Leimberg Information Services, Inc.

Steve Leimberg's Asset Protection Planning
Email Newsletter Archive Message #357

Date:01-Feb-18

Subject: James Kane - Augmenting the 2017 Nevada Trust Win in *Klabacka*

"A 2017 Nevada Supreme Court opinion in Klabacka v. Nelson is a winning feather in the hat for using Nevada self-settled trusts for asset protection purposes. Klabacka is particularly helpful in view, to-date, of the sparsity of judicial opinions providing guidance on how well self-settled trusts hold up under direct attack. This Klabacka opinion also helps suggest the framework for the prenuptial (or postnuptial) agreement/self-settled trust planning I outline below."

LISI closes the week with commentary from **James M. Kane** about a 2017 Nevada Supreme Court opinion in which two self-settled trusts successfully withstood attack in a couple's divorce.

James M. Kane is a tax lawyer with his Atlanta law firm **Kane Law LLC**. He is licensed in Georgia, North Carolina and New York. James's practice includes (i) trusts & estates controversies and litigation (tax and non-tax matters and disputes), and (ii) trusts & estates tax and asset protection planning. In addition to his law degree from Emory University Law School, James has undergraduate finance and graduate Masters of Taxation degrees. Before attending law school, James was an IRS Revenue Agent (in the Atlanta Large Case Examination Division). James maintains a legal blog [Google: James Kane Legal Blog]. James has practiced law in Atlanta for 20-plus years, previously with Chamberlain, Hrdlicka, White, Williams & Aughtry (including work with David Aughtry in the tax controversy arena) and Sutherland, Asbill & Brennan. James won the 2016 Heckerling Tax Court Brief writing contest. This was a contest **Richard Covey** (who is with the New York law firm **Carter, Ledyard &**

Milburn, LLP and a founding member of Heckerling) presented to the 2016 Heckerling participants. See **LISI** Estate Planning Newsletter #2474 (November 2, 2016).

Here is James' commentary:

EXECUTIVE SUMMARY:

A 2017 Nevada Supreme Court opinion in *Klabacka v. Nelson*, No. 66772 (May 25, 2017), is a winning feather in the hat for using Nevada self-settled trusts for asset protection purposes.[i] *Klabacka* is particularly helpful in view, to-date, of the sparsity of judicial opinions providing guidance on how well self-settled trusts hold up under direct attack. This *Klabacka* opinion also helps suggest the framework for the prenuptial (or postnuptial) agreement/ self-settled trust planning I outline below.

COMMENT:

The *Klabacka* Opinion

The *Klabacka* Supreme Court opinion upholds the asset protection effect of a Nevada married couple's use of respective spendthrift self-settled trusts in their divorce. At issue in the lower Nevada trial court was one spouse's effort to get at the other spouse's self-settled trust as part of the property division in the divorce. The effort was unsuccessful. Click this link to access the *Klabacka* opinion: Klabacka

In short, the couple in *Klabacka* – who resided in Nevada – mutually entered into separate property agreements for the division and transmutation of their community property into separate property, with each spouse using the separate property thereafter to fund their respective trusts. The couple also each later converted their trusts to Nevada spendthrift self-settled trusts.

This next point is very important. The *Klabacka* couple did not have a prenuptial or postnuptial agreement. In addition, the lower trial court in *Klabacka*, based on the testimony of the parties, found that the trusts were created for maximum protection from creditors *and not for the purpose* of a property settlement in the event of divorce. This event-of-divorce factor is

the underpinning of why I suggest using a written prenuptial (postnuptial) agreement along with the two self-settled trusts. I purposely place "postnuptial" in parentheses as a result of my understanding that only a majority of states allow *postnuptial* agreements.

The Prenuptial (Postnuptial) Agreement

Using a prenuptial (postnuptial) agreement – along with two self-settled trusts I suggest for this planning -- requires full compliance of all elements necessary to overcome a challenge to the prenuptial (postnuptial) agreement. The two trusts do not reduce exposure to issues or attack that otherwise might apply to the agreement itself.

My purpose in adding a prenuptial (postnuptial) agreement along with the two self-settled trusts is to augment the favorable result in *Klabacka*, particularly for couples who do not reside in Nevada. More specifically, the couple mutually agrees under the express terms of the agreement to designate Nevada as the jurisdiction and venue for any matters between them in the event of divorce as to their self-settled trusts.

