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INTRODUCING

THE FLORIDA ASSET PROTECTION TRUST

LESS EXPENSIVE, MORE PROTECTIVE, NO OUT OF STATE TRUSTEE REQUIRED

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Over my almost twenty years as an asset protection and estate planning attorney, I have found that sometimes going back to basics can provide clients with the best results. Using planning techniques where the statutes have been tested and the case law supporting them is rich provides more certainty than planning based on newer, less tested laws. The Florida Asset Protection Trust ("FLAPT")is an irrevocable trust that is sitused (at least initially), in the state of Florida but which is highly flexible to meet the needs of the trusts's creator (called the Settlor) over time. The Settlor or the Settlor's family members and/or trusted friends can serve as the trustee so no expensive out of state corporate trustee is needed. Oddly, the Settlor is not even beneficiary of the FLAPT but can still receive asset back from the it in the future. This not only provides excellent asset protection, but the protection may even be better than Delaware or Nevada type Trusts.

I am a huge believer in education and making sure my clients not only understand THAT their asset protection planning works but also WHY it works. That being said, before going on to describe the FLAPT, I have found that many people perceive any kind of *irrevocable* trust as being inflexible and unchangeable. This simply isn't true. Therefore, to keep the length of this article reasonable, I have written a companion article entitled "The Flexible Irrevocable Trust, Far More Powerful Than You May Have Imagined." I encourage you to read it to gain a deeper understanding of how and why irrevocable trusts can accomplish the goals of estate tax reduction and asset protection and still leave you the ability to modify the trust's terms and retain significant control over trust assets.

Some Basics.
To help you better understand this article, I first want to cover a few basic terms and concepts:

> **Settlor**. When someone *creates* a trust, they are referred to as the "Settlor."[1] In so doing, the Settlor will determine who the trust beneficiaries are, who the Trustee(s) are, and the terms under which the beneficiaries will receive the assets and benefits from the Trust. The

[1] The act of *creating* a trust is called "settling" a trust in legal parlance.

terms "Grantor" and "Trustor" are also words used to refer to the creator of a Trust, however, I will use the term Settlor to avoid confusion.

Trustee. The Trustee is the person (or trust company) who determines how the trust assets are invested, and when they are bought and sold. The Trustee also makes all management decisions regarding the trust assets and makes decisions regarding how much money is distributed to (or spent on) a beneficiary. The Trustee is considered a fiduciary which is someone who holds a position involving a confidence or trust. As a fiduciary, the Trustee has an affirmative duty to manage the trust assets in a prudent manner and to use the assets in a manner which best serves the beneficiary within the guidelines set forth in the Trust Agreement.

Beneficiary. The beneficiary is the person who is entitled to receive assets from the trust (called "distributions") and the person who is entitled to benefit from the trust assets.

Self-Settled Trust. When a person (the "Settlor") creates (or "settles") an irrevocable trust where they are also a beneficiary (i.e., someone to whom the trustee can distribute assets under the terms of the trust agreement), it is called a "Self-Settled Trust."

Non-Self-Settled Trust. When a Settlor creates or settles an irrevocable trust for one or more other people (i.e., the beneficiaries) so that the Settlor is NOT a beneficiary, the trust is called a "Non-Self Settled Trust."

To make this task a little easier, lets start with a basic example that we can refer back to:

> Assume Mike creates an irrevocable trust and names it the "Brady Family Irrevocable Trust." After signing the necessary paperwork to create the trust, Mike first transfers $1 million dollars in cash to the trust. He does this by setting up a bank account in the name of the Brady Family Irrevocable Trust and then depositing money into that account. For simplicity's sake, I am going to assume that the $1 million dollars is the only trust asset, however, the trust could also hold stocks, bonds, other financial assets, real estate, and even interests in LLCs or businesses. A wonderful benefit of the FLAPT, is that it can own just about any asset that Mike could himself.
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> Mike is married to Carol and they have six nutty kids, Greg, Marcia, Peter, Jan, Bobby, and Cindy. Mike loves and trusts his wife and wants to make sure that she and the kids are properly taken care of so he names all of them as "beneficiaries" of the Brady Family Irrevocable Trust. As mentioned above, the term "beneficiaries" refers to the people to whom trust assets (e.g., money, property, etc.) can be distributed to or whose expenses can be paid from the trust's bank account.

