DOMESTIC ASSET PROTECTION TRUSTS: EXAMINING THE EFFECTIVENESS OF SOUTH DAKOTA ASSET PROTECTION TRUST STATUTES FOR REMOVING ASSETS FROM A SETTLOR'S GROSS ESTATE

MARK R. KROGSTAD†
MATTHEW W. VAN HEUVELEN††

Various states have enacted legislation allowing for the creation of self-settled spendthrift trusts in the last decade. This recent trend of legislation has given rise to domestic asset protection trusts ("DAPTs"). The enactment of DAPT laws in South Dakota and various other states has caused debate as to whether transfers to such trusts can be structured as completed gifts for federal gift tax purposes and whether the assets transferred to such trusts by a settlor can effectively be removed from a settlor's gross estate for federal estate tax purposes. This article will discuss why recent changes to South Dakota's DAPT statutes likely provide settlors the option of reducing their gross estates by making completed gifts to self-settled trusts sitused in South Dakota.

I. INTRODUCTION

Over the past several years, various states have enacted legislation allowing for the creation of self-settled spendthrift trusts. This recent legislative trend has given rise to domestic asset protection trusts ("DAPTs"). The enactment of DAPT laws in South Dakota and various other states has caused debate as to whether transfers to such trusts can be structured as completed gifts for federal gift tax purposes and whether the assets transferred to such trusts by a settlor can effectively be removed from a settlor's gross estate for federal estate tax purposes. While definitive answers remain unclear, certain private letter rulings from the Internal Revenue Service ("IRS") have offered support for the position that a settlor may make completed gifts and remove assets from his or her gross estate by transferring the assets to a DAPT provided the facts and the applicable

Copyright © 2016. All Rights Reserved by Mark R. Krogstad, Matthew W. Van Heuvelen, and the South Dakota Law Review.
† Associate, Davenport, Evans, Hurwitz & Smith, LLP; Augustana University, B.A., 2007; University of North Dakota School of Law, J.D., 2010; University of Florida Fredric G. Levin College of Law, LL.M. (Taxation), 2012.
†† Partner, Davenport, Evans, Hurwitz & Smith, LLP; Northwestern College, B.A., 2007; University of Iowa College of Law, J.D., 2010.

state law are consistent with the letter rulings.[1] South Dakota, known for having some of the most progressive trust laws in the country,[2] first enacted its DAPT laws in 2005.[3]

Over the past few decades, there has been a "substantial concern[] held by Americans about the potential of financially devastating legal judgments."[4] In other words, Americans are worried about potentially losing large sums of money through litigation. For example, the number of lawsuits filed against physicians between 1956 and 1990 "rose from 1.5 claims per every 100 physicians to 15 claims per every 100 physicians."[5] Over the past several years, juries in the United States have awarded large verdicts with potentially devastating consequences to defendants.[6]

On the other hand, protecting one's assets can be difficult. Over the last one hundred years or so, trust laws in the United States have trended weaker and weaker.[7] For example, in the United States, as a matter of public policy, a trust's spendthrift provision was traditionally void with respect to the settlor's creditors where the settlor

---

[1] *See* I.R.S. Priv. Ltr. Rul. 2009-44-002 (Oct. 30, 2009); I.R.S. Priv. Ltr. Rul. 98-37-007 (Sept. 11, 1998).
[2] *See, e.g.*, Eddy R. Smith, *It's Trust Time in Tennessee!*, 49 TENN. B.J. 29 (Aug. 2013).
[3] S.B. 93, 80th Leg., Reg. Sess., ch. 261 (S.D. 2005).
[4] Jeremy M. Veit, *Self-Settled Spendthrift Trusts and the Alaska Trust Act: Has Alaska Moved Offshore?*, 16 ALASKA L. REV. 269, 280 (1999) (quoting Richard W. Hompesch II et al., *Does the New Alaska Trusts Act Provide an Alternative to the Foreign Trust?*, J. ASSET PROT., July/Aug. 1997, at 9); BARRY A. NELSON ASSET PROTECTION & ESTATE PLANNING—WHY NOT HAVE BOTH? 15-1 (2012), http://www.ficpa.org/Content/Files/Docs/Ematerials/Materials_12AS_NelsonCombinedSupplementalMaterials.pdf.
[5] Jordon Walker, *Malpractice Lawsuits in the US: Trends over Time and How Recent Reductions in Damage Awards Could Change Medicine*, YALE J. MED. & LAW: AN UNDERGRADUATE PUBL'N (Dec. 5, 2011) (citing Kenneth E. Thorpe, *The Medical Malpractice 'Crisis': Recent Trends And The Impact Of State Tort Reforms*, HEALTH AFFAIRS, Jan. 20, 2004, at 24), http://www.yalemedlaw.com/malpractice-lawsuits-in-the-us-trends-over-time-and-how-recent-reductions-in-damage-awards-could-change-medicine.
[6] *See, e.g.*, Tony Ogden, *Top Ten Jury Verdicts of 2010*, LAWYERS USA (Jan. 18, 2011), http://lawyersusaonline.com/ blog/2011/01/18/top-ten-jury-verdicts-of-2010 (providing that the top verdict in 2010 was for $505 million "to a Las Vegas principal who developed Hepatitis C several weeks after undergoing a routine colonoscopy," versus the top verdict in 2009 which was $370 million).
[7] Veit, *supra* note 4, at 280 (citing *Trusts and Property Transfers in Trust: Hearing on HB 101 Before the House Labor & Commerce Comm.*, 20th Legis., 1st Sess. (Alaska 1997) (comments of Rep. Al Vezey)).

was also a beneficiary.[8] To obtain such protection, people in the United States were forced to establish trusts in offshore jurisdictions such as the Cayman Islands, Bermuda, or the Cook Islands.[9] These circumstances gave rise to offshore asset protection trusts ("OAPTs").[10]

OAPTs are trusts settled under the laws of foreign jurisdictions that are advantageous to protecting assets from future creditors.[11] Offshore trusts provide two primary benefits: (1) strong spendthrift protection; and (2) the possibility for a settlor to control and/or benefit from the property held in the trust.[12] Offshore trusts gained popularity in the early 1990s after the Cook Islands codified their existence in 1989.[13] Shortly thereafter, other nations, including the Bahamas, Bermuda, and the Cayman Islands, implemented their own legislation in an attempt to attract the OAPT business to their countries.[14] In 2000, it was estimated that over two trillion dollars ($2,000,000,000,000) in assets were held in offshore trusts.[15]

---

[8] HELEN S. SHAPO ET AL., THE LAW OF TRUSTS AND TRUSTEES: A TREATISE COVERING THE LAW RELATING TO TRUSTS AND ALLIED SUBJECTS AFFECTING TRUST CREATION AND ADMINISTRATION 472-78 (3d ed. 2012). Spendthrift is a provision generally intended to shield a trust interest from a beneficiary's creditors. *See infra* Part II.A.

[9] Veit, *supra* note 4, at 270.

[10] *Id*. at 276. *See also* John K. Eason, *Home From the Islands: Domestic Asset Protection Trusts Alternatives Impact Traditional Estate and Gift Tax Planning Considerations*, 52 FLA. L. REV. 41, 42 (2000) (stating that "[a]n increasingly litigious U.S. social environment has contributed to an increased occurrence of U.S. citizens sheltering significant portions of their wealth in offshore asset protection trusts."). Placing assets offshore also provides the practical obstacle between U.S. creditors and the assets held offshore because it can be difficult or cumbersome to even attempt to obtain the assets regardless of the laws in place in the offshore jurisdiction. *See generally Symposium: The Rise of the International Trust, Roundtable Discussion*, 32 VAND. J. TRANSNAT'L L. 779, 792 (1999) (providing that distance between a settlor and the trust assets is a natural barrier between creditors and the assets).

[11] *See generally Symposium: The Rise of the International Trust, Roundtable Discussion*, 32 VAND. J. TRANSNAT'L L. 779, 802 (1999) (discussing the favorable characteristics that offshore jurisdictions offer to trust settlors for optimizing a greater level of asset protection).

[12] Veit, *supra* note 4, at 276.

[13] JAMES J. FLICK & JONATHAN GOPMAN, FLORIDA BAR, ASSET PROTECTION IN FLORIDA, OFFSHORE ASSET PROTECTION TRUSTS, ASPR FL-CLE 10-1 (2013).

[14] *Id.*

[15] Eason, *supra* note 10, at 42.

As money poured out of the United States to offshore trusts, some stateside jurisdictions began taking the "if you can't beat'em, join'em" approach by developing their own set of settlor-friendly laws. Alaska was the first state to take action when its then-governor, Tony Knowles, signed the "Alaska Trust Act" into law on April 1, 1997.[16] The Alaska legislation permitted the establishment of self-settled spendthrift trusts under Alaska law.[17] Thus, it became the first United States jurisdiction to allow an exception to the longstanding rule that permitted creditors to reach a trust beneficiary's interest when the beneficiary was also the settlor of the trust.[18] The purpose of the legislation was to "stimulate economic development in Alaska and establish Alaska as a global financial center."[19] With this legislation, Alaska offered a domestic alternative to the OAPTs with the hope of bringing an influx of assets into the state's banks and trust companies and generating the related trust administration fees.[20] After the enactment of the legislation, domestic settlors could establish their trusts in Alaska and obtain a level of asset protection that previously only existed offshore, but without the risks associated with a foreign jurisdiction.[21] Fifteen other states, including South Dakota, have since followed

[16] *See, e.g.*, DAVID G. SHAFTEL ET AL., AM. COLL. OF TRUST & ESTATE COUNSEL, COMPARISON OF THE DOMESTIC ASSET PROTECTION TRUST STATUTES (Sept. 2015), http://www.actec.org/assets/1/6/Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust-Statutes.pdf (stating Alaska was the first state to take action, "[t]here are now sixteen states that allow for the formation of DAPTs."); Veit, *supra* note 4, at 269 n.1.
[17] H.B. 101, 20th Leg., 1st Reg. Sess. (Alaska. 1997).
[18] Gideon Rothschild et al., *IRS Rules Self-Settled Alaska Trust Will Not Be In Grantor's Estate*, EST. PLAN., Jan. 2010, at 3, 3-4.
[19] Veit, *supra* note 4, at 269. The legislation sought to ensure that the Alaskan financial service industry could gain the advantages of the inflow of trust capital to Alaska. *Id*. at 281 (stating that Rep. Vezey, the sponsor of the Bill, noted the substantial management fees that would be very lucrative for Alaska).
[20] *Id*. at 281.
[21] *Id*. at 276-77 (noting the risks of political instability and the expense of creating and administering a trust in a foreign jurisdiction).

