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Wealth Preservation with Asset Protection Trusts

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WEALTH PRESERVATION
WITH
ASSET PROTECTION TRUSTS

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I. INTRODUCTION

A. Definition - Organizing client’s business and personal affairs in advance so as to reduce or eliminate liability exposure or financial misfortune.

1. The law recognizes the right of individuals to arrange their affairs as to limit their liability to creditors. In re: Heller, 613 N.Y.S. 2d 809 (N.Y.Sur. Ct. 1994).

B. Litigation Environment Creates Greater Exposure to Risk of Loss

1. Expanded theories of liability (i.e. McDonald’s coffee spill)
2. Higher jury awards
3. Unpredictable judges

C. Traditional Forms Have Become Inadequate

1. Insurance
   a. Exclusions
   b. Policy limits
   c. Solvency of insurer
   d. Policy lapses

2. Incorporation
   a. Piercing corporate veil
   b. Shareholder/officer liability

D. Candidates for Asset Protection Planning

1. Professionals
2. Officers, directors, fiduciaries
3. Real estate owners with exposure to environmental claims.
4. Individuals exposed to lawsuits arising from claims alleging negligent acts, intentional torts (discrimination, harassment, libel) contractual claims.

5. Prenuptial alternative.

E. Asset protection concepts are not new.

1. Incorporation of business activities
2. Formation of LLC's, LLP's, L.P.'s
3. Offshore trusts used traditionally to avoid forced heirship or government expropriation.
4. Exemption and pre-bankruptcy planning

F. Asset protection is part of an overall wealth preservation process including:

1. Investment diversification
2. Insurance adequacy
3. Income tax planning
4. Estate tax planning
5. Wealth protection

G. Although some structures may inherently provide a level of protection (i.e. statutory exemptions), asset protection, like insurance, is most effective when undertaken before the first sign of danger.

1. Due diligence procedures should be undertaken to ensure that client's intentions are not to engage in fraudulent conveyances.
2. Obtain affidavit of solvency.
3. Obtain financial statement for client and all affiliated entities.
4. Perform Lexis search for judgments, liens and pending litigation.

II. FRAUDULENT CONVEYANCE ISSUES

A. Rule: APP not a means or excuse for fraudulent conveyances, i.e., transfer or concealment of property from creditors. American law favors free alienability of property, in absence of "present" or "subsequent" creditors.
B. Law varies by jurisdiction and transfers proper in one state may be held improper elsewhere, but certain generally accepted principles govern creditors. Common law usually divides creditors into three categories:

1. **Present creditors** — those whom the client has notice of when making transfers. N.b., a creditor does not need to have a judgment to be considered a present creditor.

2. **Subsequent creditors** — persons against whom the transferor harbored an actual fraudulent intent when transferring assets, including creditors whose rights arose after the transfers, if transferor then intended to proceed with his or her affairs in a fraudulent manner or with reckless disregard for the rights of others.

3. **Potential future creditors** — the "nameless, faceless" persons of whom the debtor had no awareness when transfer was made.

C. Transferor's intent key factor in proving fraud.

1. **Present creditors** — intent is proved by:
   a. evidence of express intent.
   b. circumstantially through facts of particular case.
   c. "Badges of fraud" — insolvency, lack of sufficient consideration, pendency or threat of litigation, concealment of transfer, or transfer of entire estate, or derivation from usual method or course of business. N.b. (Oberst v. Oberst 91 B.R. 97, Bankr. L. Rep. P 72, 462 (U.S. Bankruptcy Court, C.D. Cal. 1988) (mere preponderance of evidence is not sufficient for a finding that debtor engaged in fraudulent conveyance; level of proof required is more stringent standard of clear and convincing evidence).
   d. Subjective determination. The client must, firstly, not be insolvent at time of transfer or as a result of transfer. If creditor can prove existence of fraudulent intent, burden of proof shifts to the debtor to establish that he intended to accomplish bona fide goals (e.g. estate and financial planning) as a result of transfer.

2. Subsequent creditors must show actual fraud to prevail - they cannot make a case of constructive fraud founded on indicia or badges of fraud.

3. Future creditors - Fraudulent intent, or lack thereof, is really a question of timing; where there is no creditor, the transferor could have no intent to defraud, even if motivated primarily by a desire to divest oneself of property so that it will be protected should a problem later develop.
   a. See Klein v. Klein, 112 N.Y.S. 2d 546 (1952) (court found police officer's transfer of property out of concern that he might, at some future time, be sued for false arrest or some other act in connection with his duties in the enforcement of the law, "no more than insurance against a possible disaster.")
b. *Wantulok et al. v. Wantulok*, 214 P 2d 477 (1950), (court found that if there were no creditors or purchasers, the conveyance could not be fraudulent to them. *The motive with which such a conveyance is made and the fears by which it is prompted are of no importance unless there are creditors to be protected by the statute.*)

c. *Oberst v. Oberst*, supra. (transfer to detriment of identifiable creditors is within the scope of fraudulent conveyance law, planning for one's future well-being is not).

d. Remedies of Creditors - The fraudulent conveyance statute is a remedial statute. A creditor's remedy includes voiding the transfer and recovery against the transferee.

D. Other statutory restrictions on transfers:

1. IRC §§ 7206 and 7212 (crime to conceal or hinder the collection of tax).

III. DOMESTIC TRUSTS IN GENERAL

A. Trusts separate legal ownership from beneficial ownership. Since a trust beneficiary does not generally have legal ownership of trust property (until a distribution is made), the property is free from the beneficiary’s creditors claim.

B. Advantages include avoidance of probate, more efficient transfer of assets, confidentiality and protection from beneficiary’s creditors (including spousal claims).

C. Disadvantages - Under most state laws, if a settlor retains benefits from the trust the settlor’s creditors can recover against trust assets if:

1. the trust was funded as a result of a fraudulent conveyance;
2. the settlor retained too much control (i.e. power to revoke or appoint property);
3. the settlor retained a beneficial interest; or
4. the trust is a sham.

D. Most states recognize the validity of spendthrift clauses which protect a beneficiary’s interest from creditors' claims. However, such clauses are generally not enforceable with respect to a settlor who is a beneficiary, to the extent of such settlor's interest. Most states have statutes against self-settled trusts which provide that a settlor cannot create a trust to protect him or her self from creditors. See Restatement Second of Trusts (1957), Section 156.
E. Asset protection available to beneficiaries of domestic trusts is dependent on three factors:

1. Settlor's retention of control over trust.
2. Power of appointment available to beneficiaries.
3. Withdrawal/invasion rights provided to beneficiaries.

