ASSET PROTECTION

Shielding Assets from Creditors and Predators

Section 1. OVERVIEW[1]

1.1 Overview: Many people are concerned about having their assets[2] taken from them by creditors. This memo briefly outlines some of the basic techniques that can be used to insulate property from various claims. This memo is intended for people who want to insulate their assets from future potential claims. This memo focuses on practical, legal methods intended to discourage and defer future creditors, but it does not discuss gimmicks, "bullet-proof" schemes, or illegal methods. This memo does not address asset protection from existing claims[3] or the divestiture of assets for welfare qualification[4].

1.2 Types of Asset-Protection: There are many types of asset protection, including: state and federal exemption statutes; various types of insurance; business entities; gift-giving (including gifts to irrevocable trusts); special-power-of-appointment trusts; domestic self-settled spendthrift trusts (also known as domestic asset-protection trusts)[5]; foreign (offshore) spendthrift trusts; expatriation; and even the complete transfer of all assets.

1.3 Type of Risks: There are as many types of risks as there are potential claimants or creditors. The claims may be against a person or against a business.

(a) Business entities (e.g., corporations, limited partnerships, and limited-liability companies) exist to shield the owners' personal assets from the company's own liabilities (referred to as "inside liabilities"), but they can also serve in some cases to protect company assets from the claims of the owners' creditors (referred to as "outside liabilities").

(b) In many states, the assets in irrevocable trusts are be protected against the claims of the creditors of the trust's beneficiaries other than the trust's settlor (creator), but in some states, even the settlor's creditors may not be able to reach the trust's assets. In deciding on which type or types of protection should be implemented, one must evaluate the potential risks and what types of entities might be implemented to protect against those risks.

1.4 A Spectrum of Asset Protection: The various asset-protection tools and techniques provide varying levels of protection. In this area of the law, it is almost axiomatic that control and flexibility diminish, and costs increase as the level of creditor-protection increases. Thus, asset-protection planning starts with the process of finding the level of asset protection that provides an acceptable combination of affordability, flexibility, and effectiveness.

---

1 Written by Nevada attorney Layne T. Rushforth. Although this memo provides information that may apply throughout the United States, the primary focus is on Nevada law. This memo is intended to provide general information and is not given as legal advice for any particular person's situation.

2 In this memo, "property" and "assets" are used interchangeably.

3 If you have current problems with creditors, call an attorney who specializes in bankruptcy and debtor protection to discuss your situation.

4 For questions relating to Medicaid qualification and other "elder law" issues, please consult an elder law attorney. You can find an elder law attorney on the web pages of the American Academy of Elder Law Attorneys. Point your web browser to http://www.naela.org/ and click on the button labeled "Locate an Elder Law Attorney"

5 A "spendthrift trust" is a trust whose assets cannot be reached by the creditors of a beneficiary under the laws that apply to that trust. A "self-settled spendthrift trust" is a spendthrift trust for the benefit of the trust's settlor (creator).

Section 2. ASSETS AT RISK

2.1 Who Are My Creditors? You do not have to look very hard to find people and agencies who want your property. It is too easy to find yourself owing people money, and sometimes unwittingly. Some possible creditors include tax-collecting agencies, accident victims, health-care providers, credit card issuers, business creditors, and creditors of others where you have cosigned or guaranteed their obligations.

2.2 What Property Is at Risk? The general rule of thumb is that if you have the right to demand something for your own benefit, your creditor can use the law to demand it, too. In the abstract, the property[6] that is available to satisfy the claims of your creditors includes about any transferable right or benefit that you have. It includes property that you own outright (by yourself or with others), contractual benefits (such as the right to compensation under an employment contract or the proceeds of a life insurance policy for which you are a beneficiary), and interests under a will or trust are some examples of "assets" or "property" that are vulnerable to the claims of creditors.

Section 3. BASIC ASSET-PROTECTION TOOLS

3.1 Liability Insurance: The best protection against liability is insurance. Before you do anything else, you should seriously consider purchasing or increasing "umbrella" coverage on your homeowner's insurance policy. Since those policies rarely cover business-related liability, for any business activities, consider purchasing or increasing liability coverage under your business insurance policy or policies.

3.2 Converting to Exempt Assets: One of the easiest steps in protecting assets is to convert vulnerable assets into assets that are exempt. For example, cash in savings might be used to improve or pay down the mortgage on a home when the resulting value will be covered by the homestead exemption. One also might consider increasing permitted contributions to ERISA-based plans or to IRA accounts that are below the exempt amount. Exempt assets are discussed in the subsections that follow.

3.3 Qualified Retirement Plans: Retirement plans, such as 401(k) plans, that are covered by federal law can be totally exempt from the claims of creditors.[7]

3.4 Home and Homestead: Nevada law provides for several exemptions related to a person's primary residence.

(a) *Limited Medical Exemption.* A primary residence is protected from execution upon a judgment for medical bills, regardless of equity, but this protection ends when no one living in the residence qualifies as the debtor, the debtor's spouse, or the debtor's child who is a minor or a disabled adult.[8]

---

6 In this memo, "property" and "assets" are used interchangeably.

7 ERISA-based plans have been ruled to be exempt from creditors' claims and excluded from a bankruptcy estate. [See Patterson v. Shumate, 504 U.S. 753, 112 S. Ct. 2242, 119 L. Ed. 2d 519 (1992).] The exemption does not usually apply to IRA accounts, but there can be some protection if the IRA is a rollover from an ERISA-based plan. "ERISA" is the Employee Retirement Income Security Act of 1974.

8 NRS 21.095.

(b) *Limited Homestead Exemption.* As of July 1, 2007, Nevada's homestead exemption law[9] protects up to $550,000 of equity in a person or married couple's primary residence. This includes the land and the home, and the home can be a mobile home even if the owner rents rather than owns the land.

(c) *Unlimited Homestead Exemption.* For almost eight years, from 1997 to 2005, Nevada law permitted an unlimited homestead for a homeowner who was granted "allodial title" by the state.

(1) The homeowner of an unencumbered single-family dwelling was eligible to apply for an "allodial title", which is granted when the homeowner prepays the property tax for his or her life expectancy based on the calculations of the state treasurer's office. The program was discontinued by the 2005 Nevada legislature, but applications that were filed on or before June 13, 2005 were processed, and allodial titles that were issued are still recognized.

(2) Once the "certificate of allodial title" was issued, the property became exempt from further property taxes so long as the homeowner owns the property, and the homestead exemption covers the entire equity in the home and all "appurtenances and the land on which it is located". In other words, for property with "allodial title", the dollar limitation to the homestead exemption does not apply.

3.5 Miscellaneous Exemptions: In addition to the homestead exemption, Nevada law also provides several specific exemptions from executions upon judgments.[10] The most significant exemption is the unlimited exemption for annuities and life insurance.[11] Another significant exemption is the cumulative exemption for retirement funds, which is currently $500,000.[12]

3.6 Business Entities: Business entities—such as corporations, limited partnerships, and limited-liability companies—can provide two types of protection. They can shield business assets from the claims of its owners' creditors, and they can shield the owners' assets from the claims of the businesses' creditors.

(a) *Shielding Personal Assets from Business Liabilities.* Corporations, limited partnerships, limited-liability companies, limited-liability partnerships, and business trusts came into being for the purpose of allowing persons to form and to own a company as a separate legal entity that can conduct business without exposing those persons to personal liability for the company's obligations.

(b) *Shielding Business Assets from Personal Liabilities.* In most states, including Nevada, the laws relating to limited partnerships and limited-liability companies (LLCs) do not permit the creditor of a partner or member ("owner") to force a liquidation of the company. That would generally be unfair to the other owners. The law permits a court that is enforcing a judgment to issue a "charging order" that requires the company to distribute the owner's

---

9 NRS Chapter 115.

10 NRS 21.090. "NRS" refers to the "Nevada Revised Statutes".

11 The unlimited exemption of annuities and life insurance became effective October 1, 2011, but there are exceptions for premiums payments that are determined to be fraudulent transfers.

