

“Forum shopping” is a phrase first year law students are introduced to in civil procedure class. It describes the phenomenon which occurs when a litigant chooses what he or she perceives to be the most favorable place to litigate among all of the courts which have proper jurisdiction. In the recent past, the estate planning bar and other professionals have been putting “forum shopping” to new use in the trusts context by “situs hunting.”

As a result of decades of monitoring and adapting to (and sometimes starting) trends in the trust arena, South Dakota is among the jurisdictions that have emerged as premier situs for trusts. This article will briefly address some of the areas where South Dakota’s trust environment is favorable vis-à-vis many other jurisdictions.

## **ASSET PROTECTION**

Planners should evaluate a variety of factors when selecting a jurisdiction for their clients’ asset protection trusts (sometimes called DAPTs, short for Domestic Asset Protection Trusts). Certain commentators have gone so far as to suggest that it may be malpractice for an attorney to attempt asset protection in

a Uniform Trust Code (UTC) state. The Third Restatement of Trusts, rather than restating common law, takes novel and creditor-friendly positions in several areas, in which the UTC has joined (despite some amendments seeking to further the UTC from the Third Restatement). Among these are an abolition of the common law distinction between discretionary trusts and spendthrift trusts. The Third Restatement says any creditor may attach a sole trustee/beneficiary’s interest in trust. Furthermore, under the UTC/Third Restatement approach, a creditor can attach and exercise a general power of appointment. South Dakota has codified and clarified asset-protection friendly answers to these developments.

South Dakota recently further limited its exception creditors, tightening the protections afforded to South Dakota Asset Protection Trusts. The only exception creditors allowed under South Dakota law are ex-spouses and children, and only to the extent the obligation arose before the creation of the trust. The 2-year statute of limitations is among the shortest available in DAPT jurisdictions.

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## DYNASTY TRUSTS

The Rule Against Perpetuities (the RAP), is known to most law students as the bane of their existence and to most lawyers as the thing from law school they forgot the soonest. But this arcane common law rule, probably originally intended to prevent the over-reach of dead-hand control, turns out to play an important role in today's environment of transfer taxes. The Constitution prohibits a federal direct tax on asset holdings, but Congress does tax the "privilege" of transferring that wealth, either at death (estate tax and generation skipping transfer tax) or during life (gift tax). The rule against perpetuities, therefore, has the dubious side-effect of ensuring that, at some point, trust property ends up in the hands of individuals, where it will eventually be subject to transfer taxes.

South Dakota became a pioneer of dynasty trusts by repealing the rule against perpetuities back in 1983 and remains a top-regarded dynasty trust jurisdiction today. Once assets are funded into a dynasty trust, no further transfer need occur. Because there's no transfer, and no further corresponding payment of transfer tax, families can avoid these taxes indefinitely, leading some to nickname South Dakota the "little tax haven on the prairie."

But tax avoidance isn't the only reason dynasty trusts could be attractive. Others include safeguarding a family fortune from improvident beneficiaries, defeat of creditors' claims, perpetuation of the settlor's memory and passing a set of ethical values to future generations, provision for investment management, protection of disabled beneficiaries, and preventing assets (such as closely held businesses) from being encumbered or sold.

## THE SOUTH DAKOTA ADVANTAGE

Top Tier Trust Jurisdiction, 2004-2014

*Trusts & Estates Magazine*

#1 Dynasty Trust Jurisdiction, 2012-2014

*Steve Oshins*

#1 Decanting Jurisdiction, 2013-2014

*Steve Oshins*

#2 Asset Protection Jurisdiction, 2014

*Steve Oshins*

#1/#2 State Tax System, 2005-2014

*Small Business & Entrepreneurship Council*

Family Ltd. Partnership State of Choice

*Steven M. Pack*

## NO STATE INCOME TAX

South Dakota is an attractive jurisdiction due to its favorable tax environment. South Dakota imposes no personal or corporate income taxes. This means that high-income families in high-income tax states would do well to consider funding a South Dakota trust with income-producing assets. To the extent that income left undistributed (or, distributed to beneficiaries in lower-tax states), state income tax is reduced or avoided all together. Also worth noting is that South Dakota's insurance premium tax is the lowest in the nation, at 8 basis points.