Alaska's lead and adopted their own legislation permitting trust settlors to establish self-settled trusts.[22] However, not all states have adopted uniform legislation.[23]

This article sets forth the historical background on trust law doctrines that provide beneficiaries a certain level of asset protection and a historical background on the development of DAPTs.[24] This article further analyzes how federal transfer taxes interact with typical DAPTs and how differing state laws affect how DAPTs are utilized as estate planning vehicles.[25] Finally, this article examines South Dakota's DAPT statutes and discusses whether a settlor's transfers to a South Dakota DAPT could be considered completed gifts for federal gift tax purposes and whether the transferred assets could be excluded from the settlor's gross estate for federal estate tax purposes.[26]

II. HISTORICAL BACKGROUND

Federal transfer tax provisions of the Internal Revenue Code ("Code") have consequences that are ultimately dependent on state trust law.[27] Specifically, whether a gift is a completed gift for purposes of federal gift tax laws under Chapter 12 of the Code or whether an asset is included in a decedent's gross estate for purposes of federal estate tax laws under Chapter 11 of the Code. The determination may depend, in part, on the application of specific provisions of state trust laws. As such, it is important to examine state trust law before addressing specific transfer tax issues related to DAPTs. Of most

---

[22] SHAFTEL ET AL., *supra* note 16, at 1.
[23] *See* S.D.C.L. §§ 55-16-1 to -16 (2012); COLO. REV. STAT. ANN. § 38-10-111.5 (West 2016); DEL. CODE ANN. tit. 12, §§ 3570-3576 (West 2016); HAW. REV. STAT. ANN. § 554G (West 2016); MO. ANN. STAT. §§ 456.5-505 (West 2016); N.H. REV. STAT. ANN. § 564-B:8-814 (West 2016); NEV. REV. STAT. ANN. §§ 166.010-.170 (West 2016); OKLA. STAT. ANN. tit. 31, §§ 13, 16 (West 2016); R.I. CODE ANN. § 18-13-2 (West 2016); TENN. CODE ANN. §§ 35-16-104, 107 (West 2016); UTAH CODE ANN. § 25-6-14 (West 2016); WYO. STAT. ANN. §§ 4-10-505, -510 to -523 (West 2016).
[24] *See infra* Part II.A-C.
[25] *See infra* Part III.A-C.
[26] *See infra* Part IV.A-C.
[27] *See generally* Comm'r v. Estate of Bosch, 387 U.S. 456 (1967); *see also infra* Part III.A-C.

importance are the state trust laws related to (1) spendthrift provisions and (2) the classification of distribution interests.[28]

A. Spendthrift Language

A settlor may attempt to shield assets in trust from a beneficiary's current or future creditors through a "spendthrift trust."[29] A spendthrift trust utilizes a spendthrift clause, which "expressly prohibit[s] the voluntary and involuntary alienation (by creditor attachment or otherwise) of the beneficiary's trust interest."[30] In other words, the clause disallows a beneficiary from assigning, or a creditor from reaching, the beneficiary's beneficial interest in the trust.[31] Traditionally, settlors used spendthrift clauses to protect trust assets from the creditors of irresponsible beneficiaries.[32] Thus, in cases where beneficiaries recklessly incurred debt that put the trust assets at risk, the spendthrift clause limited the trust's exposure to the possible invasion of the trust by the creditors of the beneficiaries.[33]

Like many laws in the United States, the concept of spendthrift trusts can be traced to English law.[34] Under English common law, however, spendthrift provisions were traditionally invalid.[35] Even today, English law continues to invalidate a trust's

[28] *See infra* Part II.A-B.
[29] NELSON, *supra* note 4, at 15-1 (citing *In re* Knowles, 123 B.R. 428 (Bankr. M.D. Fla. 1991)).
[30] Eason, *supra* note 10, at 47.
[31] Elena Marty-Nelson, *Off Shore Asset Protection Trusts: Having Your Cake and Eating It Too*, 47 RUTGERS L. REV. 11, 19 (1994) [hereinafter Marty-Nelson I].
[32] *Id*. (citing Nancy S. Roush & Robert K. Kirkland, *Spendthrift Trusts Not Limited to Protection of Immature Dependents*, EST. PLAN., Jan./Feb. 1991, at 16, 17).
[33] SHAPO ET AL., *supra* note 8, at 392-422.
[34] Gene Vitamanti, *U.S. law based on English Common Law*, THE SAN DIEGO UNION-TRIBUNE (December 31, 2007), http://www.sandiegouniontribune.com/news/2007/dec/31/us-law-based-on-english-common-law/.
[35] *See, e.g.*, Gideon Rothschild et al., *Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch?*, 32 VAND. J. TRANSNAT'L L. 763, 773 (1999).

spendthrift protection as a matter of public policy.[36] Nevertheless, "[i]t is a truism that notions of public policy are not static, but vary with time and place, and courts are obliged to revisit public policy if they choose to cite to it as a judicial check against otherwise permissible estate and asset planning opportunities."[37] In 1875, the pendulum of public policy began to swing in the opposite direction as American law diverged from English law and validated spendthrift trusts in the United States.[38] Since 1875, American courts have applied the maxim "*cujus est dare, ejus est disponere*," which means, "[w]hose it is to give, his it is to dispose."[39] Accordingly, spendthrift clauses are routinely used in the United States to protect a settlor's right to dispose of his or her assets. By providing in the trust instrument that "the interest of a beneficiary of the trust may not be either voluntarily or involuntarily transferred," it restrains the alienation of trust assets and prevents the creditors of the beneficiaries from thwarting the settlor's intent in establishing the trust.

B. DISCRETIONARY LANGUAGE

The term "discretionary language" refers to a power given to the trustee to use his or her discretion with respect to making distributions from the trust. A purely discretionary trust is one for which the trustee has unrestricted discretion with regard to:

---

[36] RESTATEMENT (THIRD) OF TRUSTS § 58 cmt. a (AM. LAW INST. 2003) ("Spendthrift restraints are not permitted under English law . . . .").

[37] Rothschild et al., *supra* note 35, at 773.

[38] *Id*. The United States Supreme Court recognized the validity of spendthrift trusts stating:

> We concede that there are limitations which public policy or general statutes impose upon all dispositions of property, such as those designed to prevent perpetuities and accumulations of real estate . . . . We also admit that there is a just and sound policy . . . to protect creditors against frauds upon their rights . . . . But the doctrine, that the owner of property . . . cannot so dispose of it, but that the object of his bounty . . . must hold it subject to the debts due his creditors . . . is one which we are not prepared to announce as the doctrine of this court.

Id. (quoting Nichols v. Eaton, 91 U.S. 716, 725 (1875)).

[39] SHAPO ET AL., *supra* note 8, at 396; *Cujus est dare, ejus est disponere*, BLACK'S LAW DICTIONARY (6th ed. 1990).

(1) whether distributions are made to the beneficiaries; (2) the amount of any distributions; and (3) the time timing of any distributions.[40] Settlors frequently couple spendthrift language with discretionary language to provide multiple layers of asset protection.[41] The Restatement (Second) of Trusts provides as follows:

> [I]f by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply, a transferee or creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal.[42]

Since a beneficiary of a discretionary trust has no enforceable right to compel a trustee to make a distribution, the creditor of such a beneficiary also cannot compel the trustee to make a distribution for the benefit of the debtor-beneficiary.[43] In other words, a creditor of a beneficiary stands in no better position than the beneficiary.[44] Thus, providing the trustee with unfettered discretion over distributions is another way to shield the assets of a trust from the creditors of beneficiaries.[45]

C. SPENDTHRIFT TRUSTS & DISCRETIONARY TRUSTS OF TODAY

Although discretionary language and spendthrift language are generally considered enforceable today, vestiges of English law remain.[46] Since Elizabethan times, it has been "against public policy to permit a man to tie up his own property in such a

---

[40] *See* RESTATEMENT (SECOND) OF TRUSTS § 155(1) (AM. LAW INST. 1959); *see also* Marty-Nelson I, *supra* note 31, at 24-25.
[41] Marty-Nelson I, *supra* note 31, at 27-28; s*ee also* Mark Merric, *How to Draft Distribution Standards for Discretionary Dynasty Trusts*, EST. PLAN., Mar. 2009, at 3, 3-4.
[42] RESTATEMENT (SECOND) OF TRUSTS § 155(1) (AM. LAW INST. 1959).
[43] *Id.* § 155 cmt. b; GEORGE C. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS & TRUSTEES § 228 (Rev. 3d ed. 2007); 2A AUSTIN W. SCOTT & WILLIAM F. FRATCHER, THE LAW OF TRUSTS § 155 (4th ed. 1987).
[44] Marty-Nelson I, *supra* note 31, at 25.
[45] Veit, *supra* note 4, at 270-71.
[46] *See generally* RESTATEMENT (SECOND) OF TRUSTS § 156 (AM LAW INST. 1959) (providing an exception to discretionary language and spendthrift language where the trust is self-settled); Estate of Paxton v. Comm'r, 86 T.C. 785, 818-19 (1986) (providing an exception to discretionary language and spendthrift language where the trust is self-settled).

