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Domestic Asset Protection Trusts: A Comparison of the Laws of Utah and Wyoming¹

by Timothy O. Beppler and Christopher M. Reimer

In recent years, asset protection has gone from a niche industry to a mainstream area of estate planning. Whereas estate planning lawyers were once primarily concerned with minimizing taxes, since the 1980s they have focused increasingly on asset protection. The surge of interest in asset protection tools can be attributed to a variety of factors, including bankruptcy reforms and the perception of a growing risk of liability, whether from tort, contract, or professional conduct. One viable option for clients seeking to place assets beyond the reach of future creditors consists of the asset protection trust. A number of states have enacted statutes making self-settled spendthrift provisions enforceable, subject to certain conditions. The Rocky Mountain region has been no stranger to this trend, with the recent enactment of domestic asset protection trust statutes in Utah and Wyoming. This article will examine the requirements and relative benefits of Utah and Wyoming as a situs for an asset protection trust.

THE ROAD TO THE DOMESTIC ASSET PROTECTION TRUST

Courts in the United States have traditionally held that self-settled trusts are not entitled to spendthrift protection. Consequently, creditors have been able to satisfy judgments out of the assets of self-settled trusts, regardless of the inclusion of a spendthrift clause. The traditional refusal of United States jurisdictions to recognize self-settled spendthrift trusts caused settlors to create trusts in foreign jurisdictions that recognized their validity. As American society has grown increasingly litigious and new risks of personal liability have arisen, settlors have looked to foreign jurisdictions to mitigate the growing risk of personal liability, whether

by contract, by tort, or by professional conduct. Proponents of offshore asset protection trusts cite a number of beneficial aspects of locating a trust in a foreign jurisdiction, making it more difficult for a creditor to satisfy a judgment from trust assets. Unfortunately, offshore asset protection trusts come with a number of drawbacks. Establishing such trusts can be complicated and expensive. Many individuals may also be hesitant to transfer control over their assets to a foreign trustee or to an unfamiliar jurisdiction that may not possess the economic and political stability that settlors have come to expect from the United States. Finally, United States courts have demonstrated hostility towards offshore trusts and, on occasion, have used various means to diminish such trusts' effectiveness as asset protection tools. As such, clients may prefer to take advantage of some of the more recently-enacted asset protection trust statutes offered in some U.S. states.

Alaska passed the first domestic asset protection statute, providing asset forfeiture protection to irrevocable, self-settled trusts. Delaware followed Alaska's lead, allowing for irrevocable, self-settled spendthrift trusts. Nevada enacted the next such statute allowing domestic asset protection trusts. Currently, domestic asset protection trusts are recognized by statute in at least eleven states. Such trusts have many uses, the most important of which is to protect a settlor's assets from attachment by creditors. While the scholarly literature contains some debate about the effectiveness of such trusts in light of Constitutional and conflict of laws principles, domestic asset protection trusts are still in their infancy, and courts have had few opportunities to address their effectiveness. Such

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trusts have spawned a rich literature regarding the legitimacy and policy-advisability of asset protection trust statutes.

UTAH ASSET PROTECTION TRUSTS

In 2003, the Utah Legislature enacted Utah Code section 25-6-14, which allows settlors to create self-settled spendthrift trusts for their own benefit. *See* Utah Code Ann. § 25-6-14 (2007). While Utah's statute contains many similarities to asset protection trust statutes passed by other state legislatures, it contains a few notable differences. For example, the Utah statute specifies numerous conditions and situations where a transfer to an asset protection trust is not effective. Additionally, the Utah statute is notable for imposing a short statute of limitations on creditors seeking to avoid transfers to an asset protection trust.