## MODERN, FLEXIBLE TRUST LEGISLATION

**Directed Trusts.** South Dakota's statutes allow for directed trusts. These statutes allow clients to heed the advice of ACTEC fellow Sheldon G. Gilman that "the best course of action for our clients and their families is to appoint a single trustee - a trustee who is trained for the job -



South Dakota  
The Trust-Friendly State

preferably a corporate institution, who will be responsible for all trust administration issues, and then appoint an advisor or a committee of advisors who will provide the corporate fiduciary with the necessary insight into the clients' family members and will provide meaningful oversight of the trustee's administrative services." Directed trusts open the door for concentrated holdings, for example, in funding closely held business interests into trust, which may be the primary motive for establishing the trust. In South Dakota, those advisors can take the form of "special purpose entities," providing further protection for individuals who may otherwise be reticent to assume the liability of acting in such capacity.

South Dakota had the first US statute recognizing the authority of a trust protector, which provides for added protections, oversight and flexibility. These attributes are especially important for trusts of lengthy or perpetual duration.

**Trust Modification.** South Dakota's decanting statute provides flexibility in modification of trusts that would otherwise be irrevocable.


**Regulatory and Judicial Environment.** By statute, South Dakota seals trust records, preserving the privacy of families with assets in South Dakota trusts. The judiciary is familiar with judicial reformation and modifications of trusts, finer distinctions with respect to asset protection issues, and has a heightened sensitivity to the privacy concerns surrounding trusts. The Governor has enlisted a standing task force to monitor and address trust issues generally, and the legislature is frequently a vanguard for trust legislation nationally. In addition to top-notch trust law, South Dakota has created corporate and business law that complements its system of trust laws.

## CONCLUSION

Because of the advantageous trust-friendly tapestry that South Dakota has woven, it is well worth the advisor's time to consider whether certain of those advantages could be valuable to his or her clients. The advantage for certain clients of finding the right situs can be enormous. The advantage to the advisor for directing the client there can be equally great. We at First Covenant Trust & Advisors would be glad to discuss this with you further.

## AUTHOR'S NOTE

To read this article with references and footnotes, please see our website, [CovenantTrustLLC.com](http://CovenantTrustLLC.com), and click the Newsletters link. 

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# Financial Advisors:

## Bring Peace of Mind to Your Clients through Trusts

According to a 2011 study by Michael Sisk, only 45% of widows keep their assets with the same financial advisor following the death of their husband. Only 2% of children keep their inheritances with their parents' financial advisor. Regardless of whether there's a death, once assets are transferred, 95% of inheritors promptly change advisors. **Many times these changes are not in the beneficiary's best interest, but with trusts, you have a tool for your client's wishes to be carried out and a safeguard for their beneficiaries.**

Trusts can provide relief to some of the topics most concerning to your clients about their beneficiaries: their naïveté about money, irresponsible spending, or the influence of an inheritance on their initiative and responsibility. Trusts can provide the platform to develop a relationship not only with your clients, but with their descendants as well. This puts you in position both to help your client prepare the assets for the beneficiaries, and also to prepare the beneficiaries for the assets. If that is not enough, your relationship with the client's assets can be built directly into the trust, ensuring that the assets stay under your roof as long as the trust lasts (even if you change firms).

First Covenant is an independent, advisor-friendly trust company. With your cooperation as the financial advisor, and working together with your clients and their estate planning attorney, First Covenant can provide a solution for your clients to keep their assets with a trusted advisor. 



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## FIRST COVENANT TRUST AND ADVISORS

First Covenant Trust & Advisors was founded to meet the need for independent, expert fiduciary services. The area of trusts is dynamic and complex, which can be intimidating for those who aren't familiar with it. That's where First Covenant Trust can help.

First Covenant provides a variety of services: we can guide an estate through probate by acting as executor of a will, or we can serve as trustee for a variety of trusts—from testamentary trusts, irrevocable life insurance trusts, and charitable trusts to complex dynastic asset protection trusts. First Covenant is supported by individuals and organizations which, combined, provide decades of experience and expertise in the provision of fiduciary services and the related tax, accounting, and legal issues that surround trust and estate administration.

Our goal is to provide individualized fiduciary services to each client the way we would want to receive the same service: in the most efficient, effective and caring manner possible.

First Covenant also wishes to act as a resource to advisors and planners in the legal and financial community in the area of trust and estate administration. To that end, we are providing this newsletter aimed at touching on current issues, tax changes, or other topics relevant in the field. Our advisors are available to discuss the status of the law, strategies for dealing with the ever-changing tax and regulatory environment, and developing creative solutions to the issues faced by clients. We would love to hear from you. 

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How do you choose a location to situs your trust? You may want to take advantage of all the trust-friendly regulations South Dakota has to offer.

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