MAXIMUM ASSET PROTECTION
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USE OF TRUSTS IN ASSET PROTECTION

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I. Use of Trusts in Asset Protection

The goal of all asset protection planning is to insulate assets from claims of creditors without concealment or tax evasion. It is usually impossible to completely and absolutely protect assets, and the focus is on making assets more difficult and more expensive to reach.

All asset protection planning is based on the following two premises: (1) creditors can generally reach any asset owned by a debtor;[1] and (2) creditors cannot reach those assets that the debtor does not own.[2]

When working within the context of the first premise, the goal is to make it more difficult and more expensive for a creditor to reach the debtor's assets. This may include encumbering assets, converting assets from non-exempt to exempt, substituting assets or transferring ownership to legal entities. Working within the second premise, the goal is to fit within its parameters, but without any detriment to the client-debtor. Generally, this means that as the end-result of the planning the debtor should not own any assets, but should retain their beneficial enjoyment and some degree of control.

Continuing with the second premise, debtors strive to achieve two incompatible goals – (i) they want to possess the beneficial enjoyment or control of their assets, whether through direct ownership or otherwise, and (ii) they also want to distance themselves from the ownership and control over the assets, to make such assets inaccessible to creditors.

In this obvious dichotomy, trusts come to the rescue by splitting the beneficial enjoyment of trust assets from their legal ownership.

The beneficiaries of a trust are the beneficial owners of the assets holding equitable interests, but they do not hold legal title to the assets. The legal title is vested in the trustee of the trust. The trustee of a trust thus stands in the position of a fiduciary to the beneficiaries.[3] The trustee holds title to the trust assets for the benefit of the beneficiaries and has to administer the trust for the benefit of the beneficiaries and no one else.[4]

A creditor's ability to satisfy a judgment against a beneficiary's interest in a trust is limited to the beneficiary's interest in such trust.[5] Consequently, the common goal of asset protection trusts is to limit the interests of beneficiaries in such a way so as to preclude creditors from collecting against trust assets.

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[1] Code of Civil Procedure § 695.010(a).
[2] *Id*.
[3] See, generally, Probate Code §§ 16000-16015.
[4] Probate Code § 16002(a).
[5] *Garcia v. Merlo* (1960) 177 Cal.App.2d 434; *Booge v. First Trust & Sav. Bank* (1944) 64 Cal.App.2d 532-536; *Estate of Bennett* (1939) 13 Cal.2d 354.

Trusts are widely used in asset protection. Not all types of trusts are effective asset protection devices, but a properly drafted and structured trust may be an almost impregnable form of asset protection.

A. Structuring Trusts for Asset Protection

1. Revocable v. Irrevocable

a. Generally

The most commonly drafted trust is the revocable inter-vivos trust (the so-called "living trust"). Living trusts protect beneficiaries from claims of creditors to the same extent as irrevocable trusts. However, if the debtor is a settlor of the trust, the living trust will not provide the settlor-debtor with any measurable degree of asset protection, because and to the extent of the settlor's power to revoke.[6]

The protective benefits of an irrevocable trust were addressed in a recent California decision, *Laycock v. Hammer*.[7] In 1998 the debtor established an irrevocable life insurance trust and a few months later transferred a life insurance policy to the trust. A couple of years later the debtor (and then his estate) was pursued on a money judgment and the creditor attempted to reach the life insurance policy transferred to the irrevocable trust. The court stated unequivocally that the life insurance policy was the property of the trust and not of the debtor, and the creditor could not reach the policy.[8]

Consequently, any trust created to protect the assets of a settlor must be irrevocable.