way that he can still enjoy it but can prevent creditors from reaching it."[47] In 1487, an English statute provided that "all deeds of gifts of goods and chattels, made or to be made in trust to the use of that person or persons that made the same deed or gift, be void and of none effect."[48] In other words, according to this rule, an individual cannot establish a trust for his or her own benefit. This is still the rule in the majority of jurisdictions in the United States. Thus, where this rule applies, a settlor cannot establish a spendthrift or discretionary trust for his own benefit and still avoid the claims of his or her creditors.[49]

The rule against self-settled (discretionary) trusts is imposed by statute in various jurisdictions and judicially enforced in others.[50] In 1986, the Tax Court in *Estate of Paxton v. Commissioner* applied the above stated rule in two often-cited statements:

> Where a person creates for his own benefit . . . a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.[51]
>
> If a settlor creates a trust for his own benefit and inserts a spendthrift clause, it is void as far as then existing or future creditors are concerned, and they can reach his interest under the trust.[52]

Thus, where the beneficiary of a spendthrift trust is also the settlor of the trust, creditors are allowed to reach the interest of the settlor-beneficiary.[53] Section 156 of the

---

[47] Eason, *supra* note 10, at 48-49; SCOTT & FRATCHER, *supra* note 43, §§ 156, 168; *see also* Veit, *supra* note 4, at 274 (quoting GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS § 40, 147 (5th ed. 1973)):

> [T]o hold otherwise would be to give the unexampled opportunity to unscrupulous persons to shelter their property before engaging in speculative business enterprises, to mislead creditors into thinking that the settlor still owned the property since he appeared to be receiving its income, and thereby to work a gross fraud on creditors who might place reliance on the former prosperity and financial solidity of the debtor. In some cases there would be an actual intent to cheat or hinder creditors but it would be secret and could not be proved.

Eason, *supra* note 10, at 48-49 (alteration in original) (internal footnotes omitted)

[48] Veit, *supra* note 4, at 273.

[49] *Id.*; *see* NELSON, *supra* note 4, at 15-4 (noting there are thirteen states that have enacted legislation providing an exception for self-settled trusts).

[50] Veit, *supra* note 4, at 273.

[51] Estate of Paxton v. Comm'r, 86 T.C. 785, 814 (1986).

[52] *Id.* at 814 n.26.

Restatement (Second) of Trusts, which has been enacted in many jurisdictions, similarly establishes the same rule:

> (1) Where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditors can reach his interest.
>
> (2) Where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.[54]

Although the rule against self-settled trusts has been the well-established rule since Elizabethan times, the pendulum of public policy began to swing again in 1997.[55]

1. Alaska Leads Movement Toward the Acceptance of Self-Settled Trusts

In 1997, Alaska was the first state to enact a statute effectively permitting settlors to shield assets from creditors while maintaining an interest in the settled trust.[56] Under Alaska Statute section 34.40.110(a), "[a] person who in writing transfers property in trust may provide that the interest of a beneficiary of the trust, *including a beneficiary who is the settlor of the trust*, may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee."[57] By including the language "a beneficiary who is the settlor of the trust," the statute expressly allows self-settled spendthrift trusts in Alaska and stands against the long-standing public policy.[58]

---

[53] *Id.* at 815.
[54] RESTATEMENT (SECOND) OF TRUSTS § 156(1)-(2) (AM. LAW INST. 1959).
[55] David G. Shaftel, *Newest Developments in Alaska Law Encourage Use of Alaska Trusts,* EST. PLAN. Feb. 1999, at 51. *See generally* H.B. 101, 20th Leg., 1st Sess. (Alaska 1997) (enacting legislation allowing the creation of self-settled trusts that are not subject to the claims of the settlor's creditors) [hereinafter Shaftel I].
[56] H.B. 101, 20th Leg., 1st Reg. Sess. (Alaska 1997); Veit, *supra* note 4, at 274; David G. Shaftel, *IRS Letter Ruling Approves Estate Tax Planning Using Domestic Asset Protection Trusts*, 112 J. TAX'N 213, 214 (2010) [hereinafter Shaftel II].
[57] ALASKA STAT. ANN. § 34.40.110(a) (West 2016) (emphasis added).
[58] *Id.*; Veit, *supra* note 4, at 277.

Under Alaska's 1997 legislation, a trust containing a transfer restriction *is* subject to the claims of a creditor of the settlor if:

> (1) [T]he settlor's transfer of property in trust was made with the intent to defraud that creditor . . .
> (2) [T]he settlor may revoke or terminate all or part of the trust . . .
> (3) the trust . . . requires that all or a part of the trust's income or principal, or both, must be distributed to the settlor . . . or . . .
> (4) at the time of the transfer, the settlor is in default by 30 or more days of making a payment due under a child support judgment or order.[59]

2. South Dakota's Entrance into the DAPT Market

After Alaska enacted the exception to rule against self-settled trusts, several other states enacted comparable legislation which reversed the longstanding public policy against self-settled trusts.[60] In March of 2005, the South Dakota legislature passed, and Governor Mike Rounds signed, legislation with asset protection features, which became effective on July 1, 2005.[61] Although the South Dakota statutes were meant to provide the similar asset protection features that the Alaska statutes provided, the South Dakota statute's language differs from that of Alaska's.[62]

The initial South Dakota statutes were similar to Alaska's in that the self-settled trust instrument must: (1) expressly incorporate South Dakota law to govern validity, construction, and administration of the trust; (2) be irrevocable; (3) contain a spendthrift clause; and (4) have assets that were not transferred with intent to hinder, delay, or

---

[59] ALASKA STAT. ANN. § 34.40.110(b)(1)-(4); *see also* Rothschild et al., *supra* note 18, at 3.
[60] NELSON, *supra* note 4, at 15-4 (contending there are thirteen states that have adopted a version of self-settled asset protection trust legislation); Shaftel I, *supra* note 55, at 52 (providing that after Alaska enacted the legislation in April of 1997, Delaware followed later in 1997 and other states enacted DAPT statutes in later years).
[61] THOMAS E. SIMMONS, ASSET PROTECTION TRUSTS ARRIVE IN SOUTH DAKOTA 1, http://www.kahlerfinancial.com/PrintableDownloads/Presentation.pdf.
[62] *Compare* ALASKA STAT. ANN. § 34.40.110, *with* S.D.C.L. §§ 55-16-1 to -17 (2012).

defraud creditors.[63] However, South Dakota's initial DAPT statutes were not nearly as strong as their Alaskan counterparts. For instance, South Dakota's initial DAPT statutes provided that a trust containing a transfer restriction would be subject to the claims of the settlor's present and future creditors if any person to whom the transferor was indebted on account of an agreement or order of court for the payment of support or alimony in favor of such transferor's spouse, former spouse, or children, or for a division or distribution of property in favor of transferor's spouse or former spouse, to the extent of such debt. South Dakota's initial DAPT statutes also included an exception for creditors with tort claims against the settlor.

When applying the federal transfer tax code provisions to a settlor's transfers to a DAPT, the outcome may be dependent on the level of protection the DAPT provides to the settlor.[64] Thus, the minor differences between Alaska's DAPT statutes and South Dakota's initial DAPT statutes in their treatment of creditors with tort claims and creditors seeking child support and alimony could likely have been significant in either determining the federal gift tax consequences to a settlor's transfers to the trust or in determining the federal gross estate of a settlor for federal estate tax purposes.

Over the years, South Dakota has made several changes to its initial DAPT statutes to rival, and perhaps exceed, the protections offered by the Alaskan DAPT statutes. In 2011, South Dakota eliminated the exception for tort claims, which is also

---

[63] S.D.C.L. §§ 55-16-2(1)-(3), -9 (2012); *see also* David G. Shaftel, *Comparison of the Twelve Domestic Asset Protection Statutes: Updated Through November, 2008*, 34 ACTEC J. 293 (2009) [hereinafter Shaftel III].
[64] *See infra* Part III.C.

not available in Alaska.[65] By eliminating this exception, even broader asset protection is afforded to a settlor because a creditor

> who suffers death, personal injury, or property damage on or before the date of a qualified disposition by a transferor, which death, personal injury, or property damage is at any time determined to have been caused in whole or in part by the act or omission of either such transferor or by another person for whom such transferor is or was vicariously liable[66]

is no longer allowed to invade self-settled spendthrift trusts.[67] In 2013, South Dakota's legislature once again strengthened the asset protection legislation by eliminating the exception for child support and alimony obligations that arose after the time the settlor transferred assets to the DAPT. For instance, due to this legislative change, a settlor could transfer assets to a South Dakota DAPT, and those assets would be protected from claims of alimony or child support arising after the transfer.

In 2014, South Dakota's legislature further amended the state's DAPT laws so that a married settlor could, upon giving a certain notice to his or her spouse or receiving consent from such spouse, eliminate any exception with respect to marital property so that all assets transferred to a DAPT would receive protection from any creditor. These changes could alter the transfer tax consequences to a settlor's transfers to a South Dakota DAPT.

