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Send Client Letter About Self-Settled DAPTs Post Wacker

Sample language to use.

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Some have interpreted the recent Alaska decision in *Toni 1 Trust v. Wacker*, 2018 WL 1125033 (Alaska, Mar. 2, 2018) as a death knell to using U.S.-based domestic asset protection trusts, known as DAPTs, in client planning. We believe that this interpretation is incorrect, but practitioners may choose to use this case as an opportunity to write to clients to inform them of the case and what planning options

to consider. Other practitioners may feel that the negative interpretation some commentators have given to *Wacker* might make it prudent for them to communicate the negative perception to clients with DAPTs. With the new large, but temporary, estate tax exemptions, the use of DAPTs may be more important than ever. The following sample letter may be adapted by practitioners to communicate these changes to clients, and former clients, if there's a concern that they may be relying on prior advice with respect to DAPTs previously completed.

Via Regular Mail

[Date]

Re: Self-Settled Trusts and the Recent *Tony 1 Trust v. Wacker* Case

Dear Client/Former Client/Inactive Client:

We are writing to you to inform you of an important recent case that may have impact on U.S.-based domestic asset protection trusts known as DAPTs that we may have completed for you in the past. The hallmark feature of these trusts is that the person establishing the trust (referred to as the "grantor," "settlor," or "trustor") is also a named or possible addable beneficiary of the trust. This letter is written to notify former and current clients of the *Wacker* case and other developments, and has not been customized to your situation. We welcome the opportunity to speak to you specifically about your situation if you contact us.

- If you are represented by new counsel, please give this letter, and the attached article, to your current attorney to review the impact of the recent case as well as other developments affecting DAPTs, the administration of DAPTs, and the status and options of a DAPT with legal counsel. *[Practitioners might choose to attach one or more articles from various journals to the letter to provide a more in-depth discussion or to write a short memorandum summarizing the* Wacker *case and status of DAPTs. The reference in this sample letter should be modified accordingly.]*

- If you are a current client, please call our office and make an appointment to meet in person, by web conference or by phone to review the above matters.
- If you aren't a current client and don't have other counsel, please call our office and make an appointment to meet in person, by web conference or by phone to review this situation, but please understand that your file has been closed since our last meeting, and your entire plan and all documents may need to be evaluated to properly advise you in this situation.

In *Wacker*, the Alaska Supreme Court held that the law of the residence of a man who set up an Alaska trust and conveyed assets to it for the alleged purpose of avoiding creditors would apply, instead of Alaska law, for the purpose of determining whether the transfer to the trust would be set aside because it was for the express purpose of avoiding payment to a specific and imminent creditor. We believe that the case simply confirmed that the statute that purported to grant the Alaska courts exclusive jurisdiction to decide matters relating to the transfer of assets to a self-settled trust could not block other state or federal courts from deciding matters relating to such a transfer. The Court did not hold that Alaska law would allow the creditors of the grantor access to the trust's assets. Other commentators have stated that the case confirms that DAPTs do not work for those residing in non-DAPT jurisdictions (e.g., a New York resident creating a DAPT in Alaska).

The *Wacker* case is not the only recent development that might be viewed as negatively affecting DAPTs. The Uniform Voidable Transfers Act is an academic and widely accepted new model law being adopted by many states that states in a commentary (Section 4, Comment 8) that a transfer to a self-settled DAPT is voidable if the transferor's home state doesn't have legislation that allows trusts that are formed by a grantor who is a beneficiary of the trust to be immune from penetration by creditors of the grantor.

"By contrast, if Debtor's principal residence is in jurisdiction Y, which also has enacted this Act but has no legislation validating such trusts, and if Debtor establishes such a trust under the law of X and transfers assets to it, then the result would be different. Under §10 of this Act, the voidable transfer law of Y would apply

to the transfer. If Y follows the historical interpretation referred to in Comment 2, the transfer would be voidable under § 4(a)(1) as in force in Y."

Some commentators have criticized this comment as not being supported by the law and point out that this is merely a comment and is not an actual proposed law. Many commentators have recommended that states that adopt the UVTA in the future should do so without adopting or endorsing this controversial comment, but there is no certainty.