Practice *Pointer*: A living trust may have a very limited asset protection use. A living trust that has a generic name (*i.e.*, instead of the Jane Smith Trust, the Sunshine Trust), and a third-party trustee, can be used to own real property, and will afford the settlor a certain amount of anonymity. A creditor of Jane Smith will have a more difficult time ascertaining what real estate she owns if the real estate is titled in the name of the third-party trustee of the Sunshine Trust. This type of planning has limited usefulness: (i) if the debtor's name appears anywhere in the chain of title (a diligent search will pull up the property), and (ii) because a title company may refuse to insure the sale of the property if it knows of the connection between the debtor and the trust.

b. The Qualified Personal Residence Trust

The qualified personal residence trust ("QPRT") is an irrevocable trust very frequently used for both estate planning and asset protection. QPRTs are used to transfer a settlor's residence out of

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[6] Probate Code § 18200.
[7] (2006) Cal.App.4th (slip opinion).
[8] Slip. Opn. page 9.

the settlor's estate at a low gift tax value. Once the trust is funded with the settlor's residence, the residence and any future appreciation of the residence is excluded from settlor's estate.

The QPRT is a split-interest trust, with the settlor retaining a term-of-years right to live in the residence rent-free, with the remainder interest going to the remainder beneficiaries. The gift of the remainder interest is a completed transfer, and the settlor no longer owns that interest and it is not reachable by the creditors of the settlor.

To the extent the settlor retains an interest in the QPRT, the QPRT will be deemed self-settled (discussed below), and the protective benefits of the trust will not apply. However, even though a settlor's creditor has the legal ability to reach the retained interest, in practice that is rarely, if ever, attempted. The retained interest has very little value to a creditor because such an interest would be difficult to sell at a foreclosure sale.

Consequently, creditors either do not pursue residence interests held in QPRTs, or are more willing to negotiate on favorable terms with the settlor-debtor.

2. Spendthrift Trusts

a. Generally

A spendthrift trust is a type of trust that either limits or altogether prevents a beneficiary from being able to transfer or assign his interest in the income or the principal of the trust.[9] Spendthrift trusts have traditionally been used to provide for beneficiaries who are incompetent or are simply unable to take care of their own financial affairs. Today, almost every trust incorporates a spendthrift clause.

<u>Example</u>: Mr. Howell is worried that his wife will spend her entire inheritance on a shopping spree in Paris. Instead of giving her unfettered access to the trust on his death, the trust provides that the trustee shall make periodic distributions of cash to Mrs. Howell. Mrs. Howell is not given any power to invade the trust or anticipate her distributions (no power to transfer or assign interest in the trust).

If a trust incorporates a spendthrift clause and the beneficiary is therefore precluded from transferring his interest in either income or principal, then the beneficiary's creditor will not be able to reach the beneficiary's interest in the trust.[10]

The protection of the spendthrift trust extends solely to the property that is in the trust. Once the property has been distributed to the beneficiary that property can be reached by a creditor, except to the extent the distributed property is used to support the beneficiary.[11] If a trust calls for a distribution to the beneficiary, but the beneficiary refuses such distribution and elects to retain

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[9] *County Nat. Bank etc. Co. v. Sheppard* (1955) 136 Cal.App.2d 205; 11 Witkin, *Summary of Cal. Law* (9th ed. 1990) Trusts, § 165, p. 1017.
[10] Code of Civil Procedure § 695.030(a) and Probate Code §§ 15300 and 15301(a).
[11] Probate Code §§ 15300, 15301(a), 15306.5(c); *Frazier v. Wasserman* (1968) 263 Cal. App. 2d 120, 127.

property in the trust, the spendthrift protection of the trust ceases with respect to that distribution and the beneficiary's creditors can now reach trust assets.[12]

b. Exceptions to the Spendthrift Protection

There are three notable exceptions to the protection afforded to a beneficiary of a spendthrift trust.

i. Self-Settled Trusts

If the settlor of a trust is also a beneficiary of a trust, then the assets that the settlor has retained a benefit in will not be protected by the trust's spendthrift clause.[13] This is known as a prohibition against "self-settled" trusts.

The settlor does not need to be either the sole settlor or the only beneficiary of the trust. As long as the settlor is a beneficiary of the trust to any extent, to that extent the trust will be deemed self-settled.

Example: Husband and wife establish a trust for their own benefit, and contribute their community property. The trust will be self-settled as to each spouse.

