MCF Private Trust

Asset Protection: The Path to South Dakota

One of the most innovative new estate planning strategies for protecting the assets of wealthy clients involves the use of self settled trusts with trust administration in South Dakota. This growing trend for South Dakota asset protection strategies helps high net worth individuals mitigate the risk to their wealth without going offshore.

Asset protection is a set of legal techniques and a body of statutory and common laws aimed to protect the assets of individuals. The goal of asset protection planning is to insulate assets from claims of creditors without concealment or tax evasion.

The general rule, in most states, is that if the grantor of the trust is a beneficiary, then a creditor can claim and collect the maximum amount that can be distributed to or for the grantor's benefit. However, there is a growing trend to allow self-settled asset protection trusts which in theory runs contrary to the general rule. That is, a self-settled asset protection trust allows the grantor of the trust to be a discretionary beneficiary, yet still protect the trust assets from the grantor's creditors.

Generally the self-settled asset protection trust must meet the following requirements:

+ the funding of the trust is not a fraudulent transfer under the applicable law;
+ the grantor cannot have the ability to amend or revoke the trust;
+ the grantor's/beneficiary's interest in the trust must be completely discretionary;
+ the trust contains a spendthrift provision; and
+ the trustee is located in the state and at least some of the trust administration is performed in the same state.

State laws vary with respect to self settled trusts and therefore selecting the most advantageous jurisdiction is critical to the success of the estate planning technique. Such considerations include, but are not limited to, statute of limitations, public policy and statutes on claims related to pre-existing judgements and fraudulent transfers.

The statute of limitations applied to known or existing creditors varies from two to four years and the statute of limitations as to future creditors varies from a six month discovery statute to six years, depending upon whether the action is a contract or personal injury claim. The shorter the statute, the better the protection. Most states have a public policy exception with regard to child support claims and most allow claims from divorcing spouses and/or alimony, particularly if the trust was funded during the marriage.

A “tort” is a civil wrongdoing recognized by the courts as grounds for a lawsuit. Defending trust’s assets against pre-existing tort judgments can be problematic in several states and, in most cases, not permitted.

A fraudulent transfer is defined as “a transfer of property that is made to swindle, hinder, or delay a creditor, or to put such property beyond his or her reach.” For example, an individual that is in the midst of litigation and transfers assets to a trust thereby trying to isolate his money from the reach of his judgement creditors would be considered a fraudulent transfer. This is an example of a fraudulent conveyance that can be set aside by the court at the request of the defrauded creditor. When comparing the various state statutes, the burden of proof is one of the key factors in whether the fraudulent conveyance rule is “friendly” to self-settled trusts. Ideally, the statute incorporates a “clear and convincing evidence” standard. This means that the person seeking to reach the trust assets must prove that it is “substantially more likely than not” the claims are true.

While several states permit self-settled asset protection trusts, it is important to analyze the relevant laws to determine if it is a favorable jurisdiction. South Dakota is considered to have the top rated self-settled asset protection statutes. All of the considerations outlined above, such as statute of limitations for creditors, public policy for child support, and fraudulent transfers are favorable to the grantor. South Dakota has one of the shortest fraudulent conveyance periods at two years as well as a “clear and convincing” burden of proof requirement. South Dakota is the only state exempting alimony claims, and it does not limit contributions by the grantor. Additionally, South Dakota has many other beneficial statutes including its court privacy statutes’ (i.e., cases are automatically sealed in perpetuity), the fact that it does not impose any form of state taxation on the assets that comprise a trust located there, and it has efficient and cost-effective processes for trust modification, reformation, decanting and virtual representation. Moreover, South Dakota was the first state to enact laws defining limited powers of appointment and discretionary distributions from trusts as not being considered property interests. All of its laws are favorable to asset protection.

As a result, most of the unique and creative estate planning strategies intended to protect assets of wealthy clients involve the use of the self-settled trusts with trust administration in South Dakota. South

Dakota law provides that the appointment of a South Dakota corporate trustee as trustee of a trust automatically places the administrative situs of the trust in South Dakota.

In our litigious society, high net worth individuals seek ways to mitigate the risk to their wealth without going offshore. As the Trusted Advisor, it is our recommendation that you review your clients' estate plans and consider whether or not their assets may be at risk. Do they work in a high-risk profession? Are they a target for litigation? Are they planning a second marriage and don't want a prenuptial agreement? If so, a South Dakota strategy may be the answer. Start the conversation now, and protect your clients' wealth and legacy.