



Family Legacy Protection Planner

HOW TO EASILY INTEGRATE ASSET PROTECTION TRUSTS INTO YOUR ESTATE PLAN

Asset protection has become a common goal of estate planning. Asset protection trusts come in many different forms and can be used to protect property for your use and benefit as well as for the benefit of your family. In this issue you will learn how you can easily integrate asset protection trusts into your estate plan.

What is An Asset Protection Trust?

An asset protection trust is a special type of irrevocable trust in which the trust funds are held and invested by the Trustee and are only distributed on a discretionary basis. The purpose of an asset protection trust is to keep the trust funds safe and secure for the benefit of the beneficiaries instead of having those assets be an available resource to pay a beneficiary's debts.

Asset protection trusts come in two forms: third party trusts and self-settled trusts. A third party trust is set up by one party for the benefit of another, while a self-settled trust is set up by one party for their own benefit.

Third Party Asset Protection Trusts Equal Inheritance Protection

Leaving an inheritance outright to your child or grandchild without any strings attached is risky in this day and age of high divorce rates, lawsuits, and bankruptcies. Aside from this, your beneficiaries may not have developed the financial skills necessary to manage their inheritance over the long run. There is also the very real risk that an outright inheritance left to your spouse will end up in the hands of a new spouse instead of in the hands of your children or grandchildren. Finally, a beneficiary may be born with a disability or develop one later in life that will end up rapidly depleting their inheritance to pay for medical and other bills.

There are a number of different types of third party asset protection trusts that you can establish to insure your hard earned money is used only for the benefit of your family:

- *Trusts for minor beneficiaries* – Minor beneficiaries cannot legally accept an inheritance, so a discretionary trust for a minor is a necessity.

- *Trusts for adult beneficiaries* – Adult beneficiaries who are not good with managing money, are in a lawsuit-prone profession, have an overreaching spouse, or have an addiction problem will benefit from a lifetime discretionary trust.
- *Trusts for surviving spouses* – If you are worried that your spouse will not be able to manage their inheritance, will remarry, or will need nursing home care, you can require your spouse's inheritance to be held in a lifetime discretionary trust.
- *Trusts for disabled beneficiaries* – Disabled beneficiaries who receive an inheritance outright run the risk of losing government benefits and would need to spend down the funds to requalify, but an inheritance left to a special needs trust can be used to supplement, not replace, government assistance.

Planning Tip: Asset protection trusts designed for inheritance protection can be as rigid or as flexible as you choose. For example, a beneficiary can be added as a co-trustee at a certain age or after the beneficiary reaches a specific goal such as graduating from college. Another option is to name a corporate trustee, such as a bank or trust company, but give the beneficiary the right to remove and replace the corporate trustee with another one.

You can also make trust distributions as limited or as broad as you choose. For example, you can state that the funds can only be used to pay medical bills or for education, or the Trustee can be given broad discretion to make distributions in the best interest of the beneficiary. You may also want to require the Trustee to take into consideration the beneficiary's income and other assets before making distributions. Alternatively, the Trustee can be given the authority to deplete the trust in favor of one beneficiary to the detriment of other beneficiaries. If there are multiple beneficiaries, such as a trust for the benefit of your spouse and your children, the Trustee can be directed to give preferential treatment to one or more beneficiaries over the others.

Self-Settled Asset Protection Trusts Are the New Frontier

The basic premise of a self-settled asset protection trust is that a person can transfer their own assets into the trust and retain a beneficial interest in the assets to the detriment of their creditors. Until the late 1990s, self-settled asset protection trusts were not recognized in the United States. Prior to this a self-settled asset protection trust was required to be established offshore in an exotic place such as the Cook Islands or the Cayman Islands. Then in 1997 Alaska became the first state to recognize self-settled asset protection trusts, followed closely by Delaware. Since then, a handful of other states have enacted self-settled asset protection legislation in some form, bringing the current total to fifteen:

- Alaska – 1997
- Delaware – 1997
- Hawaii – 2010
- Mississippi – 2014
- Missouri – 2004
- Nevada – 1999
- New Hampshire – 2009
- Ohio – 2013
- Oklahoma – 2004
- Rhode Island – 1999
- South Dakota – 2005
- Tennessee – 2007
- Utah – 2013
- Virginia – 2012
- Wyoming – 2007

A domestic (rather than offshore) self-settled asset protection trust avoids some of the burdensome IRS reporting requirements. While the laws of these states vary widely, in general they require the trust to be irrevocable, at least one trustee must be a state resident or a corporation authorized to do business in the state, and some assets need to be located in the state. From there the laws differ on "exception creditors" (creditors who can still access the trust assets, such as an ex-spouse who is owed alimony or a child who is owed child support) and statutes of limitation with regard to preexisting and future creditors (1.5 years to 6 years).

Planning Tip: You should be aware that there are only a limited number of U.S. cases interpreting domestic asset protection statutes and this type of planning is still developing. Nonetheless, when layered with other types of asset protection planning, including liability insurance, third party asset protection trusts, and limited liability entities such as LLCs or corporations, a domestic self-settled asset protection trust offers another tool in your planner's toolbox designed to put up roadblocks between your assets and your creditors.

The Bottom Line on Asset Protection Trusts

Asset protection trusts offer many planning opportunities for people of even modest means. We are available to answer your questions about asset protection trusts and help you integrate this type of planning into your estate plan.

ENSURE YOUR FAMILY IS PROTECTED

If you want to ensure that your family is protected, please schedule your complimentary Estate Planning Strategy Call with San Francisco's premier estate planning attorney, Matthew J. Tuller.

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