12 1NRS 21.090(1) (q).

share of income to the judgment creditor. Because Nevada law has made the "charging order" the exclusive remedy, a creditor cannot force a liquidation of the business or its assets to satisfy the creditor's claim. The charging order is discussed more fully in subsection 3.10 of this memo.

(c) *Using Multiple Business Entities to Shield Assets.* If a business loses a lawsuit and does not have enough cash to pay the judgment, all of its assets are subject to attachment and sale in order to satisfy the judgment. It can be prudent to divide a business into multiple entities in order to reduce the exposure. For example, suppose you have three apartment complexes in a single limited-liability company. Suppose further that a tenant of one of the apartments is seriously injured and prevails in a lawsuit against the company. Now, all of the company's assets, including all three apartment complexes, are exposed to that liability. On the other hand, if a separate company were formed and operated separately for each apartment complex, a lawsuit against one company would not affect the other companies' assets.[13]

3.7 Corporations: A properly established corporation can protect its shareholders from the corporation's liabilities. If claimants want to establish the personal liability of a corporation's shareholders, the claimants must "pierce the corporate veil" by arguing (i) that corporate formalities have not been observed, (ii) that the corporation is really the "alter-ego" of its majority shareholder(s), or (iii) that the corporation is under-capitalized.

(a) Corporate formalities include proper formation under state law, the issuance of stock, the adoption of bylaws, regular meetings of shareholders and directors, the maintenance of corporate records, including meeting minutes and accounting records.

(b) The "alter-ego" theory can be used to pierce the corporate veil if the majority shareholder(s) use the corporate assets as though they were their personal assets. This can occur if personal and corporate assets are co-mingled, personal obligations are paid from corporate funds, or if corporate assets are held out to be personal assets.

(c) To counter the argument that a corporation is under-capitalized, the corporation must have sufficient assets and reasonable liability insurance coverage. The corporation cannot be merely an empty shell, with insufficient assets to carry on its business.

(d) If a corporation's employee (including an officer) does something that harms someone else, that "culpable" employee can be sued individually, and the corporation offers no protection to that employee. It does offer protection to the shareholders, officers, and other employees who were not responsible for the actions of the culpable employee.

3.8 Limited Partnership: Limited partners are protected similarly to shareholders in a corporation, and the same guidelines and limitations apply. They have no personal liability with respect to partnership obligations. Limited partnerships do not participate in the management of the business, so it is far less likely that a limited partner, as such, will be named in a lawsuit for his or her own negligence or other misconduct. A limited partnership must have at least one general partner who is personally responsible, but that general partner can be a corporation.

(a) Under Nevada's Revised Uniform Limited Partnership Act [NRS Chapter 88], a judgment creditor of a partner cannot usually force the liquidation of the limited partnership.

[13] In the discussion of limited-liability companies, below, a "series LLC" is mentioned. This is a single entity that can hold different assets without exposing the liabilities attributable to one asset to any other.

A judgment creditor can obtain a court order directing the partnership to make the debtor partner's income distributions to the creditor. This order is referred to as a "charging order", which is discussed more fully in subsection 3.10 of this memo.

(b) By not allowing one partner's creditor to liquidate the corporation, the limited partnership can serve as a protection for the non-debtor partners. The limited partnership can also serve to protect a limited partner's non-partnership assets from the claims against the partnership. The general partner is exposed to partnership liability, but if the general partnership is a corporation, the corporation can protect the stockholders' personal assets from partnership and corporation liabilities.

(c) The assets of the limited partnership itself are at risk to partnership liabilities. Separate limited partnerships for different assets can insulate one partnership's assets from the claims against another. For example, if a limited partnership owns several apartment complexes, a claim arising at one apartment complex may result in a lawsuit against the limited partnership, which puts all of the apartment complexes at risk. On the other hand, if each apartment complex was in a separate limited partnership, a lawsuit against one apartment complex would not affect the others.

(d) Partnerships and corporations should exist for valid business purposes, and personal-use assets, such as homes and vehicles, should not belong to business entities in the absence of valid business agreements. In other words, your home should not belong to a business entity unless you are paying rent to the business entity.

3.9 Limited-Liability Companies: A limited-liability company ("LLC") is like a limited partnership without a general partner.[14] The owners of an LLC are called "members". Like the shareholders of a corporation, the members of an LLC are protected from personal liability for business obligations.

(a) For federal tax purposes, an LLC with two or more members is usually treated as a partnership, and a one-member LLC is usually treated as a sole proprietorship.

(b) One variant of the LLC is a "series LLC", which is an LLC with two or more separate series (i.e., divisions). Each series can have different assets and different members, and the liabilities of one series do not affect the assets or members of any other series.

(c) An LLC is not foolproof. Claimants seeking to establish personal liability of LLC members for LLC obligations can use the same arguments that are used to "pierce the corporate veil", which are discussed in subsection 3.7, above.

3.10 The "Charging Order": A "charging order" is a court order that requires that the distributions that would otherwise be made to the owner of a business (e.g., member, partner, or shareholder) to be made instead to the owner's creditor(s). It creates, in essence, a lien against the business owner's interest in the company.

(a) Under Nevada law, the charging order is the "exclusive remedy", which means that the creditor has to accept the distributions that are made, and the creditor has no ability to demand distributions, to force a liquidation of the company or its assets, or to participate in the management and operation of the company.

[14] Nevada adopted its law on LLC's in 1991 [NRS Chapter 86].

(b) For many non-Nevada business entities, the charging order is not the exclusive remedy, and the courts can force a liquidation (or partial liquidation) of the company and its assets to satisfy a creditor's judgment. In addition, other states' courts have forced a liquidation of one-member limited-liability companies where the court has determined that a charging order is an inadequate remedy for the creditor. Some other states allow the courts to compel a partial liquidation of a limited partnership or limited-liability company if company assets can be liquidated without reducing the value of the other owners' interests.

(c) Having a charging order may make the creditor responsible under federal tax law to pay income taxes on the debtor-owner's share of the company's income, even if no income is actually distributed. This possibility may serve as a disincentive for the creditor to ask for a charging order.

(d) In most situations, a charging order works effectively to defer payment to an owner's creditor, but it does not work to totally avoid that payment. A creditor holding a charging order is entitled to be paid whenever distributions are made to other owners, and if the company is liquidated, the creditor will be paid in full before the owner is paid anything. In the end, a patient creditor can eventually be paid in full as long as there are distributions that eventually are made. An impatient creditor may be willing to settle for a lesser amount. [Subsection 3.12 provides a hypothetical situation to illustrate how this might work in real life.]

3.11 <u>Choice of Business Entity</u>: A business entity is chosen for the protection afforded by state law and optimizing tax-planning strategies.

(a) As mentioned above, state law can provide protection in two ways. First is the protection of a business owner's assets from business liabilities. Second is the protection of the business' assets from the owner's personal liabilities.

(1) There are many choices that provide essentially the same protection for shielding personal assets from business liabilities. With the exception of the sole proprietorship and general partnership, state-recognized business entities, if properly formed and operated, will preclude the general creditors of the business from claiming assets of the business' owners to satisfy business obligations. Corporations, limited partnerships, limited-liability companies, limited-liability partnerships, and business trusts are on equal footing in this respect.

(2) On the other hand, the limited partnership, the limited-liability company, and certain small corporations (as described below) are the only entities that protect the assets of the business from the judgments against the business owners. This is because the statutes relating to those entities make a "charging order" an exclusive remedy to an owner's creditors, as discussed in subsection 3.10. This is not true for a limited-liability partnership, business trust, certain corporations, or other entities.

{A} For a corporation to have this protection, it must have at least two shareholders and fewer than 100 shareholders, and it cannot be a professional corporation or a subsidiary of a publicly traded corporation.[15]

---

[15] NRS 78.746.

