Washington Healthcare News

wahcnews.com Articles, Interviews and Statistics for the Healthcare Executive

VOLUME 4, ISSUE 9 SEPTEMBER 2009

Are the Assets in Your Trust Accessible to Creditors?

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A question we're often asked is whether a trust provides asset protection – can my creditors reach the assets in my trust? The answer is usually yes – most estate planning trusts do not provide asset protection for the person who created the trust (the settlor). Generally, if the settlor can use the trust's assets, then the settlor's creditor can reach the trust's assets. However, a special type of trust, called an asset protection trust (APT) may protect the trust's assets even though a settlor has limited access to the trust's assets.

Fewer than 15 states have provisions for an APT. Oregon and Washington do not, but Alaska has provisions for an APT. Alaska law provides that a settlor can create a trust that includes a provision that the beneficiary's interest may not be "voluntarily or involuntarily transferred before the distribution is paid or delivered to the beneficiary" (this is called a spendthrift provision). This provision prohibits a creditor that existed at the time and after the APT was created from using the APT's assets to pay the creditor's claim unless an exception applies. If a settlor receives a distribution from the APT, then the creditor may be able to access that distribution.

To qualify as an Alaska APT, the trust must include the following: (1) a provision that the trust is irrevocable (it cannot be amended); (2) Alaska law governs the validity, construction and administration of the trust; (3) a spendthrift provision; (4) a qualified trustee; (5) assets deposited in Alaska; and (6) the settlor must sign a solvency affidavit prior to transferring assets to the trust.

The settlor may retain the right to receive "discretionary distributions" of income or principal from the trust's assets. Discretionary distributions means that the trustee decides whether to make and the amount of the distributions that may be made to the settlor. The settlor's right to receive distributions should not be mandatory because then the creditor may force the trustee to make a distribution and access those distributions. The settlor may "use" certain trust assets – like real estate or tangible personal property and those assets would not be subject to a creditor's claim.

A "qualified trustee" is an Alaska resident individual, trust company or bank with trust powers headquartered in Alaska. The settlor may serve as an adviser to the trustee or as a non-qualified co-trustee so long as the settlor does not retain control over discretionary distributions. (The settlor cannot as co-trustee make decisions regarding distributions to the settlor). The qualified trustee must be responsible for maintaining trust records, preparing or arranging for the preparation of the fiduciary income tax returns, and part of the trust administration must occur in Alaska.

There are exceptions to the rules which allow a creditor to reach the assets of the Alaska APT. If the transfer of the assets to the trust was fraudulent or was intended to hinder, delay or defraud a creditor, then the court will not uphold the spendthrift provision. However the creditor must have been a creditor when the APT was created and file a law suit on or before four years after the date of the transfer to the trust or one year after the creditor discovered the transfer (10 years for bankruptcy if there is fraud).

As long as the settlor creates the APT and transfers assets to the APT before any claim has been asserted, the claim is barred against those assets. A potential claim or liability is not enough. Those people who are in high risk professions or businesses may still adopt an APT that will protect them against potential risks that are not yet a specific claim.

There are several groups of people who would benefit from an APT including (1) professionals at high risk of potential liabilities or litigation; (2) couples seeking an alternative to a prenuptial agreement; (3) people wanting to protect a nest egg; and (4) people who are vulnerable to financial scams. An Alaska APT can be a very effective tool for protecting an individual's assets from future creditors. However, they are not appropriate in every situation so care must be taken in establishing an APT.

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