Domestic Asset Protection Trusts (South Dakota): Why Not, When Not, & How Not

Everyone would use an asset protection / self-settled trust if it were free.

You already know why: you live with a target on your back. If you're an athlete, entertainer, founder, surgeon, or anyone with visible wealth, you don't measure success only by what you earn — but by what you actually keep after lawsuits, divorces, business failures, and changing tax laws have had their shot at you.

A South Dakota Asset Protection Trust ("APT" or "self-settled trust") is one of the few tools that can legally move a meaningful portion of your wealth to higher ground. At the same time, you're still alive, still in control of your career, and still able to benefit from the assets.

This paper explains *the why not, when not, and how not*, and just as importantly, *why, when*, *and how* to use one.

Beginning with the End in Mind

Long-term wealth preservation isn't about clever tricks. It's about designing your balance sheet so that:

- A serious lawsuit or business blow-up may hurt your income *going forward*, but can't easily strip assets you've already earned.
- Divorce or relationship risk can't automatically drag your entire net worth into a courtroom.
- The capital you've built survives you, in a structure your family and advisors can manage for decades.

A self-settled APT is an irrevocable trust you create, governed by the law of a state such as South Dakota, in which you can be a discretionary beneficiary. At the same time, a third-party trustee holds legal title and controls distributions. Properly drafted, the trust includes a strong "spendthrift" clause preventing most creditors from forcing distributions or attaching your beneficial interest.

South Dakota adds several critical advantages:

- A short, creditor-unfriendly statute of limitations for fraudulent-transfer claims (generally two years from transfer or six months from discovery).
- A higher "clear and convincing" burden of proof for a creditor alleging fraudulent transfer into a South Dakota APT, compared with the more common "preponderance of the evidence" standard in many states.
- No state income tax, powerful privacy laws, top-tier decanting and directed-trust statutes, and perpetual (or near-perpetual) trust duration.

For a public-facing, high-earning client, that combination means you can ring-fence a portion of your liquid wealth in a structure designed to be extremely difficult — and prohibitively expensive — for a future creditor to penetrate.

Think of an APT as another layer of insurance, not a loophole: it works best when it's created early, funded deliberately, and integrated with everything else in your plan — LLCs, operating companies, buy-sell agreements, and liability and umbrella insurance.

History of Asset Protection Trusts and Case Law Highlights

From offshore experiments to domestic statutes: Modern asset protection planning really took off in the offshore world. For years, high-risk clients used jurisdictions such as the Cook Islands and Nevis to put both legal and geographic distance between themselves and U.S. creditors. That worked, but it came with cost, complexity, and optics that didn't fit every family.

Beginning in the late 1990s, a small group of U.S. states – Alaska and Delaware first, followed by South Dakota, Nevada, and others – enacted self-settled asset protection trust statutes. These statutes allow an individual to:

- Transfer assets into an irrevocable trust governed by a favorable state's law.
- Remain a discretionary beneficiary.
- Add strong spendthrift language that limits most creditor access, as long as solvency and fraudulent-transfer rules are respected.

As the map filled in, competition emerged: where should a serious client *actually* situate their trust? Independent comparisons have been blunt. The Merric & Worthington "Best DAPT Jurisdictions Based on Three Types of Statutes" article, along with the Oshins DAPT rankings, repeatedly place South Dakota in the top tier, alongside Nevada and (depending on the metric) one or two others. South Dakota earns those marks on statute of limitations, absence or narrowness of exceptions for creditors, strong discretionary support and anti–alter ego statutes, and modern trust administration tools (directed trusts, decanting, long duration). For practitioners, that's the backdrop: a handful of best-in-class jurisdictions, with South Dakota consistently in that conversation, and a long period where everyone assumed DAPTs "worked" but had little courtroom guidance on how judges would treat them.

What recent DAPT litigation has actually taught us

For roughly twenty-five years after the first DAPT statutes, professional commentary looked like the Hybrid DAPT memorandum in your materials: no one could point to a fully litigated, end-to-end case squarely confirming (or killing) a domestic APT.

That uncertainty led many conservative planners to favor Hybrid DAPTs – third-party trusts where the settlor can be added later – precisely to de-risk the "self-settled" question.