F. Maximum asset protection would be available to trust beneficiaries where trust provides the following:

1. Independent trustees.
2. Right to receive income or principal distributions in trustee's discretion.
3. Trustee given power to make payment on behalf of beneficiaries rather than directly to them.
4. Trustee authorized to acquire assets for the use of beneficiaries (e.g., home, art, etc.).
5. Trustee given power to holdback distributions if adverse to beneficiary's interest.
6. Power of appointment given to beneficiaries is limited.
7. Inclusion of sprinkling beneficiaries.
8. Include spendthrift provision or consider using a trust situs which recognizes a spendthrift trust
9. Assets which may create liability exposure to other trust property should be segregated into separate trusts or entities (i.e., LLC's) and trustees should be given authority to create separate trusts and entities to isolate such property. See e.g., Matter of Heller, 161 Misc.2d 369, 613 N.Y.S.2d 809 (Sur. N.Y. 1994).

G. Limitations on spendthrift trust protection.

1. Internal Revenue Service — See e.g., BankOne Ohio Trust Co. v. U.S., 80 F.3d 173 (6th Cir. 1996).
2. Tort creditors.
3. Child/spousal support.
4. Reciprocal trusts ineffective.
5. Self-settled trusts.
H. Specific trusts with asset protection aspects.

1. Discretionary trust.

2. Support trusts — Distributions limited to health, support and maintenance.

3. Credit shelter discretionary trusts.

4. Marital trusts limiting principal invasions.

5. Split interest trusts (i.e., CRTs, GRATs, QPRTs).

I. Although trusts may not be protected from the settlor’s creditors if the settlor retains a beneficial interest therein, planning opportunities should not be overlooked.

1. Trusts for the benefit of spouses and children will be protected from the settlor’s creditors (provided not a fraudulent conveyance) as well as the beneficiaries’ creditors. If there is a divorce or the spouse predeceases, the settlor can thereupon become a discretionary beneficiary.

2. The settlor can retain a power of appointment over the trust to prevent the transfer from being a completed gift.

3. The settlor can retain an income interest only which would protect the principal from creditors.

4. The settlor can give the trustee limited discretion to distribute principal to the settlor only for emergency needs or where the settlor has insufficient resources for support and maintenance. (See D. Marie v. Bank of California National Assn. 46 Cal. Rptr. 924 (1965).)

5. In some states a revocable trust may be utilized to avoid a spouse’s right of election claims. (See e.g. Cherniak v. Home National Bank and Trust Company of Meridian 198 A.2d 58 (Conn. 1964).

IV. DOMESTIC ASSET PROTECTION TRUSTS

A. Six states have enacted legislation providing spendthrift protection to a settlor-beneficiary of a discretionary trust (provided the transfer is not a fraudulent conveyance).

1. Alaska
2. Delaware
3. Nevada
4. Missouri
5. Colorado
6. Rhode Island
B. Review of Alaska Trust Law


2. In contrast to Restatement (Second) of Trust §156(2), Alaska law (AS 34.40.110) now permits a settlor to create a trust for his own benefit which will be protected from the settlor's future creditors so long as:
   a. The settlor does not retain the right to revoke or terminate the trust.
   b. The settlor was not in default by thirty (30) days or more in making a child support payment.
   c. The settlor's ability to receive distributions from the trust is within the discretion of the trustees rather than mandatory.
   d. The transfer of property to the trust was not intended to hinder, delay or defraud creditors (i.e. a "fraudulent conveyance" generally subject to a four (4) year statute of limitations under Alaska law).

3. Under AS 34.40.110, a creditor existing at the time the trust is created must bring suit within the later of four (4) years from the transfer or one (1) year after the transfer is, or reasonably could have been, discovered. A creditor arising after the transfer to trust must bring suit within four (4) years from the transfer.

4. Alaska law (AS 13.36.310) prohibits a challenge to a trust (except as otherwise provided above) on the grounds "...that the trust or transfer avoids or defeats a right, claim, or interest conferred by law on any person by reason of a personal or business relationship with the settlor or by way of a marital or similar right."

5. The Alaska Trust Act also modified Alaska's common law Rule Against Perpetuities to provide that where the trustees have discretion to make current distributions to a trust beneficiary the trust will not be invalid because it fails to vest within the normal perpetuities period. (AS 34.27.050(a)).

6. A mere choice of law clause will not be sufficient to establish a trust as an "Alaska" trust. Alaska law (AS 13.36.035) sets forth definitive statutory requirements for establishing a trust as a trust subject to Alaska's trust law:
   a. At least one (1) trustee must be a "qualified person" under AS 13.36.390(1), meaning that at least one (1) trustee must be either a trust company or a bank with trust powers with its principal place of business in Alaska, or an individual resident of Alaska.
   b. Some of the trust assets must be deposited in Alaska, either in a checking or brokerage account or other similar account located in Alaska.
   c. The Alaska trustee's duties must include both the obligation to maintain the trust's records and to prepare or arrange for the preparation of the trust's...
income tax returns, although neither of these requirements must be exclusive to the Alaska trustee.

d. Part or all of the trust’s administration must occur in Alaska, including the physical maintenance of the trust’s records in Alaska.

7. Consistent with the foregoing requirements of AS 13.36.035, an Alaska trust may be settled by any person, regardless of whether or not they are domiciled in Alaska.

C. Review of Delaware Trust Law

1. The synopsis of the Act notes the purpose of the legislation is to allow Settlors to reduce estate tax by excluding creditors’ claims against self-settled trusts. The Act notes recent legislation in Alaska and "is intended to maintain Delaware's role as the most favored jurisdiction for the establishment of trusts."

2. Delaware law (12 Del. C. § 3570 et seq.) applies to "qualified dispositions" made on or after July 1, 1997.

3. A "qualified disposition" is a disposition by or from a transferor to a trustee who is (i) a Delaware resident, bank or institution authorized by Delaware law to act as a trustee, and (ii) maintain or arrange for custody in Delaware of some or all of the trust corpus, maintain records (on an exclusive or nonexclusive basis), prepares or arranges for the preparation of fiduciary tax returns or otherwise materially participates in the trust's administration.

4. A trust must be irrevocable but can include one or more of the following provisions:
   a. Settlor may retain power to veto distributions.
   b. Settlor may retain a special power of appointment.
   c. Settlor may receive income, principal or both in the sole discretion of a trustee who is neither the settlor nor a related or subordinated party of the transferor (I.R.C. § 672(c)).

5. Provided the transfer of property to the trust was not intended to hinder, delay or defraud creditors (i.e., a fraudulent conveyance) no action to enforce a judgment shall be brought for attachment against such qualified disposition.
   a. Under § 3572(b) a creditor existing at the time a transfer to a trust is made must commence an action to enforce a judgment within the later of 4 years or 1 year after the transfer was or could reasonably have been discovered by the creditor.
   b. If the creditor's claim arose after the transfer the action must be brought within 4 years of the transfer.
6. Certain creditors may, however, avoid qualified dispositions:
   a. Any person to whom the settlor is indebted on account of an agreement or court order for support, alimony or property distribution in favor of a spouse, former spouse or children; or
   b. Any person who suffers death, personal injury or property damage on or before the qualified disposition, which, death, personal injury or property damage was caused by transferor or another person for whom transferor is liable.

