



# MANAGEMENT OF A NEVADA SELF-SETTLED SPENDTHRIFT TRUST

*Instructions to the Settlor and the Trustees*

*By Layne T. Rushforth*

## 1 Type of Trust.

1.1 Generally: A Nevada "self-settled spendthrift trust" (SSST) is an irrevocable trust that is compliant with Chapter 166 of the Nevada Revised Statutes (NRS) and under the terms of which the Trust's Settlor (creator) is a permitted beneficiary.<sup>1</sup> It is often referred to as a "Nevada asset-protection trust" (NAPT) or a "domestic asset-protection trust" (DAPT).<sup>2</sup>

1.1.1 *Independent Trustee*. An independent trustee (not the settlor or related or subordinate to the settlor) can serve as the sole Trustee. The Settlor can direct investments, if desired.

1.1.2 *Settlor as a Co-Trustee*. The Settlor cannot be the sole Trustee of an SSST. If the Settlor wants to manage the trust personally, the Settlor can act as a "Managing Trustee" with the power to manage the trust EXCEPT for the power to make distributions.<sup>3</sup> The power to make distributions must be held by one or more other persons, frequently called the "Distribution Trustee", "Distribution Adviser", or "Distribution Committee".

1.1.3 *Read the Trust Agreement*. Regardless of the type of trust, you should read the entire trust agreement and consult with an experienced trust-and-estate attorney to make sure that you fully understand your role.

1.2 Tax Status: The provisions in the trust agreement will determine the tax status of the SSST.

1.2.1 *Income-Tax Status*. The SSST can be a "grantor trust" or a "non-grantor trust" for federal income-tax purposes. A grantor trust is ignored for federal income-tax purposes, which means that the income from trust assets will be reported on the Settlor's individual income tax return (IRS Form 1040). A non-grantor trust is a separate entity for federal income-tax purposes, and the income from trust assets will be:

(a) Reported by the Trust on IRS Form 1041 as to income that is not distributed to one or more beneficiaries; or

(b) Reported by the beneficiaries on IRS Form 1040 as to the income that they received, as shown on IRS Form K-1 that is provided by the Trustee.

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<sup>1</sup> Please read <http://rkllegal.info/pdf/ap.pdf> for more information regarding asset protection in general. The "Settlor" is the creator of a trust. Equivalent terms include "grantor", "trustor", and "trust maker". The singular term is used here, but there can be more than one settlor.

<sup>2</sup> There are several states that respect a DAPT to some degree. For a list of the states and a comparison of the states' laws, see David Shaftel's ACTEC comparison: <https://www.actec.org/assets/1/6/Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust-Statutes.pdf>, which is updated from time to time.

<sup>3</sup> NRS 166.040(3).

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1.2.2 *Gift-Tax Status.* For federal gift-tax purposes, transfers to the trust can be considered “completed gifts” or “incomplete gifts”, depending on the powers the Settlor retains to change distributions.

(a) If the trust is designed as a completed-gift trust, the value of the contributed assets will be reported by the Settlor as taxable gifts on a federal gift-tax return (IRS Form 709). Any distribution to the Settlor (or payment for the Settlor’s benefit) will bring the distributed property back into the Settlor’s estate.

(b) If the trust is designed as an incomplete-gift trust, contributions to the trust are ignored for gift-tax purposes, but distributions from the trust to any beneficiary other than the Settlor will be deemed a taxable gift and must be reported as such by the Settlor.

1.2.3 *Estate Tax Status.* The inclusion or inclusion of the SSST’s assets in the Settlor’s estate for estate-tax purposes primarily depends on whether the SSST was a completed-gift trust or an incomplete-gift trust.

(a) The assets owned by an incomplete-gift SSST will be included in the Settlor’s estate for federal estate-tax purposes.

(b) The assets owned by a completed-gift trust will be excluded from the Settlor’s taxable estate unless the IRS can establish that there was an agreement (“understanding”) with the Distribution Trustee that the Settlor could have any distribution that the Settlor asked for.

