

## Michigan Asset Protection Trusts

**Take-Away:** A fair amount of control may be retained by a settlor over a self-settled asset protection trust and still enjoy the creditor protection afforded by such a trust.

**Background:** As previous missives have reported (on several occasions,) Michigan has a self-settled domestic asset protection trust statute(MDAPT), technically called the Michigan Qualified Dispositions in Trust. [MCL 700.1041 et seq.] This statute authorizes the settlor to create an irrevocable trust and still benefit from the trust and/or use the MDAPT's assets. The statute permits the trust assets to be protected from the settlor's creditors, primarily in the form of a short statute of limitations regarding the settlor's transfers to the MDAPT and also a higher burden of proof that judgment creditors must meet to set-aside the settlor's transfers to his/her MDAPT. [MCL 700.1042(2)(3).] In a brief search, it does not appear that any Michigan appellate court has yet to address this MDAPT statute since it was enacted in 2017, so one must wonder if many settlors are adopting MDAPTs.

Perhaps the biggest concern to the use of the MDAPT is the settlor's loss of control over trust assets since an MDAPT must use an independent qualified trustee. [MCL 700.1042(p)(i).] Which tends to beg the question, how much control can the settlor retain over his/her MDAPT? An interesting court decision out of Delaware demonstrates that a settlor can retain a surprising amount of control over his/her DAPT.

***Matter of CES 2007 Trust, C.A. No. 2023-0925-SEM (Delaware Chancery Court, May 2, 2025)***

**Facts:** While it is not clear from the decision, it appears that the settlor of the DAPT was Michigan resident. The details follow:

**DAPT Terms:** The settlor created the trust under Delaware's DAPT statute back in 2007, using the US Trust Company as the initial independent trustee until it resigned because it was not paid its fees. Apparently, that was the pattern with successor independent trustees, too. The settlor was prohibited under the trust instrument from acting as the trustee. The settlor retained the role of 'advisor' under the trust with the full power to

manage the investments of the trust in a fiduciary capacity (much like a trust director under Michigan's Trust Code.) The settlor's brother served as the initial Trust Protector of the trust who held the power to remove the independent trustee and to appoint a successor trustee. The independent trustee held the power to distribute net income and principal from the trust for the benefit of the trust's beneficiaries. The trust beneficiaries were described as the settlor's wife, his parents, and their issue, if alive. Thus, the settlor was an issue of his parents, so he was part of the class of discretionary beneficiaries of the trust. The trust also had a spendthrift provision that prohibited a beneficiary from assigning or pledging his/her interest in the trust.

**DAPT Assets:** The settlor transferred to the trust 90% membership interests in three different LLC's, of which he was named the LLC manager. These LLC's owned real estate, thus managed by the settlor under the LLC Operating Agreements. The trustee later testified that it did not have knowledge about the underlying management of the trust-held LLCs, and that 'policing management of the LLCs is beyond its fiduciary responsibilities as trustee.' Practically speaking, as the LLC manager, the settlor indirectly controlled the cash-flow of the trust, making the decision whether, and how much, to distribute to the LLC member, which was the DAPT.

**Settlor's Judgment Creditor:** In 2019, 12 years after the Delaware trust had been formed, a judgment was entered against the settlor in the Oakland County, Michigan circuit court for \$14 million, which stemmed from a 2014 loan to an affiliate of the settlor to construct a high-end commercial and residential development in Ann Arbor. The Michigan circuit court issued an injunction that prohibited the settlor from transferring assets outside the ordinary course of business pending satisfaction of the Michigan judgment.

**Delaware Dispute:** The Michigan judgement creditor then came to Delaware and sought to invalidate the spendthrift provision in the settlor's Delaware trust on the basis that the spendthrift provision was void and that the Delaware trust was a sham in light of the control the settlor retained over it in his capacity as the manager of the three LLCs. The creditor claimed that the 'purported' trustee never did and never was intended to materially participate in the administration of the trust, and thus the trust did not qualify for protection under Delaware's DAPT statute. Coming as no surprise, the settlor responded that the trust was not subject to any collection actions, since it was a qualified asset protection trust under Delaware law.

