South Dakota Asset Protection Trusts 101

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South Dakota has unique laws that allow grantors of a South Dakota Asset Protection Trust (SDAPT), commonly known as a Domestic Asset Protection Trust (DAPT), the ability to shelter assets. An SDAPT is an irrevocable trust that specifically enables a grantor to be a beneficiary and still maintain protection from his or her creditors.

Asset protection trusts are prohibited in most states. However, some states specifically authorize these trusts. The three leading asset protection trust states are South Dakota, Alaska and Nevada.

SOME ADVANTAGES OF AN SDAPT INCLUDE:

- Shields trust assets from future creditors;
- The grantor retains certain interests in, and powers over, the trust;
- Can limit estate taxes by limiting the degree of control the grantor has so there is no retained interest for federal estate tax purposes; and
- Less complex and expensive than creating and maintaining an offshore asset protection trust.

SOME DISADVANTAGES OF AN SDAPT INCLUDE:

- Loss of some control; and
- Finite case law.

THERE ARE CERTAIN REQUIREMENTS TO CREATE A SDAPT. TO QUALIFY AS A SDAPT, THE TRUST INSTRUMENT MUST:

- Expressly incorporate South Dakota law to govern the validity, construction, and administration of the trust;
- Be administered in South Dakota;
- State that the trust is irrevocable;
- Contain a spendthrift clause; and
- Have some assets located within South Dakota.

FURTHER, THE GRANTOR MUST APPOINT A "QUALIFIED PERSON" TO ACT AS THE TRUSTEE. A QUALIFIED PERSON IS:

- An individual, other than the transferor, who resides in South Dakota; or
- An entity authorized by South Dakota to act as a trustee.

Only one of the trustees must be a qualified trustee, so the grantor may appoint co-trustees to allow someone other than a qualified trustee to also serve as trustee. Although the trust is irrevocable and places a number of restrictions on the grantor, a grantor may maintain the following powers without disqualifying the trust from protections:

- A transferor's power to veto a distribution from the trust;
- An inter vivos power of appointment;
- A testamentary power of appointment;
- The transferor's potential or actual receipt of income, including rights to such income retained in the trust instrument;
- The transferor's potential or actual receipt of income or principal from a charitable remainder unitrust or charitable remainder annuity trust;
- The transferor's receipt each year of a percentage of the value as determined from time to time pursuant to the trust instrument;
- The transferor's potential or actual receipt or use of principal;
- The transferor's right to remove a trustee or trust advisor and to appoint a new trustee or trust advisor, other than a person who is a related or subordinate party;
- The transferor's potential or actual use of real property held under a qualified personal residence trust;
- A pour back provision that pours back to the transferor's will or revocable trust all or part of the trust assets.

Certain restrictions apply to these powers. Note that the fraudulent transfer laws of all states prohibit transfers to a self-settled trust to avoid existing creditors if the transfer was made with the intent to defraud a creditor. Creditors existing prior to a transfer to the trust have 2 years from the date of the transfer or 6 months after discovery of the transfer to bring an action, whichever is later. If a creditor becomes a creditor subsequent to the transfer to the trust, the claim must be brought within 2 years after the transfer is made. Creditors do have to show that the transfer was fraudulent by clear and convincing evidence which is a fairly high threshold. Also, the trust must be in existence for at least 10 years to protect against creditors in bankruptcy.

To provide an additional layer of liability protection and allow you to have even more control, you can also use a South Dakota entity in combination with the DAPT. Your assets are transferred to an entity such as an LLC or limited partnership which are then solely owned by the DAPT. You can serve as a manager of the entity allowing greater flexibility and control of the assets. In addition, using a South Dakota entity helps reinforce your ties to the state and further bolsters asset protection. Finally, a creditor's sole remedy against a South Dakota LLC or limited partnership is a charging order which means that a creditor does not obtain any rights in the entity and cannot force a distribution.

Schedule an appointment today to talk with one of our qualified estate planning attorneys to see if a South Dakota Asset Protection Trust is right for you.