You Can Relax If Your Estate Plan Includes A SPA Trust

During times of economic and tax law uncertainty, the more flexible your estate plan, the better. As some parts of the country are rebounding economically from effects of the COVID-19 pandemic, other areas continue to struggle. In addition, there's the possibility of major tax law changes on the horizon that could greatly affect your estate plan.

Because of this uncertainty, it's worth your while to consider all the strategies that can build flexibility into your plan. One strategy to consider is the special power of appointment (SPA) trust.

A Trust With A Twist

A SPA trust — sometimes referred to as a SPAT — is essentially an irrevocable trust, but as the creator or "settlor" of the trust, you grant a special power of appointment to a trusted individual. This person (the so called "appointer") acts in a nonfiduciary capacity to direct the trustee to make distributions to you (or to anyone else other than the appointer or his or her creditors or estate).

A properly designed SPA trust allows you to remove significant amounts of wealth from your estate, taking advantage of the current gift tax exemption, while retaining the ability to access the trust's assets — via the appointer — should your needs change in the future. In addition, because you aren't a beneficiary of a SPA trust, it won't be classified as a self-settled trust, making it possible to enjoy asset protection that's superior to that available through a domestic asset protection trust (DAPT).

SPA Trusts vs. DAPTs

Typically, self-settled trusts aren't protected against claims by your creditors. But around one-third of the states have statutes that authorize DAPTs. These trusts shield assets against many creditors' claims, even though the settlor retains an interest in the trust assets as a beneficiary. There's some risk involved with DAPTs, however, because their effectiveness in protecting assets isn't well established, particularly for nonresident settlors who live in non-DAPT states.

With a SPA trust, you have no beneficial interest in the trust assets. So long as you don't retain any improper control over the trust, and distributions to you are entirely within the appointer's discretion, the assets should be protected against creditors' claims in all 50 states.

SPA trusts aren't risk-free, however. Conceivably, a creditor could argue that frequent distributions from the trust to you make you a *de facto* beneficiary. One way to avoid such a challenge may be for the appointer to direct distributions to your spouse, rather than you, making it more difficult to argue that you're a *de facto* beneficiary.

Another risk is that a creditor might challenge a gift to the trust as a fraudulent transfer. (See "Be aware of fraudulent transfer laws" below.)

SPA Trust Plus LLC

For certain types of assets — particularly business interests — holding these assets in a limited liability company (LLC) owned by a SPA trust can provide significant benefits. Typically, the trust would own the LLC as a nonmanaging member, while you would be appointed as the LLC's manager. The LLC provides an extra layer of protection for the underlying assets, while you retain control over the business.

Because you don't own the LLC (it's owned by the trust), the assets are protected against the claims of your creditors (subject to fraudulent transfer laws). You can even receive management fees from the LLC, which, if reasonable, would be characterized as payment for services rather than distributions from the trust.

Be Aware Of Fraudulent Transfer Laws

Before you transfer assets — whether it's to a trust, another entity or an individual — be sure to familiarize yourself with the fraudulent transfer laws in your state. If a creditor successfully challenges a transfer as fraudulent, it can defeat the purpose of a SPA trust or other asset protection strategy.

To avoid running afoul of the fraudulent transfer laws before you give away assets — either directly or in trust — determine whether any current or potential creditors are likely to challenge the gift as a fraudulent transfer. And analyze your financial situation to be sure that you aren't insolvent and won't render yourself insolvent by making the gift.

Is A SPA Trust Right For You?

Because a SPA trust is irrevocable, you may be apprehensive of losing control of the trust's assets during uncertain times. However, at the same time, if you hold the assets outside of such a trust, they can be exposed to creditors' claims or gift or estate taxes. Your estate planning advisor can help you determine if a SPA trust is right for you.

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