D. Review of Nevada Trust Law.

1. Nevada amended spendthrift protection for self-settled trusts meeting the requirements set forth in NRS 166 effective October 1, 1999 as follows:
   a. Trust must be irrevocable.
   b. Settlor is only a discretionary beneficiary.
   c. Transfer was not intended to hinder, delay or defraud known creditors.
   d. Settlor may retain a veto power over distributions or hold a testamentary, special power of appointment.
   e. All or part of the property is in Nevada.
   f. All or part of the administration of the trust is performed in Nevada.
   g. At least one Nevada resident is a trustee and has powers that include maintaining records and preparing tax returns for the trust.

2. A creditor may not bring an action with respect to property transferred to a spendthrift trust unless brought within 2 years after the transfer or 6 months after he discovers or reasonably should have discovered the transfer, whichever is later. If a person becomes a creditor after the transfer is made, he must bring the action with 2 years after the transfer.

E. Review of Rhode Island Legislation

1. R.S. Chapter 18-9 applies to "qualified dispositions" made after June 30, 1999. A qualified disposition is a transfer to a trust which is
   a. Irrevocable
   b. Incorporates the laws of Rhode Island to govern the validity, construction and administration of the trust
   c. Contains a restriction on assignment of income or property
d. Wherein the transferor retains only:
   (i) Power to veto distributions
   (ii) Testamentary special power of appointment
   (iii) Right to receive distributions in the sole discretion of trustee who is neither related or subordinate

e. A creditor may not bring an action to avoid a qualified disposition if:
   (i) The creditor's claim arose before the transfer was made unless the action is brought within 4 years after the transfer or, if later, within one year after the transfer was or could reasonably have been discovered by the creditor; or
   (ii) The creditor's claim arose after the transfer, unless the action is brought within 4 years after the transfer is made.

V. FOREIGN SITUS TRUSTS

A. Overview.
   1. Historically used to avoid forced heirship and government expropriation.
   3. Requires creditors to litigate in foreign jurisdiction under its laws and system.
   4. Does not rely on secrecy or concealment to be effective.

B. Similar to domestic trust, as it can act as will substitute or supplement to avoid probate and maintain confidentiality, handle grantor's affairs in event of disability or unavailability.

C. Provides procedural, substantive and psychological barriers to creditors as many jurisdictions do not honor United States judgments making assets beyond practical reach of most creditors.

D. Trusts separate legal ownership from beneficial ownership. Since a trust beneficiary does not generally have legal ownership of trust property (until a distribution is made), the property is free from the beneficiary's creditors claim.

E. Carefully selected trust law provides greater degree of substantive certainty in planning.
   1. Most critical aspect in selecting a jurisdiction is fraudulent conveyance law. Formerly, most English jurisdictions, followed Statute of Elizabeth, passed in 1571, and there was no period of limitation within which to bring an action.
   2. Fairly recently, a number of jurisdictions have passed legislation specifically addressing asset protection trusts created by foreign grantors, which substantially reduces the reach of the Statute of Elizabeth.
a. Settlor's ability to retain enjoyment or control, while still protecting assets, is more expansive than in U.S.; many jurisdictions will honor a spendthrift clause protecting the settlor, e.g. even though settlor retains certain powers, trust's corpus is shielded from own creditors.

b. No jurisdiction will protect transfers made by an insolvent grantor.

3. Other factors to consider in selecting jurisdiction:

a. Need for a stable responsible foreign trustee in stable country.

b. Effect of tax laws.

c. Existing language barriers.

d. Availability of professional trust services and modern tele-communications facilities.

e. Solidity of reputation in global financial community.

f. Statutory framework of jurisdictions, including short statute of limitations period for challenging a trust.

g. Provisions for protector status.

h. Whether and to what extent a settlor can be a beneficiary and protector.

i. Whether foreign judgments are recognized.

j. Standard of proof required to succeed in a fraudulent conveyance action.

k. Access to courts and legal fees required to litigate offshore.

4. The following jurisdictions have enacted favorable asset protection trust legislation, some offering greater protection than others.¹

a. Anguilla  k. Labaun
b. Antigua  l. Marshall Islands
c. Bahamas  m. Mauritius
d. Barbados  n. Nevis
e. Belize  o. Niue
f. Bermuda  p. St. Vincent
g. Cayman Islands  q. St. Lucia
h. Cook Islands  r. Seychelles
i. Cyprus  s. Turks and Caicos
j. Gibraltar

F. Overview of Cook Islands

1. General Characteristics

   a. The Cook Islands are located in the south Pacific Ocean east of Australia and south of Hawaii.

   b. The capital is Rarotonga, with a modern international airport and regular air services to Los Angeles, Hawaii, Tahiti, Fiji, and Auckland.

   c. The islands are remote from the world's major financial centers, but have modern communications systems and its time zone is only 3 hours behind PST.

   d. The Cook Islands are self-governing. Their closest link is with New Zealand, and they use New Zealand currency. They have been independent since 1965.

   e. English is the official language, and there is a common law legal system. Appeals of court decisions are brought before the Privy Council in England.

2. Confidentiality

   The Cook Islands banking laws mandate secrecy about client information, with the penalty of one year imprisonment for a violation.

3. Taxes

   a. The Cook Islands are a "no-tax" jurisdiction.

   b. So long as businesses organized in the Cook Islands do not do business there, they are exempt from tax.

4. Fraudulent Disposition/trusts

   The Cook Islands enacted comprehensive trust legislation in the International Trusts Amendment Act 1989 (effective September 8, 1989) which has since been amended several times, most recently in 1997.

   a. The legislation addresses "International Trusts" ("ITs") and the effect thereon of fraudulent dispositions and bankruptcy.

   b. With respect to fraudulent dispositions, a creditor seeking to set aside a disposition must prove beyond a reasonable doubt that:

      (i) the disposition was made with an intent to defraud that particular creditor; and

      (ii) the transferor was rendered insolvent by the transfer. (If the fair market value of the settlor's property after the transfer to the trust
exceeds the value of the creditor's claim at the time of the transfer, there is no intent to defraud.)

c. If the creditor meets this burden, the transfer is not void or voidable. Instead, the transferor must pay the creditor's claim from property which would have been subject to its claim but for the transfer, that is, from property in respect of which the action is brought.

d. Furthermore, the statute expressly states that an IT will not be void by virtue of the settlor's bankruptcy.

e. Recent amendments (in 1997 and 1999) also contain limitations provisions.