Example: John settles a trust for the benefit of his children, but retains for himself the right to income for life. To the extent of John's retained lifetime income interest, the trust is self-settled. The remainder interest for the benefit of children is not self-settled, as the children-beneficiaries were not settlors.

If a trust is self-settled that means only that the interest of the settlor-beneficiary is not protected from creditors. It does not mean that the trust is invalid, that other beneficiaries are unprotected or that the trust does not offer other benefits. In the above example, the trust is self-settled only as to John, and not as to his children.

The prohibition against self-settled trusts in California is well-settled. In *DiMaria v. Bank of* California *Natl. Assoc.*,[14] the settlor-beneficiary of a trust retained the right to the income for life and to invade principal if income was insufficient for her support, with remainder interest given to her children. The trustee was required to make distributions pursuant to an ascertainable standard. The settlor could not revoke the trust.

The court held that only "the income and the additional corpus required for her support and obtainable by her from the trustee" is subject to creditor claims.[15] The rest of the corpus, including the remainder interest were not for the benefit of the settlor-beneficiary, and thus not self-settled (and therefore not reachable by the settlor's creditors).

[12] Probate Code § 15301(b).
[13] Probate Code § 15304(a).
[14] (1965) 237 Cal.App.2d 254.
[15] *Id*. at 258.

If the trustee of a self-settled trust has any discretion in making distributions, then the creditors of the settlor may reach the maximum amount that the trustee may distribute in his discretion to the settlor-beneficiary.[16]

Consequently, when a trust is self-settled, to obtain any asset protection for the settlor, discretionary powers should be avoided in favor of a clearly ascertainable standard.

While California, like most other jurisdictions, strips the spendthrift protection of a trust when it is self-settled, certain jurisdictions no longer conform to this rule. These jurisdictions include certain U.S. states, like Delaware, Alaska and Nevada, and certain foreign nations, like Saint Vincent and the Grenadines and the Cook Islands (these jurisdictions are discussed in more detail, below). Forming an irrevocable trust in one of these jurisdictions may be another way to preserve the protection of the spendthrift clause of a self-settled trust.

ii. Sole Trustee and Sole Beneficiary

When a debtor is the sole beneficiary and the sole trustee of a trust, the trust's protective benefits are lost because the trust is deemed terminated and the beneficiary holds trust assets free of trust.[17] This happens because of the doctrine of merger – the debtor now holds all the equitable interests in the trust in his capacity as the beneficiary, and all the legal interests in his capacity as the trustee. When the equitable and legal interests are vested in one person, there is no longer a trust relationship and that person can fully dispose of the property as any other person.

California has a limited anti-merger statute which provides that when the settlor of a trust is also the sole trustee and the sole beneficiary the trust is not merged or terminated if it names one or more successor beneficiaries.[18] The intent of this statute is to insulate a trustee of living trust from personal liability when acting in his capacity as a trustee.[19]

Because the California anti-merger statute has little relevance when drafting asset protection trusts, such trusts should not have the same one trustee and beneficiary. This may be avoided by naming a co-trustee, by adding another beneficiary, or by picking a jurisdiction with a strong anti-merger statute.

A beneficiary of a trust includes any person who has a present or future interest in the trust, vested or contingent.[20] In *Ammco Ornamental Iron* a creditor of a beneficiary, who was also the sole trustee, attempted to challenge the spendthrift clause of an irrevocable trust by arguing that under the doctrine of merger the trust terminated. The debtor-beneficiary held a life estate, and on his death the trust corpus was to be distributed to the beneficiary's children pursuant to a

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[16] Probate Code § 15304(b).

[17] *Hill v. Conover* (1961) 191 Cal.App.2d 171, 180; *Ammco Ornamental Iron, Inc. v. Wing* (1994) 26 Cal.App.4th 409, 417; Rest. 2d Trusts § 99, subd. (5), com. e., pp. 228-229.

[18] Probate Code § 15209(a).

[19] *Mead v. Dickinson* (2004) 2004 Cal.App.Unpub.LEXIS 5657, page 20.

