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UNDERSTANDING ASSET PROTECTION PLANNING

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I. INTRODUCTION

A. Asset Protection and the Fear Factor

In asset protection planning, there are three elements to what I describe as the "fear factor." The first element of the fear factor relates to client uncertainty and anxiety as to their future. It is what causes clients to seek out the services of an attorney to assist them with asset protection planning, or in some cases, renders clients susceptible to paying for and getting themselves involved in plans that are neither necessary nor appropriate.

The second element of the asset protection planning fear factor is client uncertainty as to how a recommended asset protection planning technique will work in practice, and whether it will result in a loss of control (or worse) for the client over their assets.

The third fear factor in asset protection planning is the risk of plan and/or lawyer failure (the two are intertwined). Poor design or implementation of an asset protection structure may lead to several adverse consequences, including: (i) immediate gift tax liability for assets transferred into the trust; (ii) acceleration of gain recognition for income tax purposes; (iii) increased exposure of assets to creditors; (iv) mismanagement and embezzlement of assets by fiduciaries; and (v) civil and criminal liability for the client.

Asset protection planning is a complex practice area to begin with, but it carries a certain mystique that is arguably not found in many other practice areas. While no one would question the complexity of securities regulation, patent law or international taxation, these are practice areas that have a far greater infrastructure in place to support academic and practical learning and scholarship.

This paper is intended to serve as a resource for those desiring to learn more about the practice of asset protection planning. What I have written is based upon: (i) personal experience; (ii) questions that I have received from clients, colleagues and those to whom I have lectured and taught; and (iii) the thought leadership of many before me. Over the past decade, I have read, reviewed and/or consulted an enormous amount of material on asset protection planning, including not only the materials cited at the end of this paper, but also domestic and foreign primary sources, numerous journal and magazine articles and continuing education outlines.[1]

B. Asset Protection and Risk Management

Risk management is a discipline focused on the identification and analysis of risk and the planning of contingent actions and mitigation steps to manage risk. Asset protection planning should be viewed as a phase of risk management, not as a standalone objective.

Private client lawyers who serve as trusted advisors to their clients (or want to develop that relationship) are in a unique position to assist a client in the evaluation of personal and enterprise risk exposure and the making of recommendations to mitigate risk. Before considering asset protection planning techniques, every client should undergo a personal risk management analysis. The objective of personal risk management analysis is to learn about the client's family, community, professional, business and investment activities, in order to (i) identify activities and relationships that may expose the client to legal and financial risk; (ii) analyze and quantify potential sources of risk; and (iii) determine risk mitigation and management strategies. If the client is an entrepreneur or business owner, the risk management analysis should also occur at the enterprise level.

I must stress that asset protection planning is not a substitute for risk management. Particularly when human lives are involved, actions that may minimize the occurrence or severity of risks should *always* be considered first. Asset protection planning should not be used as a shortcut to the avoidance of responsible conduct.

C. **Reasons to Consider Asset Protection Planning**

Asset protection planning is lifetime planning that focuses on the management and preservation of property during life and after death, with a view towards protecting wealth from potential future creditors. In our current environment of escalating litigiousness and a divorce rate exceeding 50% of marriages, asset protection planning is an essential component of wealth management. Asset protection planning can help to protect personal assets from legal threats, including threats arising from business, professional and commercial activities; regulatory liability; and personal and family activities. Asset protection planning has also taken on increased significance in response to reductions in the protective capability of liability insurance, due to increased exclusions, declining coverage availability, increased premiums, concerns over carrier viability and the costs of coverage litigation. Finally, asset protection planning techniques can be used to address clients' concerns regarding confidentiality and privacy. In particular, asset protection trusts may be used to limit public or family knowledge of wealth, encourage family harmony, deter litigation and deter criminal activity against the client's family.

D. **Factors Suggesting a Need for Asset Protection**

Asset protection planning should be incorporated into the wealth planning of all clients. It is particularly important for high net worth clients and for clients whose business, professional and/or personal activities generate risks that cannot be adequately insured against for purposes of protecting personal assets from creditor claims.

Asset protection planning may also be helpful in discouraging litigation against clients whose position or profession may create an appearance of deep pockets. Common profiles of clients who are particularly well suited to asset protection planning include professionals, corporate officers and directors, individuals serving as fiduciaries, real estate developers and investors, individuals contemplating marriage, affluent individuals with liquid assets and entrepreneurs and closely-held business owners. I have experienced a growing interest in asset protection planning among clients and families facing issues with addiction and substance abuse, mental illness and mental disability among the settlor or a family member.

Among clients domiciled in jurisdictions with favorable creditor exemptions (e.g. Florida or Texas), asset protection planning may be necessary because a reliance on exemptions may cause an imbalance in marital assets between married clients that is undesirable for estate planning purposes. In addition, while Federal bankruptcy law has made it more difficult for transient individuals to avail themselves of beneficial state law creditor exemptions, social, demographic and economic trends in the United States have greatly increased the likelihood that affluent and emerging affluent clients will relocate one or more times during their adult lives.

E. Considerations among Estate Planning Clients

Aside from what might be considered common "profiles" for asset protection clients, asset protection planning considerations should be evaluated for all estate planning clients. Even clients without an obvious need merit consideration. Some questions that every estate planner should ask are as follows:

1. Does the client's reliance on the marital deduction create additional risks?

Are assets passed outright to a spouse? If assets are passed to a spouse in trust, is the trust susceptible to creditor attack on the basis of sham trust arguments, where for example, the spouse is careless in the management of the trust?

2. Is there a bypass or family trust that is vulnerable?

Even if the trust is a spendthrift trust, are there situations under which the trust might be susceptible to creditor piercing? Some potential examples include: (i) marital or family support obligations; (ii) maintenance of the beneficiary; (iii) public policy challenges by personal injury victims; and (iv) amounts owed to the IRS.

3. Is there a bypass or family trust that provides for the distribution of assets upon the reaching of an attained age by beneficiaries?

Once the assets are distributed to a beneficiary, the assets will be subject to the claims of the beneficiary's creditors. A beneficiary's interest in the trust or the assets after distribution, will also be vulnerable to attack in the event of a divorce of the beneficiary (remember, there is a 50-50 statistical chance of this occurring if the beneficiary marries). This risk can be reduced through careful selection of the situs of the trust and appropriate drafting of the trust instrument.

4. Does the client have (or are they considering) split interest trusts that are susceptible to creditor attack?

To the extent that the trusts provide an income or remainder interest to the settlor, the rule against self-settled spendthrift trusts may apply. Accordingly, creditors may be able to reach income or remainder interests in split interest trusts, such as grantor retained annuity trusts (GRATs), qualified personal residence trusts (QPRTs), charitable remainder trusts (CRTs) and charitable lead trusts (CLTs). In the case of charitable split-interest trusts, although the charitable portion of the trust should not be subject to the reach of a creditor, the charity may be indirectly impacted by the litigation. Moreover, if a creditor is successful in reaching an interest in a split-interest trust, due to grantor trust treatment, a settlor may be deprived of their expected economic benefit, but will still be liable for income tax on trust income.

F. Benefits and Limitations of Asset Protection Planning

When discussing asset protection planning with clients, it is important to communicate to them that asset protection is not a panacea for all of the client's legal, tax, financial and personal matters. There are generally no quick solutions. Thorough fact gathering and analysis, careful planning and ongoing maintenance are required to achieve success. Due to the complexity and potential risks associated with asset protection planning, it is especially important to avoid quick fixes and gimmicks.

Practitioners in this area must appreciate and communicate the long-term consequences of asset protection planning. Asset protection trusts, for example, are typically irrevocable. Practitioners should direct the client's attention to the implications of executing an irrevocable instrument and focus on the importance of preparing a well-drafted trust instrument. The instrument and plan must be capable of serving the client's objectives on a long-term basis.

It is also extremely important that practitioners and clients respect the structure that is implemented. Otherwise, it is unreasonable to expect that the structure will be respected in court if that becomes necessary due to a creditor challenge. For an illustration of this concept, one need only examine the body of cases concerning family limited partnerships. Finally, clients and their advisors must be prepared and capable practitioners in this area. The exercise of good judgment is critical to successful asset protection planning.

G. Common Misconceptions About Asset Protection Planning

The mystique of exotic locales, Swiss bank accounts, the aggressive promotion of asset protection planning by unlicensed U.S. and offshore promoters and the facts of several publicized asset protection cases have helped to contribute to many misconceptions about asset protection planning. The following discussion addresses some of the most common misconceptions.

1. Asset protection planning is intended to conceal assets

Irrespective of applicable bank secrecy laws in foreign jurisdictions, asset protection should always be based on the assumption that full disclosure will be required. All activity of the foreign trust will generally be required to be reported to the IRS. Offshore secrecy laws are still helpful, as they encourage privacy, which in turn acts as a deterrent against litigation. In many jurisdictions used for asset protection trusts, trust laws are more advantageous for trust settlors who wish to minimize disclosure to beneficiaries or potential beneficiaries.

2. Asset protection trusts are a vehicle for tax avoidance

Certain offshore jurisdictions are referred to as "tax havens" because they do not impose income taxes on non-locally sourced income. Notwithstanding, the United States taxes its residents on worldwide income and requires annual disclosure of foreign accounts. Most offshore trusts are structured for U.S. tax purposes as grantor trusts and are generally tax neutral for U.S. income and wealth transfer tax purposes. In some cases, domestic asset protection trusts can be used to minimize state capital gains taxes in corporate M&A transactions and/or to reduce overall wealth transfer tax liability.

3. Asset protection planning is expensive

Many asset protection planning techniques can be employed with minimal cost.[2] Litigation is expensive and distracting. Once an asset protection plan has been implemented, the ongoing maintenance costs are generally modest in comparison to alternatives and in light of the protection afforded.

4. Asset protection planning is presumptively unethical

As a matter of policy, Federal and state laws have long recognized the benefits of enabling individuals to protect assets from the claims of creditors. Some examples include unlimited liability protection for corporate shareholders, Federal and state creditor exemption laws and the recognition of spendthrift and anti-alienation provisions.

5. **Offshore trusts expose assets to foreign or local currency risk**

Assets may be held in U.S. accounts or in foreign accounts denominated in U.S. dollars (USD) or other major currencies.

6. **Asset protection planning has been proven ineffective**

Case law has proven that unethical and illegal conduct on the part of individuals and their advisors will not be respected. Provided that fraudulent conveyance and other applicable laws are complied with, the efficacy of exemption planning is confirmed by extensive state and federal case law. Domestic asset protection trusts have not yet been tested in the courts, but have been endorsed by the legislatures of eight states, and as further discussed below, the arguments in support of their effectiveness are compelling. Moreover, case law has in dicta, validated the effectiveness of offshore asset protection trusts.[3] In any event, many clients prefer the lesser uncertainty that a technique may not work than the potentially greater certainty of financial detriment if they fail to implement any planning whatsoever. As lawyers, we often try to approach situations of uncertainty with analytical methods that are best described as binary, rather than analog. Clients, on the other hand, particularly financially successful business clients, generally have a greater appreciation for advice that is based upon a balancing of risk and return.

7. **Asset protection is for people who get sued all the time**

The principal purpose of asset protection planning is to protect assets by deterring litigation. Any person whose real or perceived financial resources are sufficient to outweigh the costs of litigation is a potential defendant. Accordingly, while certain business, professional and personal activities may increase an individual's exposure to litigation, most individuals can expect to be named as a defendant one or more times during their lifetime.

8. **Asset protection trusts expose assets to embezzlement**

All trusts involve the separation of legal and equitable title and create possibilities for conflict, negligent or intentional wrongdoing and mismanagement. Whether a trust is domestic or offshore, appropriate checks and balances can be provided through careful structuring and drafting to ensure that a client's assets are protected from unlawful or negligent conduct.

9. **Asset protection trusts require the use of unregulated and unstable "banana republics"**

There are several foreign and domestic jurisdictions that can be used for settlement of an asset protection trust. Most of the foreign jurisdictions used are economically and politically stable and are predominantly British Overseas Territories,[4] British Crown dependencies[5] or Commonwealth Realm[6] nations with ongoing ties to the United Kingdom. In the case of foreign trusts, assets are rarely located in the situs of the trust.

H. Knowing and Qualifying Your Client

Four simple steps employed at the onset of an asset protection planning engagement can go a long way towards ensuring the design and implementation of an ethical and effective asset protection plan. First, always perform due diligence to learn about the client. Electronic resources to assist with this abound. Second, if the client has expressed an interest in asset protection planning, it is important to determine the client's motivations for seeking your assistance. This can help screen out clients whose objectives are other than honorable. The best way to do this is often by a series of relaxed conversations. Visiting them at their home or business may also prove helpful. Third, determine the client's solvency. You may wish to engage the client's accountant or financial planner for this purpose.[7] Finally, the client's living needs should be analyzed and documented, to ensure that the client retains sufficient assets for his or her living needs. The information gathered from these four steps, in conjunction with an analysis of applicable law, professional rules and personal and law firm standards of ethics and professionalism will help define appropriate constraints for advising a client.

II. TRANSFER CONSIDERATIONS

A. Fraudulent Transfers

1. Introduction

Fraudulent transfers are transfers of property made or presumed made with the intent to delay or defraud creditors. Fraudulent transfers are generally characterized by a lack of fair and valuable consideration and attempts to place the property beyond the reach of creditors. A "fraudulent transfer" is not the same as "fraud." "Fraud" is a knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment. The remedy for fraud is that it "vitiates all transactions *ab initio*." In contrast, a "fraudulent transfer" (or fraudulent conveyance) is most commonly a transfer made with the intent to hinder, delay or defraud a creditor. The remedy for a fraudulent transfer is that the transfer is merely *voidable*.

2. Sources of Fraudulent Transfer Law

In the United States, there are four primary sources of fraudulent transfer law. The English Statute of Elizabeth, 1570 is the foundation for fraudulent transfer law in all common law jurisdictions. The Statute of Elizabeth defined insolvency, determined persons legally injured and identified transfers that are fraudulent notwithstanding lack of actual intent on part of debtors to defraud. Violations of the Statute of Elizabeth were originally punishable by imprisonment. Statutory or common law variants of the Statute of Elizabeth are still in effect in six states.

The second source of fraudulent transfer law is the Uniform Fraudulent Conveyance Act (UFCA). Originally adopted in 1918, the UFCA was enacted in 25 states. The UFCA served as a basis for the Bankruptcy Reform Act of 1978 provisions relating to fraudulent transfers. The UFCA is currently in effect in 4 states and the U.S. Virgin Islands.

The third source is the Uniform Fraudulent Transfer Act (UFTA), which updated the UFCA in 1984. The UFTA is the model for fraudulent transfer statutes in 40 states and the District of Columbia.

The fourth source is the United States Bankruptcy Code. Bankruptcy Code Section 544(b) permits a fraudulent transfer to be recovered by the use of state fraudulent transfer laws. Bankruptcy Code Section 548 provides that a bankruptcy trustee may recover assets fraudulently conveyed. As revised by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCA), assets transferred up to two years prior to the filing of the petition may now be recovered.

As part of BAPCA, new Bankruptcy Code Sections 548(e)(1)(A) – (D) were added to address self-settled spendthrift trusts. Section 547(e)(1) provides that transfers may avoided for up to ten years before filing where: (i) a transfer made to a self-settled spendthrift trust or "similar devise"; (ii) by the debtor; (iii) the debtor is a beneficiary of such trust or similar devise; and (iv) the debtor made the transfer with the actual intent to hinder, delay or defraud any entity to which the debtor was or became indebted, on or after the transfer date. The legislative history of this new provision suggests that asset protection trusts settled more than ten years prior to a bankruptcy filing may be more likely to be respected. The new provision also contains a special rule for securities laws violations that was added in response to perceived abuses arising in scandals like Enron and WorldCom. Under the new rules, a "transfer" now includes a transfer made in anticipation of any money judgment, settlement, civil penalty, equitable order or criminal fine incurred by or which the debtor believed would be incurred by: (i) any violation of Federal or state securities laws; or (ii) fraud, deceit or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security required to be registered under Federal securities laws.

Settlors of trusts in foreign jurisdictions must also comply with foreign law regarding fraudulent transfers.

3. Types of Fraudulent Transfers

There are two types of fraudulent transfers: (i) Actual intent fraudulent transfers and (ii) constructive fraudulent transfers. An actual intent fraudulent transfer is a transfer made with the intent to hinder, delay or defraud a creditor. The elements are: (i) the defendant effected a transfer; (ii) of an interest in the debtor's property; (iii) within the applicable statute of limitations; and (iv) the transfer was made with actual intent of the debtor to hinder, delay or defraud the creditor. To assist a creditor in proving an actual intent fraudulent transfer, the law provides "badges of fraud" that when present, may create a presumption of fraudulent intent. Under common law, there are generally seven,[8] while under the UFTA, there are eleven.[9]

A constructive fraudulent transfer is a transfer to the defendant of: (i) an interest in the debtor's property; (ii) within the applicable statute of limitations; and (iii) without reasonably equivalent value in exchange for the transfer (Bankruptcy Code and UFTA) or fair consideration (UFCA), where the debtor was either: (i) insolvent or left insolvent; (ii) intentionally left unable to pay debts as they matured; or (iii) left with an unreasonably small amount of capital.

4. Fraudulent Transfer Remedies

Under the UFCA, the availability of remedies depends upon whether or not claims have matured to become due and payable. In the case of mature claims, available creditor remedies include (i) the setting aside of the conveyance or annulment of an obligation or (ii) attachment or levy of execution on the property. In the case of immature claims: (i) a debtor may be restrained from disposing of property; (ii) a receiver may be appointed to take charge of property; (iii) a conveyance may be set aside or an obligation annulled; or (iv) or any other order circumstances require may be issued by a court.

Under the UFTA, there is no distinction between mature and immature claims. Creditor remedies available include: (i) avoidance of the transfer or obligation to the extent necessary to satisfy a creditor's claim; (ii) attachment or other provisional remedy against the asset transferred or other property of the transferee; (iii) an injunction against further disposition by the debtor, the transferee or both, of the property transferred or other property; (iv) appointment of a receiver to take charge of the transferred asset or other property of the transferee; or (v) any other relief the circumstances require.

Under Federal bankruptcy law, a bankruptcy trustee has the power to avoid a fraudulent conveyance of property of the estate. The trustee may recover the property or its value, but actual recovery is generally preferred to avoid valuation issues. If the property has depreciated in value, the court may enter a money judgment to account for the difference.

In some cases, there are also criminal law remedies for fraudulent transfers.[10]

B. Contempt

Contempt is an act calculated to embarrass, hinder or obstruct a court in the administration of justice, or which is calculated to lessen its authority or its dignity.[11] In general, civil contempt consists of the failure to do something which the party has been ordered to do for the benefit or advantage of another party to the proceeding before the court, while criminal contempt is an act done in disrespect of the court or its process or which obstructs the administration of justice or tends to bring the court into disrespect.[12] While impossibility is generally a defense to contempt, self-created impossibility is not a defense to a civil contempt charge.[13] Both advisors and clients need to be particularly conscious of these constraints in asset protection planning.

C. Timing for Asset Protection Planning

Asset protection planning is about *planning*. To avoid the possibility of a fraudulent transfer or other adverse consequences, asset protection planning is most commonly performed while the seas are calm. Attempting to implement a plan on the eve of bankruptcy or a lawsuit may violate bankruptcy or state fraudulent transfer laws.

However, where a client is aware of an actual or potential claim, there are circumstances under which it may be prudent to arrange one's affairs so as to protect certain property from creditors. For example, a debtor with adequate assets to fund a claim may wish to control which assets are easily reached by a creditor for personal, business or tax reasons. The Supreme Court case *Grupo Mexicano* offers support for the legality of this type of planning.[14]

Where a client is put on notice of a potential legal claim that may be covered by insurance, a frequently overlooked area is the need to have qualified personal defense counsel involved to ensure that (i) the client's rights against the carrier are fully protected and (ii) to control terms of settlement. Many clients (and their attorneys) wrongfully assume that the interests of the client and their insurance carrier are aligned. This is rarely the case.