III. FRAMING THE TAXATION ISSUES

---

[65] H.B. 1155, 86th Leg., 2011 Reg. Sess. (S.D. 2011) (as first read in House, Jan. 25, 2011) (eliminating the self-settled trust exception for "any person who suffers death, personal injury, or property damage on or before the date of a qualified disposition by a transferor, which death, personal injury, or property damage is at any time determined to have been caused in whole or in part by the act or omission of either such transferor or by another person for whom such transferor is or was vicariously liable"); *see also* S.D.C.L. § 55-16-15 (2012).
[66] S.D.C.L § 55-16-15 (2010). This language was eliminated during the 2011 South Dakota Legislative Session. H.B. 1155, 86th Leg., 2011 Reg. Sess. (S.D. 2011) (enacted).
[67] *Id.*

As discussed in Part I, it was the perceived need to shield assets from potential creditors that motivated U.S. persons to utilize asset protection trusts.[68] An asset protection trust's primary benefit is limiting one's liability.[69] However, asset protection trusts also present settlors with transfer tax planning possibilities.[70] This Part will examine how asset protection trusts are used in transfer tax planning.[71]

A. THE GIFT & ESTATE TAX

There are two transfer taxes that will be discussed in this article with respect to DAPTs: (1) the estate tax and (2) the gift tax. The estate tax is imposed on the transfer at death of a decedent's "taxable estate."[72] The "taxable estate" is the value of the gross estate less any applicable deductions.[73] Therefore, very generally, for an interest in property to be subject to the estate tax, the interest in property must be within the decedent's gross estate.[74] One way to avoid estate tax on interests in property is to irrevocably transfer one's property out of his or her gross estate during his or her lifetime. However, to do this, the transferor cannot retain any prohibited interests.[75] Where a transferor retains a prohibited interest—such as (1) "the possession or enjoyment of, or the right to the income from, the property"; (2) "the right . . . to designate the persons

---

[68] *See supra* Part I.
[69] Shaftel II, *supra* note 56, at 215 (asserting the Alaska DAPT statutes were enacted to offer asset protection to those transferring assets offshore); Elena Marty-Nelson, *Taxing Offshore Asset Protection Trusts: Icing on the Cake?*, 15 VA. TAX REV. 399, 400-01 (1996) [hereinafter Marty-Nelson II].
[70] Shaftel II, *supra* note 56, at 215 (asserting that "it quickly became apparent to practitioners . . . that transfer tax minimization planning was a concomitant benefit of [the DAPT] statute"). *See generally* Eason, *supra* note 10, at 74 (recognizing the transfer tax advantages provided by OAPTs and the possibility of transfer tax advantages provided by DAPTs).
[71] *See infra* Part III.A-C.
[72] I.R.C. § 2001(a) (2012).
[73] I.R.C. § 2051 (2012).
[74] *See* §§ 2001(a), 2051.
[75] *See generally* I.R.C. § 2033 (2012) (providing that "[t]he value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death."); I.R.C. §§ 2035-2038 (2012) (providing generally that transfers by the decedent of an interest in property are only brought back into the estate when the decedent retains a prohibited interest in the property or such transfers was made within three years of the decedent's death).

who [can] possess or enjoy the property or the income"; or (3) the power to change the enjoyment of the interest in property—the property will, at the transferor's death, be included in his or her gross estate.[76]

A gift tax, meanwhile, is imposed "each calendar year on the transfer of property by gift during such calendar year" (during the transferor's lifetime).[77] Under section 2511 of the Code, the gift tax applies "whether the transfer is in trust or otherwise, . . . direct or indirect, and whether the property transferred is real or personal, tangible or intangible."[78] Whether property is transferred by gift is determined under the Treasury Regulations, which provide that a gift tax will be imposed only on "completed gifts."[79] A gift is complete where "the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another."[80] A gift is incomplete, however, where the "donor reserves the power to revest the beneficial title to the property in himself, . . . [or] the power to name beneficiaries or to change the interests of the beneficiaries as between themselves."[81] Thus, in order for a gift to be complete, the property must be given away absolutely and without a retained interest or retained power over *who* will receive the property.[82]

Generally, a transfer that results in a completed gift by a taxpayer also results in the value of the gifted property interest being excluded from the taxpayer's gross estate.

---

[76] I.R.C. §§ 2036, 2038 (2012); *see also* Eason, *supra* note 10, at 44.
[77] I.R.C. § 2501(a)(1) (2012).
[78] I.R.C. § 2511(a) (2015).
[79] Treas. Reg. § 25.2511-2(b) (as amended in 1999).
[80] *Id.*
[81] *Id.* § 25.2511-2(c). A transfer will be a completed gift, however, if the right to change the beneficiaries is a fiduciary power limited by a fixed ascertainable standard. *Id.*
[82] *Id.* § 25.2511-2(b)-(d). Under the Regulations, a gift tax generally will not be imposed when the settlor retains any of the following: the power to revoke the transfer, the power to name new beneficiaries, the right to alter the interests of the beneficiaries, or a testamentary power of appointment. *Id.* § 25.2511-2(b)-(c).

Thus, assuming the gift actually has the effect of removing the property from the gross estate, the property typically will not be subject to the estate tax. The gift tax is therefore intended to prevent gifted assets from escaping transfer taxes. As a result, the law imposes a gift tax on many lifetime transfers of property removed from a transferor's gross estate. Thus, irrevocably transferring property out of one's gross estate may trigger a gift tax.[83] However, the estate tax rules and the gift tax rules are determined under separate sections of the Code.[84] Because they are determined under different sections of the Code, it should be noted that a transfer could potentially be subject to both the gift tax and the estate tax under certain situations.[85] However, with proper planning, these particular situations can be avoided. For purposes of this Article, it will be assumed that a transfer will not be subject to both the transfer taxes.

B. Potential use of Domestic Asset Protection Trusts

When transferring assets to a DAPT, the taxpayer must retain the necessary "dominion and control," otherwise the transfer could be considered a completed gift potentially triggering a gift tax.[86] On the other hand, for asset protection purposes, a taxpayer must limit the retained control to prevent creditors from having access to the assets.[87] Most often, the settlor satisfies these competing considerations by retaining an *inter vivos* or testamentary non-general power of appointment over the transferred assets.[88] Therefore, it is fairly straightforward for a settlor of an asset protection trust to

[83] Robert A. Esperti et al., Irrevocable Trusts: Analysis with Forms ¶ 14.04[2] (2011).
[84] *See* I.R.C. §§ 2001, 2501 (2015).
[85] Marty-Nelson II, *supra* note 69, at 420-21.
[86] I.R.C. §§ 2501(a)(1), 2511 (2015); Treas. Reg. § 25.2511-2(b) (as amended in 1999).
[87] *See* Restatement (Second) of Trusts § 155(1) (Am. Law Inst. 1959) (providing that a creditor cannot make claim against the assets of a trust where the distributions are made to the beneficiary in the *absolute and unfettered discretion of the trustee*).
[88] Treas. Reg. § 25.2511-2(b) (as amended in 1999). This is conditioned on the fact that the power is not limited by an ascertainable standard. Esperti et al., *supra* note 83, ¶ 14.04[1][b].

ensure the avoidance of a gift tax on the initial transfer to a DAPT trust and still obtain the asset protection benefits. However, avoidance of the gift tax would most likely cause the transferred assets to be included in the settlor's gross estate for estate tax purposes.[89]

Although a taxpayer may set up a trust to avoid a gift tax on the front end and pay the estate tax on the back end, it is generally a basic transfer tax planning axiom that it is more beneficial to make lifetime transfers, which may incur a gift tax, as opposed to waiting to make transfers at death (however, this is not always true, especially with regard to low basis assets).[90] Lifetime transfers provide two fundamental advantages over transfers at death.[91] First, provided the gifted property is not included in the transferor's taxable estate under sections 2033 through 2046 of the Code, lifetime transfers enable any post-transfer appreciation in value and any income generated by the transferred asset to escape transfer taxation.[92] Second, the gift tax imposed on lifetime transfers has a lower effective tax rate than the estate tax.[93] While the estate tax is tax-inclusive, meaning it is imposed on the taxable estate's full value, the gift tax is tax-exclusive, meaning it is imposed on only the value of the property the donee actually receives *after* the gift tax has been paid.[94] Therefore, the transfer tax base does not include the gift tax paid, thereby lowering the effective tax rate.[95]

---

[89] *See Section 2038 Can Pull Lifetime Gifts Back Into the Estate*, FED. TAXES WEEKLY ALERT Art. 22 (Thomson Reuters/Tax & Accounting) Nov. 26, 2003 (stating that incomplete gifts are included in the decedent's gross estate, under section 2038, as transfers in which the decedent retained the power to revoke).
[90] *See* ESPERTI ET AL., *supra* note 83, ¶ 14.04.
[91] *Id*.
[92] *Id*.; Marty-Nelson II, *supra* note 69, at 420-21; Eason, *supra* note 10, at 74.
[93] ESPERTI ET AL., *supra* note 83, ¶ 14.04.
[94] *See id*. ¶ 14.04.
[95] *See id*. The following example illustrates the tax-exclusive nature of a gift:

> Mike Johnson owns a building currently worth $1.8 million. Assume that Mike has already used up his applicable exclusion amount and gifts the building to his daughter Molly at a time when the applicable gift tax rate is 50 percent. To isolate the effect of tax-exclusive gift tax rate, assume further that the value of the property will remain the

Although making transfers during one's life may provide significant advantages as opposed to making transfers at death, gifting is not always appealing to taxpayers.[96] Taxpayers are often hesitant to part with "dominion and control" of their property because taxpayers are concerned that they may need the gifted assets in the future.[97] Thus, taxpayers would like the possibility to retain some benefit from the assets, such as the benefit provided by self-settled discretionary spendthrift trusts. Some commentators suggest that DAPTs may provide a solution for the hesitant taxpayers.[98] It is argued that DAPTs allow taxpayers to "have their cake and eat it too."[99] In other words, these commentators argue that a settlor of a DAPT could receive the tax benefits of excluding the assets from the gross estate by making a completed gift subject to gift tax but retain the enjoyment of the transferred property as a discretionary beneficiary.[100] But is a transfer to DAPT actually a completed gift for federal transfer tax purposes? The answer depends, at least in part, on the applicable state law.

