

## Situs Hunting

By David A. Greene, JD, CPA

“Forum shopping” is a phrase first year law students are introduced to in civil procedure class. It describes the phenomenon which occurs 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.”<sup>1</sup>

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 has emerged as a 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).<sup>2</sup> 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.<sup>3</sup> 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 the 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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<sup>1</sup> Douglas Moore, *Trusts & Estates Magazine*, 2010, “Situs Shopping.”

<sup>2</sup> Prominent Nevada estate planner Steve Oshins lists many of these factors in his DAPT state rankings chart (where South Dakota is ranked second, behind Nevada). [http://www.oshins.com/images/DAPT\\_Rankings.pdf](http://www.oshins.com/images/DAPT_Rankings.pdf)

<sup>3</sup> Charles Epps Ipock, Case Note, *How an Obscure Tennessee Opinion Uncovers the Veil of Legal Malpractice Between Asset-Protection Trusts and the Uniform Trust Code*, 3 ST. MARY’S J. LEGAL MAL. & ETHICS \*1 (2013), [http://www.stmaryslawjournal.com/pdfs/Ipock\\_final.pdf](http://www.stmaryslawjournal.com/pdfs/Ipock_final.pdf).

## Dynasty Trusts

The Rule Against Perpetuities (the RAP), known to most law students as the bane of their existence<sup>4</sup> 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<sup>5</sup> 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).<sup>6</sup> 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<sup>7</sup> by repealing the rule against perpetuities back in 1983<sup>8</sup> and remains a top-regarded dynasty trust jurisdiction today.<sup>9</sup> 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."<sup>10</sup>

But tax avoidance isn't the only reason Dynasty Trusts could be attractive, including 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,<sup>11</sup> provision of investment management, protection of disabled beneficiaries, and prevention of assets (such as closely held businesses) from being encumbered or sold.<sup>12</sup>

## 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.

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<sup>4</sup> Glick, Thomas G. <http://www.tomglick.com/home/in-the-news/ruleagainstperpetuities>

<sup>5</sup> Article 1, Section 9

<sup>6</sup> Grayson M. P. McCouch *Who Killed the Rule Against Perpetuities?*, 40 Pepp. L. Rev. 5 (2013), at 1291.

Available at: <http://digitalcommons.pepperdine.edu/plr/vol40/iss5/7>

<sup>7</sup> Mider, Zachary R., "South Dakota, Little Tax Haven on the Prairie." Bloomberg, January 9, 2014.

<http://www.bloomberg.com/bw/articles/2014-01-09/south-dakota-dynasty-trusts-tax-haven-for-rich-families#p2>

<sup>8</sup> Zaritsky, Howard., "Rule Against Perpetuities, A Survey of State (and D.C.) Law." ACTEC, 2012.

[http://www.actec.org/public/Documents/Studies/Zaritsky\\_RAP\\_Survey\\_03\\_2012.pdf](http://www.actec.org/public/Documents/Studies/Zaritsky_RAP_Survey_03_2012.pdf)

<sup>9</sup> [http://www.oshins.com/images/Dynasty\\_Trust\\_Rankings.pdf](http://www.oshins.com/images/Dynasty_Trust_Rankings.pdf)

<sup>10</sup> Mider, Zachary R., "South Dakota, Little Tax Haven on the Prairie." Bloomberg, January 9, 2014.

<http://www.bloomberg.com/bw/articles/2014-01-09/south-dakota-dynasty-trusts-tax-haven-for-rich-families#p2>

<sup>11</sup> Joshua C. Tate, *Perpetual Trusts and the Settlor's Intent*, 53 U. KAN. L. REV. 595, 617 (2005); *id.* at 613-17 (responding to Dukeminier and Krier), cited in Grayson M. P. McCouch *Who Killed the Rule Against Perpetuities?*, 40 Pepp. L. Rev. 5 (2013), at 1293.

Available at: <http://digitalcommons.pepperdine.edu/plr/vol40/iss5/7>

<sup>12</sup> Nenko, Richard W., "Perpetual Dynasty Trusts: Tax Planning and Jurisdiction Selection." 2011.

[https://www.wilmingtontrust.com/repositories/wtc\\_sitecontent/PDF/lib-WP-PerpetualDynastyTrusts.pdf](https://www.wilmingtontrust.com/repositories/wtc_sitecontent/PDF/lib-WP-PerpetualDynastyTrusts.pdf)

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—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."<sup>13</sup> 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.<sup>14</sup>

South Dakota had the first US statute recognizing the authority of a trust protector,<sup>15</sup> 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 your 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.

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<sup>13</sup> Gilman, Sheldon G., "Effective Use of Trust Advisors Can Avoid Trustee Problems." 2008.

<http://www.lynchcoxlaw.com/CM/Custom/Trust-Advisors-2.asp>

<sup>14</sup> [https://dlr.sd.gov/banking/trusts/documents/20\\_008\\_new\\_legislation.pdf](https://dlr.sd.gov/banking/trusts/documents/20_008_new_legislation.pdf)

<sup>15</sup> Worthington, Daniel G. and Merric, Mark. "Which Situs is Best in 2012?" Trusts & Estates Magazine, January 1, 2012.