## **2 Distributions While the Settlor is Living.**

2.1 Trust Distributions to a Settlor: A settlor or creator of a Nevada self-settled spendthrift trust<sup>1</sup> cannot receive distributions or benefits from the trust without the consent of someone else. For the purposes of these materials, we refer to the person who authorizes distributions as the Distribution Trustee.<sup>4</sup>

2.2 Indirect Distributions: Care must be taken to avoid any distributions to a settlor from any asset belonging to the spendthrift trust without the approval of the Distribution Trustee.

2.2.1 *Account Access.* Some bank accounts, brokerage accounts, and other investments offer check-writing privileges, debit cards, ATM cards, credit- cards,

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<sup>4</sup> NRS 166.040. Nevada law does not specifically require that a trustee approve distributions to or for the settlor, but for most purposes, it is appropriate to designate as a co-trustee the person who must consent to a distribution. Some trusts specify a group or committee who must approve distributions instead of just one person. For the purposes of this memo, “Distribution Trustee” refers to the person or committee whose consent is required for a distribution that benefits the settlor of a self-settled spendthrift trust, whether or not the committee or person is designated as a trustee. If an independent trustee is serving as the sole trustee, such a trustee is “someone other than the Settlor” and can do what the Distribution Trustee would do.

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automatic bill-paying services, automatic transfers, and other programs that would allow a settlor of a spendthrift trust to benefit from distributions. **Unless such services require the consent of the Distributions Trustee, they may cause the trust to lose its status as a spendthrift trust as to the affected assets.**

*2.2.2 Trust-Owned Business Entities.* If a settlor is receiving distributions (such as compensation or reimbursements) from a corporation, limited-liability company, partnership, or other business entity that is owned by the spendthrift trust, if those distributions are made in the ordinary course of business and for full and adequate consideration, these distributions are considered acceptable. Even so, until the law is clarified, either by court rulings or by the legislature, it is our recommendation that even this type of distribution be avoided without the consent of a third party. We suggest that a manager, director, or officer of the company who is not a settlor of the spendthrift trust be required to approve any distributions to a settlor so long as the spendthrift trust is an owner of an interest in the company.

*2.2.3 Ongoing Consent.* With the consent of the Distribution Trustee, arrangements can be made for ongoing, regular distributions to a settlor of a self-settled spendthrift trust, including some of the benefits and privileges discussed above, but only if the Distribution Trustee's consent can be unilaterally terminated or withdrawn at any time, effective immediately.

*2.3 Dispute Period:* In some trusts, some things change when there is litigation that could challenge the creditor-protection of the SSST. RLK's documents define a "dispute period". In brief, a dispute period exists when a creditor is suing to get paid from the Trust's income or its property or when the Settlor is being sued for more than a specific dollar amount. It is common to provide that during a dispute period, the Settlor's right to remove and replace a trustee is suspended, and some distributions may require approval of another advisor, such as a Trust Protector.

### **3 Control.**

*3.1 Internal Management:* The Distribution Trustee does not have to participate in the decisions relating to the internal management of the spendthrift trust or the management of any of its assets, except with respect to distributions to a settlor of the spendthrift trust. This means that the Managing Trustee or Managing Trustees, who are usually the settlor(s), have full authority to invest, encumber, buy, or otherwise transfer assets so long as no settlor can receive a distribution without the consent of the Distribution Trustee.<sup>5</sup>

*3.2 Dividends; Liquidation:* Because no distribution to the Settlor is involved, dividends and liquidating distributions *that are payable directly to the trust* are permissible without the consent or approval of the Distribution Trustee.

*3.3 Other Advisors:* Nevada law permits other "advisers" to get involved in the administration of the SSST.

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<sup>5</sup> See footnote 4 regarding the Distribution Trustee.

3.3.1 *Trust Protector.* It is typical to designate a Trust Protector, who is given the authority to remove and replace the Trustees when the Settlor's right to do so has been suspended due to incapacity or during a dispute period. The role of the Trust Protector is defined solely by the trust agreement and can include having the power to declare a dispute period, to grant and negate powers of appointment, to approve certain types of investment decisions (such as the sale of a business or real property) or distributions to certain beneficiaries, to approve a trust modification, and to do anything else the Settlor wants.