C. HAVING YOUR CAKE AND EATING IT TOO.

As discussed in Part II, the settlor of a self-settled trust is also a potential beneficiary of the trust.[101] One cannot, however, gift property to oneself.[102] Thus, when

---

> same until Mike dies. If Mike gifts the property, the transfer tax payable will be $600,000 (.5 x the $1.2 million that Molly receives after payment of the tax). On the other hand, if Mike keeps the property until death, the estate tax payable will be $900,000 (.5 x the $1.8 million value of the asset in the estate). The difference is that the $600,000 of gift tax paid is removed from the tax base.

Id. 14.04, Example 14-3 (citations omitted).

[96] Shaftel II, *supra* note 56, at 213-14; Eason, *supra* note 10, at 74; ESPERTI ET AL., *supra* note 83, ¶ 14.04.

[97] Shaftel II, *supra* note 56, at 213-14; *see also* Eason, *supra* note 10, at 74; ESPERTI ET AL., *supra* note 83, ¶ 14.04.

[98] *See, e.g.*, Shaftel II, *supra* note 56, at 213-14.

[99] Rothschild et al., *supra* note 18, at 3-4; Shaftel II, *supra* note 56, at 213-14. The same argument is made with OAPTs in that trust settlors receive the benefits of irrevocably transferring property without either retaining any prohibited interests or actually divesting complete control over the trust assets. *See* Marty-Nelson I, *supra* note 31, at 13.

[100] Rothschild et al., *supra* note 18, at 3; Shaftel II, *supra* note 56, at 213-14.

[101] *See supra* Part II.A.

the settlor irrevocably transfers property to a trust and retains an interest as a beneficiary, the value of the beneficial interest retained is not a completed gift, and no gift tax can be imposed on the value of the retained interest.[103] However, when the settlor transfers property to an independent trustee of a self-settled discretionary spendthrift trust where the settlor merely retains the right to discretionary distributions, the beneficial interest retained by the settlor is not considered an enforceable interest.[104] The settlor is not entitled to receive anything, but *may* receive something depending on how the discretion is exercised. The settlor's beneficial interest is therefore considered something less than an "interest"; it is a "mere expectancy."[105]

As discussed above, to assure a completed gift, the effect of the transfer must be to remove the property beyond the transferor's dominion and control.[106] If a settlor merely retains an interest in or to discretionary distributions, the settlor has no power to directly exercise dominion or control over any of the trust assets, which supports the conclusion that such a transfer by the settlor to the trust is a completed gift.[107] This position is supported by Treasury Regulation section 25.2511-2(b) which provides:

---

[102] DALE S. ADAMS & ROBERT B. SMITH, FEDERAL ESTATE & GIFT TAX., ¶ 1.03, at 5 (2012).
[103] *See* Treas. Reg. § 25.2511-2(b) (as amended in 1999). There may, however, be a completed gift with respect to the other beneficiaries, and a gift tax is imposed on the value of the other beneficiaries' interest in the trust property. *Id.*
[104] Rev. Rul. 77-378, 1977-2 C.B. 347; *see also* Treas. Reg. § 25.2511-2(b).
[105] *Id.*
[106] Treas. Reg. § 25.2511-2(b).

> As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete. But if upon a transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all the facts in the particular case.

Id.
[107] ESPERTI ET AL., *supra* note 83, ¶ 14.04[1][b]. *See also* Rev. Rul. 77-378, 1977-2 C.B. 347 (ruling that "[t]he transfer of property to an irrevocable inter vivos trust, under the terms of which the trustee has the discretionary power, entirely voluntary under the trust instrument and applicable state law, to distribute income and principal to the grantor constitutes a completed taxable gift of the entire value of the property transferred.").

> [I]f a donor transfers property to another in trust to pay the income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among his descendants, no portion of the transfer is a competed gift. On the other hand, if the donor had not retained the testamentary power of appointment, but instead provided that the remainder should go to X or his heirs, the entire transfer would be a completed gift.[108]

In the example provided in the regulation, the fact that the donor retains an interest in discretionary distributions does not prevent the gift from being completed.[109] Moreover, the entire transfer by the settlor would be a completed gift.[110] This is because the settlor's "hope or passive expectancy" of a trust distribution has no value, which results in no adjustment for any possible retained benefit or interest by the settlor.[111]

Although a settlor who only receives a beneficial interest in discretionary distributions does not directly retain dominion or control over the property, the settlor can do so indirectly, which changes the gift tax analysis.[112] A settlor can retain indirect control through its creditors.[113] For example, if the settlor's creditors have access to the discretionary trust, the settlor could "run up" debt and relegate its creditors to the trust assets to satisfy the settlor's obligations.[114] Consequently, when the settlor's creditors can access the assets of a trust, the settlor retains dominion and control indirectly, and the transfer to that trust would be incomplete for gift tax purposes.[115] This concept is paramount to a DAPT's effectiveness as a vehicle to avoid inclusion of the value of the trust property in the settlor's gross estate for federal estate tax purposes.

---

[108] Treas. Reg. § 25.2511-2(b).
[109] *Id.*
[110] *Id.*; Rev. Rul. 77-378, 1977-2 C.B. 347.
[111] Rev. Rul. 77-378, 1977-2 C.B. 347 (ruling that "a hope or passive expectancy is not a right[, and] [i]t is not enough to lessen the value of the property transferred.").
[112] ESPERTI ET AL., *supra* note 83, ¶ 14.04[1][b].
[113] *Id.*
[114] *Id.* The settlor, in effect, can use the trust as security against future indebtedness.
[115] *Id.* (citing Paolozzi v. Comm'r, 23 T.C. 182 (1954)).

Whether the value of property transferred by a settlor to a self-settled discretionary spendthrift trust will eventually be subject to estate tax is a relatively more complicated analysis than whether the transfer will be considered a completed gift. Section 2031 of the Code provides that the "gross estate" includes the value at the time of death of all property only to the extent provided in sections 2033 through 2046 of the Code.[116] Section 2033 of the Code provides that the gross estate includes "[t]he value of all property to the extent of the interest therein of the decedent at the time of his death."[117] The property, however, must be "beneficially owned by the decedent at the time of his death" to be included under section 2033 of the Code.[118] Therefore, where the decedent made a lifetime transfer of property to a trust, the property would not be includable under section 2033 of the Code because the property was not beneficially owned by the decedent at the time of death.[119] The inclusion provisions, sections 2036, 2037, and 2038 of the Code, however, prevent this simple avoidance of estate tax by pulling the decedent's transferred property back into the gross estate where the decedent retained or controlled certain interests.[120] Sections 2036(a)(1) and 2038(a) of the Code are the inclusion provisions that are most likely to apply where property has been transferred to a self-settled DAPT.[121] Both of these inclusion provisions are interpreted broadly.[122] As a result, the two provisions have the propensity to overlap one another.[123] Generally speaking, there are three requirements for the inclusion in the decedent's gross

[116] I.R.C. § 2031 (2012).
[117] *Id.* § 2033 (2015).
[118] Treas. Reg. § 20.2033-1(a) (as amended in 1963).
[119] *See* Treas. Reg. § 20.2033-1(a) (as amended in 1963).
[120] *See* I.R.C. §§ 2036-2038 (2016).
[121] *Id.* §§ 2036(a)(1), 2038(a) (2016); *see also* Eason, *supra* note 10, at 80-81.
[122] Estate of De Foucaucourt v. Comm'r, 62 T.C. 485, 491 (1974); I.R.S. Tech. Adv. Mem. 90-43-074 (Oct. 26, 1990). *See generally* ROBERT E. MADDEN, TAX PLANNING FOR HIGHLY COMPENSATED INDIVIDUALS, ¶ 14.03, at 8 (2015) (discussing the Tax Court's broad interpretation of I.R.C. § 2038).
[123] Marty-Nelson II, *supra* note 69, at 423.

estate under section 2036(a) of the Code.[124] There must be: (1) a transfer by the decedent, under which the decedent has (2) retained a prescribed interest (3) for a prescribed period.[125] The key is determining whether the decedent retained a prescribed interest for purpose of section 2036 of the Code.[126]

To be pulled back into the settlor's gross estate for the retention of a prescribed interest under section 2036, the settlor must have retained: (1) possession or enjoyment of, or the right to the income from, the property or (2) the right to designate the persons who may possess or enjoy the property or the income therefrom.[127] Where a settlor may receive distributions from the trust only in the absolute discretion of a trustee, thus giving the settlor a "mere expectancy," the settlor has not directly retained "possession or enjoyment of, or the right to income from, the property" as required under section 2036(a) of the Code.[128] However, this does not end the analysis.[129] In a self-settled discretionary trust, inclusion of the assets in the settlor's gross estate could also occur indirectly if either:

i. the settlor's retained enjoyment of the property by virtue of an implied agreement between the settlor and the trustee to that effect; or

