

# THE NEW MICHIGAN DOMESTIC ASSET PROTECTION TRUST

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## I. RATIONALE

*“Until approximately 20 years ago, the laws throughout the United States prevented an individual from creating a self-settled trust and protecting the trust assets from claims by his or her creditors. With limited exceptions in the area of pension and retirement trusts, this rule applied to virtually all self-settled trusts, including self-settled spendthrift trusts. (A spendthrift trust prevents the voluntary or involuntary transfer of trust assets by a beneficiary before the property is distributed to the beneficiary by the trustee.) As a result, if a person created an irrevocable trust and gave the trustee discretion to use the income and principal for the person, his or her creditors could reach all of the trust assets. As society became more litigious, however, and people felt the need to shelter their assets, some states began to follow the practice of other countries that allow asset protection trusts. Michigan law had not evolved in this manner. Although the Michigan Trust Code recognizes spendthrift trusts and generally protects the interests of the beneficiary from claims of creditors, the trust property may be reached by creditors of the settlor if the trust is revocable, and the assets are subject to limited protection if the trust is irrevocable. With one exception (for a type of trust in which the settlor retains a beneficial interest that follows his or her spouse's life interest), the Michigan Trust Code does not authorize domestic asset protection trusts. As a result, if a Michigan resident wanted to create a DAPT in the United States, he or she had to do so in one of the other 15 states, including Ohio, that allow these trusts. Michigan needed to enact DAPT legislation, in order to remain competitive. For many individuals, particularly those with considerable assets, an asset protection trust may be attractive for a variety of purposes. When Michigan residents go to another state to establish the trust, there is an economic cost to this State. Every state's DAPT law requires the trust to have some presence in or connection with that state, typically through the use of a local trustee (or co-trustee), such as a bank or trust company. Thus, states with a DAPT law were drawing trust business away from Michigan. The enactment of the Qualified Dispositions in Trust Act not only will permit Michigan residents to create asset protection trusts in this State, but also may make Michigan a destination for out-of-state residents to establish DAPTs. Nationwide, the DAPT industry is growing, and the positive economic impact could be significant.”*

Source: Legislative Analyst, Suzanne Lowe (quoting sources outside the Michigan Senate Fiscal Agency) December 27, 2016.

## II. FIVE KEY FEATURES

- A. The trustee of the DAPT must be a “qualified trustee,” i.e., a corporate trustee authorized to serve as a trustee under Michigan law or an individual *other than the transferor* and residing in Michigan.
- B. The transferor can retain certain rights and interests in the trust.
1. The right to veto distributions from the trust.
  2. The right to direct the investment decisions of the trust.
  3. The power of appointment, exercisable through their Last Will and Testament, effective as of date of death, to appoint assets funded in the trust to anyone but known creditors or creditors of the estate.
  4. The right to receive income from the trust and/or principal distributions at the discretion of the trustee or advisor under a discretionary or support provision.
  5. The right to remove a trustee or advisor and appoint anew.
  6. After death of transferor, the qualified trustee has the power to pay transferor’s debts, expenses of administration, or any estate and inheritance tax imposed upon the transferor’s estate, without regard to source of payment.
  7. Requirements include:
    - a) Self-created irrevocable trust
    - b) A spendthrift provision, restricting the transferability of a beneficiary’s interests in property for an express period of time, disallowing voluntary or involuntary transfers before an actual distribution by the trustee to beneficiary, with the
      - right to adjust discretionary beneficiary
      - right to veto distribution
      - right to use trust property
      - right to remove or replace trustee
      - right to appoint a third-party trust protector, who can change beneficiaries or amend trust for administrative purposes
  8. An Affidavit of Solvency must be executed by the transferor, before any transfer of properties to the DAPT. The Affidavit of Solvency must certify that (i) the transfer will not render transferor insolvent; and (ii) the transfer

isn't being executed with intent to defraud any creditor; and (iii) transferor is unaware of any pending or threatened litigation other as disclosed in the affidavit.

C. Limitations upon attack by creditors of transferor

1. Protections against creditors, who qualify, will commence two (2) years after transfer, or thereafter, one (1) year after creditor's discovery, if transfer deemed improperly concealed. MCL 700. 1045(3).
2. While creditors may still have ability to make claim against certain assets transferred to the trust, there are restrictions upon those claims. MCL 700.1045(2)(a) requires that the challenges must be brought under sections of the Michigan Uniform Voidable Transfer Act, MCL 566. 34, 566.35. ("Fraudulent Conveyance Act")
3. Limitations period shortened from six (6) years to two (2) years, with a one (1) year discovery rule for existing creditors.
4. Creditor must establish, by clear and convincing evidentiary testing, a very high standard, that transfer was done with actual intent to defraud creditors.
5. Provided the challenge is successful, avoidance of the disposition is limited only to satisfaction or amount of present value of such creditor's claim.
6. The attack does not void the disposition to the trust, but rather requires the trustee to transfer sufficient value to the benefiting creditor to satisfy the claim.

D. The transferor cannot retain the right to amend or revoke the trust or direct assets funded in the DAPT for return to transferor.

E. Replacement or Addition to Ante-Nuptial Agreements

So long as a DAPT has been created and funded more than thirty (30) days prior to a marriage, the DAPT is not subject to piercing in the event of marriage dissolution, which differs from the conventional pre-nuptial agreements, which require (i) notice and (ii) signature of the benefiting new spouse. In the case of a DAPT created for this purpose, no notice or consent of the new spouse is required!

