

# Domestic Asset Protection Trusts v. Prenuptial Agreements

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*Divorce is an unfortunate reality these days as 40% - 50% of first marriages and 60% of second marriages end in divorce.' Without appropriate planning, a spouse seeking divorce will likely be entitled to an equitable portion of marital property, which includes business interests, liquid assets, gifts, employment income, and in some cases, inheritances and other assets held prior to the marriage. Therefore, it is important for couples contemplating marriage to find ways to clearly communicate their wishes with regard to their assets and income before the wedding day. If the couple fails to adequately address these issues, decisions may be left to the discretion of the judge during the course of what is often an expensive, exhausting, and time-consuming divorce proceeding.*

## **PRENUPTIAL AGREEMENTS**

Historically, individuals concerned about protecting assets acquired before marriage used traditional prenuptial agreements. Prenuptial agreements are good, but there are numerous personal and legal issues that deter couples from actually executing a prenuptial agreement. In fact, a recent survey found that only approximately 3% of all married or engaged couples have executed a prenuptial agreement.<sup>2</sup>

Even for those relatively few couples who have executed a prenuptial agreement, there is no guarantee that the agreement will stand up to a legal challenge if the relationship sours. Statutory and case law imposes stringent requirements upon prenuptial agreements, both technically and procedurally. Absent appropriate care and attention to detail, prenuptial

agreements are susceptible to challenges and may be invalidated by the court. Each party should be represented by independent counsel to avoid conflicts of interest as well as accusations of duress or coercion in the process. Additionally, a strong prenuptial agreement will include a full disclosure of the assets and liabilities of each prospective spouse on schedules attached to the executed prenuptial agreement. Furthermore, the agreement must be fair at the time of execution, and it "may be invalidated if the party challenging the agreement demonstrates that it was the product of fraud, duress, or other inequitable conduct."<sup>3</sup> Fairness will be determined by a judge or a jury, which may result in a popularity contest in the courtroom. In some states, prenuptial agreements are completely disregarded in divorce proceedings.

One common mistake that renders an agreement vul-

nerable is when a couple waits too long before discussing a desire for a prenuptial agreement. In the most extreme case, the party demanding the prenuptial agreement thrusts an agreement upon the other party "on the steps of the church or synagogue" on the day of the wedding. While such a scenario is perhaps a bit of an exaggeration, prenuptial agreements are often invalidated if executed too close in time to the wedding ceremony.<sup>4</sup>

As a practical matter, asking a future spouse to enter into a prenuptial agreement often causes discomfort to blossoming love relationships. The person being asked to enter into a prenuptial agreement may well interpret such a request as implying that their future spouse does not trust them, or that their future spouse expects the marriage to fail. As a result, many couples are reluctant to even talk about such agreements.<sup>5</sup> Moreover, the requirement for full and accurate financial disclosure deters many couples who might otherwise consider a prenuptial agreement from entering into a signed agreement. The bottom line is that while many couples are delighted to share their lives together when entering into a marriage, they may feel uncomfortable sharing information about their net worth.

## **AN ALTERNATIVE: THE DOMESTIC ASSET PROTECTION TRUST**

Because of the issues and complications surrounding prenuptial agreements, many couples are looking for alternatives to protect assets obtained prior to marriage and protect future inheritances. Asset protection trusts give couples a great alternative to the traditional prenuptial agreement. While asset protection

trusts can be formed domestically or off-shore, establishing and administering foreign asset protection trusts has become very expensive. And, in addition to the high cost, most people are uncomfortable with sending their assets offshore.

A much better alternative may be a domestic asset protection trust (DAPT) situated in one of the fifteen states that authorize the use of self-settled asset protection trusts in some form.<sup>6</sup> One state offering a particularly favorable statute is Wyoming.<sup>7</sup> Wyoming law<sup>8</sup> permits the creation of a self-settled trust that provides a more surefire alternative for protecting one's assets from a claim by a future spouse than the traditional prenuptial agreement.

