

Asset Protection Trusts

Creditors of a trust beneficiary (business creditors, credit card companies, accident victims with a court judgment and divorcing or former spouses, to name a few), upon learning that their debtor is the beneficiary of a trust may seek a court order allowing them to collect from the trust assets. Every well-drafted trust should have a “spendthrift clause” to prevent such attacks on your estate plan, and a trust with the right additional terms can function as an asset protection trust.

Spendthrift Clause

Under Maine law, the spendthrift clause will fail to provide protection if the trust is revocable and the settlor is the debtor, any may also fail if the debtor-beneficiary is also the trustee, or even if he or she has other legal rights to withdraw or control some of the assets of the trust. Effective asset protection trusts are irrevocable trusts (including formerly revocable trusts which became irrevocable due to the death of the settlor or for some other reason) which are legally protected against collection efforts against the beneficiaries of the trust. There are several varieties of asset protection trusts.

Self-settled Trusts

Self-settled trusts are trusts in which the settlor is also a beneficiary. An example is the typical revocable living trust. Revocable trusts provide no asset protection for the settlor under the common law of Maine and most other states. Since the settlor has the power to revoke the trust and can withdraw assets from the trust for his or her own benefit, a court can order the settlor to pay a creditor with trust funds. In Maine and most other states, to the extent the settlor can withdraw or spend the assets, a self-settled trust cannot protect those assets from the settlor’s creditors. A properly drafted Maine trust which allowed the Trustee to distribute income to the Settlor, but prohibited the distribution of any principal, would be effective to protect the principal from creditors, but not the income. A court can generally give a creditor whatever the Settlor of such a trust can get, but not more.

Domestic Asset Protection Trusts

In recent years, a number of states, such as Delaware, Alaska, Nevada and South Dakota, have enacted statutes, changing the common law to allow a settlor to remain a potential beneficiary of a self-settled trust, as long as the trust is irrevocable and has an independent trustee or co-trustee located in the state with the desired legal protection. One key provision is that, although the trustee has the discretion to make payments to or on behalf of the settlor, the settlor has no power to compel the trustee to make such payments. The legal theory is that if the settlor cannot compel the trustee to make a distribution, no court can order the trustee to pay a settlor's creditors. This should work, but "domestic asset protection trusts" are new enough that there are few court decisions to rely upon.

Offshore Trusts

Foreign asset protection trusts (often called "offshore" trusts) are legally established under the laws of a foreign jurisdiction which allows creditors no access to trust assets, unless the creditor starts litigation in the foreign jurisdiction and wins a judgment there. Such countries often have very short periods of time within which such a suit must be initiated for example, within 6 months of the date the trust was created. Most jurisdictions that are popular for offshore trusts have a substantial body of court decisions protecting the assets of trusts from creditors. The Cook Islands is a popular jurisdiction for establishing offshore asset protection trusts.

Fraudulent Transfer Laws

All self-settled trusts (even offshore asset protection trusts) are liable to creditor invasion based on the "fraudulent transfer laws". This English common law concept has been enacted into statutory law by each of the states, and most other countries with legal systems that recognize trusts. It says (with various nuances and exceptions) that a person with a known (or reasonably expected) creditor cannot frustrate that creditor's legitimate claim by transferring assets to a third party without consideration. *Bona fide* purchasers are protected, and the creditor's claim attaches to the sale proceeds. Transfers to independent trustees or irrevocable trusts are not. However, claims must be made within a statute of limitation enacted by each jurisdiction, and some limitation periods in countries popular for offshore trusts are very short. Fraudulent transfer laws also allow creditors to recover assets

if the transfer left the transferor insolvent, even in some cases when the debt did not exist at the time of the transfer.

Protecting assets from your own creditors is a complex area of law, and this is only a brief introduction to the concept. However, protecting the assets you give or leave to others, from their creditors (even known creditors), is easy enough that everyone should consider it.

Asset Protection for Maine Trusts

The Maine Uniform Trust Code, which became effective in 2005, does not protect self-settled irrevocable trusts from all creditor claims against the settlor. However, the Code has strong creditor protection features. A settlor's creditor can generally not reach any assets to which the settlor has no access. For example, if the irrevocable trust has an independent trustee and provides that the Settlor can receive distributions from income, but cannot get any of the principal, a court can only order that the trustee must pay the creditor the income. However, if the court finds that the creation of the trust was a fraudulent transfer as to the creditor in question, the court can order a distribution of the trust principal.

Third Party Asset Protection Trusts

The Maine Uniform Trust Code allows a settlor to establish an irrevocable trust for third party beneficiaries, and allows such beneficiaries to serve as their own trustees, while protecting the trust assets from creditors of the beneficiaries. The trust must have spendthrift provisions and distributions by the beneficiary-trustee must be limited to whatever is necessary for "health, education, maintenance and support". However, an independent trustee can be given the power make distributions to the beneficiary for any reason.

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