III. ADVISOR LIABILITY

A. Professional Discipline

Attorney liability for professional discipline is determined under state professional responsibility rules. Violation of ethical rules may lead to professional discipline. In general, under the Model Rules[15] and Model Code of Professional Liability,[16] violation should not give rise to civil liability to the client or a third party.[17]

B. Civil Liability

1. Malpractice

Legal malpractice consists of either negligence or breach of contract in the representation of a client. An attorney is required to employ that degree of skill ordinarily exercised by the profession. A client is entitled to be compensated for any damages proximately caused by an attorney's malpractice.

2. Agency Theory and Attorney Privilege

Under agency theory, a lawyer acting in a lawful manner at the direction of his or her client is not liable for the consequences of his or her client's actions.[18] Notwithstanding, the privilege a lawyer has for his or her actions in representing a client is a qualified one.[19] A lawyer may be held liable for the intentional torts of malicious prosecution and abuse of process.[20] A lawyer may also be held liable for conspiring with a judgment debtor to defraud a creditor.[21]

3. **Civil Conspiracy and Aiding and Abetting**

A civil conspiracy is a malicious combination of two or more persons causing injury to person or property, where there is an unlawful act independent from the actual conspiracy.[22] The modern application of civil aiding and abetting can be traced to Restatement (Second) of Torts 1979. Section 876 of the Restatement sets out three ways in which persons acting in concert may be held liable for each other's tortious conduct. Under Section 876(b) a person may be held liable if he knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other party in carrying out the conduct.[23] The difference between civil conspiracy and aiding and abetting is that a conspiracy involves an agreement to participate in a wrongful activity, whereas aiding and abetting merely involves the provision of substantial assistance or encouragement to someone who performs wrongful activity. Both causes of action are forms of concerted-action liability and are not separate theories of recovery. Instead, each is a way in which a person may become jointly liable for another's tortious conduct.[24] Not all jurisdictions recognize civil aiding and abetting.

C. **Criminal Liability**

1. **Mail Fraud[25]**

Federal law prohibits an individual from "devis[ing] or intending to devise any scheme or artifice to defraud or for obtaining money or property by means of false or fraudulent pretenses, representations or promises." The elements of mail fraud are: (i) a scheme to defraud; (ii) money or property; and (iii) use of the mail system (or private carrier) to further the scheme. It is a crime to defraud by false statements. In some cases, it is also a crime to defraud by material omissions where the defendant has breached a fiduciary duty to disclose material information under circumstances that result in harm or could result in harm.

2. **Criminal Conspiracy[26]**

It is a Federal offense for two or more persons to conspire to commit "any offense against the United States or to defraud the United States or any agency thereof in any manner or for any purpose…." The elements of criminal conspiracy are: (i) an agreement between two or more persons to commit an unlawful act; (ii) knowingly engaging in the conspiracy intending to commit those offenses that were the objects of the conspiracy; and (iii) commission of an overt act by one of the co-conspirators in furtherance of the conspiracy. A co-conspirator does not need to have knowledge of all of the details or members of the conspiracy to be held liable. The jury is allowed to presume knowing participation when a defendant acts in furtherance of the conspiracy's objective.

3. **Obstruction of Justice**

A lawyer may be held liable by filing lawsuits in Federal or state court if the court finds that the actions were done with a corrupt purpose. The liability may arise even if the lawyer's efforts were otherwise lawful, but were motivated by a corrupt endeavor and were efforts by the lawyer to protect his or her own financial interest.[27] A lawyer may also be held criminally liable for misrepresenting a fact for the purpose of obstructing justice.[28] A lawyer who instructs a witness not to testify (including his or her own client) for corrupt purposes may be held criminally liable for obstruction of justice.[29] Finally, a lawyer who instructs a client to or personally destroys or alters evidence, may be held liable.[30]

4. **Bankruptcy Crimes[31]**

The purpose of the bankruptcy crimes regime is to promote honest administration in bankruptcy proceedings and ensure distribution to creditors of a bankrupt estate. The regime is applicable to any proceeding, arrangement or plan under the Bankruptcy Code. 18

U.S.C. § 152 provides nine circumstances where an individual may be criminally liable for bankruptcy fraud. Under 18 U.S.C. § 152, a lawyer may be convicted of bankruptcy fraud for: (i) knowing and fraudulently concealing a client's assets from a creditor during bankruptcy proceeding; or (ii) knowingly and fraudulently destroying, mutilating or concealing a client's records after the client has filed for bankruptcy.

5. Criminal Aiding and Abetting[32]

Anyone that aids, abets or counsels the commission of an offense against the United States or willfully causes the commission of an offense against the United States may be held criminally liable. Lawyers have been convicted for aiding and abetting a false claim or making false statements in conjunction with a bankruptcy proceeding under 18 U.S.C. § 2. A lawyer may even be convicted under this statute where his or her client was acquitted of the underlying offense.[33]

6. Concealment of Assets From Bank Regulators[34]

This provision imposes criminal liability on any person who: (i) conceals assets from Federal bank regulators; (ii) corruptly impedes or endeavors to impede the functions of such regulators; or (iii) corruptly places or endeavors to place assets beyond the reach of such regulators.

7. Tax Crimes

Practitioners should be familiar with Sections[35] 7212 and 7206(4). Section 7212 targets interference with tax administration and criminalizes conduct of any person that corruptly endeavors to impede any officer or employee of the United States or in any other way corruptly obstructs or impedes or endeavors to obstruct or impede, the due administration of the Internal Revenue Code. The punishment that may be imposed is a fine of up to $5,000 and three years imprisonment. "Corruptly" means an act with the intent to secure an unlawful advantage or benefit for oneself or another.[36]

Section 7206(4) criminalizes the conduct of any person that removes, deposits or conceals or is concerned in removing, depositing or concealing any property upon which levy is authorized by Section 6331, with intent to evade or defeat the assessment or collection of any tax imposed. A violation is a felony punishable by a fine of up to $100,000 ($500,000 for corporations) and three years of imprisonment.

8. Anti-Money Laundering

Anti-money laundering legislation was enacted by Congress in 1984 to combat drug trafficking, but the reach of the Federal money laundering laws is not by any means limited to criminal offenses involving illegal drugs. In general, the Money Laundering Control Act[37] imposes criminal liability on persons who conceal or attempt to conceal the proceeds of unlawful activities. The Act also reaches those persons who deal with persons or property associated with unlawful activity. Section 1956 of the Act applies to laundering of monetary instruments, while Section 1957 applies to engaging in monetary transactions in property derived from unlawful activity. The Act can potentially apply to a lengthy list of Federal criminal statutes and depending on the circumstances, activities that are a felony under applicable state law. The application of appropriate due diligence procedures by professional advisors, as advocated in this paper, is the most effective way to minimize exposure to money laundering liability. Practitioners should also be familiar with the Patriot Act, including the sections on international counter money laundering and the amendments to the Bank Secrecy Act.

IV. LIABILITY INSURANCE

One of the most basic forms of risk management is to change a practice or behavior that may lead to liability. When making a change is not possible, is inefficient, or otherwise undesirable, insurance can be used to protect against contingent loss. In FAS 113, the Financial Accounting Standards Board defines insurance as "indemnification against loss or liability from specified events and circumstances that may occur or be discovered during a specified period."[38] Insurance is based upon the transfer and distribution of risk. The practice of transferring or distributing risk through the equivalent of insurance contracts is an ancient one, and is believed to have originated with Chinese and Babylonian traders in the 3rd and 2nd millennia BC, respectively.

Over the past several thousand years, the insurance markets have continuously innovated and evolved to meet the risk management needs of society. More recently, advances in consumer and enterprise information technology have contributed to unprecedented changes in the global insurance industry, including growing segmentation and specialization of the industry, and significantly more complex policies.

Ideally, any delivery of client service that is based upon an assumption that insurance coverage exists should include a careful review of the client's current coverage. The analysis should include an evaluation of coverage held, the scope of coverage, exclusions, and coverage amounts. With all due respect to insurance agents (and to your clients), do not accept at face value the statement by a client that they are adequately covered.

Following a risk management analysis and an evaluation of the client's coverage, a gap analysis report should be prepared identifying gaps in coverage. This gap analysis report can be used to shop for supplemental or additional insurance coverage, and to the extent necessary, provide the basis for considering other asset protection planning techniques.

V. SPOUSAL TRANSFERS AND GIFTING OF PROPERTY

Transferring property into the name of a spouse for asset protection planning purposes can be a simple and inexpensive solution, provided that the clients: (i) remain happily married; (ii) stay free from major creditor trouble; (iii) will not benefit from the use of the marital deduction in their estate plans; and (iv) are U.S. citizens.

While most clients don't want to be told they need to plan for their divorce, with a divorce rate exceeding 50% of marriages, expectations as to the creditor protection benefits of spousal gifting need to be realistic. If a divorce occurs, assets transferred to a spouse may be treated as nonmarital property in the divorce proceeding. To the extent of judicial discretion, query whether a judge would be sympathetic to the argument of a spouse with minimal assets for rebalancing the assets among the spouses if the imbalance was originally created with the objective of defeating potential creditors?

Even assuming a long and blissful marriage, spousal transfers may prove ineffective in protecting assets from potential future creditors. First, spousal transfers may be attacked under a resulting trust theory. For example, suppose that because "W" is a physician and is concerned about professional liability, most assets, including the primary residence, are held in the name of "H", an entrepreneur. Where assets are titled in the name H, but held and managed for the benefit of both W and H, a creditor of W may seek to reach the assets under an argument that the assets are held by H as trustee of a resulting trust for the benefit of W and H. Inasmuch as self-settled spendthrift trusts are not likely to be recognized under state law (even in states with domestic trust legislation, unless the strict requirements of the legislation are followed), W's creditor may prevail. This strategy also overlooks the possibility that H's personal and commercial activities may generate equal or greater financial exposure. The use of spousal transfers may also cause clients and their advisors to fail to: (i) undertake comprehensive risk management analysis; (ii) examine the possible risk exposure of the transferee; or (iii) consider the use of asset protection planning techniques. Thus, spousal transfers may increase a family's wealth exposure or contribute to a false sense of security.

Asset protection planning with spousal transfers relies upon the intentional imbalancing of assets among spouses for its effectiveness. In contrast, balancing assets among spouses is generally desired for marital deduction planning. In addition, even in the case of clients with estates below the point of concern over marital deduction planning, there are additional limitations on using spousal transfers to the extent that the transferee is not a U.S. citizen. Section 2523(a) provides the general rule that the transfer of an interest in property by gift to a spouse is deductible in computing taxable gifts for the taxable year. However, under Section 2523(i), where the donee spouse is not a U.S. citizen, the marital deduction provided under Section 2523 is disallowed. Instead, gifts to a non-U.S. citizen spouse are eligible for the annual exclusion provided under Section 2503, except that for gifts made in 2007, the first $125,000 (indexed for inflation) of gifts per year to an alien spouse will not be taxed.[39] The annual exclusion will apply only to the extent that the gifts would qualify for the marital deduction if the donee were a U.S. citizen.

For the reasons discussed above, the advisability of transferring property by gift to a family member or friend should also be carefully questioned. In addition, clients should be advised that when they transfer title of property in this manner, they should assume that not only are they giving up control over the property, they are empowering the transferee to exercise all rights in the property for the benefit of the transferee.

VI. EXEMPTIONS

A. Introduction

Exemption laws provide for certain amounts or classes of property that may be held by an individual debtor free from creditor claims. Exemption planning, the practice of proactively using exemption law to protect assets, has traditionally been perceived as lower in risk and controversy than other techniques, including the use of asset protection trusts. However, exemption planning is neither as benign, nor as simple, as often perceived.

In the United States, there are two sources of exemption law: state laws and the Bankruptcy Code. In non-bankruptcy cases, state exemption laws apply. While this point itself is not controversial, state exemption laws are frequently imprecise and in general, lack the type of uniformity that can be found in many other areas of the law. In addition, it is common for state law exemptions that involve streams of payments (e.g. retirement benefits) to be measured based upon subjective support standards, rather than objective dollar amounts.[40] This is truly an area where the devil is in the details.

In bankruptcy cases, the issue of what exemption law should apply has long been a matter of controversy, and has been described as one of the most "contentious and persistent issues in bankruptcy exemption policy in the United States...."[41] Ignoring the constitutional questions, the crux of the issue is whether debtors in bankruptcy should be permitted or required to use state exemption laws, or alternatively, have the right to use a federal exemption system.[42]

Under Bankruptcy Code Section 522(b), a debtor has the choice of using either (i) the federal bankruptcy exemptions found in Section 522(d) or (ii) the Federal nonbankruptcy and applicable state law exemptions. However, Bankruptcy Code Section 522(b)(1) provides an "opt-out" provision that allows a state legislature to determine that only state law exemptions will be available to domiciliaries of the state. The effect of this provision is to empower state legislatures to restrict debtors to an exemption regime that may be less advantageous than would otherwise be available under the federal exemptions provided in Bankruptcy Code Section 522(d).[43]

Additional, recurring sources of controversy in bankruptcy exemption policy have been (i) whether debtors should be restricted in their ability to convert assets from a nonexempt to exempt form and (ii) due to significant disparities among some states in the generosity of their state law exemptions, the capability of debtors to forum shop prior to bankruptcy. These issues were addressed in BAPCA, in large part in response to the widely publicized utilization of exemption law by Enron executives who acquired large exempt homesteads in Texas and Florida.

Prior to BAPCA, a debtor was required to live in a state for 180 days to use the state's exemption laws in a bankruptcy case. BAPCA now requires a debtor to live in a state for 730 days to use the state's exemptions. In response to homestead exemption abuses, debtors who relocate prior to bankruptcy are now subject to a 1245 day residency requirement before they are eligible to use the state's homestead exemption in full. Prior to meeting the 1245 day requirement, the homestead exemption for relocating debtors is limited to the lesser of (i) the state law exemption or (ii) $125,000.[44] BAPCA also permanently reduces the maximum homestead exemption amount available to a debtor if the court determines after notice and a hearing, that the debtor has been convicted of a felony, which under the circumstances, demonstrates that the filing of the bankruptcy case was an abuse of bankruptcy law, or the debtor owes a debt arising from certain types of "bad faith" civil or criminal conduct.[45]

B. **Homestead Exemption**

Among those states that provide homestead exemptions, the laws vary considerably in the amount eligible for the exemption. While seven states have exemptions that are unlimited in amount,[46] most states are well under $100,000, and $5,000 is common.[47] Moreover, a handful of states do not have a homestead exemption.[48]

Exemptions also vary as to how stringent the requirements are to qualify for the exemption. For example, the exemption in Bankruptcy Code Section 522(d)(1), while modest in amount, includes real or personal property used by the debtor or debtor's dependents as a residence. In contrast, the Florida homestead exemption is limited to a residence on ½ acre of contiguous land if located within a municipality, or up to 160 acres of contiguous land and improvements outside a municipality.[49] In either case, under Florida case law, in order to qualify as homestead, the real property must be *the* permanent place of residence of the debtor or his or her family.[50]

C. **Jointly-Held Property**

Subject to applicable exemptions, property held individually or by joint tenants, or tenants in common, is generally subject to attachment and levy by creditors in whole, or in part. However, assets owned by a husband and wife as tenants by the entireties (TBE) is considered to be held by the marital unit, and is not subject to attachment or levy by most creditors of one spouse. Only a limited number of jurisdictions recognize TBE ownership, and to the extent they do, variations exist as to what types of property may be held as TBE and what is necessary to create title as TBE. Even if TBE is not recognized in a client's domicile, the asset protection benefits of TBE can still be utilized by acquiring real property in a state that provides for TBE ownership.

D. **Life Insurance and Annuities**

Life insurance and annuities are often marketed by touting their asset protection planning benefits. Many states exempt life insurance and annuities as a matter of public policy. State exemption laws vary considerably, however, in the amounts and the extent to which life insurance and annuities are exempt property. For example, while death benefits are generally exempt, many states do not exempt, or substantially limit, the exemption provided for the cash surrender and loan values of life insurance contracts. Moreover, in many states, creditors can recover from life insurance proceeds any payments made by the insured as premiums in fraud of creditors.

Where applicable exemption law provides adequate legal support, life insurance can prove to be a very effective asset protection planning tool, and one that may be more palatable to many clients than an asset protection trust. Life insurance can also provide several desirable tax advantages. Whether considering a retail or private placement contract, a highly experienced specialty life agent is recommended. Such an individual is likely to have the best access to and understanding of multiple products and an understanding of how to construct an asset protection-oriented solution. The agent's direct access to carrier executives and senior underwriters is also helpful to achieving the best underwriting result.

E. **Retirement Plans**

Section 206(d)(1) of the Employee Retirement Income Security Act of 1974 (ERISA) requires as a condition of plan qualification, that a pension plan provide that benefits provided under the plan may not be assigned or alienated. This anti-alienation provision protects benefits provided under an ERISA plan from the reach of creditors, and under the preemption provision of ERISA, has the effect of superseding any and all contrary state laws as they relate to employee benefit plans. [51] In *Patterson v. Shumate*, the Supreme Court clarified that ERISA's anti-alienation provision is applicable not only in a nonbankruptcy setting, but in a bankruptcy proceeding.[52]

Under Bankruptcy Code Section 541(a), a bankruptcy estate is comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case." Because bankruptcy courts give effect to restrictions on the transfer of beneficial interests that are enforceable under applicable non-bankruptcy law, the effect of the anti-alienation provision in ERISA is to exclude ERISA plans from the bankruptcy estate.[53] Until the enactment of BAPCA, however, non-ERISA plans were not excluded from the bankruptcy estate unless they qualified for a federal or state law exemption.

Prior to BAPCA, the protection of benefits in non-ERISA retirement plans was largely dependent upon exemptions similar to that provided in Bankruptcy Code Section 522(d)(10)(E), which provides an exemption for retirement benefits, but only to the extent necessary to reasonably provide for the support of the debtor and his or her dependents. In addition, uncertainty existed as to whether individual retirement arrangements (IRAs) were exempt under Bankruptcy Code Section 522(d)(10)(E) and in the case of opt-out states, under state law exemptions.[54] In *Rousey v. Jacoway*, the Supreme Court held that IRAs were exempt in bankruptcy under Bankruptcy Code Section 522(d)(10)(E).[55] Questions also arose as to whether rollovers from an ERISA or exempt retirement plan caused the funds to lose their exempt status.[56]

BAPCA resolves these issues. As a result of BAPCA, all retirement arrangements that are exempt from taxation under Internal Revenue Code Sections 401, 403, 408, 408A, 414, 457 or 501(a) are exempt from creditors in bankruptcy.[57] Retirement arrangements or accounts that do not meet qualify for one of the foregoing tax exemptions are only exempt in bankruptcy to the extent that they meet the requirements of the Federal bankruptcy exemption (*i.e.*, Bankruptcy Code Section 522(d)(10)(E)), or an applicable state law exemption. BAPCA also clarifies that direct transfers and eligible rollover contributions retain their exempt status.

BAPCA also clarifies the eligibility of IRAs for exemption. Under the amendments to Bankruptcy Code Section 522, IRAs described in Sections 408 and 408A are exempt, but only up to an aggregate amount of $1 million dollars. IRA balances that are the result of eligible rollover contributions and earnings thereon are not included in the $1 million limit. A bankruptcy court has the discretionary authority to grant relief from the $1 million ceiling if the interests of justice require.[58] These limits do not apply to simplified employee pension plans under Section 408(k) and simple retirement accounts under Section 408(p).

The BAPCA revisions apply irrespective of whether a debtor is claiming exemptions under Federal bankruptcy law or state law, including opt-out states. As beneficial as these new provisions are in expanding the protection of interests in retirement plans, it is important to remember that they are only applicable in a bankruptcy case.

F. Section 529 and 530 Accounts

Contributions to an education IRA qualifying under Section 530 are excluded from the bankruptcy estate, but only if (i) the designated beneficiary of the account was a child, stepchild, grandchild or stepgrandchild of the debtor for the taxable year for which the account contribution was made and (ii) the funds have not been pledged or promised to any entity in connection with an extension of credit and are not excess contributions under Section 4973(e).[59] Similar rules apply in the case of funds used to purchase a tuition credit or certificate or that are contributed to Section 529 account under a qualified State tuition program.[60]

VII. ASSET PROTECTION WITH BUSINESS AND INVESTMENT ENTITIES

A. Introduction

Business entities, including corporations, general and limited partnerships and limited liability companies, may be used for asset protection planning. The discussion in this paper is limited to entities providing limited liability to owners and does not discuss the use of general partnerships. When considering the use of corporations, limited partnerships (LP) and limited liability companies (LLC) for asset protection planning, the first step is to determine the nature and characteristics of the property interests that the client seeks to protect. For example, is the property real property or personal property? If personal property, is it tangible or intangible property? Is the property liquid or easily marketed to convert it to cash? Is the property movable? Is the property subject to restrictions on transferability?

