

NEWS ALERT

TRUSTS & ESTATES



This newsletter is second in a series on the modernization of Connecticut's trust laws by Public Act 19-137, effective January 1, 2020.

Asset Protection Trusts: "Everybody Gets a DAPT!" (even those outside Connecticut)

By Suzanne Brown Walsh and Richard A. Marone | September 11, 2019

In a previous [newsletter](#), we recently heralded the passage of the "Connecticut Qualified Dispositions in Trust Act", which permits the creation and establishment of self-settled domestic asset protection trusts ("DAPTs").¹ To recap: a DAPT is an irrevocable, self-settled trust, which permits the person establishing the trust (the "grantor" or "settlor," referred to as the "transferor" in the law) to fund the trust with his or her own assets and remain a permissible beneficiary of the trust. A properly-structured DAPT shields those trust assets from the claims of most future creditors of the grantor, making them particularly attractive planning techniques for business owners and professionals in high risk occupations, such as executives and medical professionals.

Connecticut DAPTs are also available to nonresidents, even those in states without their own DAPT legislation, such as Massachusetts and New York. A Connecticut DAPT may be particularly attractive to Massachusetts residents. Why? Because Connecticut only taxes trusts established by its residents, and Massachusetts only taxes trusts with Massachusetts trustees or Massachusetts-source income. That means that a Connecticut DAPT created and funded by a Massachusetts resident will pay no state income tax on its accumulated capital gains.

The following is a reminder of the DAPT requirements that apply to all Connecticut DAPTs, whether created by residents or nonresidents.

Basic Requirements

- The DAPT must be irrevocable and be "self-settled," meaning that it is created and funded by its Grantor,² either directly, by the Grantor's exercise of a general power of appointment or through a trust decanting.
- There must be at least one resident, "Qualified" Trustee who is not the Grantor.
- Only a Qualified Trustee or a Distribution Director (who is not required to be a CT resident) may have distribution authority.
- Whoever holds the distribution authority must be independent, to avoid the appearance of an implied distribution agreement, which is prohibited.
- The DAPT must say that the laws of Connecticut govern its validity, construction and administration.
- The DAPT must include provisions declaring that it is a spendthrift trust and that any beneficiary's interest cannot be transferred, assigned, pledged or mortgaged, whether voluntarily or involuntarily.

¹ See generally, Sections 99 – 109 of Public Act 19-137.

² The statute refers to the person creating the trust as a "Transferor."

Powers and Interests the Grantor May Keep in a DAPT

- The Grantor may act as a Non-Qualified, Co-Trustee with limited powers, but this is not advisable, as that could reduce the creditor protection afforded by the DAPT.
- The Grantor can be a permissible income and/or principal beneficiary of the DAPT, or receive an annual annuity or unitrust payment of up to five percent. However, it is best not to mandate any distributions to the Grantor for any reason or allow them subject to a standard, as that would significantly reduce the creditor protection afforded by the DAPT.
- The Grantor may retain the authority, held either individually or as a Trust Director, to veto distributions to other beneficiaries. This allows the Grantor to avoid making a completed gift when the trust is funded.
- The Grantor may hold the power to remove and replace a Trustee or Trust Director with an independent Trustee or Trust Director, or to appoint a Trust Director who in turn has the authority to remove and appoint Qualified Trustees or Trust Directors.
- The DAPT may allow the Trustee to reimburse the Grantor for income taxes on the DAPT's income or capital gains, or to pay such taxes directly, without diluting its creditor protection.
- The Grantor may hold limited testamentary powers³ to appoint to anyone other than the Grantor's creditors, the Grantor's estate or the creditors of the Grantor's estate.

Creditor Protection of a DAPT

A properly drafted and funded Connecticut DAPT:

- Should allow the Grantor to shield DAPT assets from all claims arising after the DAPT is funded, including future claims of a current or future spouse, child, or of any creditor.
- Should allow the Grantor to shield DAPT assets from state claims for reimbursement of incarceration costs or other non-Medicaid benefits rendered to the Grantor.
- Will not allow asset transfers to render the Grantor or the Grantor's spouse eligible for Medicaid.
- Will not defeat state or federal reimbursement claims or rights of recovery for Medicaid benefits paid to the Grantor or the Grantor's spouse.
- Does not defeat creditor claims if DAPT funding is a fraudulent transfer as to any creditor.

If you would like more information about this exciting new planning opportunity, please contact one of our attorneys in the Trusts and Estates Department.

³ i.e., exercisable in his or her will.

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