3.3.2 *Investment Adviser.* The Trustee can be required either to consult with an investment adviser or to make the investments that a designated Investment Adviser directs. If the Trustee is only required to consult with an adviser, the Trustee maintains the fiduciary duty to invest prudently. If the Trustee is required to make the investments as directed by the Investment Adviser, the Trustee becomes a "directed trustee" or "directed fiduciary" and has no liability for the investment decisions directed by the Investment Adviser.

3.3.3 *Family Adviser.* A Settlor may wish to get family members involved in some aspects of the Trust's administration and may appoint one or more Family Advisers. It is typical for a trust to require the Trustee to consult with the Family Adviser on specific decisions relating to distributions, investments, business management, and so forth. For example, the Family Adviser may be given the power to veto the sale of a business or a distribution to a troubled beneficiary.

3.3.4 *Duties.* The duty of each adviser is dependent on the scope of the powers held by such adviser. Some powers are exercised without fiduciary responsibility, and other powers require the exercise of due care. Most SSST trust agreements specify which powers are fiduciary powers and which are not, and many trust agreements expressly exclude an adviser from liability unless the adviser is guilty of fraud, deceit, willful or wanton misconduct, or gross negligence. (Without that, most trust advisers would decline to serve.)

3.4 Difficult Decisions: When a difficult decision arises, you may get conflicting advice from advisors and from beneficiaries. Difficult decisions will primarily relate to investments and to distributions to beneficiaries. You have several options that will help reduce your exposure to claims that you have made a wrong decision.

3.4.1 *Attorney.* Consult with your attorney about the decision, its consistency with the law and the trust agreement, and its possible consequences. He or she may give you guidance to resolve the issue.

3.4.2 *Notice of Proposed Action.* Nevada law permits the Trustee of a trust to send a formal notice regarding the action the Trustee wants to take. Thirty days after the notice is sent, if no objection is made, the Trustee can proceed without liability. The process can be more difficult if minor beneficiaries are involved, but it usually can be done. If a beneficiary objects, the Trustee either takes no actions or petitions the court for instructions. a notice of proposed action can be used for virtually any aspect of the

administration of the trust. Care must be taken to follow the specific requirements of the law.<sup>6</sup>

3.4.3 *Petition for Instructions.* A Trustee can ask the court to make the decision by filing a petition for instructions. The petition can ask for approval of the Trustee's desired action, and that is the most common format. Another approach is to present the court with various options and ask the court to choose from among them. Notice of the hearing on the petition is given to all beneficiaries, who may file an objection with the court and appear at the hearing. Once a court order is issued, the Trustee who complies with such an order is without liability.

3.5 Trust Modification: An irrevocable trust can be modified in several ways, but this should be done only when the consequences have been considered. If you think the trust agreement should be modified, ask your trust-and-estate attorney about modification by decanting, by a nonjudicial settlement agreement, or by court reformation.<sup>7</sup>

## 4 Specific Situations

4.1 Real Estate: We suggest that any deed conveying real estate to a spendthrift trust convey it to the trust itself.<sup>8</sup> The deed should specifically explain the role of the various trustees, perhaps using language something like this:

*The Managing Trustee may sell, exchange, encumber, and/or otherwise transfer the property without the consent of the Distribution Trustee if the full proceeds of the sale, transfer, or exchange are completely paid, delivered, or transferred to the Grantee herein, but the consent of the Distribution Trustee is required if the Grantors will receive any payment, distribution, consideration, or benefit of any kind for less than full and adequate fair-market consideration.*

*Under the terms of the spendthrift trust's governing instrument, the Grantors, as beneficiaries of the spendthrift trust, may be allowed to use the property only in the discretion of the Distribution Trustee with the Distribution Trustee's consent on such terms and conditions as the Distribution shall from time to time determine, and the Distribution Trustee's consent may be unilaterally withdrawn at any time without cause.*

*The foregoing imposes limits on the trustees' ability to convey title for the purposes of NRS 164.067(1), but nothing herein requires anyone dealing with the trustees to examine a copy of the trust agreement or to otherwise investigate the application of any proceeds from the sale or exchange that are delivered to the trustees in accordance with the foregoing.*

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<sup>6</sup> NRS 164.725.

<sup>7</sup> See <http://rkllegal.info/pdf/trustmodifications.pdf> for more information.