The second step is to determine whether the asset protection efforts are intended to shield the client from potential liability associated with activities or holdings of the entity (the classic limited liability use for which corporations were developed), or to use an entity to protect the client's assets from other sources of potential liability. For example, in the case of a client with a trucking business and a large investment portfolio, an example of the former would be the incorporation of the client's trucking business, while an example of the latter would be the transfer of the client's investment portfolio into a limited partnership.

The third step is to analyze potential tax consequences of the entity structures under consideration. As appropriate under the particular factual circumstances, this may include an analysis of Federal, state, local and in some cases, foreign, income tax consequences. If the client will be providing services to the entity, the analysis should also include consideration of self-employment tax consequences. Finally, the analysis should consider wealth transfer tax consequences, including Federal estate, gift and generation-skipping transfer taxes and to the extent applicable, state wealth transfer taxes.

The performance of the three foregoing steps should lead to three (or more) decisions. First, whether to use a corporation, limited partnership or limited liability company. Second, tax classification decisions should be made to achieve optimal tax treatment. Third, a jurisdiction (either domestic or foreign) will need to be selected for organizing the entity or entities.

B. Corporations

When used appropriately, corporations are a proven method of providing limited liability to *investors* from activities of the corporation. In comparison to limited partnerships and limited liability companies, corporations are frequently the least effective type of limited liability entity for protecting assets of the entity from claims of an equity owner's creditors. If a creditor seizes shares of the corporation, the creditor may generally exercise all of the rights of the shareholder, including management rights. An additional concern with the use of corporations is that fiduciary duties required under corporate law may provide further protection to a creditor who becomes a shareholder. In contrast, the operative documents of a limited partnership or limited liability company can generally explicitly dispense with fiduciary duties that would otherwise be owed among partners or members. In some cases, however, these potential weaknesses can be protected against through the use of a well-drafted close corporation and shareholders agreement.

While not as common as might be thought if measured by the amount of time spent in the typical law school course, there are some circumstances under which a corporation's usefulness as a means of providing limited liability to shareholders can be compromised. The most commonly applied exception is veil piercing, where due to disregard of corporate formalities, a creditor of the corporation is permitted to reach assets of the shareholders. Moreover, for similar reasons, under the doctrine of reverse piercing, a creditor of a shareholder may be permitted to reach assets of the entity. Other exceptions include: (i) the alter ego doctrine (where no separate identity of the individual and the corporation exists); (ii) the illegal purpose doctrine (where the corporation is being used solely or primarily for an illegal purpose) and (iii) where the corporation is being used as a sham to perpetrate fraud. Finally, directors and officers (who are frequently shareholders) may be held liable under myriad common law and statutory causes of action.

C. Limited Partnerships and LLCs

Both limited partnerships and limited liability companies can be employed advantageously to protect investors from entity-level creditors, as well as to protect assets from personal creditors. In comparison to corporations, LPs and LLCs provide greater flexibility and efficiency in organizational design, including capital structuring, restrictions on transferability, opting out of statutory law, the retention of management control and tax classification. These entities also permit intrafamily wealth transfers with valuation discounts, while providing greater tax flexibility than corporations.

1. Creditor Remedies

There are generally three remedies available to creditors of the limited partner or the member of an LLC. The first remedy is a charging order. A charging order is an order issued by a court that charges an owner's interest in the entity with the amount due to the creditor. The issuance of a charging order generally results in the imposition of a lien on the LP or LLC interest. In the case of a charging order, a creditor is entitled to distributions from the entity only to the extent of the amount of the debt owed. Moreover, a creditor holding a charging order is entitled to distributions only to the extent otherwise made by the entity and has no right to compel distributions. Where a charging order is issued, the partner or member retains his or her ownership interest. A charging order is not the exclusive remedy in most jurisdictions.

The second remedy available to creditors of a partner or member is foreclosure. Foreclosure generally arises where a creditor is able to convince a court that the charging order will be insufficient to satisfy the creditor's claims. A court can order foreclosure on the lien imposed on the LP or LLC interest by the charging order. The effect of foreclosure is that the LP or LLC interest is permanently divested to the benefit of creditor. The creditor will become an assignee or transferee (depending on language of applicable statute) with respect to the interest. Under the relevant state statute or as controlled in the organization's governing documents, this does not usually entitle the creditor to participate in management of the entity.

The third remedy is dissolution. Dissolution is a remedy permitting a creditor transferee who has not become a partner or member to seek judicial dissolution of the entity. A creditor would then receive a pro rata share of the entity's assets. This remedy can be highly detrimental to all of the partners or members of the entity.

2. Availability of Creditor Remedies

LLCs first became available in the U.S. in 1977 in Wyoming. State LLC laws are typically based on either the Uniform Limited Partnership Act of 1976 (ULPA-1976) or the Uniform Limited Liability Company Act (ULLC). Most state LLC statutes are still based on ULPA-1976. Both ULPA-1976 and the ULLC contain problems that should be considered in entity and jurisdiction selection. Under the ULLC, both foreclosure and dissolution are permitted remedies.[61] States that have adopted the ULLC with dissolution provisions include: Hawaii, Illinois, Montana, South Carolina, South Dakota, Vermont and West Virginia. States that have adopted the ULLC without dissolution provisions include California, Colorado, Delaware, Utah and Virginia.

3. Rights of a Creditor under Limited Partnership Acts

Section 703 of the Revised Uniform Limited Partnership Act (RULPA) provides that "[o]n application to a court of competent jurisdiction by any judgment creditor of a partner, the court may charge the partnership interest of the partner with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee. This section does not deprive any partner of the benefit of any exemption laws applicable to his partnership interest." Foreclosure is not explicitly mentioned in RULPA Section 703, but nothing in that section or elsewhere in RULPA indicates that a charging order is exclusive remedy (or that Section 703 is the exclusive provision for creditor remedies).

Following RULPA, in the Uniform Limited Partnership Act of 2001 (ULPA-2001), additional creditor rights and remedies were added in Section 703. Section 703 of ULPA-2001 provides that a court may order a foreclosure upon an interest subject to a charging order at any time and that the purchaser at the foreclosure sale has the rights of a transferee – opening up the possibility that a creditor may become a partner or member of the entity. ULPA Section 703 provides some protection against this, however, by allowing an interest subject to a charging order to be redeemed by the entity prior to foreclosure. Section 703 also provides that it is the "exclusive remedy by which a judgment creditor of a partner or transferee may satisfy a judgment out of the judgment debtor's transferable interest."

Most LLC statutes that are not based on the ULLC are based on RULPA, rather than the newer, and more refined, ULPA-2001. RULPA contains a linkage provision in Section 1105 which provides that "[i]n any case provided for in this [Act] the provisions of the Uniform Partnership Act govern." This provision opens the possibility to bringing in other creditor remedies to the extent RULPA fails to address an issue.

When using an LLC for asset protection planning, it is advisable to organize the LLC in a jurisdiction that has adopted a statute providing that the charging order is the *exclusive* remedy. Some examples include Delaware, Alaska, Idaho, New Jersey and Wyoming. While not as protective, some state statutes, including those of Minnesota, New Jersey and Tennessee, explicitly disallow judicial dissolution.

4. **Delaware Advantages**

In Delaware, a charging order is the exclusive creditor remedy by statute for both limited partnerships and LLCs.[62] Other remedies are expressly barred in the statutes. A creditor has only the right to receive distributions that the judgment debtor would otherwise have been entitled to receive. Additional protection was provided in the August 2005 amendments to the limited liability company act. The amendments provide the capability to bind assignees to the provisions of a limited liability company agreement without obtaining their signature.[63]

5. **Ohio as an Example**

Ohio's limited partnership and limited liability statutes do not provide restrictions on creditor remedies and **should not be used** for entities that are intended to provide asset protection. The statutes for both types of entities are based upon RULPA and do not provide that the charging order is the exclusive remedy.[64] [65] Many states have similarly flawed legislation.

6. **Foreign Jurisdictions**

Several foreign jurisdictions have enacted limited partnership and limited liability company acts. Among foreign LLC acts, Nevis is considered the most modern offshore limited liability legislation. The Nevis Limited Liability Ordinance of 1995 provides that a charging order is the sole remedy available to a creditor of a member and that a judgment creditor will have only the rights of an assignee. In the case of LLCs that have already been organized under U.S. law, the Nevis ordinance makes provision for the redomiciliation of the entity to Nevis.

7. **Participation in Management**

Traditionally, the participation of a limited partner in the management and control of a limited partnership would override limited liability protection for that partner and cause the partner to be personally liable for entity obligations. Over time, LP acts have been modernized to provide status-based liability shields for limited partners comparable to that afforded under corporate law, LLP acts and LLC acts. This movement began with RULPA in 1985 and was substantially strengthened in ULPA-2001 Section 303.

8. **Use of Single Member LLCs**

In re Albright,[66] a bankruptcy case, draws into question the utility of a single member LLC for asset protection purposes. In *Albright*, the court held that the trustee in bankruptcy of a debtor who was the sole member and manager of a single member Colorado limited liability company could substitute himself as member in place of the debtor. The court noted that under the Colorado Act, the debtor's membership interest was personal property that was transferred to the estate upon the filing. Because the entity was a single member LLC, no unanimous written approval of the transfer was necessary. According to the court, a charging order exists to protect other members from an LLC from having to share governance responsibilities with someone they did not choose or accept as a co-manager, the creditor of another member. The charging order limitation serves no purpose in a single member LLC, because no other persons' interests are affected.

9. **Bankruptcy of an LLC Member**

In a recent Chapter 7 bankruptcy case, *In re Ehmann,* a court held that the operating agreement was not an executory contract under Bankruptcy Code Section 365 and consequently Bankruptcy Code Section 541(c)(1) applied.[67] In *Ehmann*, the operating agreement of a family LLC attempted to restrict the rights of a trustee in bankruptcy taking an interest as an assignee. The court held that the interest of the debtor in the LLC became the property of the estate notwithstanding any agreement of applicable law that would otherwise restrict or condition transfer of such interest of the debtor. Consequently, the trustee was admitted as a member and permitted to pursue the rights of a member. The *Ehmann* opinion was subsequently vacated in response to a request from the defendant, after the case was settled.

10. **Phantom Income Argument**

Many promoters of limited partnerships and LLCs for asset protection assert the so-called phantom income argument to support the use of these entities. The phantom income argument arises from Rev. Rul. 77-137, 1977-1 C.B. 1978, in which a limited partner assigned his interest without the written consent of the general partners, in contravention of the partnership agreement. The partnership agreement provided that a limited partner may irrevocably assign, without the consent of the general partners, the right to share in the profits and losses of the partnership and to receive all distributions, including liquidating distributions, to which the limited partner would have been entitled had the assignment not been made. On the basis of these facts, the IRS ruled that an assignee acquiring substantially all of the dominion and control over the interest of a limited partner is treated as a substituted limited partner for Federal income tax purposes. Some commentators have asserted that under Rev. Rul. 77-137, a creditor who obtains a charging order will be required to report the debtor partner's share of partnership income and that this negative tax impact will deter creditors from obtaining a charging order. The law on this issue is unclear. An important distinction between the facts of Rev. Rul. 77-137 and a charging order is that Rev. Rul. 77-137 involved a permanent assignment of the entire economic interest.

VIII. PROTECTION OF ASSETS WITH ASSET PROTECTION TRUSTS

A. **Background on the Use of Trusts to Protect Assets**

Trusts originated several centuries ago as a means of protecting property. A trust is a unique legal device that enables the separation of title and management of the property from the beneficial enjoyment of the property. This separation of legal ownership from beneficial rights can be used to shield property from creditors.

A trust may be revocable or irrevocable. Revocable trusts are ineffective for creditor protection purposes, because assets of a trust may be reached by a creditor of the settlor and in the event of a settlor bankruptcy, may be revoked by the bankruptcy trustee. In contrast, assuming that a settlor does not serve as trustee, an irrevocable trust will effectively and irreversibly transfer legal title in property to another person.

It is common for trusts to contain spendthrift provisions. A spendthrift provision prohibits beneficiaries of the trust from transferring or assigning their rights to future payments of income or principal. Spendthrift provisions also prevent creditors of a beneficiary from reaching a trust beneficiary's interest in the trust to satisfy creditor claims against the beneficiary.

There are two important limitations to the creditor protection afforded by spendthrift provisions. First, a spendthrift provision is only capable of protecting assets inside the trust. Any distributions made from the trust may be reached by creditors. Second, in most states, spendthrift provisions cannot be used to protect the beneficial interest of a settlor who is also a beneficiary in the trust (this type of trust is often referred to as a "self-settled spendthrift trust"). As a result, under the trust laws of most states, an individual cannot protect his or her assets from the reach of future creditors by creating a trust in which he or she is also a beneficiary.

For creditor protection purposes, the efficacy of a trust is also dependent upon whether the trust is structured to provide for required or discretionary distributions of income and/or principal. Generally, trusts that require periodic distributions of an amount are less protective than discretionary trusts that provide trustees with the discretion to either distribute or accumulate income of the trust, because the creditor of a beneficiary can step into the shoes of a beneficiary to compel distributions if required by the trust instrument.

B. **How Asset Protection Trusts Work**

An asset protection trust is a trust that is established under the laws of a jurisdiction (either foreign or domestic) that recognizes the validity of (i) a trust that is a self-settled spendthrift trust and (ii) a spendthrift clause as applied to protect a settlor's interest in the trust from the reach of the settlor's creditors. The trust instrument commonly names the settlor and other designated persons or classes of persons (e.g. "my grandchildren"), as beneficiaries. Except to the extent that certain economic rights may be reserved by the settlor, the trust is typically structured as a discretionary trust whereby the trustee has the discretion to either distribute or accumulate income of the trust.

The trustee of the trust is generally a corporate fiduciary resident in the jurisdiction where the trust is deemed to be located (the situs). In some cases, there may also be a co-trustee, who may or may not be resident in the jurisdiction of the trust's situs. The discretion of the trustee is typically controlled through the use of a trust protector, who is empowered with rights such as the right to veto distributions, the right to hire and fire the trustee and in some cases, the right to amend the trust instrument or consent to an amendment.

While not required, a letter or memorandum of wishes is frequently provided by the grantor to the trustee prior to or concurrent with the trust settlement. The letter of wishes provides nonbinding, suggestive guidance to an independent corporate trustee on how the trustee should exercise its discretion under the trust instrument. For example, the letter of wishes may suggest whether, and under what circumstances: (i) income and corpus should be retained; (ii) income should be distributed equally among beneficiaries; (iii) certain beneficiaries should be favored over others (or excluded entirely); and (iv) corpus should be distributed. The letter of wishes may also express preferences regarding trust investment policy and asset custody.

IX. DOMESTIC ASSET PROTECTION TRUSTS

A. Common Characteristics of Domestic Trust Legislation

Among the U.S. states that have enacted legislation permitting asset protection trusts, the common denominator is generally the allowance of a self-settled spendthrift trust. While each state's legislation varies, there are common themes. First, some jurisdictions require a portion or all of the trust assets to be maintained in the state in a bank account, brokerage account or in certain other assets (e.g. Alaska, Oklahoma and Utah). Second, some jurisdictions have based their legislation on the Delaware Act, but without the same attentiveness to detail and refinement (Rhode Island, South Dakota). Third, state laws vary as to the degree of flexibility they provide for income and wealth transfer tax planning. Finally, the laws vary in the extent to which they seek to limit creditor claims through modifications to their fraudulent transfer laws. I use the following criteria in evaluating domestic jurisdictions:

1. Does the jurisdiction impose limitations that impact choice and flexibility over trust investments?
2. Does the jurisdiction provide flexibility in drafting for income and wealth transfer tax planning?
3. What is the reputation of the jurisdiction as a legal forum for the resolution of disputes?
4. What is the reputation of the jurisdiction with regards to the protection of property rights?
5. What is the reputation and capability of the jurisdiction's trust industry?
6. To what extent and how effectively does the jurisdiction seek to limit the rights of creditors to challenge transfers into an asset protection trust?
7. If a test case challenging a domestic asset protection trust was asserted in the jurisdiction of trust situs, other than the settlor, what parties could be expected to intervene on settlor's behalf (or supporting settlor's position)?
8. How often does the jurisdiction update trust laws and by what process?

B. Advantages of Domestic Trusts

Domestic asset protection trusts offer many of the same creditor protective features as offshore asset protection trusts. The protective nature of offshore asset protection trusts is primarily attributable to the practical difficulties of penetrating offshore structures, rather than upon an expectation that they will be respected by a U.S. court. In contrast, the protective nature of domestic asset protection trusts is based upon an expectation that U.S. courts will be required to respect a domestic asset protection trust under applicable U.S. legal principles, including the full faith and credit clause of the Constitution and conflicts of laws principles.

Offshore asset protection trusts have been the subject of judicial criticism in several cases and over the past summer, were highlighted as part of a bipartisan Senate Permanent Subcommittee on Investigations examination into offshore tax abuses.[68] Thus, even when structured and operated in a legal and ethical fashion, offshore trusts are controversial. Due to the substantial differences and perceptions concerning domestic asset protection trusts and their widespread use among mainstream, wealthy U.S. individuals, it is unlikely that domestic asset protection trusts will ever be viewed in the same light.

Finally, in comparison to offshore asset protection trusts, domestic asset protection trusts offer greater flexibility for tax planning and do not trigger the complexity or potential penalty exposure of foreign trust reporting compliance obligations.

C. Potential Disadvantages of Domestic Trusts

The primary disadvantage to domestic asset protection trusts is that there is no case law proving their effectiveness. Notwithstanding, the legal grounds for supporting a domestic asset protection trust are compelling. In addition, domestic asset protection trust legislation is generally less aggressive than offshore legislation with respect to fraudulent transfer rules, and the use of a domestic trust will not have the effect of forcing a legal battle offshore (to the extent that is desired).

D. Sources of Law Supporting Domestic Asset Protection Trusts

1. Restatement (Second) of Conflict of Laws

Section 270 of the Restatement is intended to control the determination of what state's laws should apply to a trust. Does the state designated to govern have a substantial relation to the trust? The essential question under the Restatement is does the application of that law violate a strong public policy of the state with which as to the matter at issue, the trust has its most significant relationship?

2. Full Faith and Credit Clause

Art. IV, Section 1 of the Constitution provides that "Full Faith and Credit shall be given in each State to the public Acts, Records and judicial Proceedings of every other State. A court located in the state of the asset protection trust is obligated to give full faith and credit to a valid out of state judgment. Proponents of domestic asset protection trusts argue that this means that full faith and credit does not have to be given to an out of state judgment unless that court had jurisdiction over the person against whom judgment was sought, which in the case of an asset protection trust, would be the trustee, not the settlor. If the state does not have jurisdiction under its long arm statute against the trustee, then the domestic asset protection trust could arguably survive a full faith and credit challenge

3. Supremacy Clause

Article VI, Section 2 of the Constitution provides that "this Constitution and the laws of the United States which shall be made in Pursuance thereof...shall be the supreme law of the Land...any Thing in the Constitution or Laws of any State notwithstanding." Under the Supremacy Clause, conflicts between Federal and state law are required to be resolved in favor of the Federal law. The Supremacy Clause could be used in a Federal bankruptcy proceeding against the settlor of a domestic asset protection trust.

4. Contracts Clause

Article I, Section 10 provides "[n]o State shall ... pass any ... Law impairing the Obligation of Contracts." Under the Contracts Clause, a creditor could argue that state laws permitting asset protection trusts impair the ability of the creditor to collect debts by seizing assets to which would otherwise be available. The argument against this is that creditors are adequately protected by fraudulent transfer laws.