Trust Requirements

Utah law provides that a settlor may transfer property to a trust in which the settlor retains a beneficial interest, and that creditors may not satisfy claims out of that interest if certain conditions exist. The chief requirements for such a trust are: (1) that the trust includes an enforceable spendthrift provision; (2) that the trust was created on or after December 31, 2003; and (3) that

the trust be irrevocable. The trust must have at least one trustee that is a trust company authorized to engage in trust business in the state of Utah. An individual non-qualified co-trustee may serve alongside the qualified Utah trust company.

Settlor Rights and Powers

Utah's statute allows settlors of spendthrift trusts to retain certain rights and powers. However, settlors should be careful to avoid retaining powers that give them actual control over the trust or trustee, which could render trust assets subject to a judgment. A settlor may retain the right to veto distributions, a testamentary special power of appointment or similar power, or the power to appoint nonsubordinate advisors/protectors without causing the trust to lose its irrevocable status. A settlor may also retain the power to remove and terminate the trust, but only if it is exercisable with the consent of a person with a substantial beneficial interest in the trust, which interest would be adversely affected by exercise of the settlor's power to revoke or terminate all or part of the trust. A settlor may maintain the right to receive distributions of income and/or principle at the discretion of another, including a non-settlor trustee, to receive an interest in charitable remainder unitrust of charitable remainder annuity, and to receive principal subject to an ascertainable standard set forth in the trust. The

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settlor may serve as a distribution advisor, investment advisor, or trust protector. The trust may also have nonsubordinate advisors or protectors who can: (1) remove or appoint trustees; (2) direct, consent to, or disapprove of distributions; and (3) serve as investment directors.

Fraudulent Transfers

Understanding a jurisdiction's fraudulent transfer rules is essential to anyone who seeks to engage in asset protection planning. Forty-three states, including Utah, have adopted the Uniform Fraudulent Transfer Act (UFTA). Under UFTA, a transfer of property may be considered void if made with intent to defeat claims by creditors. Consequently, a creditor may satisfy a claim with the transferred asset, circumventing the purpose of an asset protection trust. Utah's version of UFTA applies to transfers of property to asset protection trusts. A court may satisfy a claim or liability out of a settlor's beneficial interest in a trust if the transfer was made with actual intent to hinder, delay, or defraud. The burden of proof imposed on creditors asserting that a transfer is fraudulent is that of clear and convincing evidence. The statute of limitations with respect to a UFTA action in Utah is set forth in Utah Code section 25-6-10, and depending on the circumstances, can be one or four years from the transfer, or if later, within one year after the transfer could reasonably have been discovered by the claimant. *See id.* § 25-6-10. Under Utah Code section 25-6-14(8), if a creditor successfully avoids a transfer to an asset protection trust, the transfer will only be considered void "to the extent necessary to satisfy the settlor's debt to the creditor . . . and the costs and attorney fees allowed by the court." *Id.* § 25-6-14(8). The risk of fraudulent transfers raises ethical issues for estate planning attorneys, who may face liability or ethical sanctions for assisting clients in engaging in fraudulent conduct. Utah's asset protection statute does not require a solvency affidavit, but provides some protection from liability for assisting in the creation of asset protection trust to attorneys and others who satisfy requirements imposed by the statute. Unlike Wyoming, Utah does not require due diligence or any kind of affidavit before a settlor may create a self-settled spendthrift trust.

Exceptions

Utah's asset protection statute provides a number of situations where spendthrift provisions are not enforceable. Exceptions include the following: child support claims; alimony claims; property division upon divorce; taxes or other money owed to the government; violations of written agreements; public assistance received by the settlor under the Medical Benefits Recovery Act;

trusts requiring that all or part of a trust's income and/or principal must be distributed to the settlor as beneficiary; transfers made when the settlor is insolvent or the transfer renders the settlor insolvent; and situations where trust assets are listed in a written representation of the settlor's assets given to a claimant to induce the claimant to enter into a transaction or agreement with the settlor.

Moving Trust Situs

Utah allows a trust located in another jurisdiction to be moved to Utah. To do so, the trust must have a Utah trust company as a trustee and the trust must be administered in Utah.