[20] Probate Code § 24(c).

testamentary power of appointment held by the beneficiary. The court held that when the remainder beneficiary is in existence and ascertained and the remainderman's interest is not subject to a condition precedent, the remainder interest is vested in such beneficiary.[21] The fact that the interest of the remainder beneficiary was subject to a complete divestment (due to lifetime distributions to the current beneficiary), did not change the remainder beneficiary's status as a beneficiary of the trust.[22] Consequently, the children of the debtor-beneficiary also qualified as the beneficiaries of the trust, and the doctrine of merger was inapplicable.

iii. Support Payments

Even if an irrevocable trust has a spendthrift clause, a court may order the trustee to satisfy a beneficiary's support obligation to a former spouse or minor child out of any distributions that the trustee has decided, in his discretion, to make to the beneficiary.[23]

This is an example of two conflicting public policy rationales. Spendthrift clauses have been enforceable, historically, because our society places a great deal of importance on private property rights. Consequently, creditors cannot generally reach a beneficiary's interest in a spendthrift trust. However, our society places an even greater importance on satisfying support obligations, and even a spendthrift trust will not shield a beneficiary from such obligations.

3. Discretionary Trusts

a. Generally

A trust is called "discretionary" when the trustee has discretion (as to the timing, amount and the identity of the beneficiary) in making distributions.[24] There must not be any trust provisions that mandate a distribution, but there may be provisions that set standards for distributions.[25] Because the trustee is not required to make any distribution to any specific beneficiary, or may choose when and how much to distribute, a beneficiary of a discretionary trust may have such a tenuous interest in the trust so as not to constitute a property right at all. If the beneficiary has no property right, there is nothing for a creditor to pursue. The statutes follow this line of reasoning by providing that a trustee cannot be compelled to pay a beneficiary's creditor if the trustee has discretion in making distributions of income and principal.[26]

Practice Pointer: When drafting a trust that allows the trustee to exercise discretion in making distributions subject to a standard (including an ascertainable standard), the discretion clause should be carefully worded. Practitioners should always favor using permissive phrases such as "trustee may pay to the beneficiary" instead of mandatory phrases such as "trustee shall pay to

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[21] *Ammco Ornamental Iron* at 418.
[22] *Id.*
[23] Probate Code § 15305(c).
[24] 11 Witkin, *Summary of Cal. Law* (9th ed. 1990) Trusts, § 166, p. 1019.
[25] Probate Code § 15303(c).
[26] Probate Code § 15303(a).

the beneficiary." In *U.S. v. Taylor*,[27] the trust provided that the trustee "shall pay" to the beneficiary so much of the income from the trust as the trustee deemed necessary for the support of the beneficiary. The court interpreted that language to mean that the trustee was mandated to make distributions, and his discretion was limited only to determining the amount "necessary."[28]

Even if a trust is truly discretionary it should have a spendthrift clause. While the trustee would not need to honor a beneficiary's demand for a distribution, it is possible that absent the spendthrift clause a creditor would force the beneficiary to assign his interest in the trust (whatever it may be) to the creditor. If that happens, then some day when the trustee does make a distribution, it will be made to the creditor. Also, most trusts are never fully discretionary and it makes sense to obtain the protection of the spendthrift clause.

Once the beneficiary receives a distribution from the trust, even if it is discretionary, the protective benefits of the trust cease. The distributed assets are treated as any other assets of the beneficiary-debtor, and there is no statutory protection available for such assets simply because the assets used to be held in a trust.

In a case of first impression, a California court held that even a fully discretionary trust cannot shield a beneficiary from child-support obligations because of the overriding public policy support for satisfying child support obligations.[29] In interpreting Probate Code § 15305, the court stated that "The statute cannot have been intended to allow a beneficiary to defraud support creditors by hiding behind the trustee's discretion."[30]

The court's analysis is suspect. The intent of the Probate Code is irrelevant if the debtor-beneficiary has no property right in the trust because of a trustee's unfettered discretion.

b. Drafting Considerations

A properly drafted discretionary trust is an almost impregnable form of asset protection. But if the trust is discretionary, it means that there are no mandated distributions and no demand rights granted to the beneficiary. This potentially leaves the beneficiary at the mercy of the trustee.