DAPTs are powerful trusts that protect assets from potential unknown creditors, which by definition includes a future divorcing spouse. Moreover, a DAPT allows the creator to name himself or herself as a potential beneficiary in many cases—hence the name "self-settled" trust. Unfortunately, some jurisdictions are so pro-creditor — Illinois, for instance — that individual asset protection is not given consideration in the state's courts.<sup>9</sup>

## **BLOODLINE PRESERVATION TRUST**

One way to mitigate the negative jurisprudence applied in some states is to utilize a fairly new type of DAPT set up by a third party for the benefit of another individual known as a "Bloodline Preservation Trust" ("BPT").<sup>10</sup> The BPT concept is simple. You choose an asset protection jurisdiction, but unlike a traditional DAPT, the trust creator is not a beneficiary of the trust. The BPT is set up for the benefit of the creator's spouse, descendants and/or family members. A trust

structured in this manner is, by definition, a third-party trust. This allows the creator to avoid the legal uncertainty that is inherent with a self-settled domestic asset protection trust formed in jurisdictions that have not enacted statutes permitting self-settled asset protection trusts.

In their various forms, DAPTs are effective against a future divorcing spouse and other creditors, provided that the funding of the trust does not violate the applicable fraudulent transfer law.<sup>11</sup> So, to be an effective asset protection tool for a prospective spouse, it is imperative that the DAPT be created and funded before the marriage. Significantly, in establishing a DAPT, there are no requirements that the creator or beneficiary of the DAPT disclose to their future spouse a plan to create a DAPT, or disclose the assets funded in the trust.

An individual contemplating marriage can establish a DAPT in a state permitting such trusts and, upon the dissolution of the marriage, shield those assets from any equitable distribution. This technique is appealing to many individuals who desire to protect their assets from their future spouse — and the unpredictability of a judge's discretion — quietly and with less hassle. Not only is a properly structured and implemented DAPT far less likely to be subject to legal attack than a prenuptial agreement, but the creator also avoids having to engage in "the conversation" with the future spouse — which at best is uncomfortable, and at worst can lead to the breakup of the relationship when the prospective spouse sputters, "you don't trust me otherwise you wouldn't ask me to sign this!"

## DAPT REQUIREMENTS

As with any estate planning technique, a DAPT must meet certain criteria to be valid. At minimum, the domestic asset protection trust:

- Must be irrevocable;

- Should appoint a trustee (or trustees) with the discretion to administer the trust;

- Must appoint a trustee, whether corporate or individual, that is a qualified trustee of the jurisdiction in which the trust is formed; and

- Must contain a spendthrift clause, which restricts the transferability of a beneficiary's interests in

the trust property.<sup>12</sup>

Additionally, in exchange for restricting the use of the trust assets, those who establish DAPTs receive several benefits. First, because the assets gifted to the DAPT constitute trust property, the creator may protect those assets against claims made by future creditors of the creator, including a future spouse. Furthermore, unlike other types of irrevocable trusts where the grantor gives up all rights to the assets funded to the trust, a grantor or creator of a DAPT retains a beneficial interest in the trust while protecting the assets from future unknown creditors. Therefore, a potential spouse can establish a domestic asset protection trust that is fully discretionary, receive financial benefit from the trust during his or her lifetime, and protect the trust assets from a bad marriage that is solemnized after the creation of the trust.

## LAYERED STRATEGIES

Finally, certain individuals contemplating marriage and establishing a DAPT would benefit from further enhancing this already powerful strategy by layering or combining additional levels of asset protection. Individuals with a significant amount of assets, and/ or those holding certain "high-risk" classes of assets such as real estate holdings or business interests, might consider combining underlying entity structures with the DAPT. Specifically, one could create an LLC (Limited Liability Company) under the laws of an asset-protection oriented state (again, Wyoming being a good example). The individual would then transfer specified assets into the LLC, with the LLC structure providing the individual with protection against liabilities associated with the assets transferred into the LLC. The individual would in turn have the LLC membership interests owned by the DAPT. The layering and stacking of strategies would present considerable additional barriers to a would-be creditor or divorcing spouse.