[124] *See* I.R.C. § 2036(a)(1)-(2).
[125] *Id.*
[126] *See* Eason, *supra* note 10, at 80 (citing Estate of Whitt v. Comm'r, 751 F.2d 1548, 1558 (11th Cir. 1985)). "[I]f the transferor retains in himself essentially full lifetime benefits from transferred property, the ultimate shifting of enjoyment at the [transferor's] death is sufficiently akin to testamentary disposition of property to justify the imposition of estate tax at that time." *Id.*
[127] I.R.C. § 2036(a). For the issues discussed in this article, the focus of § 2036(a) will be on whether retention of a discretionary interest in a spendthrift trust amounts to retention of possession or enjoyment of, or right to the income from, the property. ESPERTI ET AL., *supra* note 83, ¶ 14.04[2].
[128] I.R.C. § 2036(a)(1); *see also* HOWARD M. ZARITSKY, TAX PLANNING FOR FAMILY WEALTH TRANSFERS: ANALYSIS WITH FORMS, ¶ 8.06, at 30 (2011); Shaftel II, *supra* note 56, at 216. Also, note that it is the trustee who expressly has the right to designate who shall enjoy the property and not the settlor. Thus, the settlor does not directly hold the right to designate the persons who shall possess or enjoy the property or the income therefrom.
[129] ZARITSKY, *supra* note 128, at 30; Eason, *supra* note 10, at 82.

ii. the settlor's retained interest in the trust property, which interest may be deemed to exist solely by virtue of the settlor's ability to use the trust as a form of security for the settlor's indebtedness, where under state law the settlor's creditors can reach trust property in satisfaction of the settlor-beneficiary's obligations.[130]

If there were an implied agreement between the settlor and the trustee, the settlor clearly retains a prohibited interest resulting in inclusion of the trust assets in the settlor's gross estate.[131] However, implied agreements are not the focus of this Article and for purposes of this Article the authors have assumed that implied agreements will not exist between settlors and their trustees. The issue, for purposes of this Article, is whether any creditor of a settlor's DAPT in South Dakota can reach trust property under state law.

Property is included in a decedent's gross estate pursuant to section 2038 if the decedent retained the power to alter, amend, revoke, or terminate any other person's enjoyment of the transferred property.[132] Similar to section 2036(a), there is a threat of estate inclusion where applicable state law provides creditors with the right to pursue the trust property by virtue of the settlor's retained beneficial interest in the trust property.[133] Therefore, for either section 2036 or section 2038, the central question is whether the settlor's creditors can reach trust property to satisfy the settlor-beneficiary's obligations, which effectively allows a settlor to incur debt and relegate the settlor's creditors to the trust property for repayment.

---

[130] Eason, *supra* note 10, at 82. S*ee* ESPERTI ET AL., *supra* note 83, ¶ 14.04[2]; Rothschild et al., *supra* note 18, at 3.

[131] Eason, *supra* note 10, at 94 (citing Estate of Skinner v. United States, 316 F.2d 517, 519-20 (3d Cir. 1963). *See* ESPERTI ET AL., *supra* note 83, ¶ 14.04[2](a); *see also* I.R.S. Priv. Ltr. Rul. 2009-44-002 (Oct. 30, 2009).

[132] I.R.C. § 2038(a) (2016). Section 2038 applies regardless of whether the settlor has a beneficial interest in the transferred property.

[133] *See* Rev. Rul. 76-103, 1976-1 C.B. 293; Eason, *supra* note 10, at 82-83.

The critical issue of a creditor's ability to reach the property in a discretionary trust is reliant on the state law as applied to creditors.[134] Therefore, generally speaking, if a settlor's creditors cannot reach the trust assets, a gift tax is imposed and the trust assets escape the estate tax. If the creditors can conversely reach the trust assets, the gift is incomplete, no gift tax is imposed on the transfer, and the value of the trust assets is included in the settlor's gross estate for estate tax purposes.[135] The next Part will discuss whether, under South Dakota state law, the settlor retains a prohibited interest in the assets transferred to a DAPT created under the laws of South Dakota so as to cause the value of the assets transferred to the trust by the settlor to be included in the settlor's gross estate for federal estate tax purposes.[136]

IV. WHETHER THE ASSETS PLACED IN A SOUTH DAKOTA DAPT WILL BE INCLUDED IN A SETTLOR'S GROSS ESTATE UNDER §§ 2036 OR 2038.

DAPTs are, theoretically, intended to provide a level of asset protection.[137] However, the asset protection provided by a DAPT is still uncertain.[138] Many of these questions will not be settled until challenged DAPTs have been brought before the courts.[139] Even then, judges from different states may have conflicting opinions. Therefore, the effectiveness of DAPTs raise interesting issues that are still open for debate.[140] That being said, for the purposes of answering whether the assets placed in a South Dakota DAPT will be included in a settlor's gross estate under sections 2036 or

---

[134] Rothschild et al., *supra* note 18, at 8, 11; Shaftel II, *supra* note 56, at 221 (discussing who may take advantage of DAPT planning).
[135] Marty-Nelson II, *supra* note 69, at 427.
[136] *See infra* Part IV.A-C.
[137] *See* Shaftel II, *supra* note 56, at 215-16 (stating that Alaska's DAPT statutes were conceived for those wanting to utilize asset protection).
[138] *See, e.g.*, Earl D. Tanner, Jr., *Rethinking Asset Protection Trusts*, 28 UTAH B.J. 42 (proposing changes to existing DAPT statutes in Utah which would weaken the asset protection features).
[139] *Id.*
[140] *See e.g.*, *Symposium: The Rise of the International Trust*, *supra* note 10, at 779.

2038 of the Code, we will not discuss whether DAPTs will be provided their theoretical protection; instead, we will assume that settlors will indefinitely receive the protection that DAPTs were intended to provide them.

As discussed in Part III, for gift tax purposes, it is key to determine whether the settlor's creditors can gain access to the discretionary trust.[141] If a settlor's creditors can invade the trust, the settlor indirectly retains dominion and control, and any gift of assets by the settlor to the trust would be incomplete for gift tax purposes.[142] Thus, in most states where self-settled discretionary spendthrift trusts are against public policy, the settlor's transfer of assets to the trust is not a completed gift.[143] This is because of a law adopted by many of these states, modeled after section 156 of the Restatement (Second) of Trusts, which generally provides that self-settled spendthrift trusts would be exposed to the settlor's creditors up to the maximum that could be distributed to the settlor, which is generally all of the trust's assets.[144] Under variants of this law, the settlor would be deemed to have retained dominion and control over property transferred to a DAPT, making the transfer an incomplete gift because the settlor could incur debt, which could be satisfied using the trust assets.[145]

Also discussed in Part III was the threat of trust assets' inclusion in the settlor's gross estate where applicable state law provides creditors with the right to pursue the trust property by virtue of the settlor's retained rights in the trust property. Bear in mind that under section 156 of the Restatement (Second) of Trusts, creditors can reach the

[141] *See supra* Part III.A-C.
[142] Rothschild et al., *supra* note 18, at 4.
[143] Rev. Rul. 76-103, 1976-1 C.B. 293; Rothschild et al., *supra* note 18, at 3; Shaftel I, *supra* note 55, at 56.
[144] Shaftel I, *supra* note 55, at 56; *see also* RESTATEMENT (SECOND) OF TRUSTS § 156 (AM. LAW INST. 1959).
[145] Shaftel I, *supra* note 55, at 56.

transferred interest in self-settled spendthrift trusts, and "creditors can reach the maximum amount which the trustee under the terms of the trust could pay to [the settlor] or apply for [the settlor's] benefit" in self-settled discretionary trusts .[146] Thus, in a state where it is against public policy for a settlor to shield one's assets in a self-settled trust, the settlor will be subject to inclusion under either section 2036(a) or section 2038(a)(1) of the Code.[147] A settlor will be subject to inclusion under section 2036(a) because the settlor retains enjoyment over the property and the right "to designate the persons who shall possess or enjoy the property or the income therefrom."[148] For example, a settlor could direct the assets away from the named beneficiaries by "running up" debts and forcing the creditors to satisfy those obligations using the trust assets.[149] Similarly, a settlor will be subject to inclusion under section 2038(a) because the settlor's ability to incur debt and relegate the settlor's creditors to the trust property for repayment is effectively a retained power to terminate the trust.[150]

However, placing the assets into a DAPT where the state has adopted legislation favoring the use of DAPTs may change this analysis. For example, if creditors cannot reach the settlor's assets, the transfer of property may be a completed gift for gift tax purposes.[151] Furthermore, if the creditors cannot reach the settlor's assets, sections 2036 and 2038 of the Code may not apply, in which case the trust assets would not be brought back into the settlor's gross estate.[152] Private Letter Ruling 98-37-007[153] and Private

---

[146] Veit, *supra* note 4, at 273 (citing RESTATEMENT (SECOND) OF TRUSTS § 156 (AM. LAW INST. 1959)).
[147] Rev. Rul. 76-103, 1976-1 C.B. 293; Shaftel II, *supra* note 56, at 214-15.
[148] I.R.C. § 2036(a)(2) (2012); *see also* Treas. Reg. § 25.2511-2(b); Shaftel II, *supra* note 56, at 213.
[149] Shaftel II, *supra* note 56, at 214; *see also* Treas. Reg. § 25.2511-2(b).
[150] Rev. Rul. 76-103, 1976-1C.B. 293; Eason, *supra* note 10, at 82-83; *see also* Treas. Reg. § 25.2511-2(b) (as amended in 1999); Shaftel II, *supra* note 56, at 215.
[151] Rothschild et al., *supra* note 18, at 5.
[152] *Id*. at 9.
[153] I.R.S. Priv. Ltr. Rul. 98-37-007 (Sept. 11, 1998)