X. DOMESTIC TRUST JURISDICTIONS

A. **Delaware**

1. **Establishing a Delaware Trust**

Any person, whether or not resident or domiciled in Delaware, may establish an asset protection trust under the Delaware Qualified Dispositions in Trust Act (the "Delaware Act") by meeting four requirements. First, the trust must be irrevocable. Second, the trust must contain a spendthrift provision. Third, the trust must provide that Delaware law governs the trust's validity, construction and administration. Fourth, the trust must appoint at least one Delaware trustee that is required to perform certain duties.

a. Delaware Trustee

A Delaware trustee is an individual that resides in Delaware or a corporation that is authorized to conduct trust business in Delaware and that is regulated by the Delaware Bank Commissioner or certain Federal agencies. The trust may also have non-Delaware trustees, non-Delaware investment and distribution advisors and non-Delaware protectors. However, the use of non-Delaware parties has to be structured carefully to minimize the risk that a non-Delaware court will be able to exercise jurisdiction

2. **Permissible Powers of the Settlor**

The settlor of a Delaware trust may not serve as a trustee, but is authorized under the Delaware Act to retain the following powers: (i) the power to consent to or direct trust investments; (ii) the power to veto trust distributions; and (iii) the power to replace trustees or advisors with persons who are not related to or subordinate to the settlor.

3. **Permissible Retained Economic Rights of the Settlor**

While asset protection trusts are generally structured as discretionary trusts, the Delaware Act permits the settlor to retain the following economic rights: (i) the ability to receive income or principal subject to trustee discretion or a standard as determined by a Delaware trustee, non-Delaware trustee or distribution advisors; (ii) the right to receive current income distributions; (iii) an interest in a charitable remainder trust or a qualified personal residence trust; (iv) up to a 5% interest in a grantor retained annuity trust, grantor retained unitrust or a total return unitrust; and (v) a non-general, testamentary power of appointment.

4. **Protective Features of a Delaware Trust**

a. Introduction

A creditor of the settlor of a Delaware asset protection trust will be required to undertake several protracted and costly legal battles to even *attempt* to reach the assets of an asset protection trust. Under the Delaware Act, actions against the settlor and actions to enforce a judgment against the settlor, are barred. Any action involving a Delaware asset protection trust must be brought in the Court of Chancery and any action to set aside the trust must be based upon Sections 1304 and 1305 of the Delaware Uniform Fraudulent Transfer Act.

b. Impact of a Delaware Asset Protection Trust on Legal Actions Against a Settlor

A creditor of the settlor will be required to assert a valid action and obtain a judgment against the settlor of the trust. Under Delaware law, a direct action against the Settlor will not be permitted. If a creditor of the settlor seeks to assert a legal claim outside of Delaware, the existence of a Delaware asset protection trust will create substantial practical and psychological impediments. First, the Delaware Act provides greater confidentiality protection for trusts than the laws of most other states, by limiting the circumstances under which a settlor is required to disclose details of the trust. Second, the titling of assets in the name of the trustee will offer greater privacy in the event of an asset search performed on the settlor of the trust by a potential litigant or judgment creditor. Third, because plaintiff's attorneys are generally compensated on a contingency fee basis, knowledge of the existence of an asset protection trust may discourage them from taking on a case or provide leverage to settle a case, due to the increased cost and difficulty and reduced likelihood, of collecting a judgment.

c. Impact of a Delaware Asset Protection Trust on Post-Judgment Actions Against a Settlor

Because trust property is titled in the name of the trustee and not the settlor, an action by a creditor of the settlor that seeks to attach or levy the settlor's property will not be sufficient to reach the trust assets. Instead, a creditor will be required to find a way to assert an action challenging the validity of the trustee's title in the trust assets. While no cases have directly addressed this matter, I agree with several commentators that have analyzed this issue that under applicable legal theories, including conflicts of laws, jurisdiction, public policy arguments, full faith and credit under the U.S. Constitution and Federal bankruptcy law, a creditor will not have valid grounds to reach the assets of a Delaware asset protection trust through a challenge to the trust's validity or the trustee's title to the assets thereto.

d. Impact of a Delaware Asset Protection Trust on Post-Judgment Actions Against a Trustee

The Delaware Act has been designed to force legal actions concerning Delaware trusts to the Delaware courts. Under the Delaware Act, the proper venue for an action is the Delaware Court of Chancery. In Delaware, plaintiffs will not have the right to a jury trial. Moreover, due to the unique nature of the Court of Chancery, the settlor of a Delaware trust can rely upon chancellors (judges) who are: (i) highly informed on the nuances of the particular laws within the scope of their court's special jurisdiction; (ii) committed to maintaining Delaware's preeminent status as a wealth-friendly jurisdiction; (iii) opposed to judicial wealth redistribution; and (iv) committed to uniformity and predictability in the law.

e. Limitation of Creditor Remedies Under Delaware Law (Irrespective of Where a Judgment is Obtained)

Even in the unlikely event that Delaware is required to give full faith and credit to a judgment against the settlor of a Delaware asset protection trust, Delaware is permitted to restrict the remedies available to judgment creditors (whether the judgment arose within or outside of, Delaware). Under Delaware law, subject to limited exceptions discussed below, creditors seeking to reach the property of a Delaware asset protection are required to prove by *clear and convincing evidence* that the property was fraudulently transferred to the Delaware trust. Thus, even if a creditor could successfully prevail on each of the steps, the creditor would be required to meet the substantial evidentiary burden of proving, by clear and convincing evidence, that the transfers into the Delaware asset protection trust were fraudulent transfers. This final legal battle would occur in the Delaware Court of Chancery.

f. Statutory Exceptions for Certain Classes of Creditors

The Delaware Act provides four categories of creditors that may reach the assets of a Delaware asset protection trust. These exceptions, are intended to defeat arguments of creditors that a Delaware asset protection trust should be defeated on public policy grounds. The four categories are as follows:

(1) Claims Arising Prior to Transfer

A creditor whose claim arose before the trust was created must bring suit within four years after the trust's creation or if later, within one year after the creditor discovered or should have discovered, the trust.

(2) Claims Arising Subsequent to Transfer

A creditor whose claim arose after the creation of the trust must bring suit within four years after the trust's creation.

(3) Claims Arising From Spousal or Child Support

A creditor whose claim results from an agreement or court order providing for alimony, child support or property division may reach the assets of the trust, but only a spouse who was married to the settlor prior to the creation of the trust may bring an action. A surviving spouse of the settlor of a trust may not bring an action to reach the assets of the trust by electing against the will, whether or not the settlor lived in Delaware.

(4) Tort claims

A person who suffers death, personal injury or property damage for which the settlor is liable may reach trust assets, but only if the injury occurred prior to the trust's creation.

5. **Advantages of Delaware as a Legal Jurisdiction**

Among U.S. jurisdictions, Delaware is unparalleled in its legal climate for protecting wealth. Delaware has a longstanding tradition of preserving and enhancing individual and corporate wealth through the foresight of its legislators and the restraint of its judiciary. Five factors are of particular note. First, Delaware is committed to maintaining its position as a national leader in trust law and financial services. Second, Delaware continuously modernizes its laws to address potential issues of concern; Delaware statutes are amended every summer for this purpose. Third, the Delaware Court of Chancery, a 200 plus year old, politically neutral body, is the most sophisticated, efficient and respected legal forum for the resolution of business and fiduciary disputes in the United States.[69] Fourth, some of the largest financial institutions in the nation are heavily invested in the Delaware trust industry and have a vested stake in ensuring that Delaware asset protection trusts are respected in the courts. Fifth, no taxes are imposed by Delaware on trusts or trust beneficiaries in the case of trusts formed by and for the benefit of nonresidents.

B. **Alaska**

Alaska was the first domestic jurisdiction to adopt comprehensive asset protection legislation. To establish a trust under the Alaska Act,[70] the trust instrument should provide that Alaska law governs the validity, construction and administration of the trust. If Alaska law governs, it will govern on issues concerning settlor capacity. The Alaska Act is a capital attraction statute designed to attract capital and create jobs in Alaska. Accordingly, "some or all of the trust assets" must be deposited in Alaska. This may include a checking account, time deposit, certificate of deposit, brokerage account, trust company fiduciary account or other similar account or deposit that is located in Alaska. Regrettably, Alaska law does not provide further clarification beyond the words "some or all" to provide guidance as to what amount or percentage of assets must be located in Alaska.

Trust assets deposited in Alaska must be administered by a qualified person. A trustee is a qualified person if they are: (i) an Alaska resident; (ii) an Alaska trust company with a principal place of business in Alaska; or (iii) an Alaska or national bank with a principal place of business in Alaska. The Alaska trustee must perform the following tasks, but the tasks do not have to be performed exclusively by the Alaska trustee: (i) maintaining records for the trust; (ii) preparing or arranging for the preparation of trust income tax returns; and (iii) administration and maintenance of physical records in Alaska.

A settlor of an Alaska trust does not have to be domiciled in Alaska. Under the Act, a trust created by a settlor for his or her own benefit that protects the trust assets from existing or future creditors, is permissible, provided that: (i) the transfer was not made with intent to defraud; (ii) the trust is irrevocable; and (iii) the settlor's ability to receive distributions from the trust is discretionary and not mandatory.[71] The settlor may retain an annuity or unitrust interest in a charitable remainder trust or a percentage of the trust not exceeding the Section 643(b) unitrust amount and may retain the right to use real property held in a QPRT or to receive income or principal from a GRAT or GRUT. The settlor of the trust may not be in default by 30 days or more of a child support judgment or order.

Under the Alaska Act, a creditor existing at the time of the transfer into trust must bring suit within the later of (i) four years after the transfer is made or (ii) one year after the transfer is or reasonably could have been discovered by the creditor if the creditor can demonstrate, by a preponderance of the evidence, that the creditor asserted a specific claim against the settlor before the transfer or files another action against the settlor that asserts a claim based on an act or omission of the settlor that occurred before the transfer and the action is filed within four years after the transfer.[72] To the extent a trust or a property transfer to a trust is voided or set aside, it is only to the extent necessary to satisfy the settlor's debt to the creditor or other person and the costs and attorneys fees allowed.

No challenge may be sustained to an Alaska Trust "on the grounds that the trust or transfer avoids or defeats a right, claim or interest conferred by law on a person by reason of a personal or business relationship with the settlor or by way of a marital or similar right."[73]

The Alaska Act contains a good faith exception that provides that to the extent a trust or a property transfer to a trust is voided or set aside under Alaska Stat. § 13.36.310(a), if the court is satisfied that the trustee has not acted in bad faith in accepting or administering the property that is the subject of the trust, then: (i) the trustee has a first and paramount lien against the property that is the subject of the trust in an amount equal to the entire cost, including attorney fees, properly incurred by the trustee in a defense of the action or proceedings to void or set aside the trust or the property transfer; (ii) the trust or property transfer that is voided or set aside is subject to the proper fees, costs, preexisting rights, claims and interest of the trustee and any predecessor trustee that have not acted in bad faith; and (iii) the beneficiary, including the settlor, may retain a distribution made by exercising a trust power or discretion vested in the trustee of the trust, if the power or discretion was properly exercised before the commencement of the action or proceeding to void or set aside the trust or property transfer.[74]

Trust protectors and trustee advisors are permitted under Alaska law[75] and by default, are not subject to fiduciary liability. Alaska has repealed the common law rule against perpetuities and provides for a 1,000 year period.

C. **Missouri**

In 1986, Missouri enacted legislation[76] that purported to protect self-settled spendthrift trusts, provided that the trust had multiple beneficiaries and the settlor did not retain the right to a specific portion of income or principal determinable solely by reference to the trust instrument. In two cases, courts held that this legislation did not vitiate the rule against self-settled spendthrift trusts.[77]

In 2005, the legislation was repealed and replaced with a new statute modeled after Uniform Trust Code Section 505. The statute provides that an irrevocable trust with a spendthrift provision will prevent the settlor's creditors from satisfying claims from the trust assets except: (i) where the conveyance was fraudulent; or (ii) at the time the trust became irrevocable, the settlor: a) was the sole beneficiary; b) retained the power to amend the trust; or c) retained the right to receive a specific portion of the income or principal that was determinable solely from the trust instrument.[78] The Committee Report to the new statute indicates that the incorporation and reenactment of these provisions was specifically intended to give settlors protection from creditors by virtue of a spendthrift clause.[79] Spendthrift protection does not apply to the extent of a child, spouse or former spouse of a beneficiary who has a judgment for support or maintenance or to claims of the State of Missouri or the Federal Government.

D. **Nevada**

The Spendthrift Trust Act of Nevada[80] is applicable to all spendthrift trusts created in or outside of Nevada if two Nevada presence requirements are satisfied. First, as to property held in the trust, all or part of the real property interests are in Nevada and all or part of the personal property interests are in Nevada. Second, either (i) the declared domicile of settlor of a trust affecting personal property must be Nevada or (ii) at least one trustee must be a qualified trustee with powers that include maintaining records and preparing income tax returns for the trust and all or part of the trust administration must be in Nevada.

A "qualified trustee" is defined as (i) a natural person resident and domiciled in Nevada; (ii) a trust company that maintains an office in Nevada; or (iii) a bank that maintains an office in Nevada and possesses and exercises trust powers.[81]

Under the Act, creditors existing at the time of transfer must commence an action within two years after the transfer was made or six months after the creditor discovers or reasonably should have discovered the transfer, whichever is later. A subsequent creditor with claims arising after the transfer was made must commence action within two years after the transfer.[82]

E. **Oklahoma**

In 2004, Oklahoma enacted the Family Wealth Preservation Trust Act. The Oklahoma Act takes a different approach than any of the other domestic acts inasmuch as it provides for the ability to create a revocable asset protection trust, subject to certain constraints. Under the Oklahoma Act, permissible beneficiaries are limited to the settlor's spouse, issue and Section 501(c)(3) charities. The settlor is not a permissible beneficiary, but is permitted to revoke the trust. The Act provides that "[n]o court shall have the authority to compel a person holding power of revocation to exercise the power." The principal purpose of the Oklahoma Act was to serve as a capital attraction tool for the Oklahoma economy. Not only must the trust be administered by a bank or trust company located in Oklahoma, the trust corpus must consist of assets in Oklahoma. This is interpreted to include Oklahoma banks, Oklahoma real estate and the securities of Oklahoma issuers.[83] Under the Oklahoma Act, up to $1 million of assets transferred plus any growth thereon is exempt from creditors. It is unclear whether discounts may be applied in determining the $1 million amount.

F. Rhode Island

Initially, the Rhode Island legislation was similar to Delaware, but has not been updated since its enactment in 1999. The legislation is found in the Rhode Island Qualified Dispositions in Trust Act.[84] Under the Rhode Island legislation, the trust instrument must expressly incorporate Rhode Island law to "govern the validity, construction and administration of the trust." The trust must be irrevocable and the settlor is not permitted to retain rights to income or principal. The settlor may retain: (i) the power to veto distributions; (ii) a testamentary special power of appointment; and (iii) the right to receive discretionary distributions from a trustee who is neither related nor subordinate.

At least one trustee of the trust must be an individual resident in Rhode Island or authorized to operate as a trustee in Rhode Island. The Rhode Island trustee is required to: (i) maintain or arrange for custody in Rhode Island of some or all of the property transferred to the trustee; (ii) maintain records for the trust on an exclusive or nonexclusive basis; (iii) prepare and arrange for the preparation of tax returns for the trust; or (iv) otherwise materially participate in administration.

Similar to Delaware, the Rhode Island legislation provides that claims arising prior to the transfer must be brought within four years after the qualified disposition was made or if later, within one year after the qualified disposition was or reasonably could have been discovered. Claims arising subsequent to the qualified disposition must be brought within four years after the qualified disposition. The legislation contains similar exceptions as those found in Delaware for: (i) child support and spousal support or property distribution claims arising on or before the date of the qualified disposition; and (ii) death, personal injury or property damage claims arising on or before the date of the qualified disposition, where the injury was caused by the act or omission of the transferor in whole or in part or the transferor is vicariously liable. The Act contains good faith exceptions similar to Alaska.

G. South Dakota

The South Dakota Qualified Dispositions in Trust Act[85] is also similar to Delaware. The Act requires that: (i) the trust instrument expressly incorporate South Dakota law to "govern the validity, construction and administration of the trust"; (ii) the trust must be irrevocable; (iii) the trust instrument must provide anti-alienation language; and (iv) at least one trustee must be an individual resident in South Dakota or a bank authorized to operate as a trustee in South Dakota.[86]

Similar to Delaware, South Dakota provides several rights and powers that may be retained by the settlor, including: (i) the power to veto distributions; (ii) a testamentary special power of appointment; (iii) the right to receive income (including rights to income retained in the trust instrument); (iv) the right to receive an annuity or unitrust interest in a charitable remainder trust; (v) the right to receive a unitrust interest of up to 5%; (vi) the right to use principal as the result of a qualified trustee acting at the direction of a trust advisor, in the qualified trustee's sole discretion or pursuant to an ascertainable standard contained in the trust instrument; (vii) the right to remove a trustee or trust advisor and appoint a new trustee or trust advisor, other than a person who is related or subordinate within the meaning of Code Section 672(c); and (viii) the use of real property under a QPRT.[87]

In the case of creditor claims, claims must be brought pursuant to the UFTA. Claims arising before the qualified disposition must be brought within the limitations period of the UFTA. Claims arising concurrent with or after the qualified disposition must be brought within four years. The Act modifies the burden of proof for fraudulent transfers and imposes a burden to prove the matter by clear and convincing evidence on the creditor. The Act contains a good faith exception.

H. **Utah**

The requirements to establish a Utah asset protection trust are: (i) an irrevocable transfer of property; (ii) at least one trustee must be a Utah trust company; (iii) some or all of the trust assets must be held in Utah in a savings account, CD, brokerage account, trust company fiduciary account or similar account; and (iv) the trust must be fully discretionary with respect to the settlor's rights to receive income or principal.[88] The Utah Act is applicable to personal and real property transferred by any means.

Creditors may reach trust assets: (i) where the claim is a judgment order, decree or other legally enforceable decision or resulting from a judicial, arbitration, mediation or administrative proceeding commenced prior to or within three years after trust creation; (ii) where the settlor's transfer into trust was made with "actual intent to hinder, delay or defraud that creditor"; (iii) in the case of child support or spousal support judgments or orders; (iv) where the transfer was made when the settlor was insolvent or rendered the settlor insolvent; (v) where the claim is for tax owed to any governmental entity; (vi) for recovery of public assistance benefits; and (vii) to the extent of the settlor's interest in the assets transferred or in the case of fraud, intentional infliction of harm or crime and, in either case assets transferred into trust were a) represented as being available to a claimant for purposes of entering into a transaction or b) transferred in breach of any written agreement, covenant or security agreement between the settlor and claimant.

The Utah Act broadly defines "creditor" to include "one holding or seeking to enforce a judgment entered by a court or other body having adjudicative authority as well as one with a right to payment, whether or not reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured." A creditor seeking to challenge a transfer bears the burden of proving the matter by clear and convincing evidence.

The applicable period under which a transfer in trust may be challenged depends upon the underlying grounds for creditor challenge. In the case of a judgment or other legally enforceable decision resulting from a proceeding, a creditor has three years from trust settlement to commence legal proceedings.[89] In the case of a fraudulent transfer, a creditor must bring a claim within the later of four years or one year after the transfer was or reasonably could have been discovered by the creditor.[90]

XI. OFFSHORE ASSET PROTECTION TRUSTS

A. **Common Characteristics of Offshore Trust Legislation**

In the past thirty years, several offshore jurisdictions have enacted legislation permitting asset protection trusts. Common characteristics of offshore trust legislation include the following: (i) modification of fraudulent transfer laws to make them more debtor-friendly (generally by increasing the burden of proof required to prove a fraudulent transfer); (ii) reduction of the statute of limitations period for fraudulent transfer claims (in some jurisdictions); and (iii) nonrecognition of foreign judgments (so that a creditor will be forced to re-litigate a case on the underlying substantive claims in the foreign jurisdiction).

B. **Advantages of Offshore Trusts**

Offshore asset protection trusts can be advantageous because in addition to the protective aspects of the legislation, if properly structured, a creditor seeking to reach the assets of the trust may have limited recourse unless they are prepared to litigate the matter in the offshore jurisdiction. Many offshore jurisdictions will not recognize U.S. judgments and have civil procedure systems that impose greater entry barriers and risks to plaintiffs than are found in the United States. For example, many offshore jurisdictions do not allow contingency fee cases, require nonresident litigants to post bond to cover projected costs prior to the initiation of litigation and apply the "English rule" under which the losing party is required to pay the attorney's fees of the prevailing party.