To some extent beneficiaries are protected from the trustee by statutes. Trustees must always exercise their discretion reasonably, and even if the trustee is granted "sole and absolute" discretion, the discretion must not be exercised "arbitrarily" and must be exercised in accordance with fiduciary principles.[31]

The statutes are not sufficient to ensure that the beneficiary will receive either regular or demanded distributions when not threatened by creditors, and it is up to the practitioner to carefully draft the trust to achieve that goal while maintaining the asset protection benefits of the trust.

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[27] (N.D. Cal. 1966) 254 F.Supp. 752.
[28] *Id*. at 755.
[29] *Ventura County Dept. of Child Support Serv. v Brown* (2004) 117 Cal.App.4th 144.
[30] *Id*. at 155.
[31] Probate Code §§ 16080 and 16081(a).

4. Drafting Trusts for Maximum Protection and Control

a. Distribution Standards

The protection of a discretionary trust is not diminished by setting forth a distribution standard for the trustee.[32] This allows the drafter to build into the trust some protection for the beneficiary, from the trustee, by including some broadly defined standards. Including distribution standards in an asset protection trust is not always advisable, as in a case of a foreign asset protection trust. Because foreign trusts are usually established for debtors facing greater creditor exposure, protecting beneficiaries from creditors is more important that protecting them from the trustee. In these cases, distribution standards are usually sacrificed in favor of unfettered discretion.

When a distribution standard is desired, the following sample standard may be used:

> The trustee may, in its discretion, pay to or apply for the benefit of the beneficiary, so much of the income or principal of the trust as the trustee deems advisable to provide for the beneficiary's health, education, support, comfort, maintenance, education, professional or vocational courses, and to otherwise enable the beneficiary to maintain his accustomed standard of living. The trustee may also pay to or apply for the benefit of the beneficiary so much of the income or principal of the trust as the trustee deems advisable to allow the beneficiary to purchase a residence, a business or to make investments.

b. Stated Intent

It is also advisable to set forth in the trust the settlor's intent for the trust. The courts in California have consistently held that it is the court's duty to carry out the intent of the settlor, provided it does not violate public policy.[33] The intent can be stated in terms of providing for and taking care of the beneficiary, and not paying any monies to any party other than the beneficiary, including the beneficiary's creditors.

c. Balancing Control and Protection

Striking the right balance between surrendering the ownership of trust's assets and retaining some control over and benefit from such assets is a difficult task. From control perspective, the debtor-beneficiary wants to be either a trustee of the trust, or wants to impose mandates and standards on the third-party trustee. From an asset protection perspective, the debtor-beneficiary needs a spendthrift trust with the maximum possible discretion conferred on the trustee.

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[32] Probate Code § 15303(c).
[33] *Brock v. Hall* (1949) 33 Cal.2d 885, 889.

When the debtor-beneficiary is the sole trustee of a discretionary trust, he has unfettered access to the assets of the trust. As discussed above, if the debtor is the sole beneficiary of the trust and also the sole trustee, then under the doctrine of merger the trust, regardless of its form, will not provide the debtor with any protection. Consequently, it may be advisable to add a co-trustee, or to add remainder beneficiaries.