**Delaware Chancery Court Decision:** The Magistrate dismissed the creditor's Petition to find the trust a sham, and it refused to enforce the Michigan judgment despite the full faith and credit provisions of the Constitution.

**Sham:** In response to the judgment creditor's claim that the trust was a sham due to the control the settlor retained in his capacity as manager of the trust-owned LLCs (and the trustee's admission that it did not supervise or monitor the LLCs that it owned) , the Delaware Chancery Magistrate noted that it is very difficult to disregard a trust entity, and that *"simply put, there were no transfers to/from the trust which would give rise to such an inquiry."*

**Retained Control:** As to the judgment creditor's claims regarding the settlor's retained control over the LLCs that were transferred to the trust as the exclusive LLC manager, the Magistrate noted "the petitioner has pled no basis on which this Court should engage in veil piercing." While the creditor claimed that the settlor's retention and exercise of control over the real estate held in the trust-owned LLCs was sufficient to enable the court to conclude that the trust was a sham and could be invaded by the creditor, the Magistrate found otherwise, finding that the trustee still effectively served a function in making discretionary distributions to or among the trust beneficiaries- thus it still had important duties that it performed under the trust instrument.

**Fraudulent Transfers:** With regard to the judgment creditor's claims that the transfers to the trust were fraudulent, the Magistrate did not rule on whether the transfers to the trust would be considered to be 'fraudulent' and thus set-aside. However, the Magistrate did note that there are statutes of limitations that can apply with respect to the ability to set-aside transfers to the trust, and that different rules apply before the funding of a qualified asset protection trust and after the funding of such a trust. Thus, the court refused to look back to transfers to the DAPT back in 2007 to examine if the uniform fraudulent transfer act (UFTA) had been violated.

**Spendthrift Provision:** As to the creditor's claim that the trust's spendthrift provision was void, the Magistrate noted that Delaware Courts would *"not give effect to a spendthrift trust that has no economic reality and whose only function is to enable the settlor to control and*

*enjoy the trust property without limitations or restraints.”* However, the Magistrate found that was not the case in this situation, since the trust and the underlying LLCs that held real estate, were for a valid business purpose with an economic reality.

**Settlor’s Indirect Control of the DAPT:** It is common for a DAPT to own interests in the settlor’s LLCs. As a frequent commentator on DAPTs, Steve Oshins, has written:

*“There is absolutely nothing wrong with the settlor serving as manager of an LLC or as general partner of a limited partnership (LP) that is owned by a DAPT. The settlor of a DAPT can serve as investment trustee of the DAPT, so why would there be an issue with the settlor managing an LLC (or LP) that is owned partially by a DAPT?”*

The issue is whether the DAPT settlor’s participation as a manager, or a general partner, or officer, in that capacity, and the conduct of the entities’ business, are reasonable, at arm’s length, and handled in a business-like manner. Restated, if the settlor takes an unreasonable salary, has perquisites paid out of the business that an unrelated party would not receive, signs entity transactions in his/her personal name instead of the entity name, then it is possible that the DAPT arrangement might not be respected and could be pierced by a court on behalf of a judgment creditor. Thus, it will be important for the settlor and the trustee of a DAPT to hold annual meetings, rigorously observe all formalities associated with the trust, and avoid any transfers that an independent third party would not approve.

**Conclusion:** This Delaware decision is an important reminder to settlors who are potentially considering the adoption of a self-settled asset protection trust, but reluctant to do so due to the loss of control over the transferred assets. A fair amount of control can still be retained over the trust while still enjoying the trust’s protection from creditor claims. Here, the settlor was the sole manager of the three LLCs held in the trust, thus controlling the cash flow to the trust. The settlor retained the role as the sole trust investment advisor, not the trustee. The settlor’s brother was named as the trust’s protector with the power to remove and replace the independent trustee, which had the sole discretion as to whether to make distributions to the settlor and other family members. While this decision is a positive development for DAPTs, it does not eliminate all issues and risks, since how the

trust is actually administered day-to-day will likely dictate whether it will be respected by a court as an asset protection device.

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