



NAEPC
Journal
of **Estate & Tax Planning**

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How the Hybrid Domestic Asset Protection Trust Has Changed the Entire Asset Protection Industry

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The Different Asset Protection Options

There are three main trust options: Domestic Asset Protection Trusts (“DAPTs”), Foreign Asset Protection Trusts (“FAPTs”) and Hybrid Domestic Asset Protection Trusts (“Hybrid DAPTs”).

Domestic Asset Protection Trusts

A traditional DAPT is an irrevocable trust set up under the laws of one of the 19 states that allows such a trust. The person setting up and funding the trust (the “settlor”) does not need to reside in one of those 19 jurisdictions. Under the statutes of each of those jurisdictions, after a certain waiting period, the assets transferred to the trust by the settlor should be protected from the settlor’s creditors.

After more than two decades since the first DAPT legislation passed, no non-bankruptcy creditor has challenged a DAPT all the way through the court system and been able to access any DAPT assets based on the judge applying local law rather than the law of the DAPT jurisdiction. Most likely this is because such a large majority believes that if tested the DAPT will work to protect its assets from a creditor of the settlor.

However, despite the very high likelihood of protection, there are many people who don’t think a DAPT will hold up if challenged. And, in fact, in the dicta of *In re Huber*, 2013 Bankr. LEXIS 2038, May 17, 2013, the judge said that local law would prevail. Most estate planners believe that the rationale was incorrect, but still that case exists, so people cite it.

The good news is that a settlement is just as good as a victory in court. In fact, our clients want cheap and quick settlements. The lack of case law after so many years indicates that DAPTs have worked rather nicely since this indicates that they all just settle.



The DAPT Weakness: There are enough people who believe that a DAPT won’t work for a resident of a non-DAPT state that one must consider the possibility that the presiding judge will have such a belief.

Foreign Asset Protection Trusts

Many planners who claim that DAPTs don’t work use Foreign Asset Protection Trusts as their primary asset protection tool and therefore are competing with DAPTs. Interestingly, especially to this author, DAPTs have fared substantially better than FAPTs if one looks at the case law. And it’s not even close.

FAPTs are spectacular asset protection tools, so the reader should not take this section of this article to imply otherwise. The point of this is merely to show how much DAPTs have outperformed FAPTs, simply to make a point that FAPT promoters have continued to misrepresent the comparison. And, again, these results are surprising even to this

author since FAPTs should be scarier to a creditor, at least theoretically. Maybe these results are skewed by the “type” of person who is more likely to set up a FAPT than a DAPT since the FAPT client is sometimes already in trouble with a creditor. And also note that many of these cases are truly “bad fact” cases which are not representative of most of our types of clients.

The FAPT Weakness: There are too many bad cases. And the trend appears to be for the judge to hold the debtor in contempt and throw him/her in jail until the assets are brought back onshore and paid to the creditor.

Hybrid Domestic Asset Protection Trusts

The Hybrid DAPT is a strategy that substantially increases the probability that the trust assets will be protected. And it is very simple. The Hybrid DAPT is just like a regular DAPT except that the settlor isn't a beneficiary of the trust, but can be added later. Thus, the trust is set up for the benefit of the settlor's spouse and descendants, for example, but not for the settlor. By not including the settlor as a beneficiary of the trust, the Hybrid DAPT is by definition a third-party trust and therefore almost certainly avoids the potential risk of uncertainty and scrutiny of a regular DAPT or FAPT.

Especially where the settlor is married and has a strong, trusting relationship with his or her spouse, is there any good reason that the settlor must have his or her name in the trust agreement as a beneficiary? It is very simple to indirectly access the trust assets through the spouse. And the trust agreement should define the settlor's “spouse” using a “floating spouse provision” that says that the spouse is the person the settlor is married to from time to time. This gives the settlor the ability to access the trust assets through a subsequent spouse in the event of a divorce or the death of the settlor's current spouse.

If the settlor has no spouse, then it becomes more difficult for the settlor to access the assets without being a beneficiary. Therefore, for the unmarried client, you simply put less of the wealth into this trust and often set up a limited liability company for assets that aren't transferred to the trust. And since a good asset protection planner will be sure to leave sufficient wealth outside of the client's asset protection trust, in most cases the settlor won't have to work through this issue anytime soon.

In case the settlor needs to be a discretionary beneficiary of the Hybrid DAPT sometime in the future (i.e., if the settlor has no spouse or child that will “share” a distribution with the settlor and the settlor now needs a distribution), the trust agreement provides that the trust protector can add additional beneficiaries, including the settlor. However, if the settlor is added, then the Hybrid DAPT becomes a regular DAPT and thus risks that the law is still unsettled on DAPTs (even though the substantial majority of people be-

lieve that they work).

There are so many ways for the settlor to indirectly access the Hybrid DAPT assets that it almost inconceivable that a settlor will ever be added as a beneficiary. The various strategies are beyond the scope of this article.

The Hybrid DAPT Weakness: There are none. This is simply a third-party trust that is, by definition, fully protected. If a trust protector ever adds the settlor in as a beneficiary, then this is the only scenario where there is a potential weakness. But this will almost never be done.

Summary

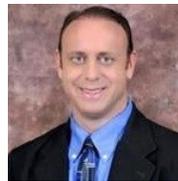
DAPTs are powerful, very protective asset protection trusts. FAPTs too are very powerful, very protective asset protection trusts. However, there is no comparison to the Hybrid DAPT.

Arguably, it is impossible to be considered a top asset protection planner without the Hybrid DAPT being one's go-to asset protection strategy. The foregoing is surely a controversial statement, and it is bound to cause some whispering among asset protection planners who don't like to hear the truth. Yet it is a powerful statement that should make asset protection planners stop and think about the probabilities of success and the goals which are to insulate the assets as much as possible in order to use the so-called “fear factor” to induce a favorable settlement or to simply walk into a courtroom without much concern.

Because of the substantially greater level of protection provided by a Hybrid DAPT over a regular DAPT or FAPT, the asset protection industry changed many years ago as asset protection planners started to “up their game” and use the Hybrid DAPT as the go-to strategy.

Link to: <https://ultimateestateplanner.com/2020/04/01/how-the-hybrid-domestic-asset-protection-trust-has-changed-the-entire-asset-protection-industry/>

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