In practice, some practitioners appoint the sole beneficiary as the sole-trustee of a discretionary, spendthrift trust, and provide for an automatic removal of the beneficiary as a trustee if and when he becomes a debtor. The hope is to accomplish the best of both worlds, give the beneficiary complete control over trust assets when there are no creditors pursuing the beneficiary, and to promptly remove the beneficiary as a trustee and achieve asset protection when the creditors appear. If the beneficiary is truly the sole beneficiary of the trust (*i.e.*, there are no remainder or contingent beneficiaries) at any time, then under the doctrine of merger the trust terminates. It is not clear what happens when a new trustee is substituted or a co-trustee is added as there is no trust in existence at that time. Similar to the advice above, practitioners should consider adding a friendly co-trustee (possibly with limited powers) or remainder beneficiaries at the outset.

d. Protecting Mandatory Distributions

No matter what distribution standards are drafted into the trust or how much control is given to the beneficiary, some settlors may want mandatory distributions. A mandatory distribution provision in a trust does not take into account the discretion of the trustee. The trustee simply must make the distribution in the manner and at the time prescribed in the trust (an example of a mandatory distribution includes a QTIP trust where income must be paid to the surviving spouse on a quarterly basis). Mandatory distributions present a problem because sometimes the trustee may be required to make a distribution when a beneficiary is being pursued by a creditor.

If a trust calls for mandatory distributions and the protection of the beneficiary is desirable, it may be advisable to include in the trust a clause prohibiting any and all distributions to a beneficiary while that beneficiary is being pursued by a creditor.[34] It is important to make clear the settlor's intent that such clause should override all other trust provisions.

B. Domestic Asset Protection Trusts

A properly drafted trust, incorporating the pointers from the discussion above, may be an insurmountable obstacle to creditors; provided that the trust is for the benefit of a third-party beneficiary.[35] Most asset protection clients are looking to protect their own assets and are usually not beneficiaries of existing trusts. Consequently, the majority of asset protection trusts are self-settled. Because California strips the spendthrift protection of a self-settled trust, practitioners must look to other jurisdictions.

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[34] N.B. This may be inadvisable in a QTIP trust, because it will then fail to qualify for the unlimited marital deduction.

[35] The protective benefits of a trust may also be lost pursuant to a fraudulent transfer challenge. Civil Code §§ 3439-3439.12. A discussion of fraudulent transfers is beyond the scope of this article.

Several U. S. jurisdictions now allow self-settled trusts to afford their settlors the protection of the spendthrift clause. Alaska was the first jurisdiction to enact such laws in 1997[36] and was shortly followed by Delaware,[37] Nevada[38] and a few others.[39] All of these domestic self-settled asset protection trusts shall be referred to as "DAPTs."

Using Delaware as sample DAPT jurisdiction, a Delaware DAPT must comply with the following requirements: (i) the trust must be irrevocable and spendthrift; (ii) at least one Delaware resident trustee must be appointed; (iii) some administration of the trust must be conducted in Delaware; and (iv) the settlor cannot act as a trustee.[40]

The DAPT jurisdictions appear to be a simple solution for a settlor of a self-settled trust seeking asset protection if the settlor is a resident of a DAPT jurisdiction and has assets in the jurisdiction. California residents with California assets may not be able to reap the asset protection benefits of these trusts.

1. The Risks of DAPTs

a. Conflict of Law

Trusts are generally governed by the laws of the jurisdiction that is designated by the settlor as the governing jurisdiction.[41] There are two exceptions to the general rule: (i) states will not recognize laws of sister states that violate their own public policy,[42] and (ii) if the trust owns real property, such property will be governed by the law of jurisdiction that is the property's situs.[43]

In determining whether a law of another state would be enforceable in California, the court would analyze whether the law of the other state is contrary to a fundamental policy of California, and would then determine whether California has a "materially greater interest" than the other state in adjudicating the issue.[44]

To date, there are no California (or any non-DAPT jurisdiction) cases dealing with the protectiveness of DAPTs. It is possible that if a case involving a DAPT was litigated in California, the California court may not recognize the law of the DAPT jurisdiction and refuse to extend the spendthrift protection to a self-settled trust.