In broad terms, a court reviewing the effect of a prenuptial or postnuptial agreement may likely address: (1) was the agreement obtained through fraud, duress or mistake, or through misrepresentation or nondisclosure of material facts?; (2) is the agreement unconscionable?; and (3) have the facts and circumstances changed since the agreement was executed, so as to make its enforcement unfair and unreasonable? *See, for example, Mallen v. Mallen*, 280 Ga. 43 (Ga., 2005).

The terms of the prenuptial (postnuptial) agreement for this planning -- contemporaneous with creating and funding the couple's respective self-settled trusts – include the couple's express acknowledgement and consent (i) to the existence and use of their separate trusts *both* for maximum protection from creditors *and for the purpose* of excluding the trust property from any issue of alimony or property division in the event of divorce; (ii) to acknowledge that the property in each respective party's self-settled trust is to be treated for all purposes as separate property with none of the property for any purpose to be treated as marital property; and (iii) to jurisdiction and venue in Nevada as to any issues, or declaratory judgment questions, that may arise as to the trusts.

As an aside to item (i) above, the two self-settled trusts provide strong protection for the assets themselves, along with the couple having entered separately into the above written prenuptial (postnuptial) agreement. In addition to the event of a divorce, this asset protection also shields the assets against any number of other potential non-divorce threats; for example, accident lawsuits, third-party claims, bankruptcy, claims in excess of liability insurance coverage, etc.

This Potential Planning Is Not Limited to Nevada

Using the above *Klabacka* opinion as a framework, the planning I suggest in this article refers to using Nevada self-settled trusts. But, other state options among the 17 states presently with laws allowing protective self-settled trusts are possibilities. [Alaska, Delaware, Rhode Island, Nevada, Utah, Oklahoma, South Dakota, Missouri, Wyoming, Tennessee, New Hampshire, Hawaii, Virginia, Ohio, Mississippi West Virginia and Michigan].

And, more importantly, this potential self-settled trust planning *is not limited* to individuals who live only in one of the above 17 states. By contrast, a person in any state (e.g., Georgia) can set up this planning by purposely designing and creating a self-settled trust in one of the above 17 states, etc. This requires, among many elements, that the trustee be a resident of that other state, and, as I discuss in more detail below, that the trust be able to withstand long-arm jurisdictional attack.

The Trust Jurisdictional Concern

The celebratory trumpets for *Klabacka* sound the loudest only inside Nevada. A recent google search about the success of *Klabacka* produces, no doubt, laudable hits, such as "How Nevada Became America's Safest State for Wealth Protection"; "Supreme Court Case Reinforces Nevada as #1 DAPT [*domestic asset protection trust*] Jurisdiction"; "Nevada's Unparalleled Asset Protection"; "The Nevada Supreme Court Upholds Public Policy of Domestic Asset Trust".

For parties who live outside of Nevada with the hope of using Nevada self-settled trusts for asset protection, the still-open chink in the armor - even after *Klabacka* - is whether a state other than Nevada can exercise personal jurisdiction over the Nevada trust; for example, a New York court

bringing the Nevada trust within its jurisdictional reach in responding to a party's attack of the trust.

My planning goal, therefore, by tying in a prenuptial (postnuptial) agreement to the Nevada self-settled trusts is, with the express terms of the agreement, to bind the couple to Nevada for the jurisdiction and venue of their trusts in the event of divorce, with the result a Nevada court can oversee and apply its developing law (e.g., *Klabacka*) in favor of the defensive adequacy of the Nevada self-settled trusts.

The couple in the *Klabacka* divorce were Nevada residents, without the need for the Nevada court to address challenges to its jurisdiction over the trusts at issue in the divorce. Similar Nevada jurisdiction as to the Nevada trusts will not be as easily the same conclusion if the divorcing couple lives in a state other than Nevada, or if another third-party trying to get a hand on the trust assets does not reside in Nevada. This question geographically as to where a claimant can get a hand on a trust is referred to as "personal jurisdiction" over the trust (typically over the trustee of the trust).

Also keep in mind that doing nothing more than merely mandating within the prenuptial (postnuptial) agreement that the trusts are subject to Nevada jurisdiction and venue is for all purposes not a guarantee. The agreement arguably will effectively preclude the couple from attacking or challenging the trusts outside of Nevada.