Letter Ruling 2009-44-002 provide insight on how the transfer tax code provisions apply to DAPTs in certain states that have adopted favorable DAPT legislation.[154] However, it is important to note that section 6110(k)(3) of the Code states that private letter rulings may not be used or cited as precedent.[155]

A. PRIVATE LETTER RULING 98-37-007

On September 11, 1998, the Internal Revenue Service issued Private Letter Ruling 98-37-007.[156] The Ruling was requested with respect to a proposed transfer to a trust sitused in and governed under the laws of Alaska.[157] Under the proposed facts of the Ruling, an Alaska resident was to create an irrevocable spendthrift trust for the benefit of the settlor and the settlor's children.[158] The sole trustee was to pay during the settlor's lifetime, "any part or all of the income and/or principal in such amounts and at such time, as the [t]rustee, in its sole and absolute discretion determine[d]," among one or more of the beneficiaries.[159] The Ruling provided that there was no agreement, express or implied, between the settlor of the trust and the trustee regarding how the trustee was to make the discretionary distributions.[160] The settlor had no known prior debts or expected future debts, and the settlor was under no obligation or order of child support.[161] Lastly, the state's statute provided:

---

[154] I.R.S. Priv. Ltr. Rul. 2009-44-002 (Oct. 30, 2009); *see infra* Part IV.A-B. It is important to note that section 6110(k)(3) of the Internal Revenue Code states that private letter rulings may not be used or cited as precedent. I.R.C. § 6110(k)(3) (2016).
[155] I.R.C. § 6110(k)(3) (2016).
[156] I.R.S. Priv. Ltr. Rul. 98-37-007 (Sept. 11, 1998).
[157] *Id.* The Ruling did not specifically state "Alaska." It was implied from the use of state statutes that are identical to the Alaska Statutes. *Id.*
[158] *Id.* The proposed trust instrument provided that "the interest of a beneficiary (including the grantor) of the trust may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee." *Id.* Thus, it contained a spendthrift clause. *Id.*
[159] *Id.*
[160] *Id.*
[161] *Id.*

> [A] person who in writing transfers property in trust may provide that the interest of a beneficiary of the trust may not be either voluntarily or involuntarily transferred before the payment or delivery of the interest to the beneficiary by the trustee. If a trust contains this transfer restriction, the restriction prevents a creditor existing when the trust is created, a person who subsequently becomes a creditor, or any other person from satisfying a claim out of the beneficiary's interest in the trust unless:
>
> (1) the transfer was intended in whole or in part to hinder, delay, or defraud creditors or other persons;
> (2) the trust provides that the settlor may revoke or terminate all or part of the trust . . . ;
> (3) the trust requires that all or a part of the trust's income or principal, or both, must be distributed to the settlor; or[]
> (4) at the time of the transfer, the settlor is in default by 30 or more days of making a payment due under a child support order.[162]

The issue presented was whether the property transferred to the trust by the settlor would be a completed gift for federal gift tax purposes and whether the trust assets would be included in the settlor's gross estate.[163]

The conclusion expressed in the Ruling relied in part on Revenue Ruling 77-378.[164] In Revenue Ruling 77-378, a settlor transferred income producing property to an irrevocable spendthrift trust in which the trustee could make discretionary distributions out of income or principal to the settlor with the remaining principal being distributed to the settlor's spouse and children on the settlor's death.[165] Furthermore, the Revenue Ruling provided that the settlor's creditors could not reach the trust assets.[166] The

[162] *Id.* *See* ALASKA STAT. ANN. § 34.40.110(a)-(b) (West 2016).
[163] I.R.S. Priv. Ltr. Rul. 98-37-007.
[164] Rev. Rul. 77-378, 1977-2 C.B. 348; I.R.S. Priv. Ltr. Rul. 98-37-007.
[165] I.R.S. Priv. Ltr. Rul. 98-37-007 (referring to Rev. Rul. 77-378, 1977-2 C.B. 348).
[166] *Id.*

Revenue Ruling established that the transfer was a completed gift for federal gift tax purposes.[167]

In the letter ruling, the proposed fact pattern similarly involved an irrevocable discretionary spendthrift trust for the benefit of the settlor and settlor's family members.[168] Also, like Revenue Ruling 77-378, the settlor's creditors could not reach the trust assets because under the applicable state statutes, creditors were precluded from satisfying claims out of the settlor's interest in the trust.[169] Following the same line of reasoning as set forth in Revenue Ruling 77-378, the letter ruling concluded that the proposed transfer by the settlor would be a completed gift for federal gift tax purposes because the settlor had not directly or indirectly retained dominion and control over the trust assets.[170] However, the letter ruling added the limitation that the Internal Revenue Service was "not ruling on whether the assets held under the [t]rust agreement at the time of [settlor's] death will be includible in [settlor's] gross estate for federal estate tax purposes."[171] The IRS refused to rule on the gross estate inclusion issue because it was dependent on then-unknown facts and circumstances.[172] For example, the settlor and the trustee could have developed an implied agreement which may have caused inclusion of the assets in the settlor's gross estate.[173] It was not until eleven years later (after the assurance of Revenue Ruling 2004-64) that the Internal Revenue Service broke their

---

[167] *Id.*
[168] *Id.*
[169] *Id.*
[170] *Id.*
[171] *Id.*
[172] *Symposium: The Rise of the International Trust*, *supra* note 10, at 817 (Gideon Rothschild asserting that in an informal discussion with George Masnick, whose branch issued Private Letter Ruling 98-37-007, the stated reason "the Service did not opine on the estate tax inclusion, was because it would depend on a facts and circumstances test.").
[173] Rothschild et al., *supra* note 18, at 3; Shaftel I, *supra* note 55, at 57.

silence on this issue with Private Letter Ruling 2009-44-002 involving another Alaskan DAPT.[174]

B. PRIVATE LETTER RULING 2009-44-002

Private Letter Ruling 2009-44-002 was issued in response to a request for gift and estate tax rulings with respect to the creation of an irrevocable trust governed under the laws of and with a situs in Alaska.[175] Under the facts set forth in the ruling, an Alaska resident established an irrevocable spendthrift trust for the benefit of the settlor and the settlor's spouse and descendants.[176] The sole trustee, a trust company, was to pay during the settlor's lifetime the trust's income and principal in such amounts "as [the] trustee in its sole and absolute discretion" determined among one or more of the beneficiaries.[177] Upon the trust's termination, the trust's income and principal was to be distributed to the settlor's descendants in trust.[178] The settlor, the settlor's estate, the settlor's creditors, or settlor's estate's creditors would receive no part of the trust's income or principal.[179] If there was no living descendant, the trust's remaining assets were to "be distributed to one or more charitable organizations chosen by the trustee."[180] Lastly, the state's statute provides:

> [A] person who in writing transfers property in trust may provide that the interest of a beneficiary of the trust, including a beneficiary who is the settlor of the trust, may not be either voluntarily or involuntarily transferred before payment or delivery of the interest to the beneficiary by the trustee. Under State Statute, if the trust instrument contains this transfer restriction, it prevents a creditor existing when the trust is created or a person who subsequently becomes a creditor, from satisfying a claim

[174] I.R.S. Priv. Ltr. Rul. 2009-44-002 (Oct. 30, 2009).
[175] *Id.* The Ruling did not specifically state "Alaska"; it was implied from the use of state statutes that are identical to the Alaska statutes.
[176] *Id.*
[177] *Id.*
[178] *Id.*
[179] *Id.*
[180] Shaftel II, *supra* note 56, at 216; I.R.S. Priv. Ltr. Rul. 2009-44-002 (Oct. 30, 2009).

> out of the beneficiary's interest in the trust unless, (1) the trust provides that the settlor may revoke or terminate all or part of the trust . . . ; (2) the settlor intends to defraud a creditor by transferring the assets to the trust; (3) the settlor is currently in default of a child support obligation by more than 30 days; or (4) the trust requires that all or a part of the trust's income or principal, or both, must be distributed to the settlor.[181]

The issues presented were whether the property transferred to the trust by the settlor would be a completed gift for federal gift tax purposes and whether any portion of the trust's assets would be includible in the settlor's gross estate.[182] The ruling concluded that the transfer of assets to the trust was a completed gift because the settlor "retained no power to revest beneficial title or reserved any interest to name new beneficiaries or change the interests of the beneficiaries."[183] On the issue of inclusion, the ruling stated, "the trustee's discretionary authority to distribute income and/or principal to Grantor, does not, by itself, cause the [t]rust corpus to be includible in [settlor's] gross estate under section 2036," but left the door open that unfavorable facts that were unknown to the Service could alter the conclusion.[184] The fact that the Service left the door ajar still leaves a moderate level of uncertainty.

---

[181] I.R.S. Priv. Ltr. Rul. 2009-44-002 (Oct. 30, 2009); *see also* ALASKA STAT. ANN. § 34.40.110(a)-(b) (West 2016). The trust also stated:

> [T]he following persons may not be a trustee of any trusts created under the trust instrument: the settlor, the settlor's spouse or former spouse, any beneficiary, any spouse or former spouse of a beneficiary, or anyone who is related or subordinate to the settlor within the meaning of Section 672(c). . . . [T]he trustee "shall not pay" the settlor or the settlor's executors any income or principal of the trust in discharge of the settlor's income tax liability.

Shaftel II, *supra* note 56, at 216 (discussing I.R.S. Priv. Ltr. Rul. 200944002 (Oct. 30, 2009)).

[182] I.R.S. Priv. Ltr. Rul. 2009-44-002 (Oct. 30, 2009).