{B} If a creditor gets a judgment against the shareholder of a corporation that does not fit within the exception described in clause 3.11(a)(2){A}, that creditor is entitled to the same rights as the shareholder, and, if the shareholder holds a majority of the stock, the creditor can control the corporation. A minority shareholder has more power to disrupt the management of a corporation than a transferee of a limited-liability company does. This could be particularly disastrous if the corporation is the general partner of a limited partnership because that could potentially give the creditor the ability to control or disrupt the operation of the limited partnership.

(b) For federal tax purposes, the decision is generally to choose from being taxed as a sole proprietorship (for one-owner entities), a partnership (for entities with at least two owners), a corporation under Subchapter C, or a corporation under Subchapter S. By using IRS Form 8832, an entity can tell the IRS how it wants to be taxed.[16] Ironically, a corporation can elect to be taxed as a partnership, and an LLC can elect to be taxed as a corporation. An LLC electing to be treated as a corporation can also elect to be taxed under Subchapter S by filing IRS Form 2553.

(c) A limited partnership's major flaw is that it must have a general partner, which is liable for the partnership's liabilities. Traditionally, to avoid personal liability, the general partner was usually a corporation, instead of an individual. Because of the problems discussed in clause 3.11(a)(2){B}, above, we usually recommend against a corporation serving as the general partner of a limited partnership, especially if there is a chance the corporation will have only one shareholder or more than 74. A limited-liability company is a better choice.

(d) As a general rule, because an LLC can be taxed as a corporation — and even an S corporation — and provides the best state-law protection against internal and external claims, the LLC is generally the entity of choice in Nevada, at least from an asset-protection point of view.

3.12 Limitations of Business Entities for Asset Protection: The protection of corporations, limited-liability companies, and other entities can be meaningless as to any debts for which personal guarantees are given. In addition, as stated above, no business entity can protect a person from his or her own negligence or intentional misconduct. If personal liability cannot be avoided, then the next level of protection involves having assets that are exempt or placing assets in ownership forms that become obstacles to collection of any amounts found to be due. Even when a charging order is the exclusive remedy, the business interest is subject to a lien, and the owner of a business interest will, at a minimum, lose the right to the income from that interest and, at worst, will lose the right to his or her share of the assets of the business when it is liquidated. The following examples will illustrate that the use of a business entity does not solve all problems.

(a) Suppose H and W have three children, A, B, and C. H and W establish XYZ, LLC for their family, and, as part of their estate plan, give each of their three children a 10% interest in that LLC. Each year, regular income distributions are made to H, W, A, B, and C. Subsequently, Q successfully sues A, and A's interest in XYZ, LLC is made subject to a

[16] IRS Reg. 301.7701-3, which is part of what is commonly referred to as the "check-the-box regulations".

"charging order" in favor of Q. That means that the income that would have gone to A will now go to Q. The LLC operating agreement will probably give the family members the right to buy out A's interest, but if they do, the money will go to Q up to the amount of Q's judgment against A. The good news is that Q has no right to the assets of XYZ, LLC unless and until it is liquidated, Q can do nothing to interfere with the operation of the LLC, and the other members' interests are unaffected. The bad news is that Q becomes part of the equation until the judgment is paid in full, either by income payments or a lump-sum buyout. If Q is impatient, a lower lump-sum payout might be negotiated.

(b) If we assume the same facts as mentioned in paragraph 3.12(a), except that A files for bankruptcy instead of being sued, the bankruptcy trustee can sell A's interest to a third party, who will be able to collect the income and, if the LLC is liquidated, share in the proceeds from that liquidation.

(c) The problems discussed here could be avoided for the children by putting their interests in a spendthrift trust and for the parents by putting their interests in a self-settled spendthrift trust.[17] The business entity alone is not enough to fully protect their interests.

3.13 Gifts; Irrevocable Trusts: Assets that are given away are not generally available to satisfy claims against the donor so long as the transfer is not a "fraudulent transfer", as defined by law.[18] This applies to gifts to irrevocable trusts, which can also be established as "spendthrift trusts" that prevent both voluntary and involuntary transfers. Irrevocable Trusts are discussed in Section 4 of this memo.

Section 4. IRREVOCABLE TRUSTS

4.1 Claims against a Beneficiary: A beneficiary's interest in a trust is an asset of the beneficiary and subject to claims unless (1) the beneficiary's interest is contingent upon the occurrence of an event which has not occurred yet; (2) the beneficiary's benefits are determined by the trustee's under the trustee's discretion; or (3) the trust contains a provision making it a "spendthrift trust" within the meaning of Chapter 166 of the Nevada Revised Statutes ("NRS") or the similar law of the state having jurisdiction over the trust. To create a spendthrift trust under Nevada law, it is usually enough for the trust instrument to say, "the trust is a spendthrift trust" or "a beneficiary's interest in the trust is not subject to voluntary or involuntary transfers" for it to qualify as a spendthrift trust.

4.2 Claims against the Settlor : Assets transferred to an irrevocable trust do not belong to the creator ("settlor") of the trust and are not subject to claims of the settlor's creditors except to the extent of any benefits retained by the settlor, unless the transfer of the assets is considered a "fraudulent transfer".

(a) The traditional irrevocable trust requires the settlor to relinquish all benefits, so that the settlor can honestly say that the settlor has retained no interest in or benefit from the transferred assets. If the settlor retains benefits, most states allow the settlor's creditors to

17 Assets in a self-settled spendthrift trust can be accessed in a bankruptcy except in limited circumstances where the assets have been in the trust for over 10 years. See subsection 548(e) of the Bankruptcy Code.

18 Fraudulent Transfers are discussed in Section 5 of this memo.

reach the trust's assets, at least to the same extent the settlor can. Exceptions to this are discussed in Section 6 of this memo.

(b) Planners frequently use various trusts in which the settlor retains an interest for a term of years or for the settlor's lifetime. This type of trust includes a "qualified personal residence trust" ("QPRT"), charitable remainder trust ("CRT"), and a grantor-retained annuity trust ("GRAT"). Under Nevada law, the remainder interest that belonged to beneficiaries other than the settlor was protected as a spendthrift trust (except as to a transfer to such a trust that is considered a fraudulent transfer).[19] Until 2011, there was a question as to whether creditors could reach the settlor's retained interest, but in 2011, the Nevada Legislature classified the settlor's interest in a QPRT, a charitable remainder trust, or a grantor-retained annuity as a spendthrift trust that is outside the reach of creditors.[20]

(c) In Nevada and some other states, the settlor (creator) of a trust can create a "self-settled spendthrift trust" that is exempt from creditors' claims, which are discussed in Section 6 of this memo. In most other jurisdictions within the United States, the settlor cannot create a spendthrift trust for himself or herself. Except as to self-settled spendthrift trusts that are specifically permitted under applicable state law, to the extent assets of a trust are available for the settlor's benefit, they may also be available to the settlor's creditors through appropriate legal process; however, this can be made more difficult for a creditor to assert if there are also other beneficiaries who have rights under the trust.

4.3 <u>Special Power of Appointment Trust</u>: A trust can be created so that the settlor may receive distributions from the trust without being named as a beneficiary of that trust at its inception. This is done by giving someone the discretionary power to direct the trustee to make a distribution to the settlor or to a specified group of persons that includes the settlor but that does not include the power holder. The power to direct distributions from a trust is referred to as a "power of appointment", and if the power cannot be exercised for the benefit of the power holder, it is referred to as a "*special* power of appointment". A trust with a special power of appointment that can be exercised in favor of the trust's settlor can be used as an asset-protection trust, and that type of trust is referred to as a "special power of appointment trust" (or "SPAT"). A SPAT is a viable asset-protection device, but its use as an asset-protection technique is not based on specific statutory authority and needs to be done correctly to work properly.[21]

(a) Because the power holder does not have an obligation to make a distribution, neither the settlor nor a creditor of the settlor can compel a distribution.