<sup>8</sup> In the common law, trusts were not recognized as separate entities and did not, of themselves, hold title to asset; however, under Nevada law (NRS 0.039), a trust is considered a "person", which means that, like a corporation, a trust can hold title to assets.

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4.2 **Financial Accounts; Investments:** Ideally, financial accounts and other investments can be titled so that internal decisions with respect to investments that stay inside the trust can be managed by the Managing Trustee(s) without the consent of the Distribution Trustee. As a practical matter, it may be necessary to establish accounts that require two or more signatures, one of which must be the Distribution Trustee. A letter of instructions to the financial institution, brokerage company, or other investment institution might include the following:

*The Managing Trustee has authority to sell, exchange, encumber, and/or otherwise transfer the property without the consent of the Distribution Trustee if the full proceeds of the sale, transfer, or exchange are completely paid, delivered, or transferred to the spendthrift trust or to an account or investment in the name of the spendthrift trust; however, the consent of the Distribution Trustee is required if a settlor of the spendthrift trust will receive any distribution or benefit.*

*With the consent of the Distribution Trustee, arrangements can be made to allow regular, specified payments and transfers to or for a settlor of the trust; however, the Distribution Trustee's must be able to withdraw that consent at any time without cause, effective immediately upon giving notice of the withdrawal.*

4.3 **Bank Accounts:** If a bank does not have a method for insuring that two signatures are required on checks, we recommend that the spendthrift trust not open an account with that bank or that no settlor be a signatory.

## **5 Privacy or Protection** <sup>9</sup>

5.1 **Privacy.** Normally, ownership of assets is personal and confidential. Public records normally show only the assets that are required to be recorded, such as deeds, trust deeds, and mortgages. Other assets are generally not made part of the public record, and most people like it that way. For those who want asset protection, however, a public record of asset ownership may provide additional protection.

5.2 **Two-Year Look-Back Period:** Nevada's spendthrift trust law allows a creditor two years to challenge a transfer to a spendthrift trust as being fraudulent and void. This is referred to as a two-year statute of limitations, but there is a significant exception.

5.2.1 **Six Months from Discovery.** If the Settlor of an SSST put assets into the Trust at a time when someone had a claim against the Settlor, Nevada law allows the claimant to assert a claim within six months of becoming aware of the transfer to the Trust. So, if the transfer was made four years ago, but the claimant only became aware of the transfer in June of this year, the claimant has until December to file a lawsuit.

5.2.2 **Making Transfers Public.** Since creditors are rarely aware of transfers to trusts, this can potentially make the two-year limitation potentially meaningless. Some asset transfers, such as recording of deeds that convey the Settlor's real estate to an SSST, are made part of the public record; however, for other assets, a way must be found to make claimants aware of a transfer in order to avoid the six-month rule.

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<sup>9</sup> See also <http://rlklegal.info/asset-protection-trusts-and-public-records.html>.

5.2.3 *What Is an Existing Claim?* An existing “claim” exists when the triggering event has occurred without anyone even knowing. The surgeon who has inadvertently amputated the wrong leg of a patient, the attorney who has signed a settlement agreement without the client’s consent, the accountant who has knowingly put false information on a tax return, and the general contractor whose building has hidden defects may all have claims against them that are unknown but existing. For such cases, it is important to have the statute of limitations expire two years after the transfer of assets to the SSST, not six months after a claimant learns of the transfer, which could occur much later.

5.2.4 *Public Record.* Under Nevada law, everyone is deemed to be aware of any asset transfers for which there is a public record.<sup>10</sup> If the Settlor makes a public record of each transfer to the SSST, it is no longer possible for a creditor to say, “I was not aware of that transfer until today and so I have another six months in which to assert a claim on trust assets.” The methods for making a public record are discussed in subsection 5.3.

