Don’t Self-Settle for Inadequate Asset Protection

Why Self-Settled Asset Protection Trusts Don’t Protect Assets

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_Self-Settled Asset Protection Trusts_ are all the rage. They come in two main flavors: (1) The Domestic Asset Protection Trust (“DAPT”) and (2) the Offshore Trust, aka Foreign Asset Protection Trust (“FAPT”). To boost in-state trust business, about a dozen states have passed or are actively improving their self-settled asset protection trust statutes ... and that number is growing. Although self-settled trusts are heavily promoted by asset protection attorneys across the county, all of the relevant court cases indicate that if asset protection is your goal, you should find a more viable option.

If self-settled trusts are inadequate for asset protection, why do attorneys go to such lengths to sell them? The answer is simple: Money. Asset protection promoters market them heavily promising maximum protection and make big profits in the process. They do this despite zero court authority in existence that upholds self-settled asset protection trusts. Promoters also ignore the many court cases showing that self-settled trusts simply don’t afford the promised asset protection benefits.

**What is a Self-Settled Asset Protection Trust?**

There are three parties to any trust agreement: (1) a Settlor, who creates the trust and funds it with assets, (2) a Trustee, who holds legal title to the assets in trust for the beneficiaries, and (3) the Beneficiaries, who are eligible to receive benefits from the trust. In most trusts, the Settlor and Beneficiary are different people. In a self-settled trust, the Settlor is also a Beneficiary. In concept, the idea is incredible: contribute any amount of property to the trust and while creditors can't touch it, you can enjoy it as much as you want. The reality is that these arrangements just don't work as advertised.

Public policy has long been clear that you cannot settle a trust for your own benefit and at the same time shield the trust assets from your potential creditors. The Uniform Trust Code states that a creditor of a settlor may reach the maximum amount that can be distributed to or for the settlor’s benefit.¹ In other words, if a Settlor/Beneficiary has access to trust cash, property, vehicles, etc., so does a creditor.

Offshore jurisdictions were the first to market self-settled trusts by promising protections in a foreign jurisdiction that is not bound by the laws of the United States. In 1997, Alaska was the first state to enact a DAPT statute. Since then, over a dozen United States jurisdictions have enacted DAPT statutes. However, creditor attorneys have developed successful techniques to pierce these trusts. By frequently siding with creditors in these cases, courts have rebuffed the zeal of offshore and domestic jurisdictions to establish and promote self-settled trusts as superior asset protection tools.
Court Cases Defeating Domestic Asset Protection Trusts (DAPTs)

When it comes to self-settled trusts, there is an elephant in the room and that elephant has a name: **Bankruptcy**. In states that don’t recognize self-settled trusts, a debtor’s interest in a self-settled trust is subject to bankruptcy. The **Mortensen** case made clear that Federal Bankruptcy Law can even defeat a self-settled trust in states that recognize, protect, and advocate self-settled trusts. In **Mortensen**, an Alaska resident created a self-settled trust under Alaska’s DAPT statute under ideal circumstances: he was solvent and there were no judgments against him. Several years later he ended up in a bankruptcy court sitting in Alaska. The court applied Federal Bankruptcy Law instead of Alaska law ruling that the trust assets were reachable by the creditors in the bankruptcy under Section 548(e) of the Federal Bankruptcy Code.

Another problem with a DAPT is a potential lawsuit arising in a state that does not recognize or protect self-settled trusts. In **Dexia Credit Local v. Rogan**, the Seventh Circuit Court ruled that despite the debtor's trust having been created in a DAPT state, Illinois law applied instead. Another huge blow to DAPTs came on May 17, 2013 in **Waldron v. Huber** where, among other things, Washington State law applied rather than Alaska law where the DAPT was formed. The result was that the trust assets were not protected. Based on the **Dexia Credit** and **Huber** cases, one shouldn’t expect that a self-settled trust will be upheld in a state that does not allow them. Numerous other cases indicate that a court can apply the law of the state where the court is located and not recognize the laws of the state where an entity was formed.

If self-settled trusts don’t work in bankruptcy and don't protect against laws of DAPT unfriendly states, then you can just avoid declaring bankruptcy and avoid contacts outside of your DAPT friendly state, right? Not so fast. Unfortunately, even if you are careful not to get sued in the wrong state and manage to avoid voluntary bankruptcy, your creditors could file an involuntary bankruptcy petition against you. The court cases and the bankruptcy code have shown that even though a self-settled trust is created pursuant to a DAPT statute, the trust is still vulnerable.

Court Cases Defeating Offshore Trusts, aka Foreign Asset Protection Trusts (FAPTs)

Many asset protection promoters claim that offshore trusts are impermeable, in contrast to the absence of a single court case to support their claims. Why do they sell a product that has such an abominable record? It's a calculated risk that the resulting liability of a few failed trusts that are actually challenged will be vastly overshadowed by those that are never tested. In other words, they know that the majority of their clients will never get sued or go bankrupt. For those who are sued or face bankruptcy however, if the trust is self-settled, its assets are not protected.