   (i) If a creditor's cause of action accrues more than two years before a transfer to an IT, the transfer will be deemed not to be fraudulent, unless proceedings in respect of that cause of action had been commenced at the date of the relevant transfer.

   (ii) Also, if a creditor fails to bring an action within one year from the date the transfer to an IT occurs, the action is barred.

   (iv) Furthermore, if the transfer (whether initial or subsequent) to an IT occurs before a creditor's cause of action accrues, such a disposition will not be fraudulent as to that creditor. A "cause of action" is defined as the first cause of action capable of assertion against a settlor.

   (v) For redomiciled trusts, the limitations period commences at the time of original transfer, even when the transfer was to an offshore center other than the Cook Islands.

   (vi) Where a creditor is successful in setting aside a transfer the Court must disregard any punitive damage award from the creditor's claim.

f. Another section of the legislation sets forth certain circumstances which will not be deemed badges of fraud. Fraudulent intent cannot be imputed from:

   (i) transfer to an IT within two years of the accrual of a creditor's cause of action;

   (ii) retention of powers or benefits by the settlor; or

   (iii) designation of the settlor as a beneficiary, trustee, or protector.

5. **Trusts**

a. Retained powers and benefits are explicitly addressed by statute. An IT cannot be "declared void or be affected in any way" because the settlor:

   (i) has the power to revoke or amend the trust, to dispose of trust property, or to remove or appoint a trustee or protector;
(ii) retains, possesses or acquires any benefit, interest, or property from the trust; or

(iii) is a beneficiary, trustee, or protector.

b. The rule against perpetuities has been repealed. Alternatively, an IT may use a period at the option of the parties.

c. Other provisions of the legislation make selection of Cook Island law binding and conclusive, ensure that an IT is not subject to forced heirship laws of other countries, requires non-recognition of a foreign judgment against an IT, its settlor, trustee, and protector, recognizes the powers of a trust protector and permits trustees to delegate certain powers to others.

d. The Act also provides that community property transferred to an IT retains its character as community property.

6. Other Considerations

Based upon the authors' review of commonly selected offshore jurisdictions, the Cook Islands have one of the most comprehensive bodies of statutory law governing trusts and fraudulent conveyances. The level of comfort one obtains with such statutory certainty should be a factor to weigh against the inconvenience of traveling to this venue.

G. Choice of Law Clause Should Generally Be Upheld If Parties Have Minimum Contacts with Jurisdiction Selected.

1. Analogous to a New York business incorporated in Delaware or a trust which chooses to apply South Dakota law to avoid the Rule against perpetuities.

2. Appointing a foreign trustee should satisfy minimum contact requirement even where assets are not physically offshore.

3. Restatement (Second) of Conflicts of Laws, section 273 provides that:

"Whether the interest of a beneficiary of [an inter-vivos] trust of movables is assignable by him and can be reached by his creditor is determined...by the local law of the state, if any, in which the settlor has manifested an intention that the trust is to be administered and otherwise by the local law of the state to which the administration of the trust is most substantially related."


H. Foreign trustee.
1. Trust can have one or more trustees with at least one trustee resident in the foreign jurisdiction.

2. Duties of offshore trustee may be nominal initially, but trust would usually provide that foreign trustee has power to remove domestic trustee(s) in event threat to assets or against trust were to develop.

3. Trust generally allows trustees to invest trust assets anywhere in the world, so trustee can direct that the assets be transferred to a financial institution (as custodian) in another jurisdiction such as Zurich or London.

4. Foreign trustee should have no presence in the United States to avoid jurisdiction by U.S. court.

I. "Protectors" who act as watchdogs over the trustees.

1. A protector has veto powers over a trustee and can discharge a trustee.

2. In some jurisdictions the grantor may be a protector and may have certain veto powers over the trustees, including power to remove and replace trustees and veto investment and distribution decisions without such powers affecting creditor protection status. But vesting the grantor with such powers may expose the settlor to contempt. See FTC v. Affordable Media, et al. infra.

3. Since protector's power is a negative power (as opposed to an affirmative power to initiate action) protector cannot be compelled by a court to submit the assets to its control.

J. Non-asset Protection Reasons for Offshore Trusts.

1. A client may wish to create a long term dynasty trust not limited by Rule against Perpetuities. Some jurisdictions permit trusts to last 100 years or more.

2. Although the trust is tax neutral during the grantor's lifetime under the grantor trust rules, it becomes a non-grantor foreign trust at the grantor's death. This can present tax opportunities not available to domestic trusts.

3. Avoidance of forced heirship rules (i.e., right of election provisions).

4. Properly structured foreign situs trust can invest in companies that for one reason or another do not wish to comply with SEC filing requirements (and therefore are otherwise off limits to U.S. investors).
   a. Offshore hedge funds.
   b. Foreign variable life insurance.

5. Foreign trusts are also used to diversify risk, avoid exchange controls, avoid government expropriation and maintain privacy.

K. Trust Structure.
1. Irrevocable to avoid possibility a creditor could have settlor compelled to revoke it. May provide for reversion to settlor after a period of time provided no creditor claims exist provide for reversion.

2. Settlor's interest as beneficiary should be discretionary.

3. Settlor should retain a limited power of appointment if a completed gift is to be avoided.

4. Provision should be made for a protector and the powers of protector.

5. Give power to remove trustees located in jurisdictions where certain events occur (i.e. any threat to trust or trustees).

6. Protective provisions such as anti-duress clauses and flee clauses to allow a change of situs.

L. Tax issues.

1. Residence of Trust - Code §§7701(a)(30) and (31)(B) provide that a trust is a foreign trust unless two criteria are met effective for tax years beginning January 1, 1997:
   a. A court within the U.S. must be able to exercise primary supervision over the administration of the trust; and
   b. One or more U.S. fiduciaries have the authority to control all substantial decisions of the trust.

2. A properly structured foreign situs trust should not be taxed any differently than a domestic trust. The only distinction, in the end, will be that the reporting requirements will be triggered.

3. Even if the trust were a foreign trust for tax purposes it would be treated as a grantor trust under Code Section 679 if the grantor is a U.S. person and it has U.S. beneficiaries (in addition to the regular grantor trust provisions contained in §§671-677). The transferor will generally be treated as the owner of the percentage of the foreign trust attributable to the property transferred, as long as the trust has any United States beneficiaries and the grantor is living.