> Mike now has to choose someone to serve as a Trustee of the Brady Family Irrevocable Trust. The Trustee is the person who is responsible for (i) managing all the trust assets, (ii) making certain discretionary decisions about how much money to distribute to the beneficiaries and for what purposes, and (iii) generally carrying out the "terms" of the trust (the "instructions of the Settlor," if you will). Mike could be the Trustee in certain circumstances depending on his goals and objectives, but for the time being, assume that Mike names his brother, Mímir, as the Trustee.

So in this example, Mike is the Settlor (the creator of the Trust), Carol and the kids are the beneficiaries of the Trust (the ones who are able to receive distributions of assets from the Trust), and Mímir is the Trustee. Because Mike is the Settlor but NOT a beneficiary, the Brady Family Irrevocable Trust is a Non-Self Settled Trust. This means that the trust will be protected from the creditors of Mike, Carol, and all six children. I will explain in more detail why this is so below.

The Problem With Self Settled Trusts.
But what if, when Mike created the Brady Family Irrevocable Trust, Mike listed himself as a beneficiary so that the Trustee could directly distribute trust assets to Mike? Mike would then be **both** the Settlor of the trust and a trust beneficiary. As mentioned above, this would result in the trust being classified as a "Self-Settled Trust" or a trust a person creates for themselves. Self-Settled Trusts, unfortunately, are subject to what I'll refer to as the "Maximum Permissible Distribution Rule." To demonstrate how the Maximum Permissible Distribution Rule operates, let me go back to my example with Mike and Carol.

> When Mike created the trust, the trust agreement was drafted to allow the trustee to distribute as much or as little of the trust assets (i.e., the $1 million dollars) to any of the trust beneficiaries. This means that Mímir, as the Trustee, could give the entire $1 million dollars to Mike, or Mímir could give Mike nothing. Likewise, Mímir could make distributions in any amount to some or all of the other beneficiaries (i.e., Carol and the kids).
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> Now let's assume that Mike is sued and the person suing him ends up getting a $2 million dollar judgement against Mike. Of course, the creditor would love to get his hands on the $1 million dollars in the trust. Mímir, however, wanting to protect the money from the creditors, tells them "Too bad, so sad for you, Mr. Creditor. I will make no distributions to Mike. Go take a hike!!"

Unfortunately, despite Mímir's being an excellent Trustee by refusing to make any distributions to Mike, the judgement creditor will be able to reach the entire $1 million dollars owned by the trust. This is because the Maximum Permissible Distribution Rule isn't concerned with what the Trustee is willing to do, just what the Trustee ***has the power to do***. Therefore, since the Trustee agreement gave Mímir the power as the Trustee to give (i.e., distribute to) Mike the entire $1 million dollars, that is what the creditor can get their hands on. If the trust agreement had been drafted to say that the maximum amount the Trustee could distribute to Mike was $50,000 a year, then the creditor would be entitled to take $50,000 up front and $50,000 every year thereafter until their judgement was paid in full or until the trust ran out of money. Why? Because it's the maximum amount the Trustee is permitted to distribute to Mike.

But remember that the Maximum Permissible Distribution Rule only comes into play when a person is both the Settlor (or creator of the trust) and a beneficiary (someone permitted to receive distributions or benefits of the trust). If Mike were not a beneficiary, the Maximum Permissible Distribution Rule would not apply. Think about that for a minute.

Mike can create an irrevocable trust for the benefit of his wife and children. He and his wife, Carol, could serve as Co-Trustees so that they can jointly manage all of the assets in the trust. They can each buy and sell trust assets, write checks, collect rent from rental property, etc., and as long as the trust was properly drafted, the assets would be protected from Mike's creditors, Carol's creditors, the joint creditors of Mike and Carol, as well as the children's creditors. If they want to buy a new asset, they simply do so in the name of the trust where it will be protected. And if they simply want to take money out of the trust to spend it on consumption, Mike and Carol can simply distribute money to Carol where it can be spent on living expenses, a vacation, the kids' education, etc. Mike and Carol can even retain the right to change where the assets will go when they both die. For example, they might want to give a responsible child more control over their inheritance or give less control to a child who is not capable of properly handling money. They might decide to leave something to a charity or to a friend or family member. All of this can be accomplished without jeopardizing the asset protection provided by the trust.[2]

But what if, God forbid, Carol dies? Or what if Mike and Carol divorce. Without Carol as a beneficiary, the trust assets are unable to provide Mike benefits in the future. This is where the Florida Asset Protection Trust comes in. In order to understand how it differs from a standard irrevocable trust you may have encountered in the past, I want to turn to the "power of appointment."

The Power of Appointment.