Exclusive Jurisdiction

A common concern with domestic asset protection trusts is that their spendthrift provisions may not be enforceable against a judgment obtained in a state that does not recognize the validity of such trusts. Utah Code section 25-6-14(7) attempts to ensure that Utah courts will be the sole arbiter of any issues surrounding asset protection trusts by providing that Utah courts "shall have exclusive jurisdiction over any action brought under this section." Utah Code Ann. § 25-6-14(7) (2007). If Utah takes primary supervision over a trust's administration, an argument may be made that Utah courts are not required to recognize another jurisdiction's judgments against the assets of a Utah asset protection trust. Such a statute may be valid, but exceptions to the Full Faith and Credit Clause are narrow. As yet, no court has determined the validity of this statutory protection, so its efficacy remains unknown.

Duration

In 2003, the state legislature extended the rule against perpetuities period to 1000 years with respect to trusts.

State Income Tax Consequences

One aspect of Utah law that may make it unfavorable compared to other domestic asset protection trust jurisdictions is that the state imposes an income tax on Utah source income earned by the trust. Utah Code section 59-10-202(2)(b) provides, however, that non-Utah source income earned by a Utah asset protection trust is not taxed until distributed to a Utah resident. *See* Utah Code Ann. § 59-10-202(2)(b) (2008).

WYOMING ASSET PROTECTION TRUSTS

In 2007, Wyoming adopted asset protection trusts by amending its version of the Uniform Trust Code to add Wyoming Statutes section 4-10-510 through 523, *see* Wyo. Stat. Ann. §§ 4-10-510 to -523 (2009). Wyoming's statute contains provisions similar to

many other states, but lacks some of the restrictions and conditions imposed by Utah law. As with Utah's statute, a creditor can void a transfer by bringing an action under Wyoming's Uniform Fraudulent Transfer Act. Wyoming's statute is somewhat unique in that it requires settlors to engage in some level of due diligence before transferring assets to an asset protection trust, including signing an affidavit stating that the settlor possesses and will maintain personal liability insurance.

Trust Requirements

Wyoming allows a settlor to create a spendthrift trust for his or her own benefit if the trust instrument states that it is a "Qualified Spendthrift Trust." To be effective, such a trust must be: (1) irrevocable; (2) governed by Wyoming law; and (3) subject to a spendthrift provision. A settlor establishing a Wyoming asset protection trust must possess and maintain personal liability insurance equal to the lesser of \$1 million or the value of trust assets.

Settlor Rights and Powers

As in Utah, a Wyoming asset protection trust must be irrevocable to be valid. A settlor may maintain certain rights and powers without causing an asset protection trust to lose its irrevocable

status. Interests in principal and income that a settlor can maintain without losing a trust's irrevocable status include current income, charitable remainder unitrust, up to a 5% interest in a total return trust, and the use of real property under a Qualified Personal Residence Trust. Settlors may also retain certain powers, which in some instances are broader than those permitted under the Utah statute, including the ability to veto distributions, an inter vivos or testamentary general or limited power of appointment, the power to add or remove a trustee, trust protector, or trust advisor, and the ability to serve as an investment advisor.

Wyoming asset protection trusts may have both an investment advisor and trust protector.

Fraudulent Transfers

Like Utah, Wyoming has adopted a version of the UFTA. The UFTA applies and sets aside any transfer to a trust made: (1) with actual intent to hinder, delay or defraud; or (2) without receiving a reasonably equivalent value in exchange where the debtor is about to engage in transactions with unreasonably small assets, or, intended, believed, or reasonably should have believed the debtor would incur debts beyond the debtor's ability to repay. Wyoming is unique among domestic asset protection jurisdictions

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in requiring a certain amount of due diligence, including a sworn affidavit. Absent a showing of bad faith, trustees, trust protectors, trust advisors, other trust fiduciaries, and persons counseling, drafting, administering, preparing, executing, or funding a trust are immune from suit by a creditor. Trustees are protected if a court finds that they have not acted in bad faith in accepting or administering the property.