4. Gift and estate tax aspects:
   b. Incomplete gifts will be included in settlor's estate upon death.
   c. Can contain standard credit shelter or bypass trust language and also direct trustee to qualify other property for the marital deduction.
   d. Can preserve step-up in basis benefit on death.
e. If clients reside in a community property state, drafter should consider preserving double step-up in basis by using a jurisdiction that recognizes community property such as the Cook Islands.

f. If it is desired to make gift complete the settlor should not retain any control as protector or any power of appointment. See Section VIII, infra.

5. No beneficiary of a discretionary asset protection trust should be trustee, or protector with the power to remove and replace trustees. See Private Letter Ruling (PLR) 8916032 - which is based on Rev. Rul. 79-353, 1979-2C.B. 325. Settlor may act as protector (if otherwise permissible under applicable law), if gifts are incomplete.

6. Section 684 tax on transfers of appreciated assets is not applicable with respect to transfers to foreign grantor trusts.

7. By structuring the trust to meet the requirements of a domestic trust for U.S. tax reporting purposes, one can nevertheless provide that the trust be governed by foreign law for purposes of interpretation, validity and governing law.

8. Tax return filing requirements.

a. Even though gift is incomplete, gift tax return must be filed. Treas Reg. Sec. 25.6019-3 (a).

b. Since trust is a grantor trust, a Form 1041 Fiduciary Income Tax Return must be filed annually. However, return need disclose only that it is a grantor trust and that all income and deductions will be reported on grantor's Form 1040.

c. If trust deemed a U.S. trust for tax reporting purposes no other filing requirements. On Form 1040, Schedule B, taxpayer may answer "no" to question of whether he was a grantor or transferor to a foreign trust.

d. However, once a trust is deemed to be a foreign trust additional forms must be filed. These include Department of the Treasury Form TDF 90-22.1 and IRS Forms 56, 3520, 3520-A and Customs Form 4970. Reporting requirements for years ending after August 20, 1996 are imposed on the grantor and U.S. beneficiaries receiving distributions therefrom. Sec. 6048(a).

e. Most offshore jurisdictions do not impose income, gift, estate, excise, capital gain or any other form of tax whatsoever if the trust is properly structured and grantor is a non-resident of such jurisdiction.

9. See PLR 9536002 (5/12/95) which analyzed an offshore trust/partnership structure determining it to be gift tax and income tax neutral.
M. Combining Foreign Trust with Limited Liability Company.

1. Maximizes both flexibility and protection.

2. When first established, transferor conveys assets to LLC in exchange for LLC interest, which is transferred to the trust, allowing the manager/settlor to maintain control over LLC's assets.

3. Once threat appears, foreign trustee has power to remove domestic trustee(s) (to protect them from any potential court order) and, as sole member of the LLC, move LLC assets offshore.

4. A member of the LLC can make election to be a disregarded entity by filing Form 8832.

N. Asset Transfer Considerations.

1. Generally, liquid assets are best and least complicated to transfer offshore.

2. If client wishes to protect illiquid assets (i.e., real estate, business interests) it may be possible to borrow out most of the equity using the property as collateral and moving the loan proceeds offshore.

3. Pension assets, including IRAs, would generally not be transferred since doing so would result in immediate income taxation and possible penalties for premature withdrawals. But ERISA qualified plans are protected and in many states, non-ERISA plans (i.e. Keoghs with only one participant) and IRA's are protected under state exemption statutes.

4. Statutory provisions restrict transfers of professional corporation stock. However, to strip the equity out of the corporation, the grantor can borrow against corporate assets and transfer the proceeds to the partnership or trust.

5. "Nest egg" transfer for businessperson who must retain adequate assets to obtain bank loans versus other clients who might transfer all their property.

6. Creation of several partnerships or LLC's so that inherent liabilities of certain assets do not taint other assets, e.g. real estate.

O. Foreign vs. Domestic.

1. Foreign trusts offer more substantive barriers to creditors, since a U.S. judgment may not be enforceable offshore, whereas U.S. Constitution requires state courts to enforce other state's judgments.

2. Will settlor's designation of what state or foreign country's laws govern the trust be respected? Or will a creditor's rights be determined by the state's governmental interest or "significant relationship" with the settlor. See e.g., In re Portnov, 201 B.R. 685 (S.D.N.Y. 1996) infra. and B.V. Brooks 1998 Banky. Lexis 60 (D.CT., 1998).
3. Consider appointment of a domestic trustee resident in a state which recognizes self-settled trusts to act with a foreign trustee.

P. How Much Protection Is Necessary?

1. Some client situations warrant greater sophistication and complexity resulting in higher costs.

2. Continuum beginning with transferring assets to a spouse (at minimum cost) and proceeding through a series of alternatives offering more certainty and flexibility until you reach offshore trust/foreign LLC contribution (at the greatest cost).

Q. Costs.

1. In addition to legal fees, client will incur annual fees to offshore trustee of $1,500 to $4,000 depending on jurisdiction. Once trust is created only other ongoing costs are those for preparing the trust income tax returns.

2. Fees paid to establish asset protection trust and administrative fees paid to operate it should, if reasonable, be deductible under Code Section 212 as "ordinary and necessary expenses paid or incurred...(1) for the production or collection of income or (2) for the management, conservation, or maintenance of property held for the production of income".

3. Client should assess level of protection desired and consider annual cost to be similar to that of a single premium liability policy.

   a. A cost/benefit analysis.

   b. Typical client has at least $1,000,000 in assets to protect.

   c. Clients who place great value on peace of mind will be better able to justify more sophisticated techniques.

   d. Offshore trust on a stand alone basis, where settlor is neither a protector or a beneficiary; but client must give up control which, as a practical matter, most clients would prefer not to do.

   e. Nature and location of assets owned by LLC or trust. If client utilizes the LLC/trust technique generally there is no need, initially, to transfer assets offshore.

   f. In author's experience, less than 5% of clients creating such vehicles have been targeted by creditors and therefore these structures merely serve a similar purpose to that of insurance policies.

   g. When a creditor attack is imminent, however, a decision will have to be made to remove assets from danger of being seized. At this time assets can be liquidated and moved to another jurisdiction.
R. Other Practical Concerns.

1. Possibility that a creditor may bring legal action against planner under various theories; possibility exists that a client may have misrepresented their liabilities or that an aggressive creditor may name planner as a co-conspirator to gain some leverage in litigation. Planner must protect himself by properly advising clients that there are limits to protecting assets, demanding full disclosure, obtaining affidavits of solvency, and most importantly knowing the client.

2. Since asset protection planning must be implemented when there are no legal claims on the horizon, the planner has the difficult task of motivating a client to take action before a fear becomes a nightmare.

VI. EFFECTIVENESS OF AND CHALLENGES TO OFFSHORE TRUSTS.

A. The effectiveness of any asset protection plan is determined by the results ultimately achieved. That is, in the final analysis, how long and at what cost will the client be subject to litigation and to what extent has the client protected the assets from loss.