Now that we have covered some of the basics of trusts and understand the Maximum Permissible Distribution Rule, I want to explain another trust concept, the Special Limited Power of Appointment (sometimes referred to as a "SLPOA"). With an understanding of this concept under your belt, you will be able to appreciate the full power of the Florida Asset Protection Trust.

At the risk of sounding overly simplistic, a power of appointment is simply the power to make a gift of an asset. For example, if I gave you a power of appointment over my home, you would have the power to give my house away to whomever you choose. I can also limit the group of people to whom you can make such a gift. I could give you a power of appointment over my home but state

[2] Please see my article entitled “The Flexible Irrevocable Trust, Far More Powerful Than You May Have Imagined” to see exactly how a trust provides asset protection and to understand how versatile a tool it is. Many people are scared when they hear the word "irrevocable," but that is because they do not understand how flexible an irrevocable trust can actually be.

that you can only give it to my wife or children or a trust for their benefit. I could also give you a power of appointment over my home that you could exercise only with the permission of some other person, like my brother. In this manner, before you gave my house away, you would need to get his permission which he could withhold if he wanted. I could even retain the right to revoke the SLPOA or change the person to whom the power is given. The person to whom the SLPOA is given is oftentimes call the Trust Protector. This is how I will be referencing them for the rest of this article.

If a SLPOA is granted over trust assets, the Trust Protector has the right to give away the trust assets to a group of people defined by the Settlor. Interestingly, one of the members of that group can be the Settlor himself. And, as explained above, the terms of the SLPOA are established by the Settlor and will govern the conditions surrounding how, when, and under what conditions it can be exercised.

If a power of appointment allows the Trust Protector to exercise the power in favor of him or herself, it is called a "General Power of Appointment." If the power of appointment only allows the Trust Protector to give assets to people OTHER THAN the Trust Protector, then it is called a special power, a non-general power, or a limited power. For simplicity's sake, I will be calling it a Special Limited Power of Appointment or SLPOA. Note that General Powers of appointment cause both tax and asset protection problems and are therefore, generally not used. Therefore, I will not be discussing them here. Note that powers of appointment have a long history and a well settled body of case law supporting them. This should provide additional certainty and comfort when using them to protect your hard earned assets.

Now let's go back to our example of Mike and his family.

> Assume Mike creates an irrevocable trust and names it the "Brady Family Irrevocable Trust" and transfers $1 million dollars in cash to the trust. This time he names himself and Carol to serve as Co-Trustees so that they can jointly manage the trust assets.
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> Like before, Mike loves and trusts his wife and wants to make sure that she and the kids are properly taken care of so he names all of them as "beneficiaries" of the Brady Family Irrevocable Trust. Mike and Carol also draft the trust to give them each the right to change where the assets will go when they both die.
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> This time, however, Mike names Mímir as the Trust Protector and gives him a Special Power of Appointment over the Trust assets that allows Mímir to appoint assets to Carol, his children, and his more remote descendants (i.e., grandchildren, great grandchildren, etc.). In the event Carol dies or in the event Mike and Carol decide to divorce in the future, Mímir would also be able to appoint assets back to Mike or create a new trust for his benefit.

Similar to the more traditional "irrevocable trust," Mike and Carol can jointly manage all of the assets in the trust. They can each buy and sell trust assets, write checks, collect rent from rental property, etc., and as long as the trust was properly drafted, the assets would be protected from Mike's creditors, Carol's creditors, the joint creditors of Mike and Carol, and their children's creditors. If they want to buy a new asset, they simply do so in the name of the trust. And if they simply want to take money out of the trust to spend it on consumption, Mike and Carol can simply distribute money to Carol where it can be spent on living expenses, a vacation, the kids' education, etc. And as their situation changes over time, the trust can be modified accordingly.

But unlike a more traditional "irrevocable trust," if Carol were to die, Mímir could appoint assets back to Mike or create a new trust for his benefit which could continue to give him asset protection benefits. Mímir could even create an offshore trust for Mike if the situation warranted doing so.

But what about the Maximum Permissible Distribution Rule? If Mímir can appoint assets back to Mike in the future, does that make Mike a beneficiary? Thankfully, the answer is no. Florida Statutes Section 736.0103(4), reads in relevant part as follows:

> “Beneficiary” means a person who has a present or future beneficial interest in a trust, vested or contingent, or who holds a power of appointment over trust property in a capacity other than that of trustee. **An interest as a permissible appointee of a power of appointment, held by a person in a capacity other than that of trustee, is not a beneficial interest for purposes of this subsection**.

Since Mike is not a beneficiary of the trust, and is not a permissible recipient of trust distributions, the Maximum Permissible Distribution Rule will not subject any of the trust assets to the claims of Mike's creditors.