C. Disadvantages of Offshore Trusts

In order to move the legal battle offshore, it is necessary to structure an offshore asset protection trust so that a U.S. court does not have jurisdiction over the trustee, trust assets or any other individuals with significant rights and powers over the trust. Accordingly, for asset protection purposes, the most effective foreign trust structure requires the following: (i) the settlor cannot be named as a trustee or as protector; (ii) the settlor cannot retain the right to name or replace either the trustee or protector; (iii) the trustee must be a foreign trustee; (iii) the protector should be a foreign person; (iv) legal custody of trust assets should be situated outside the U.S.; and (v) the trust should be structured as a foreign trust for U.S. tax purposes.

In my experience, many clients are uncomfortable surrendering this degree of control over their wealth to unknown persons located thousands of miles away unless they have concerns about a potential legal situation that merits these extreme actions.

Because the efficacy of an offshore asset protection trust is based to a large extent upon the creation of practical obstacles and the use of structures that on their face often appear abusive, judicial receptiveness to offshore asset protection trusts has been largely negative. On several occasions, judges have expressed their hostility towards offshore asset protection trusts by finding settlors in contempt of court when they failed to turn over assets that had been transferred into an offshore trust.[91] In a few cases, settlors have been jailed.[92]

The structuring of the trust as a foreign trust for U.S. tax purposes also creates additional tax complications and risk. A foreign trust and its beneficiaries are subject to a strict and murky regime of reporting obligations that if not strictly complied with, may subject the settlor and trust beneficiaries to substantial penalties.[93]

In addition, a foreign trust is not an eligible shareholder in a Subchapter S corporation and in some cases, may be subject to issuer-imposed investment limitations. Finally, for U.S. settlors, a foreign trust is less flexible than a domestic trust for income tax purposes, as it is not easily structured as a nongrantor trust (and the transfer of appreciated property to a nongrantor trust will trigger gain recognition).

I am not aware of any statistics on the audit frequency of individuals reporting interests in foreign trusts or foreign accounts. I have not observed a correlation between audit activity and foreign interests with my own clients, but this is an issue that is of concern to some clients when considering whether to implement an offshore trust.

D. Conceptual Issues in Asset Protection

1. Importing the law vs. exporting the assets

Importing the law is the process of choosing the laws of another jurisdiction to govern a matter or transaction and is a longstanding tradition in our legal system. Common examples include the use of Delaware corporations and the selection of New York law in contracts.

2. **Exporting the assets**

Exporting the assets is the process of exporting the custody of assets beyond U.S. borders. Although any one of a number of foreign jurisdictions may be used, I prefer to use a Swiss private bank with no physical or operating presence in the United States.

3. **Location of assets in a third jurisdiction**

In some cases, assets may be owned by an entity organized under the laws of a third jurisdiction, which entity is owned by the foreign trust. A global custody arrangement may be used to keep custody of assets outside the U.S.

4. **Aggressive vs. non-aggressive legislation**

The type and degree of protection afforded by offshore asset protection law varies by jurisdiction. Jurisdictions vary in their degree of aggressiveness in attracting debtors or viewed alternatively, how they balance the interests of creditors and debtors. Additionally, while not directly related to aggressiveness, the reputations of offshore jurisdictions with respect to their enforcement of laws designed to combat money laundering and other illegal behavior vary. These reputations may influence the perception of the trust structure if subjected to judicial scrutiny.

Most jurisdictions with aggressive legislation have repealed the fraudulent conveyance provisions of the Statute of Elizabeth and replaced them with debtor-friendly provisions. These provisions typically include shorter statutes of limitations and the use of higher evidentiary standards to prove a fraudulent conveyance. Aggressive jurisdictions may also create various obstacles for foreign creditors seeking to collect a judgment.

Jurisdictions that are viewed as aggressive include the Cook Islands, Gibraltar, Nevis and Belize. An alternative to using an aggressive jurisdiction is to form a trust in a less aggressive jurisdiction that readily permits the migration of trusts to other jurisdictions. For example, a settlor could settle a trust in Bermuda or New Zealand, but in the event of a controversy, the trust could be migrated (moved) to the Cook Islands.

5. **Nest egg vs. *in toto***

Due to fraudulent transfer concerns, only a portion of a client's assets should be converted into an asset protected form, particularly where an offshore trust will be used. Where only a portion of a client's assets are transferred into a protected form, the client has a good faith basis for arguing that public policy supports his or her actions. It is a strong public policy under our legal system to favor individual and family self-sufficiency. Actions to preserve a family nest egg are a reasonable measure. Actions to protect all of a client's assets from creditors are likely to be viewed with skepticism. In addition, if a client has transferred all of his or her assets into asset protected forms, he or she may have a difficult time rebutting arguments that that they have retained control over the assets.[94]

6. **Control**

Successful asset protection planning, whether a simple spousal transfer or a complex offshore trust, is based upon the transfer of legal title and control of assets to another party. A client's interest in retaining control over assets must be balanced against the need to divest control to maximize asset protection.

7. **Sham arrangements**

As is the case in tax planning, asset protection planning structures must reflect reality, not paper fictions, to ensure judicial respect. Simply put, respect the structure or it is unlikely to be respected. This consideration must be kept in mind when evaluating asset protection alternatives on behalf of a client. The client must have the appropriate mindset and resources that are required to maintain the structure on a long-term basis.

8. **Confidentiality**

The purpose of asset protection planning is not to hide or conceal assets. Notwithstanding, the use of asset protection trusts can help provide individual and family financial privacy. Offshore trusts will be subject to U.S. tax reporting and cannot be kept fully confidential. In most cases, however, disclosure will be limited to the IRS and Treasury Department. For non-tax reasons, there are ways to manage the composition of assets so as to minimize the amount of required disclosure in a tax-compliant manner. In the event of litigation, the existence of and assets owned by, an offshore asset protection trust may be subject to discovery, subject to relevance arguments that can be made by defense counsel to exclude this information. Even if the information becomes available, due to the obstacles that a judgment creditor will encounter in collecting a U.S. judgment against an offshore asset protection trust, disclosure of the trust structure will create a strong motivation for settlement. In fact, a client who is being named as a defendant or co-defendant may decide to disclose that his or her assets are tied up in an asset protection trust to encourage dismissal or a settlement as to the claims against him or her. Under the laws of many domestic offshore jurisdictions, duties of disclosure on the part of trust fiduciaries are much more favorable for settlors who wish to minimize the amount of voluntary or involuntary disclosure of trust information to certain beneficiaries.[95]

XII. OFFSHORE ASSET PROTECTION TRUST JURISDICTIONS

There is no "best" jurisdiction for asset protection. Jurisdiction selection is one of the most important aspects of an asset protection engagement. Below is a checklist that I have developed for use in evaluating offshore jurisdictions. I use this checklist as a starting point in analyzing foreign jurisdictions and evaluating their suitability to achieve client objectives on a case-by-case basis. Following the checklist is a discussion of selected jurisdictions that are often identified with asset protection planning. As noted in the discussion, not all of the jurisdictions provide asset protection features in their case law or legislation. Notwithstanding, the use of a properly structured offshore asset protection trust generally provides asset protection benefits by forcing the legal battle offshore.

A. **Evaluating Offshore Jurisdictions**

Checklist for Evaluating Offshore Jurisdictions

1. **LOCATION-BASED FACTORS.**
   a. Geographical proximity and time zone.
   b. Language.
   c. Culture.
   d. Susceptibility to weather and natural disasters.
2. **GOVERNMENT.**
   a. Historical origins.
   b. Type of government.
   c. Efficiency and transparency of the political process.
   d. Reputation of government.
   e. Stability.
3. **ECONOMY.**
   a. Major sectors.
   b. Economic productivity.
   c. State and individual economic prosperity.
   d. Infrastructure.
4. **LEGAL SYSTEM.**
   a. Legal foundations.
   b. Written constitution.
   c. Independent judiciary.
   d. Levels of courts.
   e. Appointment and source of judges.
   f. Education and competency of local bar.
   g. Court of last resort.
   h. Civil procedure.
   i. Recognition of foreign judgments
5. **CAPABILITIES AS AN OFFSHORE FINANCE CENTER.**
   a. Extent of offshore finance activity.
   b. Nature of offshore finance activity.
   c. Regulatory capability and maturity.
   d. Provider capability and maturity.
   e. Provider fees.
   f. Legal standards for bank privacy.
   g. Institutional and personal culture of privacy and confidentiality.
6. **TAXATION.**
   a. Do transfers of property to a trust trigger a taxable disposition?
   b. Are income taxes imposed on the trust or its nonresident beneficiaries?
   c. Do stamp duties exist?
7. **TRUST AND FRAUDULENT CONVEYANCE LAW.**
   a. Sources of trust law.
   b. Rule against perpetuities.
   c. Recognition of asset protection trusts.
   d. What rights and powers may be retained by a settlor?
   e. What is the law of fraudulent conveyances?
   f. What is the burden of proof required to sustain a fraudulent conveyance action?
   g. What is the period of limitations for challenging a trust settlement?
   h. Does a challenge void the trust, or only a portion of the transfer?
   i. Anti-abusive trust provisions.
   j. Forced heirship.
   k. Recognition of and treatment of protectors.
   l. Provisions regulating trustee licensing and performance.
   m. Trustees' obligation to disclose trust information.
   n. Conflict and migration.
8. **INTERNATIONAL RELATIONS.**
   a. Responsibility for foreign affairs and defense.
   b. OECD, FATF, IMF compliance.
   c. Ties with United States.
   d. Ties with United Kingdom.
   e. Territorial disputes.
   f. Problems with organized criminal activities, smuggling and money-laundering.

B. Bahamas

1. Geography

The Bahamas is an archipelago of islands in the North Atlantic Ocean, strategically located southeast of Florida and northeast of Cuba. British settlement of the islands began in 1647. The islands became a British colony in 1783 and in 1973, gained independence from the United Kingdom (UK). Nassau is the capital. English is the official language. The Bahamian dollar (BSD), the official local currency, is freely exchangeable on a 1:1 ratio for the USD.

2. Economy

The Bahamas is considered a politically stable developing nation and among the more prosperous nations in the Caribbean region. Tourism, contributing about 60% of gross domestic product (GDP) and financial services, contributing about 15% of GDP, are the largest sectors of the economy. The Bahamas is vulnerable to hurricanes and tropical storms and is a major transshipment point for illegal smuggling to the United States.

3. Political System

The Bahamas is an independent country and a Commonwealth Realm. The Bahamian political system is based on a constitutional parliamentary democracy. Executive power is exercised by the prime minister and cabinet. Legislative power is vested in both the executive branch and the bicameral Parliament.

4. Legal System

The legal system is based on English common law and a written constitution. An independent judicial branch consists of three levels of courts. The Privy Council in London is the court of last resort.

C. Relevant Laws

1. The Trustee Act, 1988

The enactment of the Act and its repeal of the Trustee Act, 1893 and Variation of Trusts Act, 1961 constituted a significant overhaul and modernization of trust law in the Bahamas. The Act allows a settlor to retain, possess or acquire certain discretionary powers, including powers of revocation, powers of appointment or disposition, powers over the appointment, addition or removal of trustees, protectors and beneficiaries and powers to direct the trustee with respect to the trustee's exercise of powers.

The Act expressly permits the appointment of a protector and addresses issues pertaining to fiduciary status, liability of the protector and the right to compensation. The Act also permits the appointment of a managing trustee, who may be authorized to exercise any of the trustee's powers and does not have to be resident in the Bahamas.

Section 40(1) of the Act provides that "it shall be lawful for an instrument or disposition to provide that any estate or interest in any property given or to be given to any individual as a beneficiary [may not be alienated]." Section 40(5) of the Act provides that "neither the settlor nor any other person donating property to a trust may benefit from provisions of this section."

2. **Perpetuities Act, 1995**

The Act was amended in 2004 to increase the possible lifetime of a trust from eighty years to one hundred fifty years. This is longer than the one hundred-year period permitted in Bermuda, BVI, Cayman Islands and Nevis.

3. **Fraudulent Dispositions Act, 1991**

This Act is the source of fraudulent transfer law in the Bahamas. The Act applies to every disposition of property by any person, irrespective of where the property is situated. Under the Act, any disposition of property made with the intent to defraud and at an undervalue is voidable at the instance of the creditor seeking to set aside the disposition.

The Act defines "intent to defraud" as "an intention of a transferor willfully to defeat an obligation owed to a creditor." "Obligation" is defined as an obligation or liability (including a contingent liability) which existed on or prior to the date of a relevant disposition and "*of which the transferor had notice*. [emphasis supplied]." "Undervalue" is defined as no consideration or consideration that is "significantly less" in "money or money's worth." The "burden of establishing an intent to defraud" falls upon the creditor seeking to set aside a transfer.

No action or proceedings may be commenced under the Act unless commenced within two years of the date of the relevant disposition.

If the court is satisfied that the transferee has acted in good faith, the transferee has a first and paramount charge over the property in an amount equal to the entire costs incurred by the transferee in defending the property. If the court is satisfied that a beneficiary has not acted in bad faith, the disposition will only be set aside subject to the right of the beneficiary to retain prior distributions of property to the beneficiary as the result of a prior, proper exercise of a trust discretionary provision or power.

4. **Foundations Act, 2004**

Claimed to be the first legislation of its kind passed in a common law jurisdiction, the Act permits the formation of a private foundation to manage assets. The purpose of the foundation may be, but is not required to be charitable and may include any purpose or object that is not immoral, unlawful or contrary to public policy in the Bahamas.

A foundation must hold assets with at least $10,000 and may be established by charter or by means of a duly executed will. The foundation is required to publicly register and must file certain information (not the entire charter). Under the Act, a properly registered foundation is a legal entity that may sue and be sued in its own name and is resident and domiciled in the Bahamas. Distributions by foundations can be subject to anti-alienation provisions to provide asset protection, except for the benefit of the founder and donors. There are no perpetuities restrictions applicable.

D. **Belize**

1. **Geography**

Formerly British Honduras, Belize gained its independence in 1981, but was not recognized by neighboring Guatemala until 1992. Belize is located in Central America, bordering the Caribbean Sea, between Guatemala and Mexico. At 516 sq km, Belize is slightly smaller than Massachusetts and populated by 288,000. Belize's capital is Belmopan. English is the official language.

2. **Economy**

The primary industry in Belize is tourism, followed by agriculture. Belize has targeted offshore financial services for growth. However, Belize is plagued by a high trade deficit and foreign debt, a shortage of skilled labor, high poverty, increasing urban crime, frequent hurricanes and devastating flooding and significant environmental issues. Involvement in the South American drug trade and money laundering are also issues of concern.

3. **Political System**

Belize has adopted a constitutional monarchy similar to other Commonwealth Realm nations, with a bicameral National Assembly.

4. **Legal System**

Belize's legal system is based on English law and a written constitution. The court of record is the Supreme Court, with the chief justice appointed by the governor general on the advice of the prime minister.

5. **Relevant Laws**

a. Trusts Act

Section 7.(6) of the Act provides that where a trust is created under the law of Belize, a Belize court may not vary it, set it aside or recognize the validity of any claim against trust property pursuant to the law of another jurisdiction or the order of a court of another jurisdiction with respect to any marriage, divorce, forced heirship or creditor claims in the event of an insolvency. The Act provides that this provision applies notwithstanding the provisions of Section 149 of the Law of Property Act, Section 43 of the Bankruptcy Act and the provisions of the Reciprocal Enforcement of Judgments Act. This provision may be invoked immediately after settlement of a trust.

The maximum duration for a trust that is not charitable in nature is one hundred twenty years from creation, with no restrictions on accumulation. The Act broadly defines "charitable purpose."

Any person who under the law of Belize has the capacity to own and transfer property may be the settlor of a trust. The capacity of a settlor to establish a trust is determined under the law of Belize. The settlor may also be a trustee, beneficiary or protector. The Act permits the use of both spendthrift and protective provisions.

The Act provides that a settlor or beneficiary may give a trustee a letter of wishes or the trustee may prepare a memorandum of wishes. A trustee may, but is not bound to, consider the letter or memorandum of wishes in administering the trust. Moreover, the Act provides that a trustee is not accountable for failure or refusal to follow the letter or memorandum and has no fiduciary obligation imposed on him by a letter or memorandum.

Noncharitable trusts require the appointment of a protector by the terms of the trust. The Act sets forth the basic powers of a protector (which may be modified by the terms of the trust) and provides that in the exercise of his office, the protector is not to be regarded as a trustee, but owes a fiduciary duty to the beneficiaries.

Any person with the power to own or transfer property under the law of Belize may be a trustee. There is no requirement that a trustee be resident in Belize, however, any beneficiary may petition the court for the appointment of an additional trustee resident in Belize.

Trusts may, but are not required to be, registered. Measured annually, a trust and its beneficiaries are exempt from taxes in Belize provided that neither the settlor nor any of the beneficiaries are resident in Belize and the trust property does not include any land in Belize. Trustees of exempt trusts are not subject to exchange controls.

E. Bermuda

1. Geography

Located in the North Atlantic Ocean east of South Carolina, Bermuda is the oldest self-governing British Overseas Territory. Hamilton is the capital. The Bermudian dollar (BMD), the official local currency, is freely exchangeable on a 1:1 ratio for the USD.

2. Economy

A tourism destination spanning back to Victorian times, Bermuda is now an internationally prominent business center. Several hundred international companies have set up physical offshore operations in Bermuda, including reinsurance companies, investment companies and mutual funds. Bermuda is also the legal home to several thousand other companies. By one estimate, 75% of the Fortune 100 and their European equivalents have a Bermuda company. Bermuda is consistently ranked as enjoying the highest per capita income in the world – more than 50% higher than that of the U.S. Bermuda has a well-maintained infrastructure and telecommunications capabilities are among the best in the world.

3. Political System

Bermuda is internally self-governed with the political system based on a constitutional parliamentary democracy. Executive power is exercised by the prime minister and cabinet. Legislative power is vested in both the executive branch and the bicameral Parliament.

4. Legal System

The legal system is based on English common law and a written constitution. An independent judicial branch consists of three levels of courts. The Privy Council in London is the court of last resort.

5. Relevant Laws

a. Perpetuities and Accumulations Act of 1989

Bermuda applies the "Wait and See Rule" to accumulations and perpetuities. A perpetuity period may be fixed by the settlor for any period not to exceed one hundred years from the date of settlement.

b. Trusts (Special Provisions) Act

The Trusts (Special Provisions) act of 1989, was amended by the Trust (Special Provisions) Amendment Act 2004 in a manner that provides greater certainty as to the asset protection features of Bermuda law. Under Section 11 of the Act, a trust will not be varied or set aside even if it avoids or defeats rights, claims or interests conferred by a foreign law upon any person in respect of the protection of creditors on an insolvency. The 2004 amendments removed an exception to creditor protection where "the law of Bermuda has corresponding laws or public policy rules." The removal of this language provides greater certainty.

The law also clearly protects a trust from being set aside or varied by a Bermuda court pursuant to the laws of a foreign jurisdiction in respect of testate or intestate heirship or spousal rights. The 2004 amendments updated the definition of "heirship" and "personal rights" to protect against claims by illegitimate and adopted children and co-habitees. Dispositions to a trust made with the intent to defeat a divorce or maintenance proceeding may be set aside, but only if the Bermuda courts have jurisdiction, which will occur only if one of the parties was domiciled on the date of commencement of the proceedings or resident in Bermuda during the prior year.

No legislation expressly provides for the role of protector, but protectors are widely used in Bermuda. In *Von Knierem v. Bermuda Trust Co. Ltd.*, Bermuda Supreme Court Civil Jurisdiction, No. 154 (July 13, 1994) (unreported), the Bermuda Supreme Court held that the role of a protector with the power to appoint and remove the trustee was fiduciary in nature.

Several provisions of the Bermuda Act are beneficial to nonresident settlors. For example, subject to a few exceptions, questions as to settlor capacity are governed by Bermuda law, without regard to the laws of any other jurisdiction. This enables Bermuda trusts to be used to protect against trust litigation by disfavored heirs. Section 8 of the Act provides an *a la carte* approach to choice of law. A settlor may select the trust's applicable law and is permitted to have the law of several jurisdictions apply. Thus, a nonresident settlor could select Bermuda law as governing law, but select New York law for administration of the trust. Trusts do not have to be registered or publicly disclosed.

c. Conveyancing Act, 1983

Prior to repeal of Section 37 of the Act in 1994, legitimate trust settlements were vulnerable to attack by future creditors of a settlor due to (i) the liberal interpretation by Bermuda courts of the phrase "intent to defraud" (under case law, actions of a settlor that demonstrated a presumption of intent could be sufficient) and (ii) the lack of a statute of limitations.