B. In the real world plaintiffs must weigh the heavy costs of litigation against the likelihood of successful recovery. If, as a result of availing oneself of certain techniques, the debtor is in a better position to settle the dispute at considerably less cost, then the benefits of asset protection are realized.

C. In the author’s experience, clients who have created offshore trusts and subsequently been sued have successfully settled the disputes on more favorable terms.

D. The few reported decisions which involve settlors who have created offshore trusts offer insight into how the courts, both in the U.S. and abroad, view these structures.

1. In Re: 515 South Orange Grove Owners v. Orange Grove Partners — This case, brought in the Cook Islands in 1994, involved a California real estate developer against whom a suit was brought in 1992 in California and a judgment of $5 million was awarded in 1994. During 1993 and 1994 the defendants settled a trust in the Cook Islands and transferred assets thereto. The creditors obtained a Mareva injunction (similar to a TRO) ex parte. The author has been advised that this case has been settled. It may not have been difficult, however, for the creditor to have satisfied their burden to prove a fraudulent conveyance beyond a reasonable doubt under the facts as stated.

2. In Brown v. Higashi, U.S. Bankruptcy Court 95-3072 (1996), District of Alaska, the Court determined that the Belize trust created by the debtor was a sham and therefore the assets of the trust were included in the bankruptcy estate. The Court’s decision was based on several factors including the failure to execute any trust documents and the debtor’s retention of control.

3. In Marine Midland v. Portnoy, 201 Bankr. 685 (SDNY Oct. 7, 1996), Mr. Portnoy transferred over $1 million to a Jersey trust “when he knew his personal guarantee was about to be called.” Judge Brozman noted that the trust was created after Portnoy signed the guarantee and misrepresented, during settlement discussions (prior to bankruptcy filing), that he had incurred large expenses for cancer treatments.
and had no assets remaining to satisfy the debt. Mr. Portnoy also disclosed that his salary was being deposited into his wife's account. The Court denied a discharge noting that the debtor's actions demonstrated an intent to defraud his creditor. There are reports that this matter has been recently settled.

4. In the case of In re B.V. Brooks, 217 B.R. 98 (D.Conn, 1998), the issue before the court was again whether to apply domestic (in this case, Connecticut) law, or foreign law to the spendthrift trust exemption under the Bankruptcy Code. Citing Portnoy as precedent, and following another seemingly result oriented analysis of conflict of law rules, the court found the assets of the debtor's two trusts includable in the bankruptcy estate notwithstanding the fact that the trusts were valid spendthrift trusts under the laws of Bermuda and the Jersey Channel Islands. Although very little of the case's factual background was actually reported, the Bankruptcy Court did note that the debtor/settlor was the primary beneficiary of each of the trusts and had the right to receive all of the income. In addition, the unreported facts apparently caused the court to perceive the funding of the trusts as fraudulent since the Court twice characterized the debtor's acts in creating the trusts as a "scheme". This perception was likely buttressed by the timing of the case since the trusts were funded in 1990 and an involuntary bankruptcy petition was filed against the debtor the following year.

5. In the matter of In re Stephan Jay Lawrence, (227 B.R. 907 (S.D. FL, 1998), following a forty-two month arbitration and just sixty-six days before an award in excess of US $20 million was entered against him, the debtor funded an off-shore trust citing first the law of Jersey Channel Islands, and about a month later, the law of Mauritius, as governing. Citing both Portnoy and B.V. Brooks the Bankruptcy Court found that the sole purpose of the trust was to shield the debtor's assets from a creditor which "was about to obtain a staggering $20 Million arbitration award against him" and that "[t]he timing of the trust's creation is further evidence of this intent." The court also found the debtor’s testimony before the court to have not been credible (and on several occasions perjurious), and that the debtor was "shockingly less than candid" with the court. The court, therefore, entered judgment against the debtor, thereby denying him a discharge in bankruptcy. Subsequently, the bankruptcy trustee moved to hold the debtor in contempt if he did not repatriate the funds. In September, 1999 the Court found Lawrence in contempt (In re Lawrence, 238 B.R. 498, 500 (S.D.Fla.Bkrtpt. 1999) which finding was affirmed by the U.S. District Court in a de novo review. In re Lawrence, 251 B.R. 630 (S.D.Fla. 2000). The defendant is currently in prison while an appeal is pending.

6. FTC v. Affordable Media LLC, et al. (179 F.3d. 1228 (9th Cir. 1999). Although the facts in this case (colloquially known as the "Anderson" case after its individual defendants), were as bad as, if not worse than, those in any of the foregoing cases, the courts have not yet reached any issues of trust validity or conflict of laws. Instead, the Court has been tangling with the settlors’ alleged contempt of court in failing, pursuant to a preliminary injunction, to repatriate trust assets which had been invested in trust name offshore. Specifically, the settlors, who were also co-trustees of their own trust, as well as the trust protectors, were ordered to instruct their foreign co-trustee to repatriate more than $6 million in profits collected under an alleged Ponzi-type investment scheme. The "anti-duress" clause in the trust agreement resulted in their removal as trustees and ensured that the assets would not be
repatriated pursuant to the Court's order. When the assets were not timely repatriated, the settlors were held in civil contempt for failing to comply with the court order and jailed pending repatriation of the assets.

7. In finding the Andersons in civil contempt, the district court rejected the Andersons' impossibility defense, specifically finding that the Andersons 'in the judgment of the Court are in control of this trust since the trust instrument provided the protectors with the exclusive power to determine what constituted an event of duress.


9. As these cases illustrate "bad facts make bad law." Based on the facts presented the trusts were created after the debt was incurred and accordingly the Court, in each instance, reached the right decision. Notwithstanding the results obtained (and without condoning such transfers) the debtors apparently benefited by their wrongful transfers.

10. In the end, the best results will be obtained where trusts are settled sufficiently in advance and properly structured and administered. A recent decision recognizing the validity of a foreign trust was in the context of a divorce proceeding. In Riechers v. Riechers (NY Supreme Court, Westchester County), (New York Law Journal July 1, 1998), the defendant husband settled an irrevocable trust in the Cook Islands in 1992 as a result of 3 medical malpractice lawsuits filed against him. His wife sued for divorce in 1994. The Court in its decision, wrote:

> Assuming arguendo, that this Court had jurisdiction over the corpus of the Riechers Family Trust, which it does not, a cause of action would not lie to set aside the trust since the trust was established for the legitimate purpose of protecting family assets for the benefit of the Riechers family members."

