (the Dirty Trust) with $1 million
  
  - Only the $1 million in the Dirty Trust is potentially tainted

- **If current creditor issues:** Only split off $300,000 into Dirty Trust
  
  - Only the $300,000 in the Dirty Trust is potentially tainted
Can we have our cake and eat it too?

- Completed gift
- Ability to access the trust assets
- Protected from creditors
- Not subject to estate taxes
DAPT
Completed Gift Version

PLR 200944002 (9/30/09)

- Alaska resident / Alaska DAPT (4-yr. SOL)
- Nevada resident / Nevada DAPT (2-yr. SOL)
- Non-resident / Nevada DAPT?
What if the trust assets are includible in the grantor’s estate under IRC Sec. 2036(a)(1) (transfer with a retained interest)?

Use a Hybrid DAPT

- IRC Sec. 2035(a)(1) - “...the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death...”
Thank You For Attending Today’s Seminar

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