Conveyancing Act Sections 36A – G, which were added in the 1994 amendments, limit the ability of creditors to challenge a disposition as fraudulent. The Act defines eligible creditor as: (i) on or within two years after, the material date the transferor owed an obligation and on the date of the action or proceeding to set aside the relevant disposition that obligation remains unsatisfied; (ii) on the material date the transferor owed a contingent liability and since that date the contingency giving rise to the obligation has occurred and on the date of the action or proceeding to set aside the relevant disposition that obligation remains unsatisfied; or (iii) on the date of the action or proceeding to set aside the relevant disposition, the transferor owes an obligation in consequence of a claim, made by that person against the transferor, arising from a cause of action which accrued prior to or within two years after, the material date.

The period of limitations for an eligible creditor to assert a claim is generally six years from: (i) the later of the material date or the date the obligation became owed; or (ii) the later of the material date or the date the cause of action accrued.

F. British Virgin Islands

1. Geography

Located in the Caribbean Sea, east of Puerto Rico and directly east of the U.S. Virgin Islands, the British Virgin Islands were annexed by the British in 1672. The British Virgin Islands (BVI) is a British Overseas Territory. The capital is Road Town (on Tortola). The USD is the official currency of the BVI.

2. Economy

The economy of the BVI is one of the most stable and prosperous in the Caribbean, with tourism generating approximately 45% of national income. In the mid-1980s, the government initiated a program to enable offshore company registrations and by 2000, over 400,000 companies were registered. In late 1994, the government expanded its appeal to offshore companies by enacting a comprehensive insurance law regime.

3. Political System

BVI is internally self-governed with the political system based on a constitutional parliamentary democracy. Executive power is exercised by the chief minister and executive council. Legislative power is vested in both the executive branch and the unicameral Legislative Council.

4. Legal System

The legal system is based on English common law and a written constitution. BVI is a member state of the Eastern Caribbean Supreme Court, a three level court system independent of the executive branch and the legislature. The Privy Council in London is the court of last resort.

5. Relevant Laws

a. Tax Law

Until the termination of the U.S.-BVI tax treaty in 1983, one of the primary appeals of BVI was its status as a tax haven. The appeal of BVI was then promoted through the enactment of favorable international business company legislation.

b. Trust Law

Trust law in BVI is governed by the Trustee Ordinance, 1961, as amended, and common law. In general, BVI law, while not hostile to asset protection trusts, is not responsive to asset protection concerns. No provisions in the Trustee Ordinance provide for spendthrift clauses or asset protection trusts. Dispositions of property alleged to be fraudulent may be subject to several sources of law, including the Statute of Elizabeth, the Bankruptcy Act, 1893, the Conveyancing and Law of Property Act, 1961 and in the case of a company, the Insolvency Act, 2003. There is no statute of limitations for fraudulent dispositions. BVI trust law is favorable in its liberal approach to inbound and outbound trust migration, however, and could be used as a starting or ending point in the lifecycle of an offshore trust.

G. Cayman Islands

1. Geography

A group of three islands located 240 km south of Cuba and 268 km northwest of Jamaica, the Cayman Islands were colonized by the British during the 18th and 19th centuries, administered by Jamaica after 1863 and in 1959, became a territory within the Federation of the West Indies. When the Federation dissolved in 1963, the Cayman Islands opted to remain a British dependency. The Cayman Islands are a British Overseas Territory. The Caymanian dollar (KYD) is the official currency and is pegged to the USD at a fixed exchange rate. No exchange controls are imposed. English is the official language.

2. Economy

Approximately 70% of the Cayman Islands' GDP is derived from tourism. The Cayman Islands have no direct taxation and are a thriving offshore financial center. As of 1998, more than 40,000 companies were registered in the Cayman Islands, including almost 600 banks and trust companies, with banking assets exceeding $500 billion.

3. Political System

The Cayman Islands are internally self-governed with the political system based on a constitutional parliamentary democracy. Executive power is exercised by the Leader of

Government Business and the cabinet. Legislative power is vested in both the government and the unicameral Legislative Council.

4. **Legal System**

Caymanian law is based on British common law, local statutes and a written constitution. An independent judicial branch consists of three levels of courts. The Privy Council in London is the court of last resort.

5. **Relevant Laws**

a. Trust Law

The Cayman Islands does not have asset protection trust legislation. Trust law is based on English law, including principles of equity and the law of trusts. Trust law legislation in the Cayman Islands is modeled on English law and as in England, legislation does not seek to codify all trust law; instead the legislation focuses on trustees and the powers of the court. Under English legal principles, spendthrift protection as we know it in the United States is not available. However, a similar result may be achieved through the use of protective trusts that provide determinable interests that terminate in the event of an attempted alienation or other specified events, such as a beneficiary's bankruptcy or by providing discretionary interests. Under principles of English common law that would apply in the Cayman Islands, a protective trust benefitting a settlor would not continue to operate in the event of the settlor's bankruptcy. A protective trust may be effective in protecting assets from the reach of creditors in other circumstances.

b. Bankruptcy Law (1997 Revision)

The Cayman Islands bankruptcy law provides that the disposition to a trust made within two years immediately prior to the bankruptcy will be void against the trustee in bankruptcy regardless of whether or not the bankrupt was solvent at the time the disposition was made. The law further provides that any disposition made between two and ten years prior to the act of bankruptcy will be void if the bankrupt was not solvent at the time the disposition was made. A person will be subject to the bankruptcy law if at the time of bankruptcy, the person was: (i) personally present in the Cayman Islands; (ii) ordinarily resided or had a place of residence in the Cayman Islands; (iii) carrying on business in the Cayman Islands personally or by means of an agent or manager; or (iv) a member of a firm or partnership which carried on business in the Cayman Islands.

c. Fraudulent Dispositions Law, 1996 Revision

A disposition of property made with an intent to defraud and at an undervalue is voidable at the instance of a creditor prejudiced by it. The burden of proof of intent is on the creditor. An ordinary civil standard of proof is used. A disposition may only be set aside if a claim is raised within six years of the date of disposition, the obligation or liability (including a contingent liability) existed at the time of the disposition and the person making the disposition was aware of the obligation or liability when he or she made the disposition. If a settlor commits an act of bankruptcy within the Cayman Islands, he or she may be made bankrupt within the following six months.

H. **Cook Islands**

1. **Geography**

A group of 15 islands located approximately halfway between Hawaii and New Zealand in the South Pacific Ocean, the Cook Islands were originally settled by Māori Polynesians, who at

88% of the population, still comprise the largest ethnic group on the islands. The Cook Islands (named after Captain Cook) were declared a British protectorate in 1888, with administrative control transferred to New Zealand in 1900. Since 1965, by virtue of the enactment of the Cook Islands Constitution Act of 1964, the Cook Islands have been self-governing in free association with New Zealand. All Cook Islanders hold dual citizenship in New Zealand and the Cook Islands. The full-time population is approximately 21,000. Regular commercial jet service is available to the capital, Rarotonga, from New Zealand and Los Angeles. The islands are located in the same time zone as Hawaii. English is the official language. The New Zealand dollar, which floats on a controlled basis, is the official currency.

2. **Economy**

Once reliant upon foreign aid from New Zealand, the Cook Islands economy is now among the most prosperous in the South Pacific and centers around tourism, agriculture and onshore and offshore finance, with over 10% of the GDP derived from the finance industry. The New Zealand Dollar is the official currency of the Cook Islands. No exchange controls are imposed. All Cook Islands residents receive free health and dental care and education is both free and compulsory, resulting in a literacy rate of approximately 95%.

3. **Political System**

The Cook Islands are fully responsible for internal affairs, while New Zealand retains responsibility for external affairs and defense in consultation with the Cook Islands. The political system is based on a constitutional parliamentary democracy. Executive power is exercised by the prime minister and cabinet. Legislative power is vested in both the government and the unicameral Legislative Council. The Cook Islands enjoy a high degree of political stability, due not only to their English governmental traditions, but also to the Cook Islands' remote location, predominantly heterogeneous Polynesian (Cook Islands Māori) population and historically close ties with New Zealand. The Cook Islands have not been involved in any armed conflicts in the 21st or 20th centuries and do not maintain armed forces.

4. **Legal System**

Cook Islands law is based on New Zealand law, English common law and a written constitution. The Cook Islands judicial system includes a High Court and Court of Appeal. All judges are senior judges selected from the Court of Appeal in New Zealand. The Privy Council in London is the court of last resort.

5. **Relevant Laws**

a. Trust Law

The trust law of the Cook Islands is derived from English common law but has been modified by the Cook Islands Parliament to provide robust, pro-settlor asset protection legislation. The principal legislative acts are the International Trusts Act of 1984 and the International Trusts Amendments Acts of 1989, 1991 and 1996 (collectively, the "ITA"). This legislation and the public and private commitment and expertise available in the Cook Islands provide what many practitioners and commentators believe is the world's leading jurisdiction for asset protection planning using asset protection trusts.

Asset protection features of the International Trusts Act include:

(1) Self-settled spendthrift trusts are permitted;

(2) The Statute of Elizabeth is repealed;

(3) Fraudulent conveyances are clearly defined for purposes of Cook Islands trust law;

(4) Foreign judgments against a Cook Islands international trust are not recognized;

(5) The period of limitations for fraudulent conveyance claims and for bringing actions against Cook Islands trusts has been reduced;

(6) Broad powers and benefits may be retained by the settlor;

(7) Spendthrift protection is recognized for the interests of all beneficiaries, including the settlor;

(8) Potential "tacking" of time periods for trusts migrating from other jurisdictions; and

(9) A subsequent bankruptcy of the settlor does not cause invalidation of the trust

Under the 1989 Amendment to the ITA, the law was clarified regarding the interpretation of a foreigner's rights under the laws of his or her home country's laws by providing that such laws may not be used to nullify Cook Islands law. Section 13D of the 1989 Act provides that "no proceedings in regard to the recognition of a foreign judgment shall be entertained in the Cook Islands if that judgment is inconsistent with the International Trusts Act or the judgment relates to an aspect governed by Cook Islands laws." This language clarifies that a party asserting a claim must commence an action in the courts of the Cook Islands under Cook Islands law.

To further deter litigation, litigants in the Cook Islands are required to hire local counsel, contingent fees are not permitted and evidentiary standards require proof beyond a reasonable doubt, rather than the preponderance of evidence standard that is applied in U.S. civil litigation.

If a plaintiff proves beyond a reasonable doubt that a particular transfer was made to a trust for the particular purpose of defrauding that particular plaintiff and the making of the transfer rendered the settlor insolvent, the trust will not be void. Instead, the law provides that the particular transfer alone will be made available to the plaintiff.

The ITA allows protectors to be appointed in the trust instrument. By default the ITA exempts a protector from fiduciary liability in relation to acts or omissions when performing its obligations under the trust instrument. This provision is not beneficial to the interests of settlors or beneficiaries and it is generally advisable to invalidate this provision by making express provision in the instrument regarding the protector's fiduciary duties and obligations.

All transactions involving offshore entities are required to be processed through one of six licensed trustee companies[96], all of which are subject to supervision by the Cook Islands government.

All settlements of asset protection trusts in the Cook Islands require the settlor to provide an affidavit of solvency in a legally prescribed form.

6. **Fraudulent Transfer Law**

The principal basis for challenging the settlement of an asset protection trust or a disposition of property thereto, is the assertion of a fraudulent conveyance of property. The ITA repeals the application of British fraudulent conveyance law, the Statute of Elizabeth and supplants it in its entirety with specific rules as to when a trust or a disposition of property into trust may be challenged as a fraudulent transfer.

As compared to the Statute of Elizabeth or any of the three principal sources of fraudulent conveyance law in the United States, the ITA substantially reduces the period of limitations under which a transfer may be challenged as fraudulent and imposes a substantially higher burden of proof on creditors seeking to challenge a transfer.

Under the ITA, a creditor must prove beyond a reasonable doubt that (i) the transfer was made with the principal intent of defrauding the creditor and (ii) the settlement rendered the settlor insolvent over the property by which the creditor's claim, if successful, could have been satisfied.

Section 13B of the ITA provides that a trust will not be fraudulent if: (i) the settlement or disposition takes place either prior to a creditor's cause of action arising or more than two years after the cause of action arose; or (ii) the settlement or disposition occurs within two years of the date that the cause of action arose and the creditor fails to bring an action in a court of competent jurisdiction within one year of the settlement or disposition.

Section 13B also provides that where the settlement of a Cook Islands international trust or the disposition of property thereto occurred before a creditor's cause of action accrued, the settlement or disposition shall not be presumed to have been effected with intent to defraud a creditor.

I. Gibraltar

1. Geography

Gibraltar is a small but strategically important British Overseas Territory located in Southwestern Europe on the southernmost portion of the Iberian Peninsula. On its northern border, Gibraltar shares a 1.2 km land border with Spain and extends into the Strait of Gibraltar, which links the Mediterranean Sea and the North Atlantic Ocean. Known among locals as "Gib" or "the Rock", Gibraltar is one of the legendary Pillars of Hercules. Gibraltar was permanently ceded to Great Britain by Spain in the 1713 Treaty of Utrecht and was formally declared a British colony in 1830. In 1967, Gibraltarians voted overwhelmingly to remain a British dependency. Gibraltar's population of approximately 28,000, several thousand more daily commuters and its tourist population coexist in a location of 6.5 sq km (about 11 times the size of the National Mall) making it one of the most densely populated territories in the world. A large portion of Gibraltar's geography is dominated by the Rock of Gibraltar, which contains many miles of tunneled roads operated by the military and closed to the public and on its upper area, a nature reserve. English is the official language of Gibraltar and most residents are bilingual in English and Spanish. Reflecting Gibraltar's seafaring and trading heritage, Italian, Portuguese and French are also widely spoken. Gibraltar's currency is the Gibraltar pound (GIP), which is at par with the pound sterling (GBP). Both currencies are accepted and there are no exchange controls in Gibraltar.

2. Economy

Gibraltar is economically self-sufficient. Its GDP per capita is ranked 32nd in the world, just below Singapore and above Taiwan. Primary contributors to the Gibraltar economy are its prominence in shipping, offshore finance and as an international conference center. In finance, the sophistication, flexibility and service orientation of Gibraltar's regulators, have made it an attractive destination for fund formation. Gibraltar enjoys a unique relationship with the European Union. Under Article 227(4) of the European Economic Community

(EEC) Treaty, Gibraltar enjoys the status and prestige of being within the European Union by virtue of being a European territory for whose external relations the UK (as a British Overseas Territory) is responsible. However, Article 28 of the 1971 UK Accession Treaty relieves Gibraltar from several undesirable aspects of EU status, including the common customs tariff, the common agricultural policy and the harmonization of turnover taxes, including VAT. Gibraltar-based institutions have also traditionally catered to the banking, fiduciary and wealth management needs of private clients in Western and Southern Europe.

3. **Political System**

Gibraltar is internally self-governed with the political system based on a constitutional parliamentary democracy. Executive power is exercised by the prime minister and cabinet. Eight full-time ministers within the cabinet are responsible for defined domestic matters. Legislative power is vested in both the executive branch and the unicameral House of Assembly. Gibraltar enjoys a high degree of political stability, although Spain continues to assert territorial claims over Gibraltar. Gibraltar's sovereignty is assured by the preamble to the Gibraltar Constitution Order 1969, in which Britain assures the people of Gibraltar that Britain will never to enter into arrangements under which the people of Gibraltar would pass under the sovereignty of another state against their freely and democratically expressed wishes. Between 1997 and 2002, a series of talks were held by the UK and Spain to discuss the establishment of temporary joint sovereignty over Gibraltar. In response to these talks, the Gibraltarian Government set up a referendum in late 2002 in which a majority of the citizens voted overwhelmingly against any sharing of sovereignty with Spain. Since the referendum, tripartite talks have been held with Spain, the UK and Gibraltar.[97]

4. **Legal System**

Gibraltar's legal system is based on English common law, rules of equity and statutory law, supplemented by Gibraltar's statutory law and its written constitution. The English Law (Application) Ordinance of 1972 declares the extent to which English law is in force in Gibraltar. The common law and the rules of equity in force in England apply to Gibraltar subject to any modifications or exclusions made by Her Majesty in Council, by an act of Parliament or by an Ordinance passed by the House of Assembly in Gibraltar. In all causes or matters in which there a conflict between common law and the rules of equity with respect to the same subject, the rules of equity prevail. The Ordinance lists in its schedule the statutory law of England which applies to Gibraltar. The Gibraltar House of Assembly has enacted and amended statutory laws to suit Gibraltar's requirements, particularly as to matters addressing the need to preserve Gibraltar's status as an offshore finance center. In addition to the security of Gibraltar's English common law-based system, all Gibraltarian lawyers and accountants are trained in the UK. In 2000, Gibraltar introduced its Civil Procedure Rules, based on the streamlined Civil Procedure Rules introduced in England and Wales in 1999. Three levels of courts exist in Gibraltar.[98] In addition, matters may be appealed from the Gibraltar Court of Appeal to the Privy Council in London as the court of last resort.

5. **Relevant Laws**

a. Judgments Reciprocal (Enforcement) Ordinance

The Ordinance allows the registration and enforcement of judgments obtained in countries which provide reciprocal treatment of judgments. The United States and Gibraltar are not signatories to any conventions that provide for such reciprocity.

b. Bankruptcy Amendment Ordinance Nos. 1 and 2 (1990)

Asset protection trusts were made possible in Gibraltar through amendments to the Gibraltar Bankruptcy Amendment that supersede the Fraudulent Conveyance Act 1571 (Statute of Elizabeth) and Section 42 of the Bankruptcy Ordinance. Section 42 provides generally that if a settlor becomes bankrupt within ten years of any settlement of property, other than antenuptial and postnuptial settlements, certain settlements to children and settlements made in good faith and for valuable consideration in a purchase or encumbrance, the settlement shall be void against the official trustee unless the parties claiming under the settlement can prove that the settlor was, at the time of making the settlement, able to pay all his debts without the aid of the property comprised in the settlement and that the interest of the settlor in such property passed to the trustee of such settlement on the execution thereof.

Subsection 42(A) of the Ordinance provides that a disposition will not be voidable at the instance of or upon application by any creditor of the Settlor if: (i) under or by virtue of any disposition made in respect of property, the same became settled property; (ii)the Settlor is an individual; (iii) the Settlor is not insolvent at the date of disposition; (iv) the Settlor does not become insolvent in consequence thereof; and (v) the disposition is registered in accordance with the requirements of the regulations.

Under Subsection 42(A), "disposition" means any disposition or series thereof, howsoever effected and (without prejudice to the generality thereof) includes any transaction, gift, grant or transfer of property of any nature whatsoever.

"[I]nsolvent" means in respect of a Settlor, any Settlor whose liabilities, both actual and contingent or prospective, exceed the value of his assets, provided that no claim by creditors shall be deemed to be a contingent or prospective liability of a Settlor who at the time of making the disposition does not have actual notice of such a claim or of the facts or circumstances which may render him liable to such a claim.

"[S]ettled property" means any property held in or upon trust, other than any property held by any person as nominee for another person or as trustee for any other person who is absolutely entitled to the beneficial interest in such property.

"[T]he Settlor", in relation to any settled property, includes the maker of any disposition of property which in consequence thereof becomes settled property.

Compliance with Subsection 42(A) renders the Fraudulent Conveyance Act 1571 inapplicable and in addition, also renders Section 42 of the Bankruptcy Ordinance inapplicable, which otherwise provides for the avoidance of certain settlements. There is no specific legislation which reduces the period of time under which creditors from other jurisdictions must assert claims.