11. At the end of the day, however, the offshore trust’s effectiveness as a tool to thwart future creditors will most likely not depend on whether a United States court gives credence to the application of foreign trust law when adjudicating a claim against the settlor. Provided that the trust’s assets are located offshore (whether that be in the jurisdiction of the trust’s governing law or an established financial center such as Switzerland or Luxembourg), a creditor with a United States judgment will still be faced with significant hurdles before actually being able to levy on any of the trust’s assets. In fact, since some jurisdictions will not recognize foreign judgments, the creditor may be forced to re-litigate its entire case against the trust. Moreover, in some jurisdictions the statute of limitations on fraudulent conveyance claims may be as little as two years (which period is likely to have already expired by the time suit is brought in that jurisdiction). Finally, aside from the United States, most common law jurisdictions (ie., those jurisdictions which recognize the trust concept), (i) do not allow attorneys to take matters based on a contingency fee, and (ii) provide that the losing party to a lawsuit must pay all of the victor’s expenses, including attorneys’ fees. Combined with an evidentiary standard in some jurisdictions requiring proof beyond a reasonable doubt on fraudulent conveyance claims, assets held in trust may,
in the end, be unreachable notwithstanding the fact of a United States judgment. At
the very least, the process may prove prohibitively expensive for a creditor when the
potential reward is so uncertain.

VII. NEW TRENDS IN ASSET PROTECTION WITH AN EMPHASIS ON ESTATE
PLANNING.

A. Introduction

1. Under the law of most states, a creditor of the settlor of a trust can reach the trust
   property to the maximum extent that the trustees may distribute the property to the
   settlor. (Restatement (Second) of Trusts § 156(2)).

2. Most states limit the term of a trust so that it cannot continue to exist beyond the
   "Rule Against Perpetuities" period (generally, no later than 21 years after the death of
   individual then living or 90 years after the trust’s creation).

3. In order to attract trust business eleven states have repealed the rule against
   perpetuities thereby encouraging dynasty trusts (Alaska, Arizona, Delaware, Idaho,
   Illinois, Maine, Maryland, New Jersey, Ohio, South Dakota and Wisconsin). Only
   Alaska, Arizona, Delaware, Ohio and South Dakota do not impose a state income
   tax on trust income.

4. Numerous foreign jurisdictions have enacted legislation which prevents creditors
   from reaching the trust's assets unless the transfer was a fraudulent conveyance. It is
   reported that over $300 billion in assets have been transferred to foreign trusts by
   U.S. persons.

5. Recent legislation in Alaska, Delaware, Nevada and Rhode Island expands the turf
   war by providing estate planning opportunities with shades of asset protection.

B. Analysis of IRS Rulings and Court Decisions

1. Estate Tax Inclusion
   a. IRC § 2036 provides that a transferor’s gross estate includes the value of any
      transferred property over which the transferor retained the right to
      possession, enjoyment or income for a period not ascertainable without
      reference to his life.
   b. A gift is incomplete in every instance in which "the donor reserves any
   c. Since, under Restatement (Second) of Trusts §156(2), a settlor's creditors
      can reach trust property to the maximum extent that the trustees may
      distribute the property to the settlor, the settlor is deemed to have retained
      rights to the property within the meaning of IRC §2036 and §2511. (See,
      e.g., Paxton v. Comm'r, 86 T.C. 785 (1986), Outwin v. Comm'r, 76 T.C.
      153 (1981), and Paolozzi v. Comm'r, 22 T.C. 182 (1954)).
2. Completed Gifts

a. “If and when the [settlor’s] dominion and control of the trust assets ceases, such as by the trustee’s decision to move the situs of the trust to a state where the [settlor’s] creditors cannot reach the trust’s assets, then the gift is complete for federal gift tax purposes under the rules set forth in §25.2511-2 of the Regulations.” Rev. Rul. 76-103, 1976-1 C.B. 293.

b. Where “...the [settlor] cannot require that the trust’s assets be distributed to the [settlor] nor can the creditors of the [settlor] reach any of the trust’s assets...” the settlor has parted with dominion and control so as to have made a completed gift of the assets transferred to the trust. Rev. Rul. 77-378, 1977-2 C.B. 347.

c. Private Letter Ruling 9332006 (which is not precedential) applies the foregoing rules to a foreign situs asset protection trust of which the settlor and the settlor’s family were discretionary beneficiaries. The settlor’s transfer to the foreign situs trust was deemed by the IRS to be a completed gift and, therefore, outside of the settlor’s taxable estate because under the laws governing the trust the settlor’s creditors could not attach the trust assets.

d. Private Letter Ruling 9837007 (not precedential) applies to an Alaska trust in which the Settlor was among the class of beneficiaries. The Service held the transfer to be a completed gift but refused to rule on whether the assets in the trust would be includable in the Settlor’s estate at death.

C. Structuring Trusts for Estate Planning Benefits.

1. Introduction.

a. Basic objective of estate planning is to minimize estate, gift and generation-skipping transfer taxes to the greatest extent possible while remaining true to the client’s dispositive wishes.

b. An estate planner’s ability to minimize transfer taxes may be frustrated by the client’s desire to retain control over and/or access to his assets during lifetime.

c. A properly structured, self-settled, spendthrift trust (“APT”) provides a viable solution to a client’s desire to be able to minimize transfer taxes without putting his assets forever out of reach in the event of an emergency need.

d. As an added benefit, property held in trust will avoid the delay, expense and publicity involved in transferring property at death pursuant to a probate proceeding.

e. Since assets held in the trust will enjoy a greater degree of creditor protection than assets retained in the settlor’s individual name, a transfer to an APT
will actually enhance the likelihood that the assets will be available to the settlor in case of some future emergency need.

2. **Minimizing Estate and Generation-Skipping Transfer Taxes**
   
   a. A settlor can make an inter-vivos transfer of the gift tax annual exclusion amount to an APT trust in order to gradually reduce the size of his taxable estate without incurring any transfer tax or reducing his unified credit.

   (i) In order to have a transfer to an APT come under the IRC §2503 gift tax exclusion the transfer must be of a "present interest" under IRC §2503(b). This can be accomplished by the inclusion of "Crummey" powers in the trust agreement.

   b. A settlor could make an inter-vivos gift of his remaining IRC §2010 applicable exemption amount.

   (i) No current transfer tax liability.

   (ii) Removal of subsequent appreciation from settlor's estate.

   (iii) The loss of the IRC §1015 “stepped-up” basis is more than compensated for by the overall tax savings inherent in the differential between the maximum 55% estate (and generation-skipping transfer) tax rate and the maximum 20% capital gains tax rate.

   (iv) Settlor can make additional contributions annually to utilize the increased exemption amounts.

   c. Gifts in excess of the applicable exemption amount (in particular, gifts aggregating the §2631 generation-skipping transfer tax exemption amount of $1 million) are advisable if the settlor can afford to pay the current gift tax since inter-vivos gifts are, in effect, one-third more tax advantageous than testamentary bequests.

   d. Any gift tax paid will further reduce the settlor's taxable estate (provided settlor lives 3 years).

   e. An allocation of the settlor's $1 million generation-skipping transfer tax exemption to a transfer to trust will exempt the entire transfer of property and all future appreciation thereon from generation-skipping transfer tax.