(b) Distributions to the settlor are dependent upon the discretion of the person holding the power of appointment. There cannot, however, be an understanding or secret agreement that the power holder will exercise the power in favor of the settlor upon the settlor's request; otherwise, a creditor of the settlor may be able to persuade a court that the power holder is really the "alter ego" of the settlor and because the settlor has the *de facto* power to obtain trust assets, those assets also become available to the settlor's creditors.

---

[19] Fraudulent Transfers are discussed in Section 5 of this memo.

[20] NRS 166.040(2)(f).

[21] For a general discussion of a SPAT, see McCullough, Lee S. III, "Use 'Powers' to Build a Better Asset Protection Trust", *Estate Planning Journal*, Jan 2011. For a more detailed discussion, see Bove, Alexander Jr., "Using the Power of Appointment to Protect Assets – More Power Than You Ever Imagined", *ACTEC Law Journal* (Fall 2010), pp. 333 et seq.

(c) Transfers to a SPAT can be set aside if they are "fraudulent transfers", as discussed below.

4.4 Spousal Lifetime Access Trust. A spousal lifetime access trust (SLAT) is an irrevocable trust benefiting beneficiaries other than the settlor but providing benefits to the settlor's spouse that can provide an indirect benefit to the settlor. A detailed discussion of this technique is beyond the scope of these materials, but if the SLAT qualifies as a spendthrift trust, it will provide creditor protection for the beneficiaries. So long as the transfers to the trust are not fraudulent transfers, future creditors of the settlor will also have not access.

Section 5. FRAUDULENT OR VOIDABLE TRANSFERS

5.1 Generally: When people feel threatened by creditors or even potential creditors, it is a natural reaction to try to transfer assets to trusted persons to try to shelter those assets. NRS Chapter 112 contains Nevada's Uniform Fraudulent Transfer Act. The law allows creditors to ask a court to allow them to ignore fraudulent transfers for collections purposes. A proof of fraudulent intent is not always required for a transfer to be considered "fraudulent" for the purposes of this statute. Other states have adopted a more current version known as the Uniform Voidable Transactions Law. It serves the same purpose, but the version adopted in many states defines "creditors" to include future unknown creditors and makes transfers to self-settled spendthrift trusts void or voidable.

5.2 Problem Areas: Fraudulent or voidable transfers come in all varieties:

(a) T owes money to C. T transfers assets to his children, S & D, leaving himself without assets. Since the transferor made himself insolvent (i.e., his debts exceed the fair market value of assets), the transfer is fraudulent and can be set aside. The result would be the same if the transfer was made to a trustee of an irrevocable trust instead of the children.

(b) T owes money to C. T, who is insolvent, transfers assets to his children, S & D, to satisfy a debt T owed them. If S & D have "reasonable cause to believe" that T was insolvent, the transfer can be set aside. Since S & D are "insiders", the fact that there was adequate consideration does not protect this transfer. (Incidentally, transfers that favor one creditor over another can also be set aside under federal bankruptcy law. See also subsection 5.3 of this memo relating to "insiders".)

(c) T is in an auto accident. C was injured, and T was at fault. T is concerned that C may sue and ask for more than the limits of his insurance policy. Before C sues T, T transfers all of his assets to his children, S & D. If C files a lawsuit and wins a judgment, the transfer can be set aside because the statute refers to the time "the claim arose" and not to the time of the judgment. Since the transfer was after the "claim arose", the transfer can be set aside if challenged within the statute-of-limitations period.

(d) T has no debts and transfers all of his assets to S & D. T then makes credit purchases to the extent of his available credit limits. The transfer would probably be set aside, since it would appear that T incurred the debts with full knowledge that he could not pay them. If T could establish that at the time he incurred the credit purchase, his income was sufficient to make the payments, the transfer would probably not be set aside.

5.3 Other Issues: Transfers for full fair market value are not fraudulent conveyances, but transfers to "insiders" are subject to closer scrutiny. "Insiders" include relatives and

controlled business entities. If the transferor transfers title, but retains possession or control of the transferred asset, the statute allows the inference to be drawn that the transfer was intentionally fraudulent or that the transfer was made with a side agreement that the transferee would follow the transferor's instructions, which can allow a creditor to argue that the whole transfer was a sham.

5.4 Future Creditors: Transfers are not usually set aside as fraudulent transfers if a creditor's claim arises after the transfers; however, they can be if (1) the transfer was made with actual intent to defraud any creditor; or (2) the debts were incurred without reasonable expectation that they would be paid. It states that have adopted the Uniform Voidable Transactions law, creditors whose claim arises after a transfer may be able to void the transfer is some circumstances.

5.5 Nevada Law: To assure that Nevada's law — and not some other state's law — applies to a transfer, it is important that the transfer be initiated in Nevada. For example, if you transfer funds from a California bank account to a Nevada bank account owned by a Nevada self-settled spendthrift trust, the transfer was initiated in California, and California will apply its own law — its version of the Uniform Voidable Transaction Act — to the transfer. For a transfer into a self-settled spendthrift trust, the better approach would be to transfer the funds into a Nevada bank account owned by you or your revocable trust, which is not voidable, and then to transfer the funds from that Nevada bank account to one that is owned by the self-settled spendthrift trust. Nevada law should apply to the second transfer.

Section 6. SELF-SETTLED SPENDTHRIFT TRUST

A self-settled spendthrift trust ("SSST") is also known as a "Domestic Asset-Protection Trust" or a "Nevada Asset-Protection Trust".

6.1 Generally. A "spendthrift trust" is a trust that precludes a beneficiary or his or her creditors from reaching the assets of the trust contrary to the terms of the trust. A "self-settled trust" is a trust created by the settlor (the trust's creator) for the settlor's own benefit. Thus, a "self-settled spendthrift trust" or "SSST" is a spendthrift trust that includes the trust's settlor as a beneficiary. Traditionally, a self-settled trust could not qualify as a spendthrift trust in any state, but now there are several states that permit the creation of an SSST, otherwise known as a "domestic asset-protection trust" (DAPT). A DAPT established in Nevada is sometimes called a "Nevada Asset Protection Trust" (NAPT). For the purposes of this memo, we will use the acronym SSST to refer to a Nevada self-settled spendthrift trust or NAPT.

6.2 Current Trend. Listed alphabetically, Alaska, Delaware, Hawaii, Michigan, Mississippi, Missouri, Nevada, New Hampshire, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming have adopted statutes that exempt from collection assets held by a self-settled spendthrift trust under certain conditions. These states have responded to a demand for preventative planning options for those who currently have no known exposure to known, existing creditors, but want to shelter assets from claims of unknown, future creditors. This is attractive to those who want to create obstacles to collection without having to move assets to a foreign jurisdiction.

(a) Of course, each state's courts must recognize judgments from any other state's court under the "full faith and credit clause" of the U. S. Constitution. This means that some of the roadblocks to jurisdiction that are used in foreign countries are not available to

discourage a claimant in the courts of any state in the Union. Although judgments from one state must be recognized in all others, each state can establish its own exemptions, such as the homestead exemption and exemptions for retirement funds.

(b) Although a domestic asset-protection, trust does not provide all of the deterrents that a foreign-situs ("offshore") trust can provide, it provides better protection than an awkward implementation of one or more business entities for purposes for which they were not intended. The laws relating to self-settled spendthrift trust vary from state to state, and Alaska attorney David Shaftel has compiled a chart comparing key components of the various states' laws for the American College of Trust and Estate Counsel (ACTEC).[21]

(c) In defending the viability of an asset-protection trust, a major focus is on jurisdiction and choice of law. Just because a trust is established under laws of one state does not necessarily mean that that state's laws will govern all transactions and issues related to that trust. For example, in a case involving Montana real property, Alaska's courts determined that a provision in an Alaskan trust that said that all disputes relating to the trust had to be resolved in the Alaskan courts was invalid.[22] To reduce the chance that another state's laws will apply, you must limit the connections or "nexus" to that other state as much as possible.[23]

6.3 Purposes of Spendthrift Trusts. A self-settled spendthrift trust (SSST) is used primarily for two purposes:

(a) *Protection against Future Creditors*. The domestic SSST is seen as a more flexible and less expensive alternative to the "offshore trust", meaning one that is established under the laws of a jurisdiction other than one of the states within the United States of America. The goal is not to cheat any existing creditor, but to shield assets against the claims of unknown, future creditors.