## TAKEAWAYS

Given the flexibility and protection afforded by DAPTs, it is essential that professionals discuss the many benefits of these trusts with clients who are contemplating premarital planning. If a client combines a DAPT

executed before marriage with a prenuptial agreement, their personal asset protection is even stronger. Alternatively, if discussing a prenuptial agreement with a future spouse makes a client too uncomfortable, a DAPT can be a safe and less offensive way to protect one's assets while simultaneously maintaining the love and trust everyone desires when contemplating nuptial vows.

## (ENDNOTES)

7 How common is divorce and what are the reasons?, <<http://www.divorce.usu.edu/html/lesson-3>>; see also American Psychological Association, <<http://www.apa.org/topics/divorce/>>.

2 Sanette Tanaka, *The Growing Popularity of the Prenup*, WALL STREET JOURNAL, October 31, 2013, available at <http://www.wsj.com/articles/SB10001424052702303615304579157671554066120>.

3 *Cioffi-Petrakis v. Petrakis*, 103 A.D.3d 766, 766, 960 N.Y.S.2d 152 (2d Dep't, 2013).

4 See, e.g., *In Re Marriage of Bernard*, 204 P.3d 907 (Wash. 2009) and *Peters-Riemers v. Riemers*, 644 N.W.2d 197 (N.D. 2002) (in both cases the courts refused to enforce a prenuptial agreement presented to a spouse just days before the wedding)

5 Jeff Landers, *Skittish About a Prenup? Like It Or Not, You Already Have One*, FORBES, July 17, 2013, available at <http://www.forbes.com/sites/jefflanders/2013/07/17/skittish-about-a-prenup-like-it-or-not-you-already-have-one/>

6 Nevada, South Dakota, Ohio, Tennessee, Alaska, Wyoming, Del-

aware, Missouri, New Hampshire, Hawaii, Rhode Island, Utah, Virginia, Mississippi, and Oklahoma.

7 Effective as of July 1, 2007, the Wyoming Legislature enacted legislation permitting individuals to establish asset protection trusts in Wyoming, formally known as a Qualified Spendthrift Trust, which can provide certain protection from creditors, liabilities and judgments.

8 The Wyoming DAPT can be created by anyone living in any jurisdiction, so long as the trust states that it is: (i) a qualified spendthrift trust under Wyoming Statute § 4-10-510 et. seq., (ii) expressly incorporates the law of Wyoming to govern the validity, construction and administration of the trust, and (iii) is administered by at least one Qualified Trustee. N.E. 2d

9 *Rush Univ. Med. Center v. Sessions*, 2012 IL 112906, 2012 WL 4127261 (Ill, Sept. 20, 2012); The Illinois Supreme Court in 2012 held in the Rush University case that a self-settled trust was void as against public policy. Fortunately, this result should be easily averted using the BLOODLINE PRESERVATION TRUST.

10 BLOODLINE PRESERVATION TRUST, Reg. No. 4,073,124, Registered Dec. 20, 2011, Int. Cl.: 36; First used 10-1-2010; Most all practitioners agree that Domestic Asset Protection Trusts formed in the states that have Domestic Asset Protection Trust statutes are powerful tools when formed and funded correctly. Despite the high probability of success, there is a way to dramatically increase the odds of success; it is Hybrid form of Domestic Asset Protection Trust known as the Bloodline Preservation Trust ("BPT").

11 See, e.g., Wyoming Statute § 34-14-201. "Uniform Fraudulent Transfer Act."

12 See, e.g., Wyoming Statute § 4-10-510. «S=^»

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## Editor's note:

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