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[36] Alaska Statutes § 34.40.110.
[37] 12 Del. Code § 3572 (Qualified Dispositions in Trust Act).
[38] Nev. Rev. Stat. ch. 166.
[39] Mo. Ann. Stat. § 428.005 *et. seq*.; R.I. Gen. Laws §§ 18-9.2. Oklahoma allows *revocable* self-settled trusts, and prevents creditors from forcing the settlor to exercise his power to revoke. 31 Okla. Stat. Ann. §§ 13, 16.
[40] 12 Del. Code § 3570.
[41] Rest. 2d Conf. of Laws § 273(b); Uniform Trust Law § 107(1).
[42] *Washington Mutual Bank v. Superior Court* (2001) 24 Cal.4th 906, 916-917; Rest. 2d Conf. of Laws § 187, subd. (2); Uniform Trust Law § 107(1).
[43] Rest. 2d Conf. of Laws § 280.
[44] *Washington Mutual Bank* at 916.

If a DAPT owns California real property, then California law will govern any collection action applicable to the real property and the spendthrift protection of the DAPT jurisdiction will be inapplicable.[45] This problem may be remedied to some extent by having a DAPT own California real estate through a limited liability company or a limited partnership organized under the laws of the DAPT jurisdiction. This way the trust no longer owns California realty, but owns an intangible governed by the laws of the DAPT jurisdiction.[46]

b. The Full Faith and Credit Clause

The Full Faith and Credit clause of the Constitution provides that each state has to give full faith and credit to the laws of every other state.[47] This means that if a California court refuses to recognize the protection of a DAPT and enters a judgment for the creditor, the creditor may be able to enforce the judgment against the trustee of the DAPT, even if that trustee was located in the DAPT jurisdiction.

However, even under the Full Faith and Credit clause the states are not required to recognize the laws of sister states that are contrary to their own public policy.[48] Consequently, a DAPT jurisdiction court may refuse to enforce a California judgment because it was entered under trust laws substantially different to those of the DAPT jurisdiction.

At this point the analysis becomes quite circular. A creditor argues in California court that the court should apply California law and not Alaska law to an Alaska trust because Alaska trust law violates California public policy against self-settled trusts. In turn, Alaska refuses to recognize the California judgment because it violates Alaska public policy in protecting self-settled trusts.

This analysis should lead the practitioner to one inescapable conclusion. Until the application of the Full Faith and Credit clause is litigated in the context of a self-settled trust, the risk is too great that a DAPT would not afford the debtor with the required protection.

2. Foreign Trusts – The Superior Alternative

Foreign trusts are discussed in a lot more detail below. This section will simply point out the various aspects that make a foreign trust more advantageous than a DAPT.

The term “foreign trust” usually means a trust that states that it should be interpreted under the laws of a foreign jurisdiction. This means that the laws of the foreign jurisdiction will apply to the trust and the enforceability of the trust’s spendthrift clause. What advantages does that carry?

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[45] Rest. 2d Conf. of Laws § 280.
[46] Corporations Code §§ 15691, 17450(a).
[47] U.S. Const., Art. IV, § 1.
[48] *Nevada v. Hall* (1978) 440 U.S. 410, 424.

All foreign jurisdictions that compete in the asset protection market allow self-settled trusts to be an effective shield against creditors. This is similar to the U. S. DAPT jurisdictions that have now gone the same route.

However, foreign trusts are not subject to the Full Faith and Credit clause or the Supremacy Clause. This means that with a foreign trust there is never any doubt that the favorable law of the foreign jurisdiction will be applied to the trust, and there is also no doubt that the foreign jurisdiction does not have to enforce any judgment coming out of a U. S. state (whereas a sister state may have to recognize such a judgment).

However, even setting aside this uncertainty, foreign trusts are vastly superior to the Alaska-type trusts. For example, the foreign asset protection jurisdictions provide that the creditor has the burden of proving a fraudulent conveyance. More importantly, the creditor's burden of proof is the criminal standard of "beyond a reasonable doubt."

In foreign jurisdictions the statute of limitations on bringing a fraudulent conveyance action is not only short, but it also begins running on the date of the transfer, not the date the transfer is "discovered."

Finally, while not a legal deterrent, the costs associated with challenging a foreign trust prove to be an insurmountable obstacle to most creditors. It also surprises many that foreign trusts are usually less expensive to set up and administer than DAPTs.