(b) *Protection against Predators*. An SSST may also be appropriate for a person who is concerned that family, friends, or even strangers may persuade them to make inappropriate gifts or other expenditures. By making the trust irrevocable and qualifying it as a spendthrift trust, the settlor cannot be persuaded to make expenditures or otherwise distribute trust assets without the concurrence of a trusted advisor. This is good for those who just cannot say no when asked for financial assistance.

(c) *Income Tax Planning (NING)*. When an SSST is designed so that each transfer to the trust is an incomplete gift and so that the trust is not a grantor trust for state income tax purposes, it is called an "incomplete gift, non-grantor trust" or "ING". The Nevada version of such a trust are known as a "NING". This is used by non-Nevada residents living in a state where the state income tax is high to move income-producing assets into a Nevada trust so that the trust's income avoids the state income tax. The structure and detailed use of an ING are beyond the scope of these materials. A NING is a specialized version of an SSST. More information regarding the NING is found in a separate memo.[24]

---

21 Mr. Shaftel's 2019 chart can be downloaded from https://rushforthfirm.info/pdf/dapt-chart.pdf.

22 *Toni 1 Trust v. Wacker*, 2018 WL 1125033 (Alaska, Mar. 2, 2018).

23 See also the comment in subsection 5.5 regarding having transfers to an SSST originate in Nevada.

24 See https://rushforthfirm.info/pdf/ning.pdf.

6.4 Types of Self-Settled Spendthrift Trusts. A self-settled spendthrift trust can be designed in of many ways. Here are some of the options available:

(a) *Settlor as Beneficiary or Potential Beneficiary*. During the Settlor's lifetime, the Settlor can be the sole or primary beneficiary, a secondary beneficiary, one of many beneficiaries of equal priority, or a beneficiary only if a power of appointment is exercised.

(1) An SSST for which the settlor is the sole or primary beneficiary are commonly designed much like a revocable trust established for probate avoidance, and it can also include estate-tax planning for couples, including the creation of a bypass or credit-shelter trust and marital trust upon either settlor's death.

(2) An SSST for which the settlor is a secondary beneficiary is typically designed with an intent to make a gift for the benefit of children, grandchildren, and/or other beneficiaries. The settlor often wants to be a permissive beneficiary because of concerns that a gift to the trust may jeopardize his or her own care and comfort, especially if there is a financial catastrophe that depletes financial resources.

(3) A spendthrift trust that does not name the settlor as a beneficiary may allow someone to add the settlor as a beneficiary later or may allow someone to direct distributions to the settlor. The power to add the settlor as a beneficiary or to direct distributions to the settlor is called a "power of appointment". As long as the person holding the power of appointment is not the settlor's "alter ego" (i.e., puppet), this can provide better protection against the claims of the settlor's creditors. In some states, this type of trust would not be classified as a self-settled spendthrift trust unless and until the settlor is added as a beneficiary. This type of arrangement works only if there is no formal or informal agreement or understanding that the person holding the power of appointment will simply do what the settlor wants.[25]

(b) *Gift-Tax Consequences*. The trust can be designed so that transfers into the trust are (i) completed gifts for federal gift-tax purposes, resulting in estate tax exclusion at the time of the settlor's death or (ii) incomplete gifts for federal tax purposes, resulting in the inclusion of the trust's assets in the settlor's estate at the time of his or her death.

(c) *Grantor Trust Status*. The trust can be designed so that it is or is not a "grantor trust" for federal (and some states) income tax purposes. A grantor trust is ignored for income-tax purposes, which requires the settlor to pay all taxes on trust income as though the trust did not exist. A non-grantor trust is taxed separately, so that the beneficiaries pay the income tax on income that is distributed to them, and the trust pays the income tax on income that is retained in the trust.

6.5 Discretionary Trusts. Some states that do not generally allow a self-settled trust to qualify as a spendthrift trust still may offer some creditor protection to the assets in a trust even if the settlor is a beneficiary. For example, a California appellate court has ruled that a creditor of the settlor cannot reach assets that the trustee is not permitted to distribute to the settlor.[26] In states that follow that approach, it should be possible to allow the trustee to make distributions of trust income to a settlor without putting the assets of the trust at risk. The income would be

---

25 See subsection 4.3 on page 9 for additional discussion regarding a special power of appointment trust.

26 See DiMaria v. Bank of California, 237 Cal.App.2d 254 (1965).

exposed to attachment by a creditor of the settlor, but even that can be limited if the circumstances under which the income is allowed to be distributed are very restrictive. Nevada law prohibits a court from ordering a trustee to make a distribution to a creditor even when the trustee has the discretion to make a distribution to a beneficiary, even if the trust is not a spendthrift trust, and even if the beneficiary is the trustee.[27]

6.6 Nevada Spendthrift Trust Law. Since October 1, 1999, Nevada law has permitted a self-settled spendthrift trust (SSST). The 1999 legislation was more of a minor revision to existing laws on spendthrift trusts and fraudulent transfers than a major new act, which means that the protections afforded are based on well-established law.

(a) Nevada law does not permit fraudulent transfers or transfers that violate a court order or an enforceable obligation, and if you know about a creditor (claimant) when assets are transferred to the trust, those assets will not be shielded as to that creditor. Fortunately, Nevada law limits the time in which a creditor may challenge a transfer. This is sometimes referred to as a "look-back period" or "statute of limitations", and it applies separately to each transfer to an SSST. The length of the look-back period depends on whether the creditor existed at the time of the transfer, and that is discussed in paragraph 6.6(d).

(b) Under current Nevada law, the look-back period in NRS 166.170 applies only to transfers, and it does not appear to limit the time under which other challenges to the trust or its spendthrift trust protection might be brought. Thus, if a trust was created with the intent to hinder, defraud, or delay creditors in violation of NRS 166.040(1)(b), an action to challenge the spendthrift trust protection of the trust may not be barred even if the trust was created more than two years before the challenge to the trust is made in court.[28]

(c) Under Nevada law, the settlor may establish a valid spendthrift trust for his or her own benefit if:

(1) There is a connection to Nevada. This requirement is met if one of the following is true:

{A} Some or all of the trust assets or income are in Nevada; or

{B} The settlor is a Nevada resident; or

{C} At least one trustee:

{i} has powers that include maintaining records and preparing income tax returns for the trust, and all or part of the administration of the trust is performed in this state; and

{ii} is an individual who is a Nevada resident or is a bank or trust company that maintains an office in this state for the transaction of business and possesses and exercises trust powers.

(2) The trust is irrevocable, although the settlor may have a special power of appointment.

---

27 NRS 163.417.

28 It is not clear what the limitations period might be, but it is probably the limitations period pertinent to the obligation for which enforcement is being sought, which can be as long as six years. See NRS 11.190.

(3) The trust is not intended to hinder, delay, or defraud known creditors.

(4) Distributions to the settlor are not mandatory and made only in the discretion of a person other than the settlor.[29]

(5) The trust is subject to Nevada's statutory rule against perpetuities.[30]

(d) The length of Nevada's look-back period or statute-of-limitations period — the period during which a creditor may challenge a transfer of assets as being fraudulent or in violation of an enforceable obligation or court order — depends on whether the creditor had a claim when the transfer was made.