F. Creditor Protective Approaches

Because the DAPT Act limits a creditor's rights using qualified dispositions, lenders and those others extending credit (such as vendors, suppliers, and landlords) will likely require:

1. The obligor (including a written guarantor) agrees that no qualified disposition will be made without prior written approval of such creditor; and
  2. The obligor (including a written guarantor) agrees to remain under the designated obligations as the creditor requires with regard to any qualified dispositions; and
  3. The obligor (including a written guarantor) agrees to retain the continuing or periodic obligation for payment.
- G. Relation to Michigan Uniform Fraudulent Conveyance Act, as amended April 10, 2017 – MCL 566.31, et seq.

The Michigan fraudulent conveyance act has been amended to expressly acknowledge the provisions of MCL 700.1031 et seq. The definition of “transfer” does not include any valid transfer to a DAPT. See MCL 566.31(1) (q).

### III. IMPLEMENTATION BY LEGAL COUNSEL

- A. The client is analyzed as to assets, as to pending claims, sources of wealth (including businesses), current assets, current liabilities, contingent liabilities, aims and intentions of the client and risks of exposure. Works as a great safety measure for professionals or business owners, who engage in a litigious world. Also works well as a pre-nuptial tool for those anticipating marriage.
- B. Identification of the assets to be transferred into the DAPT, with present valuations.
- C. Preparation of a solvency analysis of the client.
- D. Identification of the proposed trustee, considering required statutory qualifications.
- E. Identification of any other fiduciaries such as distribution advisors, etc.
- F. Counsel with client as to terms and conditions desired by client, in preparation of the DAPT.
- G. Counsel compiles a confidential summary of terms and conditions of the DAPT, for review of relevant risks going forward.
- H. Counsel prepares and reviews DAPT with the client and client executes the trust instrument.

- I. Simultaneously, client executes an Affidavit of Solvency, as required by the DAPT Act, averring that:
    - 1. The property to be subsequently transferred is not derived from unlawful activities; and
    - 2. The transfer will not render the client insolvent; and
    - 3. The client has full right, title and interest to the transferred property; and
    - 4. The client has no intent to defraud any existing creditor; and
    - 5. There exists no pending or threatened court actions, except as disclosed therein; and
    - 6. The client is not involved in any administrative proceedings, except as disclosed therein; and
    - 7. The client is not currently in arrears on a child support obligations by more than thirty (30) days (preexisting child support or spousal support orders are exceptions); and
    - 8. The client does not currently contemplate petitioning for any protection under the United States Bankruptcy Code.
  
  - J. Properties already subject to existing liens, such as, homeowner associations, construction, mortgages, and any existing other statutory protections are exceptions to protection under DAPT legislation.
  
  - K. Assets transferred may not be reached by creditors of transferor after the expiration of two (2) years from date of transfer to the trust.
  
  - L. The client executes an Affidavit of Solvency prior to the transfer of assets to the DAPT, for purposes of verifying the client's continuing solvency.
  
  - M. Assets to be transferred can be typically packaged within one or more legal entity formed under Michigan law, such as a limited liability company controlled by the trustee.
  
  - N. Assets to be transferred are documented as transferred to the DAPT.
  
  - O. As appropriate, for memorialization, records of assets transferred are recorded of public record, in the Office of the Register of Deeds for the county of client's residence and/or location of real estate or deposited into escrow with third parties, or filed with other disinterested third parties.
- IV. The probate court has exclusive jurisdiction over any action to determine if a transfer is a qualified disposition and the extent of the transferor's interest or value or income from a qualified disposition, but has concurrent jurisdiction over any creditor's action for attachment or other provisional remedy against DAPT property. Proper venue is (i) in the principal place of administration as designated by the terms of the DAPT or (ii) if none stated, the principal place of administration or (iii) in any place where the trust property could be registered.

V. COMPARE STATE LAWS

- A. When relying, expressly to shield from creditors because of potential exposures for vulnerable professionals and business owners, undertake to carefully analyze with specific steps.
- B. Select the proper jurisdiction in light of personal objectives. for establishing the irrevocable trust.
- C. Select an independent trustee who resides in the state or has business nexus with the DAPT jurisdiction selected.
- D. Deposit assets **located in the DAPT state**, rather than in the transferor's state of residency.
- E. Take care not to transfer assets of the trust estate outside the DAPT state, in order to avoid intervention by creditor.
- F. Carefully examine and understand that "transfer" to the DAPT must be compliant with fraudulent conveyance statutes in both the DAPT state and transferor's state of residency.
- G. Carefully examine and understand domestic relations and divorce statutes (for property division in the case of marriage), of the DAPT state, as to marriages taking place both before and after the DAPT was created.
- H. Carefully examine and understand state income taxation for assets in DAPTs formed by non-resident.
- I. Make certain to confer absolute discretion upon the trustee over distributions from the DAPT to the transferor.
- J. Make certain that the transferor retains no ownership interest in the DAPT assets.

Statute - Mich. Comp. Laws Ann. 700.1041 – 700.1050, inclusive

Statute – Michigan Fraudulent Conveyance Act, as amended, MCL 566.31 et seq.

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