What Makes a Trust Asset Protected?

Another misunderstood aspect of trusts is why they provide asset protection at all. While this will be a short primer, having a basic understanding of this will make understanding the Florida Asset Protection Trust much easier.

There are two primary means by which a trust can offer asset protection to its beneficiaries. The first of these two is the inclusion in the Trust Agreement of something called a "spendthrift clause." The second is to give the Trustee discretion over whether or not to make distributions to the trust beneficiaries. Each of these is discussed below. Understand as you read the following discussion, that it relates to trusts that are created by someone for the benefit of another (a "Non-Self Settled Trust") and **not** a trust created by someone of which they are also a beneficiary (a "Self-Settled Trust" that would be subject to the Maximum Permissible Distribution Rule). The reason a Non-Self Settled Trust protects assets from the creditors of the Settlor is that after the Settlor transfers money to the trust, he or she does not own them anymore so there is nothing to take.

Spendthrift Protection.
A general concept in asset protection planning is that a creditor generally cannot take what a person does not have the right to give. That is the basic idea behind a "spendthrift clause." The "spendthrift clause" itself is simply a provision in a Trust Agreement that restricts a beneficiary's ability to transfer, sell, or otherwise give away any of their rights in a trust.

> Assume that Conrad establishes a trust for the benefit of his child, Betty. The trust provides that Betty will receive $50,000 each year for the rest of her life. The trust was not drafted to contain a spendthrift provision. Betty is free to give away or sell her rights under the trust as a beneficiary. Since Betty has this right, if Betty is ever sued and a judgement is obtained by the plaintiff, Betty's beneficial interest in the trust could be taken by the creditor which would give the creditor the right to receive the $50,000 per year.
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> Now assume the exact same facts, however, this time Conrad makes sure that the trust does contain a spendthrift clause thereby forbidding Betty from selling, giving away, or otherwise transferring her rights under the trust. If she is sued by the same creditor, the creditor will not be able to take her interest in the trust which will make it significantly more difficult for the creditor to reach any assets of the trust or distributions therefrom. It is important to note, however, that once a distribution is made to Betty, it is fair game for a creditor to go after.

There are some limits to spendthrift protection, however. Florida Statutes Section 1736.0503, states that a spendthrift provision is generally unenforceable against (i) a beneficiary's child with respect to a claim for child support, (ii) a beneficiary's former spouse with respect to a claim for alimony, (iii) anyone (such as an attorney) who has provided services for the protection of a beneficiary's interest in the trust, and (iv) the government. If the trust is also a discretionary trust (see discussion below), these exception creditors may still be thwarted from reaching the trust assets.

Discretionary Distribution Provisions.
The next broad category of protective trusts are discretionary trusts. If the Trustee has discretion over whether or not to make distributions to a trust beneficiary, the creditors of that beneficiary cannot reach the trust assets while they reside in the trust. Nor can a creditor force the Trustee to make distributions. This applies even in the case of child support claims and alimony. So money that stays in the trust is protected.

Florida Statutes Section 736.0504 reads as follows:

> "(1) Whether or not a trust contains a spendthrift provision, a creditor of a beneficiary may not compel a distribution that is subject to the trustee's discretion, even if:

(a) The discretion is expressed in the form of a standard of distribution; or

(b) The trustee has abused the discretion.

(2) If the trustee's discretion to make distributions for the trustee's own benefit is limited by an ascertainable standard, a creditor may not reach or compel distribution of the beneficial interest except to the extent the interest would be subject to the creditor's claim were the beneficiary not acting as trustee."

Subpart (2) of the statute further confirms that this protection will continue even if the beneficiary is also the Trustee.

So even if a beneficiary of a trust (whether spendthrift or discretionary) is the sole Trustee of their trust, the trust assets can be protected from their creditors, including, divorcing spouses. In establishing protective trusts, it is usually best to use discretionary spendthrift trusts. This belt and suspenders approach provides the best protection since the protections compliment each other. Note that spendthrift and discretionary trusts have a long history and a well settled body of case law supporting them. Therefore, like the Special Limited Power of Appointment, relying on them should provide additional certainty and comfort when using them to protect your hard earned assets.

The Florida Asset Protection Trust.
The Florida Asset Protection Trust is an irrevocable trust that is created by the Settlor for the benefit of a spouse, children, or some other family member that at first derives it's asset protection from the well settled spendthrift and discretionary trust laws. It then adds the concept of a Trust Protector and a Special Limited Power of Appointment to add flexibility and a means for the Settlor to receive assets back in the future if needed. By combining them in an intelligent manner, you can achieve asset protection for you and your family, avoid probate, maintain flexibility to make changes in the future, and save money in estate taxes.