(1) A creditor whose claim arose after the transfer to a spendthrift trust must commence an action to challenge that transfer within two years after the transfer.

(2) A creditor who had a claim at the time of a transfer to a spendthrift trust must commence an action to challenge a transfer within the later of:

{A} two years after the transfer; or

{B} six months after he discovers or reasonably should have discovered the transfer.

(3) Nevada law provides that a person is deemed to have discovered a transfer at the time a public record is made of the transfer. The statute specifically gives two examples of this, including the recording of a deed ("conveyance") or the filing of a financing statement under the Uniform Commercial Code. Thus, if the settlor of an SSST makes a public record of an asset transfer within eighteen months of making the actual transfer, the two-year look-back period will apply to that transfer. As a practical matter, this forces the settlor to choose between privacy and protection against claims that are as of yet unknown but may have been triggered by events occurring prior to the transfer of assets to the SSST.[31]

(e) Nevada law provides that:

(1) A transfer to a spendthrift trust cannot be challenged by a creditor unless it is fraudulent (under NRS Chapter 112) or unless it "violates a legal obligation owed to the creditor under a contract or a valid court order that is legally enforceable by that creditor." Proof that a transfer was fraudulent or in violation of an enforceable obligation or court order must be established by "clear and convincing proof", and the proof as to one creditor does not constitute proof for any other creditor.

---

29 In parts of this memo, the term "distribution trustee" refers to the person or persons who must approve distributions to the settlor. In some cases, this may be a trustee, a committee, a power of appointment holder, or some other designated person. Nevada law does not require that person to be a trustee.

30 Nevada's constitution only permits perpetual trusts for eleemosynary (i.e., philanthropic or charitable) purposes. [Nev. Const., Art. 15, § 4.] Nevada's Uniform Statutory Rule against Perpetuities permits 365-year trusts. See NRS 111.103 et seq.

31 For a more detailed discussion of this choice, see https://rushforthfirm.info/asset-protection-trusts-and-public-records.html.

(2) A conveyance of real property out of a trust for purposes of obtaining financing on that property followed by a re-conveyance of that property back into the trust does not start a new two-year look-back period for that property.

(3) Distributions are deemed to have been made from the most recent transfer to the trust.

(4) If a second trust is formed under Nevada's "decanting" statute, the original transfer date applies.

6.7 Potential Challenges to a Self-Settled Spendthrift Trust.[32] A self-settled spendthrift trust is not a bulletproof asset-protection arrangement, but it is useful for assets located in the jurisdiction in which they are created and probably in the other jurisdictions with laws permitting such trusts (assuming compliance with such laws). There are a number of arguments that can be raised against the protection provided by a spendthrift trust, some of which will depend on the court in which the creditor is seeking judgment, and some of which will depend on the conduct of the settlor and the trustee.

(a) First, the creditor will argue that the trust is a sham or that its trustee is nothing more than the "alter ego" of the settlor or that some of the powers of the settlor give him or her too much control.

(1) The settlor simply cannot have unilateral control over trust assets; otherwise, this argument will probably be successfully made.

(2) Putting too much property into an SSST is opening the door for an argument that the trust is a sham and that the trustee a mere puppet of the settlor. It is particularly problematic if you transfer assets upon which your lifestyle is dependent. The court may imply an "understanding" if you spend the same money from the same sources before and after the SSST is created.[33]

(3) There are defenses to these arguments:

{A} If the trust is compliant with the law, the trustee strictly follows the terms of the trust, and trust assets and trust income are not commingled with non-trust assets and income, Nevada law has been respected. Nothing in Nevada law — and in the fraudulent transfer provisions[34] or in the spendthrift trust provisions[35], in particular — makes a trust invalid because the settlor created the trust to frustrate the claims of future, unknown creditors.

{B} The "alter ego" argument must be made by "clear and convincing evidence". In 2009, the Nevada legislature made it more difficult to assert the "alter ego" theory by adding a list of actions that "are not sufficient

[32] The potential challenges against domestic asset protection trusts are well outlined in an article entitled "Domestic Asset Protection Trusts: The Risks and Roadblocks Which May Hinder Their Effectiveness" by attorney Michael A. Passananti.

33 See also subparagraph 6.8(d)(10) of this memo.

34 NRS 112.

35 NRS 166.

evidence" to justify a judicial determination that a trustee is the settlor's alter ego.[36]

{C} Only one power is prohibited for the settlor of an SSST. Nevada law provides that the settlor of a spendthrift trust can have any power except "for the power of the settlor to make distributions to himself or herself without the consent of another person. . .".[37]

(b) Second, the creditor will argue that one or more transfers of assets to the spendthrift trust were "fraudulent transfers", which generally means that the transfers were made at a time that the creditor's claim existed, and the transfers made the transferor insolvent. Fraudulent transfers are discussed above (Section 5, on page 10).

(c) Third, the creditor may argue that one or more transfers of assets to the spendthrift trust were made in violation of an enforceable obligation or of a court order.[38] Some agreements relating to loans, lines of credit, and other obligations contain covenants that prohibit the transfer of certain assets without the permission of the lender or creditor, and the lender or creditor will want to argue that the transfer of assets to a self-settled spendthrift trust is in violation of such a covenant.

(d) Fourth, if the lawsuit or other enforcement proceeding is being handled by an out-of-state court (meaning out of the state where the spendthrift trust was established), the creditor will argue that the out-of-state court should disregard the trust because its recognition is contrary to that state's public policy and/or because that state has direct jurisdiction over the assets against which enforcement is being sought.

(e) Fifth, if the legal battle is being fought in federal court, such as in a bankruptcy or federal tax-enforcement proceeding, the creditor may ask that court to apply federal law and disregard state trust law. In most cases, federal law will take precedence over state law.

6.8 Special Considerations for a Nevada Asset Protection Trust. A Nevada SSST cannot have assets the settlor (trust's creator) can spend without someone else's consent, and so it is not usually wise to put all of one's assets into it. We generally recommend a two-trust approach.

(a) A revocable trust should be established (or may already exist) to hold the checking account and liquid assets the settlor wants immediate and unfettered access to. In many cases, we recommend that, upon the settlor's death, the assets of the revocable trust will pour into the SSST.[39] By having a "pour-over" revocable trust, modifications to the ultimate disposition of assets will be made only in the SSST.

(b) Ideally, the SSST should have an independent trustee as the sole trustee, but it is also possible to have the SSST governed by multiple co-trustees that may include the settlor (creator) of the trust.

---

36 NRS 163.418.

37 NRS 166.040(3).

38 NRS 166.170.

39 Having SSST assets pour into a revocable trust may expose SSST assets to the creditors of the revocable trust, and so that approach is not recommended.

(1) The "managing trustee" has control over the investment of the trust assets. It is possible for the settlor of the trust to serve in this role. It is better if the settlor is not a trustee, but there is no problem having the settlor acting as the investment manager and requiring the trustee to invest as directed by the investment manager.

(2) The "distribution trustee" or "distribution committee" must consent to any distribution to the settlor and to the use of any trust asset (such as a home) by the settlor. The settlor cannot be the distribution trustee and should not serve on a distribution committee. If the SSST is being established by two or more persons, neither settlor should serve as a distribution trustee or a member of a distribution committee. Even when an SSST is being funded with one settlor's separate property, we also recommend against a settlor's spouse or partner from serving as a distribution trustee to avoid any argument that the settlor's spouse or partner was acting as the settlor's "alter ego".

(3) To maintain a legal connection with Nevada, there should always be a Nevada trustee. The Nevada trustee must have the power to maintain trust records and to prepare income tax returns for the trust. If the settlor is a Nevada resident, the settlor's service as the managing trustee (or a managing co-trustee) meets the statutory requirement. For a non-Nevada settlor, the Nevada trustee can be a bank or trust company or an individual who is a Nevada resident, and it is appropriate in most circumstances for the Nevada trustee and the distribution trustee to be the same individual, bank, or trust company, but this is not expressly required by the law.