6. **Bankruptcy Ordinance Bankruptcy (Register of Dispositions) Regulations 1990**

The Regulations specify the requirements for registering a disposition. The trustee making application: (i) must be the sole corporate trustee; (ii) must be judged by the Financial and Development Secretary to have adequate financial and administrative resources to act as a trustee (x) in relation to that disposition; and (y) in relation to any other dispositions; (iii) must have obtained prior written approval of the Financial and Development Secretary as to the forms of enquiry administered to the settlor; (iv) must have a level of professional indemnity insurance considered adequate by the Financial and Development Secretary in relation to the value of the business it undertakes and in any case not less than one million pounds.

In order to register a disposition, the Regulations require that certain information be provided regarding the settlement. The information required is the: (i) name and address of the trustee; (ii) name of the disposition (name of the trust); (iii) date of making the disposition and the duration thereof; and (iv) country of ordinary residence of the settlor. Nothing that will personally identify the settlor or any beneficiaries is required under the registration requirements.

The Regulations impose a high standard of due diligence on the trustee (which I have personally observed being undertaken in Gibraltar). In order to register a trust, the trustee must: (i) provide forms of inquiry to the settlor and ensure that they have been completed to the trustee's satisfaction; (ii) complete all reasonable inquiries based on information available on public record; (iii) obtain an affidavit of solvency; and (iv) satisfy the requirements of annual notification.

The regulations provide that all persons with official duties to administer the regulations are required to treat all information as secret and confidential and can be held liable on summary conviction to a fine of up to one thousand pounds. To ensure integrity in the registration process, a person (e.g., a trustee) who without reasonable cause gives any incorrect information in the application, is guilty of an offense and is liable on summary conviction to a fine of one thousand pounds and/or three months imprisonment.

J. Guernsey

1. Geography

Guernsey, the second-largest Channel Island after Jersey, is located in the English Channel, northwest of France. Guernsey and the other Channel Islands are remnants of the medieval dukedom of Normandy. Guernsey is approximately 78 sq km in size, with a population of 65,000. Saint Peter Port is the capital. Guernsey is a British crown dependency, but is not part of the UK.

2. Economy

With over 55% of the Guernsey economy based upon financial services, including banking, fund management and insurance, Guernsey is extremely prosperous, with GDP on a per capita basis exceeding its neighbors, the UK and France and rivaling the U.S.

3. Political System

Guernsey's chief of state is Queen Elizabeth II, who appoints the lieutenant governor and chief minister. The Guernsey legislature is the unicameral States of Deliberation, 45 elected voting members serving four-year terms.

4. Legal System

Guernsey's legal system is based upon English common law and local statute. The constitution is unwritten and based partly on statutes and partly on common law and practice. The court of record is the Royal Court.

5. Relevant Laws

a. Trust Law

Guernsey has not enacted asset protection legislation and has no case law providing relevant asset protection. Under Section 71(1) of the Trust Law there is no period of limitation.

K. Isle of Man

1. Geography

Once part of the Norwegian Kingdom of the Hebrides, the Isle of Man was ceded to Scotland in the 13th century and came under the British crown in 1765. Isle of Man is now a British crown dependency. Isle of Man, with a total land area of 572 sq km and population of 75,000, is located in the Irish Sea between Great Britain and Ireland. Its capital is Douglas. The currency is the GBP. A Manx pound on par with the GBP also circulates.

2. Economy

Offshore banking, manufacturing and tourism are key drivers of the Manx economy. Financial incentives have been successfully offered by the Manx government to high-technology companies and financial institutions to encourage location onto the Isle of Man.

3. Political System

Isle of Man is a parliamentary democracy. The Lord of Man is Queen Elizabeth II, as represented by the Lieutenant Governor, who is appointed for a five-year term. The head of government is the chief minister, elected by the Tynwald. The bicameral Tynwald consists of the Legislative Council, an 11-member body composed of the President of Tynwald, the Lord Bishop of Sodor and Man, a nonvoting attorney general and eight others named by the House of Keys and the 24 members of the popularly-elected House of Keys.

4. Legal System

The Isle of Man legal system is based upon English common law and Manx statute. This includes an unwritten Manx Constitution, which is not embodied in the Isle of Man Constitution Act of 1961. The court of record is the High Court of Justices, with justices appointed by the Lord Chancellor of England on the nomination of the lieutenant governor.

5. Relevant Laws

The Isle of Man has no specific asset protection legislation but has been frequently used for asset protection trusts. The Isle of Man has highly developed trust law, including the Trustee Act, 1961 and the Trusts Act 1995.

a. Fraudulent Assignment Act (1736)

The Act provides that "[a]ll fraudulent assignments or transfers of the debtor's goods shall be void and of no effect against his just creditors, any custom or practice to the contrary notwithstanding." The equivalent to this Act in England and Wales is the Statute of Elizabeth, which was repealed by the Law of Property Act of 1925. Remnants of the Statute of Elizabeth remain in the Insolvency Act 1986.

b. Re: Heginbotham, (Common Law Division, 15 February 1999)

Re Heginbotham is not an asset protection trust case but is one of only a few Manx cases dealing with fraudulent conveyance law. The case deals with successor liability arising in the sale of a business structured as a sale of assets.

Prior to *Heginbotham*, there was uncertainty as to whether or not the Statute of Elizabeth applied. In the 1908 unreported case *Re Corrin Bankruptcy - Kermode Trustee of Corrin's Bankruptcy v. Craig*, Deemster Thomas Kneen[99] stated in dicta his belief that the principles of the Statute of Elizabeth had been adopted into Manx law.

In *Heginbotham*, Deemster Cain determined that the Statute of Elizabeth had never been adopted by Manx law and the matter was governed by the Fraudulent Assignment Act. The court determined that an intent to defraud creditors can only apply to present or existing creditors. The *Heginbotham* opinion suggests that an asset protection trust settled to protect against claims of future creditors not in existence at the time of settlement will be respected under Manx law.

L. **Jersey**

1. **Geography**

The largest and southernmost of the Channel Islands, Jersey has a population of approximately 90,000. English is the official language. Jersey's currency is the GBP; a Jersey pound is also used. Saint Helier is the capital.

2. **Economy**

Jersey's economy is based on international financial services, agriculture and tourism. The financial services industry contributes more than 60% of the GDP and employs more than 25% of the working population. As of September 2002, Jersey was home to over 60 of the 500 largest banks, with over $229 billion on deposit in Jersey, including $157 billion in currencies other than sterling.

3. **Political System**

Jersey's chief of state is Queen Elizabeth II, who appoints the lieutenant governor and bailiff. The Jersey legislature is a unicameral Assembly of the States presided over by the bailiff.

4. **Legal System**

Jersey's legal system is based upon Norman customary law, statute and English common law. The constitution is unwritten and based partly on statutes and partly on common law and practice. According to constitutional convention, UK legislation may be extended to Jersey by Order in Council or at the request of Jersey's government. It is a matter of legal debate whether an Act of the UK Parliament may expressly apply to Jersey as regarding matters of self-government. In 2005, the Assembly of the States enacted legislation, The States of Jersey Law 2005, establishing that no United Kingdom Act or Order-in-Council may apply to Jersey without being referred to the Assembly of the States of Jersey. The court of record is the Royal Court, with judges elected by an electoral college and the bailiff.

5. **Relevant Laws**

a. Trust Law

Jersey does not have asset protection trust legislation. Recognition and enforcement of foreign bankruptcy orders and the rendering of assistance to foreign courts is the same for trust cases as in non-trust cases. Jersey common law with respect to fraudulent transfers has developed from the Roman law suit known as a "Pauline action." Under Jersey law, the alienation of property is voidable where a "substantial purpose" of the disposition is to defeat creditors and there is a close connection in time and effect between the disposition and the subsequent insolvency of the creditor.

In Grupo Torras SA v Al Sabah and Six Others,[100] the Royal Court (of Jersey) held that the limitation period for a Pauline action is ten years and the action may only be brought by a creditor where the facts giving rise to the debt occurred before the disposition in question. Accordingly, *Grupo Torras* provides some measure of support where a trust is settled to protect against *future* creditors.

Under current Jersey law, the capacity of a non-Jersey domiciliary to make a transfer into a Jersey trust is determined under the law of his or her domicile. Jersey trusts are also vulnerable to attack in a foreign court if transfers violate inheritance or succession laws.

M. Liechtenstein

1. Geography

The Principality of Liechtenstein was established within the Holy Roman Empire in 1719 and became a sovereign state in 1806. Located in Central Europe between Austria and Switzerland, Liechtenstein remained closely tied to Austria until the end of World War I. After the war, Liechtenstein entered into a customs and monetary union with Switzerland and has remained neutral. Liechtenstein has adopted the Swiss franc as its official currency and relies upon Switzerland for its defense. German is the official language. Vaduz is the capital.

2. Economy

Despite its alpine, doubly landlocked location and limited natural resources, Liechtenstein has a highly industrialized, prosperous economy with a significant financial services sector known for high levels of secrecy and confidentiality. Low business taxes and easy incorporation rules have contributed to Liechtenstein's reputation as a tax haven and attracted numerous holding companies to establish nominal offices in Liechtenstein, providing 30% of state revenues.

3. Political System

Liechtenstein is a hereditary constitutional monarchy on a democratic and parliamentary basis. Liechtenstein's unicameral legislative body is the Landtag, comprised of 25 members elected by direct, popular vote under proportional representation to serve four-year terms. Following elections, the monarch (Prince Hans Adam II) appoints the head of government (usually the majority party) and the deputy head of government (usually the minority party leader).

4. Legal System

Liechtenstein is a civil law jurisdiction following local civil and penal codes. Compulsory ICJ jurisdiction is accepted with reservations. The judiciary is comprised of the Oberster Gerichstof (Supreme Court) and Obergericht (Court of Appeal). All proceedings are conducted in German.

5. Relevant Laws

a. Trusts

Liechtenstein is the only country in continental Europe that has adopted the common law trust. Trust law is codified in the Personen-Und Gesellschaftsrecht (Persons and Companies Law), also known as the "PGR." Two types of trusts are recognized in Liechtenstein: (i) the Treuuhanderschaft or trust in general and (ii) Treuunternehmen or business trust.

b. Fraudulent Conveyances

Rechtsssicherungs-Ordnung (Statute on Emergency and Interim Reliefs) "RSO", Art. 67 provides that transfers may be avoided by creditors if (i) the settlor or donor had unsatisfied creditor claims (recognized by the institution of execution proceedings) and (ii) the settlor or donor acted in order to defraud the creditor or prefer certain creditors and the intention to defraud was recognizable to the recipient of the legal act at the time of the performance. RSO Art. 75 provides that the law of the place of debtor's domicile is the primary applicable law.

c. Information Exchange

Liechtenstein has no information exchange agreements with foreign governments.

d. Foundations

The Liechtenstein foundation may be used for charitable or non-charitable purposes, including the maintenance of families. The foundation is generally structured with a board of directors and in some cases, a protector. Foundations are subject to an annual capital tax imposed at a maximum rate of 0.1%.

6. Foreign Judgments

Foreign judgments are not recognized in Liechtenstein and are required to be retried in Liechtenstein on the merits and subject to local procedural rules, which include no right to a jury trial, no punitive damages and a deposit requirement for court costs and attorneys fees.

N. Saint Kitts and Nevis

1. Geography

Located in the Caribbean Sea in the chain of islands known as the Leeward Islands, about one-third of the way from Puerto Rico to Trinidad and Tobago, Saint Kitts and Nevis, two islands separated by a 3 km channel, were settled by the British in 1623. The islands, along with Anguilla, became an associated state with full internal economy in 1967. After two years of rebellion, Anguilla was granted independence in 1971. In 1983, Saint Kitts and Nevis were granted independence by the British and the Federation of Saint Kitts and Nevis became an independent state. In 1998, a Nevisian referendum seeking to separate from Saint Kitts failed to achieve the required two-thirds vote. Separation efforts have continued through lawful and peaceful means. English is the official language. The official currency is the East Caribbean dollar (XCD), which is pegged to the USD at a fixed exchange rate.

2. Economy

With a GDP per capita (PPP) of $8,800, Saint Kitts and Nevis are ranked 91 in the world, just below Mexico, Bulgaria and Uruguay and above Brazil. Tourism revenue has supplanted sugar as the largest source of foreign exchange on the islands. Additional revenue growth has been generated by Nevis' targeted growth as a modern offshore finance center.

3. Political System

Saint Kitts and Nevis is an independent country and a Commonwealth Realm. The political system is based on a federal constitutional parliamentary democracy. Executive power is exercised by the prime minister and cabinet. Legislative power is vested in both the executive branch and the unicameral National Assembly.

4. Legal System

The legal system is based on English common law and a written constitution. The Federation is a member of the Eastern Caribbean Supreme Court. The Privy Council in London is the court of last resort.

5. **Relevant Laws**

a. 1994 Nevis International Exempt Trust Ordinance (as amended, 2000)

The Ordinance has been adopted by Nevis, but not by Saint Kitts and provides asset protection legislation that was modeled on the Cook Islands International Trust Act 1984. Section 55 of the Ordinance requires the posting of a $25,000 bond before any action may be brought against trust property.

b. Nevis Limited Liability Ordinance 1995

As discussed above, the Ordinance provides a flexible regime for the organization of limited liability companies with explicit limitations on creditor remedies.

O. **Switzerland**

1. **Geography**

Founded in 1291 as the Swiss Confederation, a defensive alliance of three cantons, the Swiss Confederation gained independence from the Holy Roman Empire in 1499. The Swiss Confederation (Switzerland) is a confederation similar in structure to a federal republic, of 26 cantons (administrative divisions). Bern is the capital.

2. **Economy**

Switzerland is a neutral and peaceful country with a prosperous and stable market economy with low unemployment, a highly skilled labor force and a per capita GDP larger than that of the large Western European countries. Switzerland's public and private commitment to bank secrecy, maintenance of the franc's long-term external value and well-deserved reputation for unparalleled banking capabilities have caused Switzerland to endure as a safe haven for depositors and investors.

3. **Political System**

Political power in Switzerland is concentrated in the bicameral Federal Assembly, which consists of the Council of States (direct representation) and the National Council (proportional representation). From its members, the Federal Assembly elects the Federal Council (cabinet) for four-year terms, as well as the president and vice president, who serve single, one-year terms.

4. **Legal System**

Switzerland's legal system is a civil law system influenced by customary law. The Swiss Constitution, a revision of the Constitution of 1874, was approved by the Federal Parliament in 1998, adopted by referendum in 1999 and officially entered into force in 2000. Legislative acts are subject to judicial review, except with respect to Federal decrees of general obligatory character. Compulsory International Court of Justice (ICJ) jurisdiction is accepted with reservations.

P. **Turks and Caicos**

1. **Geography**

The Turks and Caicos were part of the UK's Jamaican colony until the UK's granting of independence to Jamaica in 1962. The Turks and Caicos then became a separate crown colony, administered by the governor of the Bahamas. In 1973, with Bahamian independence, the islands received a separate governor. Independence for the Turks and

Caicos was agreed to in 1982, but the policy was reversed and the islands remain a British Overseas Territory. The Turks and Caicos are two island groups consisting of about 40 islands (8 inhabited) in the North Atlantic Ocean, southeast of the Bahamas and north of Haiti. The island of Grand Turk is the capital. The islands are subject to frequent hurricanes and tropical storms. English is the official language.

2. **Economy**

The Turks and Caicos economy is based on tourism, fishing and offshore financial services. The Turks and Caicos are among the less prosperous Caribbean overseas territories of the UK and have been used as a destination and transit point for illegal immigrants fleeing economic and civil disorder in Haiti. They have also been identified by the U.S. government as a transshipment point for South American drug activity.

3. **Political System**

The chief of state is Queen Elizabeth II, represented by her appointed governor. An Executive Council consists of three ex officio members and five appointed by the governor from among the members of the Legislative Council. Following elections for the unicameral Legislative Council, the leader of the majority party is appointed chief minister by the governor.

4. **Legal System**

The legal system is based on English common law and to a lesser extent, Jamaican and Bahamian law. A written constitution exists. The court of record is the Supreme Court.

5. **Relevant Laws**

a. The Trusts Ordinance 1990 (as revised, 1998)

Subsection 13(a) of the Ordinance, which governs the application of foreign laws to trusts, provides generally for the application of the law of the Turks and Caicos to trusts governed by the laws of the Turks and Caicos, without reference to the laws of any other jurisdiction with which the trust or disposition may be connected. This includes issues as to the capacity of any settlor.

Subsection 34(1) of the Ordinance recognizes protective trusts, allowing beneficial interests to be subject to an anti-alienation provision or a diminution or termination provision. This subsection does not, however, expressly recognize (nor exclude), the application of protective provisions to self-settled trusts.

The Ordinance contains language similar to the objective standard adopted by the Gibraltar Bankruptcy Amendment Ordinance Nos. 1 and 2 in Subsection 42(A). Under Subsection 61(1), if by virtue of a disposition made by or on behalf of a settlor his or her property becomes trust property which is the subject of a Turks and Caicos Trust and: (i) the settlor is an individual; (ii) the settlor is not insolvent when the disposition is made; and (iii) the settlor does not become insolvent by reason of the disposition, that disposition shall not be voidable at the instance of any creditor of the settlor. The Ordinance provides that the burden of proof as to a settlor's insolvency falls on the creditor. Nothing in the Ordinance indicates that the burden of proof is other than an ordinary civil standard of proof.

XIII. TAX CONSIDERATIONS FOR ASSET PROTECTION TRUSTS

A. **Classification Basics**

For Federal income tax purposes, an offshore trust may be classified as a foreign or domestic trust. Section 7701(a)(3) defines a "foreign trust" as any trust that is not a "U.S. trust." In order to be classified as a U.S. trust, a trust must meet the "court test" and the "control test" under Section 7701(a)(30)(E).

1. Court Test

To meet the court test, a U.S. court must be able to exercise primary supervision over the trust's administration. The Regulations provide a safe harbor for meeting the court test. Under the safe harbor: (i) the trust instrument does not direct that the trust instrument be administered outside the U.S.; (ii) the trust is in fact administered exclusively in the U.S.; and (iii) the trust is not subject to an automatic migration provision that causes it to migrate outside of the U.S. if a U.S. court attempts to assert jurisdiction or otherwise supervise jurisdiction."[101] The Regulations provide an alternate test under which the trust can meet the court test. Under the alternate test: (i) a U.S. court and a foreign court must both be able to exercise primary supervision over the administration of the trust and (ii) the trust may not be subject to an automatic migration provision.[102] Under the Regulations, administration of a trust in the U.S. means carrying out the duties imposed by the terms of the trust instrument and applicable law, including: (i) maintaining the books and records; (ii) filing tax returns; (iii) managing and investing assets; (iv) defending the trust from creditors; and (v) determining timing and amount of distributions.[103]

2. Control Test

For purposes of the control test, control means: (i) one or more U.S. persons must control all substantial decisions of the trust, with no other person having the power to veto any of the substantial decisions and (ii) all persons who have authority to make decisions must be considered, not just trust fiduciaries. The Regulations define "substantial decisions" as including: (i) whether and when to distribute income or corpus; (ii) the amount of any distributions; (iii) selection of a beneficiary; (iv) whether receipt is allocable to income or principal; (v) whether to terminate the trust; (vi) whether to compromise, arbitrate or abandon claims of the trust; (vii) whether to sue on behalf of the trust or defend suit; (viii) whether to remove, add or replace a trustee; (ix) whether to appoint a successor trustee who has died, resigned or otherwise ceased to act; and (x) investment decisions (or if a U.S. person hires an investment advisor, the power to terminate the advisor).[104]

3. Subchapter S Corporations

Under Section 1362(c)(1)(A), grantor trusts are generally eligible shareholders in an S corporation. However, foreign trusts are explicitly excluded, and are not eligible S corporation shareholders. Accordingly, an offshore trust that is classified as a foreign trust under Section 7701(a)(3) is not an eligible shareholder. An offshore trust that is classified as a U.S. trust, however, can be an eligible shareholder.

B. Income Tax Status of the Trust

Domestic asset protection trusts are customarily structured in a manner that accords grantor trust treatment for Federal income tax purposes. This is commonly achieved by providing the grantor or grantor's spouse with a discretionary income interest that is not subject to the approval or consent of an adverse party.[105] In the case of a trust classified as a foreign trust, Section 679 provides that a United States person who directly or indirectly transfers property to a foreign trust is treated as the owner for his or her taxable year of the portion of the trust attributable to such property if for such year there is a United States beneficiary of any portion of the trust. Thus, if the foreign trust was settled by a United States person and has a United States beneficiary, it is generally treated as a grantor trust.