In it's more straight forward form, if you are the Settlor, you can serve as a Trustee and continue to maintain control over the trust assets. If your spouse is one of the beneficiaries, taking assets out of the trust is easy to accomplish. Rather than having to name an out of state Trustee, you can name a family member, friend, or advisor to serve as the Trust Protector to leave open the opportunity for the Settlor to receive assets transferred to the trust back in the future. It is also an excellent planning tool for a single individual to amass assets in an asset protected manner to use later in life. And unlike a multi-member LLC or retirement plan that has restrictions on what type of assets it can hold, the Florida Asset Protection Trust can hold any type of asset that the Settlor could own in their individual name. And best of all, while not simplistic, the laws allowing all this protection and flexibility are reasonably well settled.

Some of the other benefits of the Florida Asset Protection Trust are:

1. It gives you a means to protect assets in a way that is superior in many ways to Self-Settled Trusts established in states like Delaware, Nevada, Alsaka, etc. given the fact that there is still some uncertainty as to whether these laws will ultimately be upheld. In addition, unlike these Domestic Asset Protection Trusts which require you to pay several thousands of dollars to a Trustee located in that state, you, a family member, and/or a trusted friend can serve as the Trustee. But Another benefit the Florida Asset Protection Trust has over "self-settled trusts" (even if formed in states like Delaware, Nevada, Alsaka, etc.) is that the changes to the bankruptcy laws made in 2005 provide for a ten-year look back period for certain transfers to a self-settled trust. Since the Florida Asset Protection Trust is not a self-settled trust, this ten year bankruptcy rule should not apply.

2. Your Florida Asset Protection Trust may own an LLC with you as it's manager, so you are the only person with knowledge, access or control over the assets of the trust. This not only adds an extra level of protection and control, it also means that the Florida Asset Protection Trust can protect your business, not just your investment assets.

3. Your Florida Asset Protection Trust does not need to file a separate tax return nor are there ongoing fees that need to be paid as with limited liability companies or other legal entities.

4. The Trust Protector can be given the power to make sure the trust complies with new laws affecting it's ongoing asset protection and ability to save you money on estate taxes. You can also name successor Trust Protectors and retain the right to remove a Trust Protector if necessary.

5. Unlike a Self-Settled Trust set up out of state, the protection from a Florida Asset Protection Trust is protected under Florida law. This means that you can save money, not only in out-of-state trustee's fees, but also in defending an out-of-state trust.

6. Unlike a Self-Settled Trust set up out of state you can avoid the negative stigma that comes from having a trust in an exotic jurisdiction.

7. If you are sued, divorced, bankrupt, or subject to scrutiny by government agencies, you may be asked to disclose all of your assets and any trust of which you are a beneficiary. Because you are not an owner or a beneficiary of your Florida Asset Protection Trust, the trust assets do not need to be included on a balance sheet or personal financial statement. Even if the trust's existence is discovered, the trust and its assets are irrelevant because you have no legal, equitable, or beneficial interest in the trust.

8. If funded in advance, a Florida Asset Protection Trust will protect assets from creditors, divorce, bankruptcy, government agencies, or any other threat to you or the other beneficiaries not only now, but for multiple generations in the future. Even though the trust

is irrevocable, you and/or your spouse can retain the right to change the conditions, the timing, the amounts, and the identity of the potential beneficiaries of the trust.

9. The Florida Asset Protection Trust can provide you with a long term asset protection safe haven for certain assets <u>even if you have already been sued</u> so long as it is funded with exempt wages or other exempt assets. This could allow you to transfer your exempt earnings to your Florida Asset Protection Trust and spend down other non-exempt (or unprotected assets) before you are subject to a judgement.

Conclusion.
The Florida Asset Protection Trust has numerous advantages over other types of asset protection trusts. Family Limited Partnerships, and limited liability companies, but like all advanced planning techniques, the devil is in the details. Intelligently constructing an asset protection plan depends on understanding you goals and objectives. I also encourage you to read my article entitled "The Flexible Irrevocable Trust, Far More Powerful Than You May Have Imagined" to see understand in more detail how a trust provides asset protection and to understand how versatile a tool it is. Many people are scared when they hear the word "irrevocable," but that's because they do not understand how flexible they can actually be.

If you feel you could benefit from all the advantages of the Florida Asset Protection Trust, please feel free to contact my office at (407) 210-6622.