[183] *Id.*

[184] *Id.* The Service expressly stated:

> We are specifically not ruling on whether Trustee's discretion to distribute income and principal of Trust to Grantor combined with other facts (such as, but not limited to, an understanding or pre-existing arrangement between Grantor and trustee regarding the exercise of this discretion) may cause inclusion of Trust's assets in Grantor's gross estate for federal estate tax purposes under § 2036.

Id.

The ruling relied in part on Revenue Ruling 2004-64[185] involving an irrevocable inter vivos trust established for the benefit of a settlor's descendants that were "grantor trusts" for income tax purposes.[186] One of the issues discussed "was whether the trustee's discretionary power to reimburse the settlor for income tax that the settlor paid on the trust income constituted 'the possession or enjoyment of, or the right to the income from,' the trust assets so that the value of those assets would be included in the settlor's estate under Section 2036(a)(1)."[187] Revenue Ruling 2004-64 made the point that had it been mandatory for the trust to reimburse the settlor, the full value of the trust's assets would have been included in the settlor's gross estate under section 2036.[188] However, because the reimbursements by the trust were only made in the absolute discretion of the trustee, the trust assets would not be includable in the settlor's gross estate.[189] Therefore, the Service ruled that discretionary reimbursements would not cause the value of the trust's assets to be included in the settlor's gross estate.[190] The Revenue Ruling lastly noted, however,

> such discretion combined with other facts (including but not limited to: an understanding or pre-existing arrangement between *A* and the trustee regarding the trustee's exercise of this discretion; a power retained by *A* to remove the trustee and name *A* as successor trustee; or applicable local law subjecting the trust assets to the claims of *A*'s creditors) may cause inclusion of Trust's assets in *A*'s gross estate for federal estate tax purposes.[191]

Revenue Ruling 2004-64, like Private Letter Ruling 2009-44-002, does not foreclose the possibility that an interest in a discretionary trust could be included in the trust settlor's

---

[185] *Id.*
[186] Rev. Rul. 2004-64, 2004-2 C.B. 7 (meaning the trust was disregarded for federal income tax purposes and the trust's assets were deemed to be owned by the settlor).
[187] Shaftel II, *supra* note 56, at 215 (quoting I.R.C. § 2036(a)(1) (2016)).
[188] Rev. Rul. 2004-64, 2004-2 C.B. 7.
[189] *Id.*; Shaftel II, *supra* note 56, at 215.
[190] Rev. Rul. 2004-64, 2004-2 C.B. 7.
[191] *Id.*

gross estate on the basis of some other unfavorable facts that indirectly establish that the settlor had a prohibited interest in the trust assets. As mentioned in Revenue Ruling 2004-64, trust assets could be included in the settlor's gross estate where "applicable local law subject[s] the trust assets to the claims of [the settlor's] creditors."[192] However, in the Private Letter Ruling, the applicable local law did not allow for creditors to reach the trust assets; thus, it supports the conclusion that the trust assets should be excluded from the gross estate.[193]

C. SOUTH DAKOTA'S DAPTS

As seen in Private Letter Ruling 2009-44-002, where state law permits the existence of self-settled discretionary spendthrift trusts, a settlor's transfer to such trust could be a completed gift and the assets transferred to the trust could be excluded from the settlor's gross estate. As previously explained, this possibility hinges, at least in part, on the trust assets being out of reach of the settlor's creditors. Could settlors look to South Dakota to establish a DAPT if they intend their transfers to constitute a completed gift and the value of the transferred assets to be excluded from their gross estates?

The Service's prior letter rulings were based on a very specific fact situation, which included an Alaskan resident, an Alaskan trust, and, most importantly, governed under Alaska's statutes.[194] As discussed in Revenue Ruling 2004-64, which lays the groundwork for Private Letter Ruling 2009-44-002, the Service points out that where "applicable local law subject[s] the trust assets to the claims of [settlor]'s creditors," the trust's assets may be included in the settlor's gross estate for federal estate tax purposes

---

[192] *Id.*
[193] *See* I.R.S. Priv. Ltr. Rul. 2009-44-002 (Oct. 30, 2009).
[194] *Id.*; Shaftel II, *supra* note 56, at 215.

under sections 2036 or 2038 of the Code.[195] Thus, the outcome of the letter rulings could be different in jurisdictions with differing provisions. This was likely the case for South Dakota prior to 2013.

As discussed in Part II of this article, prior to 2013, South Dakota law provided an exception for creditors that is not provided in Alaska whereby a settlor's present or future creditors could reach the assets of a DAPT created under the laws of South Dakota if "any person to whom the transferor is indebted on account of an agreement or order of court for the payment of support or alimony . . . or for a division or distribution of property . . . to the extent of the debt."[196] Therefore, under prior South Dakota law, trusts were susceptible to any indebtedness on account of an agreement or court order for child support or alimony.[197] Alaska, on the other hand, does not provide such a protection for child support or alimony creditors.[198] Only when "*at the time of the transfer*, the settlor is in default by 30 or more days of making a payment due under a child support judgment or order," may a creditor reach into the trust.[199] Therefore, in Alaska, with regard to creditors who are former spouses and children already entitled to child support, at the time of the transfer of the assets into the DAPT, a settlor knows if the DAPT is subject to the claims of such creditors. Any future claims by creditors (assuming there are no fraudulent transfer issues) for child support cannot be satisfied from the trust.[200] With respect to avoiding transfer taxes, this is a crucial feature of the Alaskan statutes.

---

[195] Rev. Rul. 2004-64, 2004-2 CB 7.
[196] *See supra* Part II.A-C; *see also* S.D.C.L.§ 55-16-15 (2012)
[197] *See* S.D.C.L. § 55-16-15.
[198] *See* ALASKA STAT. ANN. § 34.40.110(b) (West 2016).
[199] *See id.* § 34.40.110(b)(4) (emphasis added).
[200] *Id.*

Recall from Subpart C of Part III that the value of any interest transferred by a decedent is included in the decedent's gross estate under section 2036 of the Code where the decedent has (1) retained a prescribed interest (2) for a prescribed period.[201] Such a prescribed interest includes the "use, possession, right to the income, or other enjoyment of the transferred property."[202]

> The "use, possession, right to the income, or other enjoyment of the transferred property" is considered as having been retained by or reserved to the decedent to the extent that the use, possession, right to the income, or other enjoyment is to be applied toward the discharge of a legal obligation of the decedent . . . .[203]

Under Treasury Regulation section 20.2036-1(b)(2), the term "legal obligation" includes "a legal obligation to support a dependent during the decedent's lifetime."[204] Consequently, a child support obligation is a legal obligation.[205] Prior to South Dakota's changes in 2013, the assets of a South Dakota DAPT could have been applied toward the discharge of a child support obligation, which would qualify as a retained prescribed interest under section 2036 of the Code.[206] A similar argument can also be made for a claim of alimony, provided that it is also a listed exception under South Dakota law.[207] Prior to the revisions to South Dakota's DAPT statutes in 2013, settlors likely could not make a completed gift to a South Dakota DAPT, and assets transferred to the trust by the

---

[201] I.R.C. § 2036(a)(1)-(2) (2015).
[202] Treas. Reg. § 20.2036-1(a)(3)(i) (as amended in 2011).
[203] *Id.* § 20.2036-1(b)(2).
[204] *Id.*
[205] *See id.*; Rothschild et al., *supra* note 18, at 11-12; I.R.C. § 2036(a).
[206] S.D.C.L. § 55-16-15 (2012); *see* Treas. Reg. § 20.2036-1(b)(2); I.R.C. § 2036(a)(1).
[207] *See* Shaftel III, *supra* note 63, at 293. Other exceptions include a claim for alimony and a claim for property division upon divorce. *Id.* Note that the exception for tort claims was eliminated in March of 2011. H.B. 1155, 86th Leg., 2011 Reg. Sess. (S.D. 2011).

settlor likely would have been included in the settlor's gross estate for federal estate tax purposes.[208]

However, South Dakota has since changed its DAPT statutes. Because of the changes, alimony and child support creditors cannot, under any circumstances, invade the assets of a DAPT, provided that the child support and alimony claims did not exist at the time the settlor transferred the assets to the DAPT. As such, in many cases the assets of a South Dakota DAPT cannot be used to discharge a legal obligation of the settlor even if the settlor eventually has alimony or child support obligations (as explained above, this analysis would be different if those obligations existed at the time the settlor transferred the assets to the DAPT). Therefore, it would appear that the Service's reasoning as set forth in Private Letter Ruling 2009-44-002 would apply to a South Dakota DAPT.

V. CONCLUSION

DAPT legislation was initially conceived with asset protection in mind—and those benefits certainly still exist. However, the issuance of Private Letter Ruling 2009-44-002 was a watershed moment because it legitimized an additional significant use for DAPTs. Private Letter Ruling 2009-44-002 was the first time the Service had tipped its hand on whether assets placed in a self-settled DAPT by a settlor were, at least in some cases, a completed gift and excludable from a settlor's gross estate.[209] Initially, it was a step forward for Alaska only. With South Dakota's legislative changes in 2013 and 2014, it is likely the reasoning set forth in Private Letter Ruling 2009-44-002 would apply to South Dakota DAPTs just as it does to Alaska DAPTs. Thus, a South Dakota DAPT may be an option for those individuals unwilling to use a traditional irrevocable trust to

[208] Treas. Reg. § 25.2511-2(b); I.R.C. § 2036(a); Rothschild et al., *supra* note 18, at 11-12.
[209] *Id*.

mitigate estate tax for fear that relinquishing dominion and control over the transferred assets means that the transferred assets will no longer be available to them. Or, in other words, by using a South Dakota DAPT, they may be able to have their cake and eat it too.