But, for other potential third-party claimants, great care with the trust planning – *independent of the prenuptial (postnuptial) agreement* – is essential to protect against a home state outside of Nevada applying its following long-arm reach to pull the Nevada trusts (in this example) into that home state court's jurisdiction.

A State's Long-Arm Reach

Most states have long-arm statutes that expand the court's power to exercise personal jurisdiction over trust and non-trust matters occurring outside that court's home state. A simple example of long-arm personal jurisdiction is where a New York resident has an automobile accident in North Carolina. The accident will fall within the North Carolina long-arm

statute so that the damaged party does not have to travel into New York in order to file a lawsuit claim against the New York resident.

The threat of long-arm jurisdiction over a trust means that *any asset protection trust planning* (whether or not related to the *Klabacka* planning I discuss in this article) requires a carefully designed checklist applied *simultaneously during the trust planning process* purposely to avoid creating or overlooking factors that otherwise expose the trust to the long-arm reach of another state. A Georgia claimant, for example, who successfully gets a Nevada trust in front of a Georgia court essentially plunders the Nevada advantage.

Now, for a one-minute primer on long-arm personal jurisdiction within the context of this Nevada trust planning. A claimant (e.g., plaintiff) has the ultimate burden of proving personal jurisdiction by a preponderance of the evidence. In some states, a party also may request that the trial court make findings regarding personal jurisdiction, but in the absence of such request, findings are not required.

In deciding whether a nonresident defendant (e.g., the Nevada trust) is subject to another state's personal jurisdiction, that other state court generally must apply two analytical steps. First, are there events, factors, or actions occurring in that other state that fit within that state's long-arm jurisdiction statute? Second, if the long-arm statute applies to such events, factors, or actions, will application of the long-arm statute resulting in personal jurisdiction over a non-resident violate the Due Process Clause of the Fourteenth Amendment to the U.S. Constitution? I purposely for this article do not delve further into these jurisdictional factors and the abundance of related case law.

As with any excellent (and successful planning), the devil is in the details. It is critically essential in this prenuptial (postnuptial) planning that there be exacting adherence to all factors necessary both for upholding the prenuptial (postnuptial) agreement and bolstering a conclusion that the self-settled trusts' jurisdiction exists and stands only in Nevada against the threat of third-party claims, including each spouse in this planning situation, etc.

"We Will Make Them Travel to Nevada!"

One last thought as to the importance of staving off personal jurisdiction claims, especially for the Nevada trust planning I outline above. I have throughout my lawyering years heard far too many over-confident comments from both lawyers and clients – in situations where a protective trust is set up in another state – that the other-state trust planning will have the beneficial effect of, at least, forcing a third-party claimant to travel out to, and litigate in, that other state. The client (and the lawyer) mistakenly begin their trust planning with this over-confident conclusion already in hand, blind to addressing the factors necessary to reduce or avoid exposure to long-arm personal jurisdiction.

As a matter of litigation practice, there is virtually no material obstacle in most home states (other than a qualifying mailing or appropriate process server) for serving lawsuit papers (e.g., a Complaint) on a trust located in another state. The threshold fight then begins with the trust asserting there are insufficient factors for long-arm jurisdiction; and the opposing home-state claimant asserting those factors do exist. This is, in most cases, a detailed, intensive legal and factual battle.

Why do I harp on the above over-confidence point? It is to emphasize, again and again, that one must address these jurisdictional elements with the same level of care and detail as to all other elements for the above self-settled trust planning. Ideally, a client – in his or her own home state -- is then in a much better position to celebrate the protective benefit of *Klabacka* and other favorable state court opinions.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

James M. Kane

TECHNICAL EDITOR: DUNCAN OSBORNE

CITE AS:

LISI Asset Protection Planning Newsletter #358 (February 15, 2018) at http://www.leimbergservices.com.

CITATIONS:

---

[i] A self-settled trust is where a person transfers his or her own property into a trust *and is also* a beneficiary of the trust. By contrast, for example, if a parent transfers property into a trust and is not a beneficiary, but names her children as the beneficiaries, the trust is not a self-settled trust. It is a "third-party settled trust" for the children.

Most states (other than currently the 17 states listed in this newsletter) offer no trust protection for a self-settled trust. Thus, in most states a person cannot transfer his or her own property into a trust, be a beneficiary thereafter of that trust, and also try to use the trust as a shield to fend off creditors or other third-party claimants.