(c) For the best asset protection, consider these suggestions:

(1) We recommend that a Nevada bank or trust company be the sole trustee or at least a co-trustee.

(2) Instead of making the settlor the managing trustee, consider making the settlor the investment advisor.

(3) Consider excluding the settlor as named beneficiary while giving someone who is not an alter ego of the settlor the power to make the settlor a beneficiary, as well as the power to remove the settlor as a beneficiary. During any period that the settlor is not a beneficiary, the settlor would have no interest under the trust that would have to be disclosed to a creditor or to a court. If a judge asks, "What is the maximum value the trustee has the discretion to distribute to or for the settlor?", the answer would be zero.

(4) If the settlor is to be a beneficiary, consider having the settlor be one of several beneficiaries, none of whom has a separate, identifiable share.

(5) All distributions should be made solely in the distribution trustee's sole discretion, with the settlor having a veto power.

(d) The Nevada statutes regarding spendthrift trusts are brief, especially as they relate to self-settled spendthrift trusts. Here are some questions that some have asked about the Nevada SSST:

(1) *Is a transfer to a SSST a completed gift for gift-tax purposes?* Yes or no, depending on what the settlor wants. The settlor can retain powers that make a

gift incomplete, or the settlor can completely divest himself or herself of any such power. Distributions to the settlor from a completed-gift trust will bring the distributed assets back into the settlor's estate for federal estate-tax purposes. Distributions from an incomplete-gift trust during the settlor's lifetime to beneficiaries other than the settlor will be treated as a completed gift for federal gift-tax purposes.

(2) *Does a Nevada asset-protection trust protect assets located in other states?* We recommend that everyone assume that the answer is "No". If, for example, a Nevada self-settled spendthrift trust owns real estate in California, and a California creditor sues the settlor of that trust, the California courts will not give "full faith and credit" to the Nevada spendthrift trust laws.[40] With respect to assets subject to the jurisdiction of a state that does not already recognize self-settled spendthrift trusts, it is likely that the courts of that state will not recognize the creditor protection afforded under Nevada law.

(3) *Will Nevada's law as to fraudulent transfers apply to all transfers to an SSST?* No, it will apply only as to transfers made within Nevada. A transfer of a California bank or brokerage account to a Nevada SSST will probably be subject to California's laws, which might allow a California court to negate the transfer. For Nevada law to apply, assets should be moved to Nevada before any transfer to an SSST occurs.

(4) *Will an SSST effectively shield its assets from the claims of the IRS or any other agency of the federal government?* Probably not. Because of the "supremacy clause" of the U. S. Constitution, the federal government has not been bound by state exemption laws (such as the homestead exemption). On the other hand, if the SSST is designed to make transfers to it a completed gift, and those transfers are not fraudulent transfers, it could be argued that the assets of the SSST are not subject to claims against the trust's settlor. Bankruptcy law can protect assets in an SSST against the claims of federal creditors if the assets have been in the trust more than 10 years.

(5) *How does an SSST affect the settlor's income taxes?* It depends on whether the trust is a grantor trust.

{A} If the SSST is designed as a "grantor trust" for income tax purposes, the income on trust assets is taxed to the trust's settlor as if the trust did not exist at all.[41] If an SSST owns the settlor's primary residence, the settlor is entitled to the same tax treatment for home-related deductions and the capital-gain exclusion on a sale as if the settlor owned the home personally.

{B} If the SSST is not a grantor trust, the settlor pays no tax on trust income. Instead, the beneficiaries are taxed on distributed income, and the trust pays the tax on undistributed income.

(6) *Can the settlor have a credit card, debit card, or ATM card that is paid from an account held in an SSST?* NO! Nevada law defines a spendthrift trust as one

---

[40] California's adoption of the Uniform Voidable Transactions Act is evidence of its antipathy toward creditor protection because that act defines creditors to include future, unknown creditors.

41 See paragraph 6.5(c) on page 13.

that permits distributions only in the discretion of a person other than the settlor. If the settlor has unilateral access to any assets of the SSST, it might be argued that (a) the settlor is ignoring the trust, which legally prevents the settlor from requiring that others honor it or (b) the trust is not a spendthrift trust, and the asset-protection features of the trust are voided. For this reason, it is recommended that there be some assets in a revocable trust to which the settlor has total access.

(7) *Can we arrange for the income from SSST assets to be automatically deposited into an account out of the SSST that the settlor has access to?* Yes, with the consent of the distribution trustee but only if the automatic deposits can be cancelled at any time in the sole discretion of the distribution trustee.

(8) *Can the settlor of an SSST remove and replace the distribution trustee at will?* Probably, but this is not tested. Nevada law merely requires that distributions to or for the settlor be made "in the discretion of another person".

{A} The law does not require that the person approving distributions be a trustee, and the law does not specify how that other person is to be designated. Thus, Nevada law does not prohibit a settlor to remove and replace a distribution trustee, but it does open the door for the argument that a distribution trustee who serves at the whim of the settlor is merely an "alter ego" of the settlor.

{B} A more conservative approach would be to allow the settlor to remove and replace a distribution trustee only "for cause", but that would require outlining causes that justify removal. Another approach would be to have a "trust protector" other than the settlor have the power to remove and replace the distribution trustee.

{C} At a minimum, we recommend that the settlor's ability to remove and replace a trustee be suspended at any time the settlor is being sued or when a creditor of the settlor is taking legal action to claim rights to the income or assets of the trust.

(9) *If my exposure to lawsuits decreases, can an SSST be unwound?* Technically yes, but only if the distribution trustee consents to a complete distribution of trust assets. This is not recommended.

(10) *Can I effectively put all my assets into an SSST?* This is not a good idea. First, from a practical perspective, you do not want to have to seek permission to spend all your money. Second, you cannot list the assets in an SSST on a balance sheet or credit application (at least not without a significant explanation). Third, a transfer of all assets to an SSST will probably make you insolvent under the fraudulent transfer laws, which could be invoked by creditors to set aside transfers to the trust. Most advisors recommend funding an SSST with resources that provide a safety net, rather than funding it with assets representing the bulk of your net worth.

(11) *If spouses create an SSST, can its assets be considered community property?* Yes. Nevada law provides that property transferred to a trust by spouses

retains its character as community or separate property, and distributions from the trust also retain the same character.[42]

(12) *Is it absolutely essential to have a Nevada Trustee?* It is not statutorily required to have a Nevada Trustee if the trust has Nevada assets or if the settlor of the trust is a Nevada domiciliary, but we strongly recommend that there always be a Nevada Trustee with at least some of the trust administration being done in Nevada. By doing this, the trust will not be automatically disqualified as a Nevada self-settled spendthrift trust if there are no Nevada assets. This also prevents a challenge to the trust if the settlor becomes or is determined to be a domiciliary of another state.

(13) *If a court rules that a transfer to the trust is fraudulent, is the trustee permitted to ignore that ruling?* No.[43] Under Nevada law, it is possible that a transfer that is technically fraudulent may be permitted to stand if the challenge to the transfer is not made within the statutory deadline[44], as discussed in paragraph 6.6(d) on page 15; however, if a court rules that a transfer is fraudulent, the transfer can be set aside by the creditor to whom it is fraudulent. The trust documents we prepare specifically direct the trustee to honor a Nevada court's final and nonappealable ruling regarding a fraudulent transfer. This provision is included so that the transfer of assets that might be fraudulent as to a known creditor can be protected as to unknown potential creditors. It is hoped that this type of provision will reduce the settlor's exposure to criminal charges or civil penalties for attempting to hinder, defraud, or delay known creditors. We will not knowingly assist anyone in an attempt to hinder, defraud, or delay the claim of anyone where the claim is based on an event occurring prior to the transfer of assets to the trust.