That landscape started to change with a recent decision from a leading DAPT jurisdiction's business court. In that case, a creditor holding a large judgment tried to bust into a long-standing domestic asset protection trust created years before the debt. The court:

- Confirmed that the trust satisfied the state's DAPT statute (qualified local trustee, irrevocability, proper spendthrift clause, and governing law).
- Refused to disregard the trust under common-law theories (public-policy limitations on self-settled spendthrift trusts, "sham" arguments, and merger of settlor/beneficiary interests).
- Emphasized that the trust primarily held LLC interests, not exposed operating assets, and declined to "pierce down" through the LLC structure.

<u>The lessons translate directly to South Dakota:</u>

- Timing matters. Creating and funding the trust *before* a problem arises, and letting it season, is dramatically safer than a last-minute transfer.
- Formalities matter. Using a qualified South Dakota trustee, clear South Dakota governing law, robust spendthrift provisions, and clean entity structuring around the trust is not optional – it's what courts look for when deciding whether to respect the structure.
- Entities matter. Holding LLC or FLP interests inside the trust – rather than raw operating assets – adds a layer of charging-order protection on top of the trust statute. Funding the LLC months before contributing the LLC into an APT is critical.

In other words, when the facts line up – early planning, a real corporate trustee, solid documentation, and a clean balance sheet – courts can and do allow a domestic APT to perform as designed.

<u>South Dakota decisions that show how courts treat protection language</u>

South Dakota's specific DAPT statute (the Qualified Dispositions in Trust Act, SDCL Ch. 55-16) has been drafted to be one of the most protective in the country: two-year limitations period, a "clear and convincing" burden of proof for fraudulent-transfer claims, tight rules around marital-property transfers, and no exception creditor for a future divorcing spouse with respect to premarital transfers.

On top of those statutes, the state's courts have produced a handful of spendthrift and asset-protection decisions that, while not technically DAPT cases, tell you how seriously South Dakota treats trust terms and governing law.

<u>Beneficiary protection in a cross-border family-law fight</u>

In <u>*In re Cleopatra Cameron Gift Trust*,</u> Cleopatra's father had established two irrevocable trusts with traditional spendthrift language; Cleopatra was a beneficiary, not the settlor. During a

California divorce, the family court joined the trust as a party and ordered the trustee to pay her ex-husband directly from trust assets to satisfy support obligations. After the trust later moved its administration to South Dakota, Cleopatra sought a ruling that the trust could not make those direct payments because of the spendthrift clause.

<u>The South Dakota Supreme Court held that:</u>

- Enforcement procedures are governed by the law of the forum where the trust is administered; and
- Under South Dakota law, a spendthrift trust cannot be compelled to make direct payments to a non-beneficiary creditor.

Result: the California judgment against Cleopatra personally stood, but the trust was not forced to pay her ex-husband directly. The American Bar Association, in its DAPT commentary, specifically notes that this was not a self-settled DAPT – it was a classic third-party spendthrift trust – but it is still an important data point about how strongly South Dakota defends spendthrift <u>language.</u>

<u>Lender blocked from reaching trust assets despite full beneficiary consent</u>

In *Plains Commerce Bank, Inc. v. Beck*, parents created B&B Farms Trust, an irrevocable spendthrift trust, naming themselves primary beneficiaries and their children as secondary beneficiaries. Years later, one son – acting both as trustee and as an individual borrower – took out a large personal loan and mortgaged trust farmland (with written consent from all beneficiaries and settlors) to secure his own debt. When he defaulted, the bank sued to foreclose.

<u>The South Dakota Supreme Court refused to allow foreclosure and held that:</u>

- The mortgage was void and unenforceable because it violated the trust's spendthrift restriction;
- Beneficiary and settlor consent did not override the spendthrift clause as to outside creditors.

Again, not a DAPT – but a clear signal: when the trust instrument says "no creditor of a beneficiary can reach these assets," South Dakota courts are prepared to enforce that promise even in the face of sophisticated third-party lenders.

<u>Sham structures get no protection</u>

On the other end of the spectrum is *United States v. Nelson*, where a South Dakota resident transferred his residence into an "irrevocable trust," named himself sole trustee, never opened trust accounts or obtained a TIN, and went on treating the property exactly as his own – living there, paying taxes personally, and granting easements in his own name. When he failed to file income tax returns, the IRS assessed taxes and filed liens against both him and the "trust," then sued to foreclose. The federal district court held the trust was a mere nominee / alter ego, and allowed foreclosure on the property.

The lesson for South Dakota APTs is straightforward: if the trust is a façade and you behave as if nothing changed, courts will ignore the wrapper. Real separation of title, proper administration, and adherence to roles (grantor, trustee, distribution advisor, investment advisor) are non-negotiable.