5.2.5 *Record Keeping.* Accurate record keeping with respect to contributions and distributions is essential. *Each addition to the trust has its own two-year statute of limitations period*, and distributions are deemed to be made from the most recently contributed assets.<sup>11</sup>

5.3 Choice: Protection or Privacy : So, for the best protection, there should be a public record of all asset transfers to a self-settled spendthrift trust. If the settlor of a spendthrift trust chooses not to make his asset transfers public, then he or she is choosing privacy over protection. For our clients, we are recommending protection over privacy, and we suggest that a schedule of trust assets be recorded when a spendthrift trust is initially formed and that a supplemental schedule showing additional assets be recorded each time additional assets are added. Ultimately, however, the Settlor must decide how much should be made part of the public record, and the decision boils down to “privacy or protection”.<sup>12</sup>

## 6 Incapacity or Death of the Settlor

6.1 Incapacity: If the Settlor becomes incapacitated, the Settlor cannot act as the Managing Trustee, and the Distribution Trustee or an independent trustee may become the sole trustee. The trust agreement will specifically provide for that situation, and its terms should be followed carefully.

6.2 Death: Upon the Settlor’s death, the Trust will continue as a spendthrift trust, but it will not longer be a self-settled spendthrift trust.

6.2.1 Once a trust is no longer an SSST, it can be protected under the spendthrift trust laws of most any state. The trust agreement or applicable law may allow the Trustee

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<sup>10</sup> NRS 166.170(2).

<sup>11</sup> NRS 166.170(7).

<sup>12</sup> Some practitioners publish a notice of transfers in the local paper as a method of complying with NRS 166.170(2), and that arguably constitute a “public record”. We advise using recording documents or filing of UCC financing statements because those are mentioned in the statute.

to change the governing law and the situs (domicile) of the Trust. Because Nevada spendthrift trust laws are quite strong, this decision should only be made after consultation with an experienced trust-and-estate attorney in the non-Nevada jurisdiction that is being considered. If Nevada law is desirable, a Nevada trustee (or co-trustee) is required at all times.<sup>13</sup>

6.2.2 The trust agreement will specifically provide for the Settlor's death, and the terms of the trust agreement should be followed carefully. Some trusts will require an immediate distribution of assets, some trusts will require the Trustee to continue to manage the Trust's assets until a specified event, and some trusts will treat portions or shares of the trust differently.

6.2.3 In addition to the trust agreement's provisions, the general duties of the Trustee, which are discussed in section 7, will continue to apply. It is advisable to consult with an experience trust-and estate attorney to assure compliance with the law and the trust instrument. Reporting to and conferring with the adult trust beneficiaries regularly will help avoid misunderstandings.

6.2.4 If the value of the Trust's assets are included in the Settlor's taxable estate for federal estate-tax purposes and the combined total exceeds the applicable exclusion amount,<sup>14</sup> the Trustee will need to work with the Settlor's personal representative (i.e., executor or administrator) and the trustee of each other trust that holds taxable assets to make sure that the tax is properly reported to the IRS on a federal estate tax return (IRS Form 706) and that the estate tax is paid from the proper sources.

## 7 General Duties of a Trustee

7.1 **Fiduciary Duties** : A Trustee (including each co-trustee) is a "fiduciary", which is a person or entity that has a duty to act in the best interest of others.

7.1.1 *Traditional Fiduciary Duties.* The standard of care owed by a Trustee to the beneficiaries of a trust is based on compliance with the fiduciary duties that are summarized in the acronym "A CLIP", which represent the duty of a trustee to:<sup>15</sup>

(a) ACCOUNT and fully disclose information relating to the administration of the trust<sup>16</sup>;

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<sup>13</sup> NRS 166.015.

<sup>14</sup> Internal Revenue Code § 2010(c) provides for an "applicable exclusion", which is the cumulative amount that can pass free of gift and/or estate tax. Subject to future legislative changes, the applicable exclusion was \$11,180,000 in 2018 and is \$11,400,000 in 2019. In 2026, this will revert to \$5 million plus cost-of-living adjustments from 2011, which may be around \$6,200,000. For the applicable exclusion in prior years, see <http://rushforth.net/advintro.html#ae>.

<sup>15</sup> See Chapter 15, "Specific Duties of Trusteeship", *Restatement (Third) of Trusts (2007)* and Bogerts, *The Law of Trusts and Trustees* § 541".

<sup>16</sup> NRS Chapter 165.