Although promoters of FAPTs claim foreign laws protect you because the trust is not subject to the jurisdiction of U.S. Courts, there are many court cases showing how offshore trusts fail. For example, it is well established that an offshore trust cannot protect onshore assets. Numerous other cases show that even though a court in the United States may not have jurisdiction over the FAPT, they have jurisdiction over the debtor and can order the debtor to repatriate the trust assets or face incarceration for contempt. In **In re Lawrence** the debtor was jailed for over six years for refusing to repatriate assets, in **Bank of America v. Weese** the debtors paid settlement of over $12,000,000 in order to avoid incarceration, and in **U.S. v. Plath** the debtor was held in contempt for refusing to obey the court order to disclose details about offshore accounts despite the fact that there was no fraudulent transfer. These are just a few lowlights of the long list of failed FAPT strategies.
For a time, offshore trust peddlers used US v. Grant as the one court case that supported their strategy, because it was the single case where a court did not hold the debtor in contempt. The purported steel bulwark of the Grant opinion came crashing down when, in the Spring of 2013, a Florida court ruled against the very strategy FAPT promoters touted, dealing a huge blow to the offshore asset protection industry. In Grant, Raymond Grant created two self-settled trusts offshore (FAPTs), one for his own benefit and one for the benefit of his wife. Raymond funded both FAPTs at a time when he was solvent and had no known claims against him, once again ideal circumstances. Years later, Raymond died and the IRS obtained a $36 million dollar judgment against Raymond’s wife Arline. The U.S. moved to hold Arline in contempt of court for failing to repatriate the assets in the offshore trusts to pay the tax liability. Initially, the court refused to do so because Arline had never exerted control or received benefits from these trusts. But later when it was proven that Arline had received funds from the trust through her children’s accounts, the court issued a permanent injunction prohibiting Arline and her children from ever receiving any benefits from the trusts. Ultimately a very expensive “asset protection” strategy kept the assets protected from creditors, but also out of reach of those the trust was created to benefit. If your goal is to protect assets from both creditors and yourself, an offshore trust may be a great fit. If, however, you seek any self-settled benefits at all, look elsewhere.

Solution – Non-Self-Settled Trust

The alternative to the self-settled trust is simple, remove the one aspect of the trust that creates all of its vulnerability; make the trust non-self-settled. A non-self-settled trust, aka third party trust, has the support of state and federal statutes, the federal bankruptcy code, and an overwhelming number of court cases. Since the Settlor is not a beneficiary, the creditors of the Settlor cannot reach the trust assets, even in bankruptcy. A properly drafted third party trust can still benefit the settlor without disrupting the asset protection. The settlor could potentially benefit from the trust through a spouse who is a beneficiary. For example, the settlor could live in a trust owned residence free from rent so long as the spouse is a beneficiary. The settlor could be an income only beneficiary and still protect the trust principal. The settlor could also maintain flexibility by appointing a trust protector or through the use of a special power of appointment.

If the trust has discretionary spendthrift language, the assets are also shielded from the creditors of the beneficiaries. If Raymond Grant had created a non-self-settled discretionary spendthrift trust for his wife Arline, instead of creating the two FAPTs that failed, the assets would have been protected from the IRS judgment and Arline and other trust beneficiaries could still have benefitted from the trusts. For example, the trust could have purchased a home for Arline to live in and paid Arline’s credit card bills.

If true asset protection is the goal, consumers and especially promoters should remember the old adage that pigs get fat and hogs get slaughtered. The court cases make it clear that a non-self-settled trust provides proven asset protection, whereas a self-settled trust lays out the welcome mat, flips on the light, and leaves the front door wide open to creditors. If you self-settle, you settle for an inferior trust.
Uniform Trust Code Section 505, Restatement (Second) of Trusts Section 156(2), and Restatement (Third) of Trusts Section 58(2).

Federal Bankruptcy Code 11 U.S.C. 541. See also In re Simmonds, 240 B.R. 897 (8th Cir. BAP (Minn.) 1999).


Dexia Credit Local v. Rogan 624 F. Supp 2d 970 (N.D.Ill. 2009).


In re Brooks, 217 B.R. 98 (D. Conn. Bkrt. 1998) (where the offshore trust was disregarded because it was self-settled and the onshore assets were seized).


Uniform Trust Code Section 505, Restatement (Second) of Trusts Section 156(2) and Restatement (Third) of Trusts Section 58(2), In re Jane McLean Brown, D. C. Docket No. 01-14026-CV-DLG (11th Cir. 2002), Shurley v. Texas Commerce Bank, 115 F.3d 333 (5th Cir. 1997).


In re Jane McLean Brown, D. C. Docket No. 01-14026-CV-DLG (11th Cir. 2002).

United States v. Baldwin, 391 A.2d 844 (1978) or U.S. v. O'Shaughnessy, 517 N.W.2d 574 (1994) (where the trust assets were not subject to tax lien because the trust was not self-settled).