Exceptions

Wyoming asset protection trusts are subject to a number of express exceptions, although the number of such exceptions is smaller than under Utah's statute. Other than a transfer voidable under the UFTA, the only exceptions to spendthrift protection for a Wyoming Qualified Spendthrift Trust is with respect to (1) child support claims and (2) qualified trust property listed upon an application or financial statement used to obtain or maintain credit other than for the benefit of the trust.

Moving Trust Situs

Wyoming's statute allows the property of a trust created outside of Wyoming to be transferred to the trustee of a Wyoming asset protection trust if the transferring jurisdiction, such as Utah, provides similar creditor protection. The transfer relates back to the date of the transfer to the original trust. An irrevocable trust from another state may also elect to become a qualified spendthrift trust under Wyoming law if it incorporates Wyoming law, obtains a qualified trustee, and contains a spendthrift clause. Wyoming's statute provides that, if a court declines to apply Wyoming law to an asset protection trust or its spendthrift provision, the qualified trustee may resign. If the trustee resigns and the trust instrument has no provision providing for the appointment of a successor trustee, the trust's qualified beneficiaries may petition a Wyoming court to appoint a successor trustee consistent with the purposes of the trust and Wyoming's asset protection statute.

Duration

The Wyoming legislature amended its rule against perpetuities in a fashion similar to the Utah statute. While Wyoming retains a twenty-one year rule against perpetuities generally, it does not apply to a trust created after July 1, 2003, if (1) the trust states that it shall terminate within 1000 years; (2) the trust is governed by Wyoming law; and (3) the trustee maintains a place of business in, administers the trust in, or is a resident of the state of Wyoming.

State Income Tax Consequences

Unlike Utah, Wyoming imposes no income tax upon trusts. This provides a significant incentive for clients to create an asset

protection trust in Wyoming, or moving the situs of a Utah trust to Wyoming prior to distribution of the trust assets.

Trustees

Wyoming's statute defines a "qualified trustee" as an individual residing in the state, a "person" authorized by Wyoming law to act as a trustee, or a regulated financial institution. Wyoming's Uniform Trust Code defines a person as, inter alia, an individual, corporation, trust, limited liability company, or partnership. This allows for the use of a "private trust company" as trustee so long as it is properly established and operated in a manner so as not to be exempt from regulation by the Wyoming Banking Commissioner.

Like Utah, Wyoming provides some protection from liability to trustees, protectors, advisors, other fiduciaries, and any person involved in counseling, drafting, preparing, administering, executing, or funding an asset protection trust.

State Income Tax Minimization

The creation of a Wyoming Qualified Spendthrift Trust can be an incomplete gift for federal gift tax purposes, and can also be structured so that it is not a grantor trust within the meaning of Internal Revenue Code sections 671 through 679. The combination of these characteristics makes it possible for a non-Wyoming resident to use a Wyoming Qualified Spendthrift Trust to own assets in a fashion that are not subject to income tax imposed by the "home" state.

CONCLUSION

Clients perceive the threat of personal liability from an increasing number of sources. As such, it makes sense to search for new tools of asset protection. In addition to traditional asset protection techniques, like limited liability companies, family limited partnerships, and offshore asset protection trusts, estate planners may now consider the use of domestic asset protection trusts. Utah and Wyoming offer two possible forums for the establishment of a new asset protection trust, or for moving the situs of a previously existing trust. Both jurisdictions have unique characteristics and offer creditor protection and tax planning opportunities.

1. A more comprehensive version of this article that includes additional footnotes and citations can be viewed at www.lrw-law.com. The authors would like to offer special thanks to Aaron J. Lytle, a third year law student at the University of Wyoming, College of Law, for his assistance with this article.