<u>A divorce court's view from outside South Dakota</u>

One additional data point comes from outside the state. In *Netter v. Netter* (Connecticut Appellate Court, 2025), a husband quietly moved substantial marital assets into several South Dakota trusts, three of which were drafted as South Dakota "Qualified Disposition Trusts" under SDCL ch. 55-16. He was the sole beneficiary and investment advisor; a South Dakota trust company served as trustee.

In the ensuing divorce, the Connecticut court treated those South Dakota trusts as divisible marital property, emphasizing:

- Connecticut's long-standing policy against self-settled spendthrift trusts;
- The secret transfer of marital assets; and
- Connecticut statutory authority to apply its prior (more restrictive) law to avoid prejudicing the non-settlor spouse.

For clients and advisors, the takeaway isn't "South Dakota DAPTs don't work." It's that your home-state law, marital-property rules, and the story around the transfers still matter. South Dakota law can supply powerful protections, but it doesn't erase a judge's ability in another state – especially in divorce court – to value or allocate interests under that state's domestic-relations statutes.

Used with that context in mind, a South Dakota-situs APT is not a gimmick. It is a statute-driven, court-respected way to move a slice of your liquid balance sheet into a different legal box – one where South Dakota law, an independent trustee, and strong spendthrift language stand between your assets and future claimants.

<u>**The Rules: Structure, Jurisdictions, and Strategic Implementation**</u>

<u>Every serious APT shares a few non-negotiables:</u>

1. Irrevocable, discretionary trust. The trustee must have absolute discretion over distributions. You can't retain a legally enforceable right to demand money back.
2. Spendthrift provision. The trust instrument must restrict voluntary and involuntary transfers of your beneficial interest, blocking most creditor attachment.

3. South Dakota situs and trustee. To use South Dakota law, at least one qualified South Dakota trustee must administer the trust, and the instrument must select South Dakota law.
4. Directed-trust architecture. In a modern South Dakota structure, investment and distribution decisions can be delegated to *advisors* or *committees*, leaving the administrative trustee independent but not micromanaging your portfolio or family dynamics.
5. Limitation of the percentage of liquid net worth. Under the American west saying, pigs get fat, hogs get slaughtered, contributing more than forty percent of a grantor's liquid net worth, into an APT sets up bad fact and circumstance, should the APT be called into action.
6. Not following the slow and steady contribution approach. Allowing a few months to elapse between contributing liquid assets to the SD LLC and contributing the LLC back to the APT again creates a bad fact and circumstance pattern.
7. South Dakota court blessing. Allowing for and paying for the South Dakota courts to enter a judgement of declaration that the SD APT is recognized as falling under SD court jurisdiction. This raises the hurdle when creditors in states (e.g., CA, NJ, and NY) challenge the validity of the SD APT.

<u>Jurisdiction comparison: South Dakota, Delaware, Nevada, Alaska</u>

You're choosing which state's law you want standing between your assets and a future plaintiff's lawyer. The headline differences among the four leading jurisdictions are:

- Statute of limitations (fraudulent transfers into the trust).
    - South Dakota: Generally 2 years from transfer, or 6 months from when a pre-existing creditor discovered (or should have discovered) the transfer.
    - Nevada: Also 2 years from transfer, or 6 months from discovery, but with slightly different treatment of pre- and post-transfer creditors.
    - Delaware: 4-year period in most cases, with carve-outs and extended rights for certain "exception creditors" such as alimony and child-support claimants.
    - Alaska: 4 years from transfer, or 1 year from discovery, generally more favorable than non-DAPT states but longer than SD or NV.
- Exception creditors. Many states' APT statutes (including Delaware and Alaska) allow certain classes of creditors — especially former spouses or support claimants — to reach trust assets despite spendthrift protections. South Dakota does not treat a *future* divorcing spouse as an exception creditor for transfers made *before marriage* and imposes specific

notice rules for transfers of marital property after marriage, tightening the planning framework but preserving strong protection.

- Fraudulent-transfer standard. South Dakota explicitly requires a "clear and convincing evidence" standard for a creditor alleging a fraudulent transfer into an APT — materially higher than the typical civil "preponderance" standard used elsewhere.
- Privacy and flexibility. Independent comparisons and Bridgeford's jurisdictional analysis highlight South Dakota's unique combination of no state income tax, top-ranked decanting statute, broad privacy (including quiet trust options and sealed court records), and extremely long trust duration.

