Six Trust-Based Asset Protection Strategies for Your Clients

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(Content provided by The Advisors Forum; Edited by James W. Garrett, Esq.)

Asset protection planning is a powerful way to provide additional value to your clients. In this newsletter you will learn about six trust-based asset protection strategies and how they can:

- Protect your client's assets from creditors, lawsuits, and divorcing spouses.
- Protect client's assets gifted to, or inherited by, a spouse, children, or other beneficiaries.

If you have questions or would like help with an analysis of which clients would benefit, please call our office now.

Lifetime Asset Protection Trusts – Eating Your Cake and Having it Too

A Lifetime Asset Protection Trust is an Irrevocable Trust created during the client's lifetime that can be used to:

- Qualify the client for Medicaid, while preserving an income stream for the well spouse and protecting the trust assets from government estate recovery after the client dies – *Medicaid Planning Trusts.*
- Create a lifetime trust for the benefit of the client's spouse, using the gift tax marital deduction – *Lifetime QTIP Trusts.*
- Create a lifetime trust for the benefit of the client's spouse, using annual exclusion gifts and the lifetime gift tax exemption – *Family Bank Trusts, also known as Spousal Lifetime Access Trusts ("SLATs").*
- Create a lifetime trust for the benefit of the client – *Self-Settled Domestic Asset Protection Trusts ("DAPTs").*

Medicaid Planning Trusts
Medicaid Planning Trusts may help your clients:

- Qualify a married client for Medicaid (while protecting an income stream for the benefit of the well spouse).
- Avoid estate recovery. (Assets held in the trust will pass to the heirs protected from government estate recovery to pay back Medicaid benefits that were

received during the client's lifetime.)

Planning Tip: Although the federal and state governments jointly fund Medicaid, each state sets its own rules and guidelines for Medicaid eligibility and estate recovery. Therefore, a Medicaid Planning Trust must be tailored to the laws of the state where the married client lives. Trusts may also be subject to a look-back period (NOT "disqualification period") of three or five years.

Lifetime QTIP Trusts
In marriages where one spouse is significantly wealthier than the other, a Lifetime QTIP Trust can be used to provide the following benefits:

- Make use of the less wealthy spouse's federal estate tax exemption.
- Provide a lifetime, asset-protected trust for the benefit of the wealthier spouse if the less wealthy spouse dies first. (Subject to state law.)
- Insure that assets left in the trust (after both spouses die) get distributed to the wealthier spouse's chosen heirs.

Planning Tip: Lifetime QTIP Trusts offer a great deal of flexibility when planning for married couples with lopsided estates. During the less wealthy spouse's lifetime, that spouse will receive all of the trust income and may be entitled to receive principal. If the less wealthy spouse dies first, then the assets remaining in the trust will be included in his or her estate, thereby making use of the less wealthy spouse's estate tax exemption.

In addition, the remaining trust funds may continue in an asset-protected, lifetime trust for the surviving spouse's benefit (subject to applicable state law), will be excluded from the surviving spouse's estate when he or she later dies, and will ultimately be distributed to the wealthier spouse's chosen heirs.

Domestic Self-Settled Asset Protection Trusts
Until the late 1990s, domestic self-settled asset protection trusts were not recognized in the United States. Prior to this a self-settled asset protection trust was required to be established outside the United States, often in an exotic place such as the Cook Islands or the Cayman Islands. Then in 1997 Alaska became the first state to recognize self-settled asset protection trusts, followed closely by Delaware. Virginia enacted self-settled asset protection legislation in 2012.

A properly formed and operated domestic, self-settled asset protection trust generally permits a person to transfer assets into the trust and retain a beneficial interest in the assets while denying creditors access to the trust. While the self-settled asset protection trust laws of these states vary widely, in general they (including Virginia) require the

trust to be irrevocable, at least one trustee to be a state resident or a corporation authorized to do business in the state, and some trust assets be located in the state. From there the self-settled asset protection trust laws differ on “exception creditors” (creditors who can still access the trust assets.) For instance, Virginia’s law does not provide protection from child support, and the statutes of limitation with regard to preexisting and future creditors is five years. In contrast, under bankruptcy law, assets remain exposed to creditors’ claims for ten years.

Planning Tip: Clients need to be aware that there are only a limited number of U.S. cases interpreting domestic asset protection statutes. Self-settled domestic asset protection trust planning is still developing. Nonetheless, when layered with other types of asset protection planning, including liability insurance, third party asset protection trusts, and limited liability entities, domestic self-settled asset protection trusts offer another tool in the planner’s toolbox designed to put up roadblocks between the client’s assets and the client’s creditors.

Testamentary Asset Protection Trusts – Ruling From the Grave

A Testamentary Asset Protection Trust is an Irrevocable Trust, created after the client’s death and used for a variety of reasons, including:

- Protecting life insurance proceeds for the benefit of the client’s heirs –*Irrevocable Life Insurance Trusts (“ILITs”*).
- Protecting retirement accounts for the benefit of the client’s heirs –*Standalone Retirement Trusts (“SRTs”).*
- Protecting other assets for the benefit of the client’s heirs – *Discretionary Trusts.*

Irrevocable Life Insurance Trusts
Aside from removing life insurance proceeds from the client’s estate for estate tax purposes, an ILIT is a powerful tool for leveraging generation-skipping planning and protecting insurance proceeds for the benefit of the client’s heirs.

Standalone Retirement Trusts
Because of the recent U.S. Supreme Court decision in *Clark v. Rameker* (which held that an IRA inherited by a non-spouse beneficiary is <u>not</u> protected from the beneficiary’s bankruptcy creditors) the Standalone Retirement Trust has become an important vehicle for protecting retirement accounts from the beneficiaries’ creditors.

Planning Tip: Discussing the new Supreme Court ruling and retirement account vulnerability is an effective way to identify assets that are not yet under management, but need to be protected.

Discretionary Trusts

A Discretionary Trust is an Irrevocable Trust that can be built into an ILIT and is an integral part of a Standalone Retirement Trust. Clients can also include Discretionary Trusts in their Revocable Living Trusts to protect other assets.

Planning Tip: Clients who are concerned about heirs, or who are or may become spendthrifts, married to an overreaching spouse, bad at managing money, or in a high risk profession, should incorporate Discretionary Trusts into all of the testamentary trusts created in their estate plan.

Trust-Based Asset Protection Planning - The Bottom Line

Even though asset protection trusts must be irrevocable to safeguard the trust property, they offer a great deal of flexibility for clients looking to protect their own property as well as property gifted to or inherited by loved ones. Since this type of planning can become complicated and should not be attempted without the assistance and counseling of an experienced attorney, we are here to answer your questions about trust-based asset protection strategies and advise your clients on options for planning. Please feel free to call our office now.