(b) COMPLY in good faith with the provisions of the governing trust instrument and applicable law;

(c) Be LOYAL to the beneficiaries, favoring the beneficiaries' interests over all others<sup>17</sup>, which includes avoiding self-dealing and conflicts of interests and not taking excessive compensation;

(d) Be IMPARTIAL as to all beneficiaries, favoring no one, except as expressly permitted in the trust instrument<sup>18</sup>; and

(e) Be PRUDENT in the investments and management of the trust.<sup>19</sup>

7.1.2 *Exclusions.* Except for the duty to comply with the law and the terms of the trust instrument, all other duties can be either reduced or eliminated under the terms of the trust agreement. In addition, many trust agreements expressly eliminate a Trustee's personal liability unless the Trustee is guilty of fraud, deceit, willful or wanton misconduct, or gross negligence. (Without that, most persons would decline to serve as a Trustee.)

7.2 Acting as Trustee: All transactions you make in behalf of the trust should clearly reflect that you are acting as trustee.

7.3 Tax Identification Number: We recommend that you immediately apply for a "tax identification number" or "TIN" (also referred to as an "employer identification number" or "EIN") for the trust, even if the trust is a "grantor trust" for federal income tax purposes. This is done using IRS Form SS-4 or it can be applied for online on the IRS web site<sup>20</sup>. The trustee should never use his or her own social security number (or, for a business entity, its EIN) for a trust bank account.

7.4 Bank Accounts: All cash contributions should be deposited into a separate account established solely for the trust. The bank (or other financial institution) should be given the trust's tax identification number when the account is opened.

7.5 Records: Keep meticulous records relating to the trust's assets, income, and expenditures.

7.6 Independence: You *must* act independently. If the IRS perceives that you are merely an agent for the settlor or the settlor's "alter ego", the trust assets may be included in the settlor's estate for federal estate-tax purposes.

7.7 Investments: You should review the provisions of the trust agreement that explain the investments you are permitted to make. A trustee is usually not required to retain the existing investments but might be permitted to do so. Unless the trust eliminates the duty, you need to

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<sup>17</sup> NRS 164.715.

<sup>18</sup> NRS 164.720. An SSSST will almost always permit the Settlor to be favored over other beneficiaries.

<sup>19</sup> NRS 164.705 et seq.

<sup>20</sup> <https://sa.www4.irs.gov/modiein/individual/index.jsp>.

see that the investments of the trust are diversified so that the risk of loss is minimized. If life insurance is an asset of the trust, a trustee generally has the duty to monitor the performance of the policy and to determine if one or more insurance policies could be replaced with something better. For some types of assets, you should make sure that there is adequate property and casualty insurance, and most insurance policies that covered the assets while they were owned by the settlor will need to be replaced with new policies once the trust is the owner.

## **8 Conclusion**

8.1 Valid Nevada Law: Nevada's spendthrift trust laws have been tested in the Nevada District Court, but there is no record of those decisions. The Nevada Supreme Court has clearly upheld the law in one decision<sup>21</sup>, but there are undoubtedly additional challenges that will be asserted. No one should assume that an SSST is bulletproof, and all parties involved must respect the formal requirements of the law and of the trust agreement in order to provide the best protection against creditors' claims possible.

8.2 Reminder: If the Settlor has access to the income or principal of the spendthrift trust without the consent of the Distribution Trustee or an independent trustee, it could cause the trust to lose its status as a spendthrift trust, at least as to the assets affected. The SSST should not own any assets to which the Settlor of the trust needs ready access. In most cases, day-to-day expenditures would come from bank accounts held in a revocable trust, and the Settlor's access to the spendthrift trust's assets will be formally approved in writing by the Distribution Trustee.

**CAUTION**: Because each trust is unique, care must be taken not to think that everything in this memo applies to all Nevada self-settled spendthrift trusts (SSSTs). This memo discusses general concepts but was not written to apply to any specific trust agreement. It was written primarily for the Settlor and the Trustees of an SSST that was prepared by an attorney at Rushforth Lee & Kiefer LLC (RLK). The principles discussed here may or may not apply to an SSST drafted by another attorney or even a specialized trust that was prepared by RLK. Consulting with a Nevada trust-and-estate attorney is always advisable.

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<sup>21</sup> *Klabacka v. Nelson*, 394 P.3d 940, 944 (Nev. 2017).