<u>Funding strategies: "slow and steady wins the race." How you fund an APT matters just as much as where you situate it.</u>

1. Start early; don't wait for sirens: Transfers made after a specific claim has arisen — or when you're obviously "on the brink" — are inviting a fraudulent-transfer attack, especially in states that have adopted the Uniform Voidable Transactions Act (UVTA).
2. Document solvency and intent: Strong practice is to obtain a solvency letter or affidavit confirming that, immediately after the transfer, you still have adequate assets to meet your known obligations. Our firm will not accept an APT without this kind of documentation.
3. Fund gradually, not in one giant panic move: We typically encourage clients to move a meaningful but not total slice of their exposed net worth — often in the 40–80% range depending on age, cash-flow needs, and risk profile — and to do so in stages. That creates a track record of ordinary, defensible transfers rather than a single oversized transfer that smells like a reaction to a specific threat.
4. Use entities for control and charging-order protection: In many designs, the APT owns interests in an LLC or family limited partnership (FLP). You or a related party may manage the entity, controlling investments, while the trust owns the equity. South Dakota LLC and LP statutes make a charging order the exclusive remedy for a creditor of a member/partner, meaning a creditor can only stand in line for distributions rather than seizing assets.
5. Segregate "clean" and "dirty" assets: Advanced structures may use a "hybrid DAPT" — where you are *not* an initial beneficiary, but a spouse/children are, and a trust protector has power to add you later if needed — or divide assets between a "clean" trust (no settlor interest) and a "dirty" trust (where you're a discretionary beneficiary). This lets you preserve at least one third-party trust even if law in your home state becomes more hostile.

6. Paper the story. A best practice seen recently, is a handwritten or signed memorandum of intent explaining, in plain language, why you're creating the trust: long-term risk management, legacy for family, integrating with estate plan, etc. If a judge ever looks at the file, you want your motives to look boringly sensible, not evasive.

Where People Go Wrong

If you treat an APT like a magic trick, it will fail like one. The biggest unforced errors we see:

1. Funding too late — or in the wrong state: Clients sometimes call after a serious accident, creditor demand, or deal gone bad, thinking they can quickly "hide" assets in a trust. Funding an APT when you already have a looming claim is an engraved invitation for a fraudulent-transfer lawsuit, especially in Uniform Voidable Transactions Act (UVTA) states that give creditors robust claw-back tools.

Worse, a few planners still try to use traditional DAPTs in states that have adopted UVTA with commentary hostile to self-settled trusts. Certain UVTA-"blue" states are high-risk for DAPT planning and that transferring into a standard DAPT from those states is generally not recommended.

2. Ignoring formalities and treating the trust like an ATM: Common patterns that blow up credibility:

- The settlor "borrows" from the trust without documentation, interest, or repayment.
- Distributions flow constantly and automatically to cover personal lifestyle, making the trust look like a disguised personal checking account.
- No minutes, no written direction from distribution or investment advisors, and no meaningful trustee oversight.

Courts look at control and behavior, not just paper. If you act like nothing changed after funding, don't expect a judge to believe the trust is real and independent.

3. Using the wrong assets: Throwing personal-use real estate directly into an APT, especially property in a high-litigation state, is usually asking for trouble. Local courts may assert jurisdiction over the property itself; real estate also tends to be the very asset plaintiffs' lawyers want. We typically keep operating real estate in local entities and protect the equity and cash (LLC interests, portfolio assets, sale proceeds) inside the APT.

4. No exit strategy: A surprising number of third-party drafts don't give the client any clean way to unwind or de-risk the structure if tax law, family circumstances, or risk profile change. A well-drafted South Dakota APT should allow a distribution advisor or trust protector to collapse or partially unwind the trust by directing full or partial distributions back to you (subject to solvency and tax analysis), or to migrate the trust offshore if US law becomes hostile.

5. Choosing the wrong team: Sloppy drafting, inexperienced trustees, and advisors who don't understand cross-border creditor law are poison here. You want:

- A South Dakota trustee whose *entire business* is independent trust administration, not product sales.
- Local legal counsel in your home state coordinating with South Dakota counsel, especially if your state has adopted UVTA.

