Nevada Asset Protection Trust

The Go-To Estate Planning Tool in the Post-2017 Tax Act Era

BY COURTNEY MCCANDLESS, ESQ.

With the recent passing of the Tax Cuts and Jobs Act (TCJA) increasing the federal estate and gift tax exemption to an all-time high, the estate planning industry has shifted focus once again. The TCJA doubled the federal transfer tax exemption to $11.18 million per individual. This means that more than 99.9 percent of Americans now do not have a taxable estate. Therefore, the focus is now on asset protection planning.

What is a Domestic Asset Protection Trust (DAPT)?

A DAPT (or self-settled spendthrift trust) is an irrevocable trust set up in a state that allows the settlor (trust creator) to be a discretionary beneficiary, while still offering a significant level of protection for the trust assets. Currently, there are 17 states that have DAPT laws, but not all DAPT jurisdictions are created equally. Unquestionably, the powerhouse DAPT jurisdiction is Nevada, primarily due to the following two features of NRS Chapter 166:

Statute of Limitations Period

All DAPT jurisdictions have a statute of limitations period that must expire before DAPT assets are protected from the settlor's creditors; Nevada has one of the shortest. In Nevada, a future creditor has two years from the date of transfer to bring a valid claim. A preexisting creditor has whichever is later to bring a valid claim: two years from the date of transfer or a six-month tolling period from the date the creditor learned of, or should have learned of, the transfer. This time period is shorter in comparison to a number of DAPT jurisdictions that have a four-year statute of limitations period and a one-year tolling period. Additionally, Nevada is one of only a few states that allows a settlor to start the discovery period by making a public record after a transfer is made. This effectively provides for a two-year statute of limitations period for all creditors, if a public record is made on the first day of the transfer, except where there is a fraudulent transfer.

No Exception Creditors

Nevada is one of only two states with no statutory exception creditors. An exception creditor is a creditor that is able to gain access to DAPT assets after the statute of limitations period, because the public policy of that state offers additional protections for that particular type of creditor. The other 15 states with DAPT laws allow for one or more types of exception creditors to pierce the DAPT, including a divorcing spouse, alimony, child support and/or preexisting tort creditors, among other potential exceptions.

Trust Design for Maximum Flexibility

Even though utilizing a Nevada Asset Protection Trust (NAPT) requires assets to be transferred into an irrevocable trust, the NAPT can be set up in such a way that the settlor can still have flexibility and indirect control of the trust assets. A NAPT must also be structured so that:

1. The NAPT does not require the income or principal to be distributed to the settlor (but the settlor can still receive distributions if subject to the discretion of another person),
2. The NAPT is not set up with the intention to hinder, delay or defraud known creditors, and
3. There must be at least one Nevada trustee to qualify to use Nevada law.

continued on page 27

continued from page 25

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Even while adhering to these requirements, the NAPT can still be structured for maximum flexibility by including the following features:

Investment Control
The settlor can serve as the investment trustee, allowing the settlor to make all investment decisions, as long as this role is limited so that the settlor cannot make distributions to himself or herself without the approval of another person. This feature is also helpful to satisfy the Nevada trustee requirement, as most clients are leery of handing over investment control and will elect to serve as the investment trustee. If the Nevada settlor declines to act as the investment trustee, another Nevada resident, Nevada trust company or Nevada bank can serve as one of the required trustees to utilize Nevada's favorable laws.

Veto Power
The settlor can retain a veto power, allowing the settlor to override any distributions that the distribution trustee has authorized. This feature gives the settlor security, knowing that regardless of the authorized distributions, the settlor has the power to reject a distribution. Plus, if the settlor chooses to act as the investment trustee (and the distribution trustee's powers are limited), the settlor will be the only person making the actual transfers (after receiving authorization from the distribution trustee to do so), as he or she is the only trustee who holds any signatory powers on the trust accounts.

Power of Appointment
A settlor can be granted a broad special power of appointment, essentially allowing the settlor to make a distribution to a beneficiary other than the settlor or to rewrite the terms of the trust. This feature is helpful when it comes to adapting to changing circumstances, such as family situations and tax laws.

Power to Remove and Replace Trustees
The settlor can retain the power to remove and replace trustees if a change is desired, providing the settlor the comfort of knowing the appointed trustees can be replaced.

Power to Use Trust Assets
A settlor who is also a trust beneficiary is permitted by statute to use property held by the NAPT without having to pay rent to the NAPT. This feature allows the real or personal property held by the NAPT to be used by the beneficiaries while it remains protected in the NAPT rather than requiring it to be distributed out from the NAPT, thereby exposing it to creditors.

Further, the importance of distributing assets in trust to future generations must not be overlooked, regardless of whether a NAPT or a different trust structure is used. Many trusts these days transfer assets outright to beneficiaries at certain ages. This scenario can be a risky gamble, because it is impossible to know what will be happening in a beneficiary's life at the time of distribution (i.e. divorce, creditor concerns, tax concerns, etc.). Instead of exposing assets to these potential creditors with an outright distribution, modern trust drafting allows a beneficiary to use and control trust assets while keeping the assets protected from creditors, divorcing spouses and unnecessary tax exposure. With the flexibilities that can be included in a NAPT, significant creditor protections and planning advantages can be attained without the client having to relinquish as much control of the assets as one might think.

Hybrid NAPT: Solution for Non-Nevada Residents

For those clients who have recently moved to Nevada and have not yet clearly established residency, or those out-of-state residents wanting to take advantage of Nevada's favorable asset protection laws, a Hybrid NAPT should be considered. DAPTs have been in existence for more than 20 years, and even with this lengthy timespan, there still arguably has not been a case addressing whether a DAPT will, for a fact, be upheld for a resident of a non-DAPT jurisdiction. This lack of case law provides uncertainty as to what law the judge in the non-DAPT state will apply: Nevada's leading asset protection laws or the law of the non-DAPT jurisdiction. Due to the uncertainty surrounding this jurisdictional question, practitioners should instead consider establishing a Hybrid NAPT for clients residing in non-DAPT jurisdictions.

Hybrid, in this context, means that the settlor sets the trust up for the settlor's spouse and descendants, and the settlor is not an initial discretionary beneficiary. By structuring the trust this way, the trust is treated as a third-party settled trust, offering substantially more protection. The Hybrid NAPT may give the settlor the power to name a trust protector to add and remove beneficiaries. This creates a built-in safety mechanism in the event the settlor needs to be added as a beneficiary, or if there is clarity on the interpretation of a non-DAPT jurisdiction's court upholding the NAPT. If the settlor's spouse is a beneficiary of the Hybrid NAPT, it is easy for the settlor to indirectly access the trust assets. If the settlor is unmarried, indirect access to the assets of the Hybrid NAPT becomes trickier and, therefore, requires more analysis when determining the assets that will fund the Hybrid NAPT.

At a time when some of the more traditional estate planning techniques may not be needed for estate tax purposes, it is important to remember that there are still plenty of other planning opportunities. When implemented correctly, a NAPT can offer additional protection, securing peace of mind that one's hard-earned assets are less exposed, while still providing the settlor with investment control, indirect control over distributions, and flexibility to adapt to changing laws and personal goals. **NL**

COURTNEY MCCANDLESS is an attorney at Oshins & Associates, LLC, where she focuses her practice primarily on advanced estate planning, asset protection planning and business planning. She can be reached at (702) 341-6000 or via email at cmccandless@oshins.com.