

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

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Asset Protection: What is our Goal?



🌐 Our goal is to protect as much wealth as we can

- Doesn't have to go through the court system
- A favorable settlement is a victory
- The goal is to move the settlement number using legitimate techniques

What is a Negative Nelly?

🌐 In the asset protection industry, a “Negative Nelly” is a person who overreacts to one bad case

- Remember that favorable settlements are victories (and are unpublished)
- If there are 1,000 favorable settlements and one losing case, does this mean the technique doesn't work?



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



2-Year Statute of Limitations



Domestic Asset Protection Trust Fifteen States Allow DAPTs

4-Year Statute of Limitations
All other states EXCEPT



5-Year Statute of Limitations



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 at least one statutory exception creditor
 - Such as divorcing spouses
 - Such as pre-existing tort creditors



Statutory Exception Creditors

- 🌐 Nevada and Utah = only states with no statutory exception creditors



Ease of Use

- 🌐 Six of the states require a new affidavit of solvency for EVERY transfer to the DAPT
 - Alaska, Mississippi, Ohio, Tennessee, Utah and Wyoming
 - Not user-friendly



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 lifetime/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
 - *In re Huber*, 2013 Bankr. LEXIS 2038, May 17, 2013

Dahl v. Dahl

- 🌐 *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.]

In re Huber

- 🌐 *In re Huber*, 2013 Bankr. LEXIS 2038, May 17, 2013

- 🌐 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

Which Would You Rather?

🌐 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

Hybrid DAPT

- 🌐 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, minimal case law 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

Getting Cash Flow Without Being a Beneficiary



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

Down and Dirty Example

- 🌐 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

Thank You For Attending Today's Seminar

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