3. **Drafting Considerations.**

   a. Trustee selection - trust must have at least a resident trustee but settlor could appoint others (e.g. advisory committee) to make investment or distribution decisions. Trustee should not be related or subservient to settlor.

   b. Trust protector - Settlor should not be protector. Protector can have power to discharge trustees, make certain trust amendments if necessary, etc.
c. Change of situs provision allows for subsequent changes if laws or circumstances change.
d. Other asset protection provisions such as anti-duress clauses and flee clauses can be incorporated into trust.
e. Distribution Guidelines - Consider incentive provisions conditioned on earned income and distributions to beneficiary's spouse while married.
f. Termination powers given to trustee if continuation not in beneficiary's best interests.
g. Spendthrift provision to protect from beneficiary's creditors/former spouses.

4. Other Considerations.
a. The trust agreement should maximize the trust’s ability to escape future transfer taxation by providing for the retention of assets for the beneficiaries' use and enjoyment of the property in trust rather than mandating distributions upon the beneficiaries attaining set ages.
b. All subsequent appreciation on the $1 million dollars will be free from both estate and generation-skipping transfer tax for so long as the property remains in trust.
c. Delaware, Nevada and Alaska have no state income tax. Once the settlor dies, assets retained in trust will, therefore, pay only United States income tax.
d. Retaining assets in an APT ensures that beneficiaries' trust interests will not be seized by third-party creditors or ex-spouses.
e. In conjunction with the repeal of the Rule Against Perpetuities, the trust can continue to accrue all of the foregoing benefits in perpetuity.
f. The trustees should be independent of the settlor (optimally, banks or trust companies should be used) in order to ensure that the trustees' "discretionary" power to distribute trust assets to the settlor is respected by the IRS and not considered to be a "sham" by reason of any prearranged understanding between the parties.
g. The trust should include a "checks and balances" system via an independent but reliable "trust protector" to guard against inappropriate action (or inaction) by the trustees. The trust protector should have the power to discharge and appoint independent trustees within the trust protector’s discretion.

5. Advanced Considerations.
a. An APT can be combined with a limited partnership or limited liability company in order to permit investment management and control of the trust
assets to continue in settlor without jeopardizing the nature of the transfer as a completed gift.

(i) Structure may provide lack of marketability and lack of control discounts on the transfer of limited partnership/membership interests to the trust, thereby permitting the transfer of real value in excess of the amount subject to taxation.

(ii) Structure will provide an additional layer of protection between third party creditors and the trust.

(iii) In the unlikely event of trust creditors, enforcement of a judgment will be limited to a charging order against the trust's limited partnership or limited liability company interest.

(iv) Use of an Alaska or Delaware limited partnership or limited liability company will increase the settlor's contacts with that state, further justifying the application of that state's law to the claims of any creditor of the settlor.

b. An APT can be combined with any split-interest gift in trust (i.e. a QPRT, GRAT, or CLT) in order that the settlor may continue to have discretionary access to the transferred property after the initial term of the trust has expired.

c. An APT can be used to own the settlor's life insurance policies in the same manner as an irrevocable life insurance trust. So long as the settlor does not retain incidents of ownership in the transferred policies he can be a discretionary beneficiary, thereby permitting distributions of cash value to the settlor. (See, PLR 9434028).

6. Domestic vs. Offshore?

a. Introduction.

(i) Although highly touted as an asset protection vehicle, domestic trusts are generally inferior to foreign-situs asset protection trusts because of legal distinctions between domestic and foreign trust law as well as the practical difficulties encountered in proceeding against a trust (and its underlying assets) situated abroad.

(ii) Selected foreign asset protection jurisdictions will not honor judgments rendered by courts in the United States, thereby requiring a creditor to re-litigate its claims offshore. In contrast, a U.S. court is required by the Full Faith and Credit Clause of the United States Constitution to honor the validly rendered judgments of its sister states (United States Constitution, Article IV, Section 1).

(iii) The Statute of Limitations for fraudulent conveyances in selected foreign asset protection jurisdictions may be as short as one year from transfer.
The standard of proof for a creditor on a fraudulent conveyance claim in selected foreign asset protection jurisdictions can be as high as "beyond a reasonable doubt" (a standard normally used exclusively for criminal matters in the United States).

b. The issue of which is better, domestic or offshore, should, therefore, focus on a settlor's primary use of the structure as an estate planning, rather than as an asset protection, vehicle.

c. **Considerations in Favor of Offshore**

(i) Statutory framework and case law in foreign jurisdiction may provide greater certainty to the result of a settlor's transfer (i.e. whether the transfer is a completed gift despite the trustees' discretionary power to return the trust assets to the settlor).

(ii) Cook Islands first enacted comprehensive asset protection trust legislation in 1984.

d. **Considerations in Favor of Domestic Trusts**

(i) Although a properly structured foreign situs asset protection trust should not be taxed any differently than a domestic trust substantial reporting requirements are imposed on foreign trusts with U.S. beneficiaries.

(ii) Many offshore asset protection trusts are designed with either automatic or discretionary "flee" clauses to cause the trust to "migrate" abroad when creditor problems arise. At that point the trust will be deemed "foreign" under the IRC and may become subject to additional tax reporting requirements.

(iii) Prospective settlors of offshore asset protection trusts must concern themselves with the economic stability and political security of the jurisdiction whose laws they are entrusting their assets to compared with the economic stability and political security in the United States.

(1) Even offshore jurisdictions with extensive histories of political and economic stability may probably not provide the same level of comfort as a domestic trust.

(iv) United States federal and state courts and the IRS may regard domestic trusts as a more legitimate creditor protection and estate planning device than offshore trusts.
(1) A domestic court may resent transfers outside of the jurisdiction of United States courts and reason that there is no "legitimate" reason for using an offshore trust (rather than a domestic trust) other than thwarting the domestic legal system. See e.g. In Re: Portnoy 201 Bkrtcy 685 (S.D. N.Y.1996) and B.V. Brooks 1998 Bankr. Lexis 60 (D.Conn.1998).

(v) Domestic trusts should, both in its creation and in its maintenance, be less expensive than an offshore asset protection trust with comparable assets.

e. Considerations in Favor of Alaska/Nevada.

(i) Due to the carveouts available to certain creditors under Delaware's statute (see D.6., supra) there is a risk the IRS may take the position that the trust property, being subject to claims of creditors, even though restricted, nonetheless renders the transfer incomplete for gift and estate tax purposes.