(14) *Can we put our home into an SSST? Does it make a difference if there is a mortgage or a homestead declaration?* Property you reside in can be owned by an SSST, and it does not matter if there is a mortgage (or trust deed) or a homestead declaration. We do encourage you to contact the insurance carrier for your homeowner's insurance policy to have the SSST named as an additional insured party. If you do not have a homestead declaration on your primary residence, we recommend that one be prepared. Nevada law permits the trustee to make a homestead election for a primary residence that is held in a trust. Federal law[45] prohibits mortgage lenders from exercising a due-on-transfer clause for a primary residence; however, for land and rental properties, obtaining the mortgage lender's consent prior to transferring such properties to a trust is recommended. The mortgage or trust deed will remain enforceable after a transfer to an SSST, but the SSST should work to limit liability for debts and obligations unrelated to the mortgage or trust deed. The SSST protects the home regardless of the home's value, while the homestead declaration exempts only up to $605,000 (as of 2020).[46]

---

[42] NRS 123.125.

[43] There might be exceptions where the ruling is made by a court without proper jurisdiction.

44 NRS 166.170.

45 See U.S.C. 1701j-3 from the Garn St. Germain Depository Institutions Act of 1982. See also 12 C.F.R. §591.5(b)(1)(vi).

46 NRS Chapter 115. See https://www.leg.state.nv.us/NRS/NRS-115.html.

(15) *Does an SSST shield assets from the claims of a spouse or former spouse in a domestic-relations dispute?* If done properly, a beneficiary's interest in a trust should not be subjection to attachment in a court proceeding; however, the existence of the trust may be taken into consideration by a court for purposes of alimony and child support. This is less likely if the beneficiary's interest is pooled with other beneficiaries' interests (which might include beneficiaries yet to be born), and all distributions to or for the beneficiary are made solely in the trustee's discretion.

(16) *Does a Nevada SSST protect assets located outside of Nevada?* That will depend on the laws of the state in which the asset is located. If that state does not recognize a self-settled trust as a spendthrift trust, there will be no protection. For that purpose, it is better to have all assets located in Nevada. For real estate, some attorneys have their clients put non-Nevada real estate into a Nevada limited-liability company, be the jurisdiction over the real estate will ultimately remain in the state where the land is located. For those who are serious about protecting non-Nevada real estate against the claims of creditors, we recommend "equity stripping", which is the process of borrowing as much as possible on a loan that is properly secured by a bona fide mortgage or trust deed on the property. The loan proceeds are invested in a Nevada account owned by the SSST.[47] Because it is typical for loan terms to include a due-on-transfer clause, it would mean that any attempt by a creditor to access any remaining equity in the property, the creditor would have to pay off the primary loan in full.

Section 7. OTHER ASSET-PROTECTION TECHNIQUES

7.1 Division of Assets between Spouses: If one spouse has a high exposure to potential liability because of his or her occupation or business, it may be advisable to divide the couple's assets. The one spouse would retain the assets and income from the business that provides the exposure and his or her separate property, and the other spouse would take the couple's investments and valuable assets, also as separate property. To make this work, the couple must agree to the division of assets long before any problems arise, and there should be little or no community property. Ideally, this agreement should be in a prenuptial agreement, but a postnuptial agreement can provide some level of protection.[48] Of course, the agreement would be binding in a divorce, so it is important that each spouse balance the relative risks and rewards of this approach. Also, with no community property, the spouses lose the benefit of the stepped-up income tax basis of all appreciated property upon the death of the first spouse to die.

(a) Foreign-Situs Trusts: Foreign-situs trusts (often called "offshore trusts") are very popular as a shield against creditors. Assets are transferred to a trust either originally established under, or subsequently made subject to, the laws of a foreign jurisdiction—such as the Cook Islands—that does not automatically honor judgments granted outside its own courts.

(1) To avoid triggering a capital gains tax on unrealized appreciate, one or more U.S. trustees control the trust, but there is always a trustee who is governed by

---

[47] See also the comment in subsection 5.5 regarding having transfers to an SSST originate in Nevada.

[48] Because assets received as gifts are separate property under NRS 123.130(2), it is probably better to do actual asset transfers as a gift rather than a mere agreement so that the statute of limitations under the Fraudulent Transfer Act can limit the time during which a transfer can be challenged as a fraudulent transfer.

the laws of the foreign jurisdiction. Until a crisis occurs that could result in claims against the settlor or the trust, the trust may operate as any domestic trust would operate. The offshore trust must not be revocable to prevent a court from ordering the settlor to revoke of the trust.

(2) A trustee or "trust protector" may be given the power to amend the trust, and the settlor can have a special power of appointment that also allows beneficiary changes.

(3) The assets remain under the control of one or more U.S. trustees. If claims against the trust are threatened, the foreign trustee exercises its powers to fire the U.S. trustees and to take control of all assets. This usually requires that all U.S. assets be liquidated so that they are no longer subject to the control of the U.S. courts, which might mean that assets would have to be sold at fire-sale prices. It is much safer if there are never any assets that are located in the U.S. or in any institution that has U.S. affiliates or asset holdings within the U.S.

(4) The best protection comes from having the offshore trust invest in offshore investments. For example, it would be hard to enforce a judgment against a person who had a Cook Islands trust investing in a corporation established in the Cayman Islands that held assets located in Jersey.

(5) In a well-known court case referred to as the "Anderson case"[49], the U. S. Ninth Circuit Court of Appeals ruled that debtors (the Andersons) could be jailed for contempt of court for failing to make assets held in an offshore trust available to creditors. The court simply did not accept debtors' argument that the assets in the offshore trust were out of their control.

{A} Some commentators originally felt that this signaled the death knell for foreign-situs trusts, but it probably only made people more careful about doing things correctly. The Anderson case quashed some enthusiasm for offshore trusts, but it involved litigation in a federal court that was brought by a federal agency against people who had enriched themselves illegally.

{B} The Anderson case demonstrates several important points: (1) no asset-protection technique is perfect; (2) a good technique done poorly may create problems but also may be better than doing nothing; (3) the courts do not believe cheaters; and (4) the federal courts do not like offshore trusts.

{C} The Anderson case made asset-protection advisors re-think their use of offshore trusts and to consider using domestic self-settled trusts instead.

(b) Regardless of the location of the assets, this type of trust usually discourages creditors from beginning the long legal battle required to challenge the trust and to seek its assets. On the other hand, legal fees to establish an offshore trust are often a deterrent, and the annual fees charged by the foreign trustee can be significant. This type of trust is generally considered appropriate only for large estates with a very high exposure to claims.

---

[49] *FTC v. Affordable Media*, No. 98-16378, 9th Circuit. It is referred to as the "Anderson case" because the case involved a family named Anderson.

Section 8. CONCLUSION

8.1 Select the Appropriate Tools. The tools discussed in this memo should be evaluated as to your specific situation. If your exposure to claims is small, adequate insurance, and a homestead declaration may be sufficient. As your exposure increases, you may wish to consider making asset transfers before a claim arises. At the highest level of exposure, you may be willing to transfer a significant portion of your assets to one or more foreign-situs trusts. You must evaluate the price you must pay for each tool (in terms of money and potential loss of control) against the anticipated protection.

8.2 No Guarantee. There is no guarantee that any particular shield will be absolutely bulletproof. Because of the ever-changing nature of laws, what works today may not work tomorrow. Even so, having assets owned by business entities and irrevocable trusts will provide more protection than simply holding assets in one's own name, and limited partnerships, limited-liability companies, Nevada self-settled spendthrift trusts, and offshore trusts, when properly utilized, can provide a significant barrier against attacks through litigation.

Version of November 28, 2020

RUSHFORTH FIRM LTD.

Telephone: 702-255-4552 | Fax: 702-255-4677
Office: 5550 Painted Mirage Road, Suite 320, Las Vegas, NV 89149-4584
E-mail: office@rushforthfirm.com
Web sites: https://rushforthfirm.info/ | https://rushforthfirm.com