As a result of this situation, every DAPT arrangement should be evaluated for possible changes. This applies not only for asset protection purposes, but also because the Internal Revenue Service may claim that a trust that is accessible to a grantor's creditors will be subject to estate tax on the grantor's death unless the creditor access is removed more than three years before the grantor's death.

There are a number of issues that may be considered:

- Existing or modified DAPTs may be helpful by using the now temporarily enlarged estate, gift and generation-skipping transfer tax exemptions. The $5.6 million per donor increase in these exemptions to $11.18 million will only be available through the end of 2025 under present law, and a future administration may reduce the exemption sooner. Thus, you should evaluate whether to use all or part of this increased exemption sooner rather than later so that growth in what is gifted can also escape estate tax while being held under a DAPT might be available for you if the estate tax were eliminated or you had the need for support in the unlikely event that other assets were no longer available for you.
- If based on *Wacker* and other developments, you now view the risks of a DAPT as too great, then you should evaluate options for modifying an existing DAPT by removing yourself as a present possible beneficiary, taking the DAPT to an offshore jurisdiction, or taking other actions that might enhance the probability of success under the intended structure.
- Many DAPTs in process will be transformed to hybrid DAPTs (as described below) or otherwise adapted using other techniques available to enhance safety and results involved in this type of planning. For any DAPT that is in process and

not yet funded (or to which additional funding will be considered), "belts and suspenders" designs might be advisable.

- A "hybrid DAPT" is not a self-settled trust, a DAPT, at inception, but rather for the benefit of individuals other than the grantor (called a "third party trust"). A named person or a person some might refer to as a "trust protector" or otherwise situated who are not trustees and who are not acting in a "fiduciary role" can be given the power to appoint or otherwise add additional beneficiaries who may be descendants of the settlor's grandparents, and the grantor may not be added unless economic events occur that make this necessary from a support standpoint. Thus, unless and until distributions are needed to the settlor, the settlor need not be a beneficiary, thereby circumventing the DAPT issue. There's a myriad of different approaches to these mechanisms.
- For existing DAPTs, consideration of having a trust protector modify the trust, or transferring (decanting) the trust into a different or new trust that is either a hybrid DAPT, or which has other mechanisms to address the possible risks, may be worthwhile. In some instances, DAPTs completed in the rush to plan before the end of 2012, when it was anticipated that the exemption might decline from $5 million to $1 million may no longer be necessary. The growth in the stock market (or other assets) since 2012 and now being six years older may have obviated the need for the settlor to have access to the trust. In such cases it might be advisable for the settlor to renounce any rights as a beneficiary. Consideration might be given to filing a gift tax return to report that renunciation as it may be considered a gift transfer to other beneficiaries, although in a discretionary trust it's not certain how that possible gift could be valued.
- We welcome coordination with and input from your CPA and any investment advisors and insurance consultants, but please keep in mind that what is shared and discussed with them may be admissible in court, so we should be careful in our approach to collaborative communications.
- Besides the trust itself, the underlying structure as to what is owned by the trust may be updated to make it much more creditor resistant, such as by having limited liability companies owned by the trust become owned mostly by the trust and in small part by another trust or family member to have the benefit of what is known as "charging order protection" if the law of a state that recognizes such protection is applicable.

For legal ethics purposes, we should point out that some might characterize this letter as constituting attorney advertising.

With careful planning, individuals in all states may be able to still maintain, or even create, a trust that can possibly benefit the grantor in a state that has a law that does not permit creditors of the grantor to pierce the trust to collect amounts owed. If the transfer to fund the trust is not "avoidable" as being for a primary purpose of avoiding the creditor, then we expect that a well-drafted trust and related plan may have a reasonable likelihood of withstanding creditor and IRS scrutiny, but there is some degree of uncertainty with respect to this. In all instances, greater care in the planning and administration of such trusts may be warranted. Obviously, modifications to existing DAPTs and the structures associated with them might make them safer.

Please consider calling to make an appointment if you are not represented by other counsel.

Sincerely,

[*Name*]

By: _____

[*Name, Title*]

Encls. – *[modify based on what the practitioner/firm may enclose with the letter]*

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