<u>Best Practices: Use Cases by Profile</u>

A South Dakota APT is not one-size-fits-all. Below are common patterns by client profile. The common thread: the trust is one layer in a broader asset-protection ecosystem, alongside entities, insurance, prenuptial agreements, and estate planning.

<u>1. Professional athletes</u>

Risk profile: Short earning window, high income at a young age, intense public scrutiny, and exposure to personal-injury claims, contract disputes, and relationship volatility.

APT approach:

- Establish a South Dakota APT early in the athlete's professional career, ideally before the first major contract or endorsement deal vests.
- Fund it gradually with a portion of signing bonuses and later earnings (for example, 10–40% of after-tax liquidity), leaving enough outside for current living expenses and lifestyle.
- Use a South Dakota LLC owned by the APT to hold marketable securities and private investments, with the athlete serving as investment advisor but not as distribution advisor.
- Pair the APT with robust liability and umbrella coverage, and — where appropriate — prenuptial agreements to keep future marital-property claims from reaching trust assets.

Result: even if a career-ending incident or high-profile lawsuit occurs, a sizable block of capital remains quarantined inside the APT for long-term lifestyle and family support.

<u>2. Entertainers, influencers, and high-visibility creators</u>

Risk profile: Defamation and IP claims, "cancel culture" events that can nuke income overnight, informal business deals, and unstable personal relationships — often across multiple jurisdictions.

APT approach:

- Build a South Dakota APT that owns membership interests in the key operating entities (LLCs receiving brand, touring, or royalty income).

- Keep personal residences and touring entities outside the APT but insulated by separate LLCs and appropriate insurance; move excess cash and investment assets into the APT as they accumulate.
- Use directed-trust structure so the entertainer's existing business manager and investment team continue running the show, while the South Dakota trustee handles fiduciary administration.
- Consider a hybrid DAPT design if the client lives in a UVTA state: spouse and descendants are primary beneficiaries; a trust protector holds power to add the client later if needed.

This structure lets the talent stay agile while ensuring that a meltdown in public reputation doesn't automatically jeopardize core capital.

<u>3. Surgeons, lawyers, and other high-liability professionals</u>

Risk profile: Malpractice claims, partnership disputes, regulatory investigations, and — for practice owners — business and lease guarantees.

APT approach:

- Keep professional-practice entities and receivables outside the APT (they're inherently "hot"). Instead, route after-tax distributions and retained practice profits into the APT over time.
- Coordinate with malpractice coverage limits; the APT is meant to protect assets beyond insured limits, not to replace insurance.
- Use separate LLCs for investment real estate, with the APT as member and the professional or family entity as manager; avoid dropping the operating practice real estate itself into the APT where possible.
- For partners in large firms or groups, integrate the APT with buy-sell and compensation arrangements to avoid triggering unwanted transfer restrictions.

Properly implemented, the APT can turn "unlimited tail risk" into something more akin to a capped deductible.

<u>4. Middle-market company CEOs and founders pre- or post-sale</u>

Risk profile: Personal guarantees on lines of credit, representations and warranties in sale agreements, employment-related litigation, and concentrated exposure to a single company's success.

APT approach — *before* liquidity event:

- Create and seed a South Dakota APT well in advance of serious sale negotiations or major financing rounds.
- Transfer a portion of non-voting equity or limited-partnership interests to the APT, ideally when valuations are still relatively low.
- Layer in an LLC or FLP to maintain operational control while the trust owns the economic interest.

APT approach — *after* sale:

- Use sale proceeds to fund or top-up the APT with a diversified investment portfolio, holding illiquid side-investments inside subsidiary LLCs.
- Consider a completed-gift hybrid DAPT to remove the assets from the taxable estate while still preserving access via spouse/descendants and a trust-protector power to add the settlor if truly necessary.

In either scenario, the goal is simple: separate the wealth you've already created from the risks of whatever you do next.

Pulling It Together

A South Dakota Asset Protection Trust is not for everyone. If your net worth is modest, your risk profile low, and your life simple, the cost and complexity might not pencil out.

But if you:

- Expect to earn, inherit, or realize seven-, eight-, or nine-figure wealth;
- Operate in an industry where lawsuits, claims, and reputational storms are routine, not rare; and
- Care about both *how much* you leave and *how cleanly* you leave it —

then an APT is the closest thing you can get in US law to moving your balance sheet out of the blast radius without giving it away entirely.

If you're serious about long-term protection and legacy, the question isn't whether you *like* the idea of an asset protection trust.

It's whether you're willing to set one up before you need it.