

MEMORANDUM

SUBJECT TO ATTORNEY/CLIENT PRIVILEGE ATTORNEY WORK PRODUCT DOCTRINE

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RE: Nevada Asset Protection Trusts

You have expressed to us an interest in receiving information on Nevada Asset Protection Trusts (“NAPT”). This Memorandum gives a general description of the requirements and limitations of such Trusts. **This Memorandum is subject to the attached disclaimer and Circular 230 Compliance Statement below.**

Background

Nevada has enacted legislation which allows for the formation of NAPTs. In general, Nevada law allows individuals to protect assets from the reach of potential creditors and still derive the benefit of such assets by transferring them to a NAPT. NAPT law usurps the old English Common law rule prohibiting a settlor (or trust creator) from receiving both a beneficial interest and creditor protection by creating a trust.

A handful of other states and foreign jurisdictions have recently enacted similar laws. However, NAPT have been part of the Nevada legal landscape for over a decade. Moreover, the Nevada legislature has shown its growing commitment to progressive asset protection planning by twice amending the NAPT legislation in a positive manner for settlors and advisors. The most recent 2009 amendments continued to strengthen the NAPT by giving settlors and NAPT drafters additional guidance as to what will and will not be protected under Nevada law.

Basic Requirements

The following is a brief description of the basic requirements for a NAPT but is not intended as a conclusive list.

(i) Discretionary Distributions.

A beneficiary of a NAPT is only entitled to distributions from the NAPT at the sole discretion of the Trustee. The Trustee's discretion to make distributions must apply to both income and principal. The Trustee can neither be under any obligation to make distributions to a NAPT beneficiary, nor may the Trustee be obligated to keep or enter into any transactions with respect to Trust Property.

(ii) Trust Irrevocable.

NAPT's are irrevocable and therefore not subject to amendment, revocation or termination. As a result, a potential settlor of a NAPT will be unable to change the NAPT's terms including without limitation the Trustee's discretion in making distributions to the beneficiary of a NAPT. However, the settlor may hold a limited power to appoint the assets of the NAPT at death.

(iii) Nevada Trustee.

At all times, at least one Trustee of a NAPT must be a Nevada resident, Bank or Trust Company. In addition, the maintenance of records and administration of a NAPT must be done in Nevada.

Trust Protector

A Trust Protector is generally appointed to oversee certain aspects of the administration of the NAPT. The Trust Protector can appoint additional Trustees, remove Trustees, request accountings, ratify larger transactions, amend the NAPT for certain purposes and even terminate the NAPT under limited circumstances.

Affidavit of Solvency

A potential settlor will generally be required to execute an Affidavit of Solvency. In the Affidavit of Solvency, the settlor must indicate that they are currently solvent and are not subject to any pending or threatened lawsuits or claims which could render the settlor insolvent. Any transfer of assets to a NAPT can not be in violation of Nevada's Uniform Fraudulent Transfer Act or the federal Money Laundering Control Act.

Estate and Gift Tax Issues

The Internal Revenue Service has recently issued a private letter ruling (See *PLR 200944002*) that a transfer to a similar trust of which the settlor was a discretionary beneficiary was a completed gift. Moreover, the IRS ruled in that same PLR that the assets of the domestic asset protection trust were not includable in the gross estate of the settlor for federal estate tax purposes. *PLR 200944002*, while non-binding on the IRS,

does give a strong indication that the IRS will not seek to include assets of such trusts in a settlor's gross estate. A settlor can avoid having transfers to a NAPT be treated as a completed gift by retaining a testamentary limited power to appoint such assets.

There are both pros and cons to having assets transferred to a NAPT qualify as a completed gift. On the one hand, there is an obvious benefit of having assets of a NAPT excluded from your gross estate so any appreciation on such assets transfer free of estate and gift taxes. However, if a NAPT settlor decides to make transfers to the NAPT a complete gift, a gift tax return would need to be filed and gift tax paid for transfers in excess of \$5,000,000 (less any previously taxable gift). In addition, the settlor's estate tax exemption would also be reduced by the value of the transfer. Finally, revisions required to the NAPT to ensure estate tax exclusion could potentially reduce the effectiveness of the NAPT as an asset protection tool.

Limitations

At the outset, a potential NAPT settlor should understand a NAPT could still be subject to attachment by potential creditors under any other state's law, federal law, rules or regulations, including without limitation any current or future federal bankruptcy law, rule or regulation.

Seasoning Periods

Nevada enacted one of the shortest vesting or seasoning periods of any state recognizing a NAPT. Under Nevada law, future creditors may not bring an action with respect to a transfer of property to a NAPT, unless the action is commenced within two (2) years after the transfer is made. Federal bankruptcy rules generally provide for a ten (10) year look back rule.

Under Nevada law, if a person is a creditor when the transfer is made, then the action must commence before the later of (i) two (2) years after the transfer or (ii) six (6) months after the person discovers or reasonably should have discovered the transfer. A creditor is deemed to have discovered a transfer at the time a public record is made of the transfer. Therefore, a settlor can start the clock running on current creditors by filing a public notice.

To bring an action, a creditor must prove that the transfer was a fraudulent transfer pursuant to Nevada's fraudulent transfer law or was otherwise "wrongful as to the creditor". Under Nevada's progressive NAPT's rules, proof by one creditor that a transfer of property was fraudulent does not constitute proof as to any other creditor and proof of a fraudulent or wrongful transfer of one property does not invalidate transfers of other property.

Lack of Established Precedent

While we recently received helpful revisions to the NAPT statutes, there is currently no case law or similar guidance regarding a NAPT. Therefore, we do not know the effect of any power held by a NAPT settlor under Nevada's law. Nor do we know how Nevada or federal bankruptcy courts will respond to or interpret such law. We enclose NRS Chapter 166 for your review.

Nevada's Favorable Tax Climate

Another aspect of Nevada law which makes Nevada a favorable jurisdiction for establishing a NAPT is Nevada's favorable tax climate. Nevada does not have a state income tax, gift tax or estate tax. The absence of any separate state taxes generally applicable to a Nevada trust coupled with its progressive asset protection regime, makes Nevada one of the most appealing jurisdictions for establishing a NAPT.

Circular 230 Compliance Statement:

Government Regulations contained in Circular 230 regulate written communication from us concerning Federal tax matters. In compliance with those Regulations, we must inform you that, except as expressly stated herein, nothing in the letter/memorandum or any enclosures or attachments communicated herewith was written or intended by the author thereof to be used, and nothing in this letter/memorandum or any such enclosures or attachments may be used or relied upon by any taxpayer, for the purpose of avoiding penalties that may be imposed on such taxpayer under the Internal Revenue Code of 1986, as amended. Furthermore, no one, without the express prior written permission of the above-signed or of Avansino, Melarkey, Knobel, Mulligan & McKenzie, may, use any part, of this letter/memorandum or any attachment or enclosure communicated herewith in promoting, marketing or recommending any arrangement relating to any Federal tax matter discussed herein or in any such attachment or enclosure. Any taxpayer other than the addressee hereof should seek advice based on the taxpayer's particular circumstances from an independent tax advisor with respect to any Federal tax transaction or matter contained in this letter/memorandum or any enclosure or attachment communicated herewith.

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