As a grantor trust, trust income will be attributed to the settlor and reported on his or her personal income tax return. The primary benefits of grantor trust treatment are as follows. First, grantor trust treatment is generally more efficient for transfer tax purposes, because taxes will be paid by the settlor, reducing his or her taxable estate. Second, except in the case of a foreign trust, the trust will be an eligible S corporation shareholder. Third, if income is accumulated, overall income tax may be less than if the trust were a nongrantor trust, due to the application of compressed income tax brackets to nongrantor trusts. Thus, where adequate assets exist for a settlor to pay income taxes, grantor trust status is generally desirable.

C. **Gift Tax Treatment of the Trust**

Under Internal Revenue Code Section 2501, a tax is imposed on the transfer of property by gift. A gift occurs for gift tax purposes when the transfer is considered a "completed" gift. In general, a gift is complete when the donor has parted with dominion and control over the property and lacks the ability to change the disposition for either his benefit or the benefit of another.[106] In jurisdictions lacking asset protection legislation, a transfer into a self-settled spendthrift trust does not cause a completed gift, because the assets remain subject to the creditors of the settlor. In contrast, where assets are transferred into an asset protection trust, absent a reservation of certain powers over the trust, the transfer will be treated as a completed gift for gift tax purposes and will trigger gift tax liability to the extent the value of the gift exceeds the annual exclusion and lifetime exclusion amounts.

For those clients desiring to avoid completed gift treatment upon the creation of an asset protection trust, a special power of appointment should be provided in the trust instrument. The power of appointment should provide a testamentary power to appoint assets of the trust to persons other than the settlor, the settlor's estate, the settlor's creditors and creditors of the settlor's estate.

D. **Estate Tax Treatment of the Trust**

Many planners assume that if a transfer of property into an asset protection trust is treated as a completed gift, the property will automatically be excluded from the settlor's estate for estate tax purposes. In fact, this issue is not as clear cut as it may seem, because the gift tax and estate tax, while closely connected, are separate transfer tax regimes. In a 1998 private letter ruling concerning the gift tax consequences of a transfer of property into an Alaska asset protection trust, the IRS issued a ruling finding a completed gift (as desired by the taxpayer), but refused to rule on the issue of whether the property subject to the completed gift was excludable from the settlor's estate. Instead, the IRS suggested that the issue of inclusion for estate tax purposes is a matter to be determined upon the facts and circumstances in existence upon the taxpayer's death.[107]

For purposes of determining whether assets in an asset protection trust are includible in a settlor's gross estate for estate tax purposes, the principal analysis will focus on the string provisions of Sections 2035, 2036, 2037 and 2038. Of particular import is Section 2036, which causes the inclusion of transferred property in the estate if the transferor retained possession or enjoyment of or the right to income from, the transferred property or retained the right, alone or with others, to designate the persons who possess or enjoy the property and its income.

Most of the domestic asset protection trust acts, and in particular, Delaware, provide considerable flexibility in structuring an asset protection trust so that the determination of whether trust assets will be included in the estate can be influenced by the settlor when the trust is established.

E. **Estate and Gift Tax Planning**

The lifetime transfer of property into an irrevocable asset protection trust provides an excellent wealth transfer tax minimization opportunity for clients. By structuring the trust to create completed gifts while avoiding subsequent inclusion of the property in the client's estate, value can be transferred less expensively than would be possible under the estate tax. While the estate and generation skipping transfer taxes are computed on a tax inclusive basis (measured by the value of the property that can be transferred before taxes), gift tax is computed on the amount that actually passes by gift.[108]

A possible exception to this rule is that property transferred by gift will not be eligible for the step-up in tax basis of the property on death. However, under the current environment, where long term capital gains are taxed at a maximum rate of 15%, the loss of potential income tax savings from foregoing the step-up in basis will not exceed the savings that can be achieved by transferring property as a taxable gift to avoid subsequent estate tax. Moreover, if a client funds the trust with proceeds from the sale of a business, a completed gift of those proceeds will not be a gift of appreciated property and consequently, will not forego the possible use of a step-up in basis at death.

Many clients resist the advice to make completed gifts because of concerns over whether they will have sufficient liquidity to pay the gift tax, concerns that their remaining wealth will be insufficient to fund their needs and uncertainty regarding the future of the estate tax. In analyzing these concerns, the primary consideration should be (i) whether the client has sufficient liquidity to pay the gift tax due on a completed gift into the trust and (ii) whether based on current financial analysis, the client has sufficient resources to live without the benefit of the trust corpus. By making completed gifts into an asset protection trust in which he or she is named as a discretionary beneficiary, a settlor can ensure that they achieve the desired wealth transfer tax savings, with the further assurance that they can benefit from the trust if necessary.

F. **Federal Income Tax Implications of Transferring Assets to an Offshore Trust**

Under the general rule of Section 684(a), the transfer of property by a United States person to a foreign estate or trust is treated as a sale or exchange at the fair market value of the property transferred. However, Section 684(b) provides an exception for any transfer to a trust by a United States person to the extent that any person is treated as the owner of such trust under Section 671. Accordingly, a transfer to a trust classified as a foreign trust under Section 7701(a)(3) will not trigger sale or exchange treatment and will be a nonrecognition event if the trust is a grantor trust.

G. **State and Foreign Tax Treatment**

States with asset protection legislation vary as to their tax treatment of nonresidents. This is a reflection of varying policies of the states with regard to their objectives in enacting asset protection trust legislation. Alaska, Delaware, Nevada, Rhode Island and South Dakota do not impose taxes, while Oklahoma and Utah do. None of the offshore jurisdictions discussed in this outline impose income or wealth transfer taxes on trusts or their nonresident beneficiaries.

XIV. COMPLIANCE

A. **Introduction**[109]

The Small Business Job Protection Act of 1996 (the "Act") introduced new foreign trust and foreign gift reporting provisions. The Act expanded information reporting requirements under Section 6048 of the Internal Revenue (the "Code") for U.S. persons who make transfers to foreign trusts and for U.S. owners of foreign trusts. The Act added new reporting requirements for U.S. beneficiaries of foreign trusts and extensively revised the civil penalties for failure to file information with respect to foreign trusts. The Act also added Section 6039F to the Code, creating information reporting obligations for U.S. persons who receive certain gifts or bequests from foreign persons. Notice 2003-75, which addresses taxpayer information reporting obligations with respect to Canadian registered retirement savings plans ("RRSPs") and registered retirement income funds ("RRIFs"), supersedes Notice 97-34 in part.

Because of their obfuscatory nature, and the substantial penalties that are triggered in the event of noncompliance, these rules have been a repeated source of criticism by practitioners. Technical comments concerning foreign trust reporting were submitted to the Department of Treasury and the Internal Revenue Service by the American College of Trust and Estate Counsel, American Bar Association Section of Real Property, Probate & Trust Law, and American Institute of Certified Public Accountants in October 2006, December 2006 and January 2007, respectively.

In addition, concerns over the ability to understand and comply with the reporting obligations for foreign trusts have caused many practitioners and promoters of offshore asset protection trusts to favor offshore trusts that are structured in a manner enabling classification as U.S. trusts. In doing so, however, the protection that would otherwise be afforded by the offshore asset protection trust is compromised. It is my belief that clients are better served by the implementation of an offshore asset protection classified as a foreign trust for U.S. income tax purposes, or a domestic asset protection trust. Concerns over tax compliance for foreign trusts are best addressed through the implementation of procedures that will ensure compliance deadlines are met, and the establishment of relationships with accountants that are willing to invest in mastering best practices for technical compliance in this area.

Provided below is a summary of the principal compliance requirements and issues that arise in the asset protection planning context. This summary is not intended to be a comprehensive discussion of all compliance obligations that may arise.

B. **Form 709**

All transfers to foreign trusts are reportable as gifts on Form 709, even if they are incomplete for gift tax purposes. Accordingly, Form 709 should be filed.[110]

C. **Form 3520**

1. **Reportable Events**

Notice 97-34 requires every U.S. person who creates or makes a transfer to a foreign trust or who is responsible for other "reportable events" defined in Section 6048 to report such event on Form 3520. In addition, U.S. persons who receive distributions from a foreign trust are also required to file Form 3520. Under Section 6677, the failure to timely file or otherwise fully comply with these requirements subjects the responsible person to a penalty of up to 35 percent of the gross reportable amount. If the failure continues for more than 90 days after the Service has provided notice, additional penalties may be imposed in the amount of $10,000 for each 30-day period of noncompliance.

2. **90 Day Filing Requirement**

A repeated source of confusion among taxpayers and tax preparers is the question of whether it is necessary for a U.S. person to file Form 3520 within 90 days of the creation of, or transfer to, a foreign trust. This ambiguity stems from a lack of clarity and consistency among the language of Sections 6048(a) and (d) and Notice 97-34. Section 6048(a) states that "on or before the ***90th day*** (or such later day as the Secretary may prescribe) after any reportable event, the [taxpayer] shall provide written notice of such event to the Secretary." A "reportable event" includes the creation of, or transfer to, a foreign trust by a U.S. person. Section 6048(d) provides that "[a]ny notice or return required under this section shall be made at such time and in such manner as the Secretary shall prescribe." This provision is inconsistent with the 90-day requirement set forth by 6048(a). Finally, Notice 97-34 states that Section 6048(a) "generally provides" that any U.S. person who transfers property to a foreign trust "must report such transfer at the time and in the manner prescribed by the Secretary" [emphasis supplied]. Regrettably, particularly in light of the substantial penalties that may be imposed on a taxpayer for failure to comply with the foreign trust reporting requirements, neither the time nor the manner for reporting has been described with adequate clarity.

3. Gifts and Bequests from Foreign Sources

Section 102 provides that "[g]ross income does not include the value of property acquired by gift, bequest, devise or inheritance." Normally, the receipt of property excludible from gross income under Section 102 triggers no reporting consequences. Accordingly, as a general rule, taxpayers have no reporting obligations arising from the receipt of a gift or bequest. Notwithstanding the general rule of Section 102, Section 6039F(a) requires taxpayers to report certain gifts and bequests from foreign sources and Section 6039F(c)(1) empowers the Service to determine the tax consequences of the receipt of a foreign gift if not properly reported.

Under Section 6039F and Notice 97-34, U.S. persons receiving certain gifts or bequests from foreign persons are also required to file Form 3520. Notice 97-34 provides a $100,000 filing threshold (the threshold is *not* indexed for inflation) in the case of gifts and bequests from foreign sources. The failure to timely report such gifts or bequests can result in a penalty of up to 25 percent of the gross reportable amount.

D. Form 3520-A

Under Section 6048 and Notice 97-34, a U.S. person who is the owner of a foreign trust is responsible for ensuring that the trustee of such trust files Form 3520-A by ***March 15*** and is subject to a penalty of 5 percent of the gross reportable amount in the event of noncompliance, as well as additional $10,000 penalties as described above in the event of continued noncompliance after receiving notice from the Service. Substantial confusion exists as to the due date for filing Form 3520-A. The March 15 filing date is different than the filing deadline for Forms 3520, 1040, 1040NR and 1041. In order to obtain an extension to file Form 3520-A, an extension request must be made using Form 7004.

E. Income Tax Return Filing Requirements for Foreign Trusts

Under current rules, the fiduciary of a foreign trust with a U.S. grantor is required to file a trust income tax return using Form 1040NR. Form 1040NR was not designed as a fiduciary income tax return. Instead, the instructions to Form 1040NR provide that "[i]f you are filing Form 1040NR for a nonresident alien estate or trust, change the form to reflect the provisions of Subchapter J…[y]ou may find it helpful to refer to Form 1041 and its instructions." The Form 1040NR must be filed by ***April 15***.

F. Information Returns for Foreign Entities

All United States persons having an interest in a foreign entity are required to file an annual information return. IRS Forms 5471, 8865 and 8858 are the prescribed information returns that are used in the case of foreign corporations, foreign partnerships and foreign disregarded entities, respectively.

G. Reporting Foreign Bank and Financial Accounts

1. Who Must File

Each United States person, who has a financial interest in or signature authority, or other authority over any financial accounts, including bank, securities, or other types of financial accounts in a foreign country, if the aggregate value of these financial accounts exceeds $10,000 at any time during the calendar year, must report that relationship each calendar year by filing TD F 90-22.1 with the Department of the Treasury on or before ***June 30***, of the succeeding year. A "United States person" is: (i) a citizen or resident of the United States; (ii) a domestic partnership; (iii) a domestic corporation; or (iv) a domestic estate or trust.

The term "financial interest" is very broadly defined and includes various types of indirect and beneficial interests in an account. Of particular relevance, a beneficiary of a trust has a financial interest where the account is held in the name of a trust in which the United States person either has a present beneficial interest in more than 50 percent of the assets or from which such person receives more than 50 percent of the current income. A United States person is deemed to have signature authority over an account if such person can control the disposition of money or other property in it by delivery of a document containing his or her signature (or his or her signature and that of one or more other persons) to the bank or other person with whom the account is maintained. Other authority exists in a person who can exercise comparable power over an account by direct communication to the bank or other person with whom the account is maintained, either orally or by some other means.

2. Purpose and Penalties

The Privacy Act Notification provided on TD F 90-22.1[111] provides an explanation of the purpose and permitted uses of the report, the information collected and the penalties[112] that may be imposed:

* * *

> The principal purpose for collecting the information is to assure maintenance of reports where such reports or records have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings. The information collected may be provided to those officers and employees of any constituent unit of the Department of the Treasury who have a need for the records in the performance of their duties. The records may be referred to any other department or agency of the United States upon the request of the head of such department or agency for use in a criminal, tax, or regulatory investigation or proceeding. The information collected may also be provided to appropriate state, local, and foreign law enforcement and regulatory personnel in the performance of their official duties. Disclosure of this information is mandatory. Civil and criminal penalties, including in certain circumstances a fine of not more than $500,000 and imprisonment of not more than five years, are provided for failure to file a report, supply information, and for filing a false or fraudulent report.

* * *

XV. SUGGESTED RESOURCES

A. Cases

Aetna Casualty and Surety Co. v. Leahey Construction Co., 219 F.3d 519 (6th Cir. 2000)

In re Albright, 291 B.R. 538 (Bankr. D.Colo. 2003)

Banco Popular v. Gandhi, 876 A.2d 253 (N.J. 2005)

Bank of America v. Weese, 277 B.R. 241 (D.Md. 2002)

Breitenstine v. Breitenstine, 62 P.3d 587 (Wyo. 2003)

In re Brooks, 217 B.R. 98 (Bankr. D.Conn. 1998)

In re Brown, 1996 WL 33657614 (Bankr. D.Alaska 1996)

In re Coker, 251 B.R. 902 (M.D. Fla. 2000)

In re Colburn, 145 B.R. 851 (Bankr. E.D. Va. 1992)

In re Ehmann, 319 B.R. 200 (Bankr. D. Ariz. 2005); 337 B.R. 228 (2006) (opinion vacated by court after defendant agreed to settle).

FTC v. Affordable Media, LLC, 179 F.3d 1228 (9th Cir. 1999)

FTC v. Ameridebt, 373 F.Supp.2d (D.Md. 2005)

Guidry v. Sheet Metal Workers National Pension Fund, 493 U.S. 365 (1990).

In re Lawrence, 227 B.R. 907 (Bankr. S.D. Fla. 1998); 238 B.R. 498 (Bankr. S.D. Fla. 1999); 279 F.3d 1294 (11th Cir. 2002).

In re Manshul Construction Corp. v. Schulman¸ 2000 WL 1228866 (S.D.N.Y.)

Nastro v. D'Onofrio, 263 F.Supp.2d 446 (D.Conn. 2003)

Patterson v. Shumate, 504 U.S. 751 (1992)

In re Portnoy, 201 B.R. 685 (Bankr. S.D.N.Y. 1996)

Riechers v. Riechers, 178 Misc. 2d 170 (N.Y. Sup. Ct., June 30, 1998)

SEC v. Bilzerian, 112 F.Supp.2d (D.D.C. 2000)

SEC v. Brennan, 230 F.3d 65 (2nd Cir. 2000)

In re Turner, 335 B.R. 140 (Bankr. N.D. Calif. 2005)

U.S. v. Craft, 535 U.S. 274 (2002)

U.S. v. Grant, 2005 WL 2671479 (S.D. Fla. 2005)

B. Books and Treatises

Bove, Alexander, Jr. (editor), *Asset Protection Strategies*, Vol I (2002) and Vol. II (2005), ABA Section of Real Property, Probate & Trust.

Brown, et al., *Bankruptcy Exemption Manual*, 2006, Thomson/West

Casner & Pennell, *Estate Planning* (Sixth Edition), 2005, CCH.

Diamond & Sullivan, *International Trust Laws & Analysis*, 2006, Wolters Kluwer.

Engel, Barry, *Asset Protection Planning Guide* (Second Edition), 2005, CCH.

Henkel, Kathryn G., *Estate Planning and Wealth Preservation – Strategies and Solutions*, Warren Gorham & Lamont of RIA, 2006.

Osborne & Schurig (editors), *Asset Protection: Domestic and International Law and Tactics*, 2007, Thomson/West.

Schoenblum, Jeffrey A. ed., *A Guide to International Estate Planning: Drafting, Compliance and Administration Strategies*, 2000, ABA RPPT.

Rosen & Rothschild, *Asset Protection Planning* (810-2nd), BNA Tax Management.

Solomon & Saret, *Asset Protection Strategies*, 2007, CCH.

Spero, Peter, *Asset Protection: Legal Planning, Strategies & Forms*, Warren Gorham & Lamont of RIA, 2006.

Spielman, Michael A., *U.S. International Estate Planning*, Warren Gorham & Lamont of RIA, (expected release, Jan. 2008).

Streng, William A., *U.S. International Estate Planning*, Warren Gorham & Lamont of RIA, 2004.

Zaritsky and Lane, *Federal Income Taxation of Estates & Trusts*, Warren Gorham & Lamont of RIA, 2006.

C. **Periodicals and Websites**

Adkisson & Riser, *Asset Protection Book*, www.assetprotectionbook.com

Estate Planning Journal (Warren, Gorham & Lamont)

International Tax Planning Association, www.itpa.org (membership required)

Leimberg Information Service, www.leimbergservices.com

Probate & Property http://www.abanet.org/rppt/publications/magazine/home.html

Trusts and Estates http://trustsandestates.com

Trusts and Trustees http://tandt.oxfordjournals.org

The World Factbook, https://www.cia.gov/cia/publications/factbook/index.html

[1] While there are many excellent resources in this practice area, I would like to acknowledge the contributions and wisdom of two individuals whose writings I have found particularly helpful: Gideon Rothschild and Richard Nenno.

[2] Some examples of low-cost asset protection planning include: (i) the use of a QTIP trust with a spendthrift clause instead of an outright testamentary bequest to a spouse; (ii) changing title of a residence from joint tenants to tenants by the entirety; and (iii) increasing contributions in a 401(k) plan.

[3] See *Riechers v. Riechers*, 178 Misc. 2d 170 (N.Y. Sup. Ct., June 30, 1998); *In re Brooks*, 217 B.R. 98 (Bankr. D.Conn. 1998)

[4] British Overseas Territories describes the fourteen territories which are under the sovereignty of the United Kingdom, but are not considered part of the United Kingdom itself. Current British Overseas Territories of interest in the offshore planning context include Anguilla, Bermuda, the British Virgin Islands, Cayman Islands, Gibraltar, and the Turks and Caicos Islands. Residents of British Overseas Territories have full British citizenship. Prior to the British Overseas Territories Act 2002 and its predecessor, the British Nationality Act 1981, British Overseas Territories were known as colonies or Crown colonies, depending on whether they were self-governing or administered directly by the Crown.

[5] Crown dependencies are possessions of The Crown in Right of the United Kingdom (the entity that represents all rulership in the United Kingdom, as opposed to the monarch herself), as opposed to overseas territories or colonies of the United Kingdom. The three crown dependencies are the Channel Island bailiwicks of Jersey and Guernsey and the Isle of Man in the Irish Sea. The crown dependencies are not part of the European Union, but are governed by Article 299(6)(c) of the Treaty establishing the European Community and by Protocol 3 to the United Kingdom's Act of Accession to the Community.

[6] A Commonwealth Realm is any one of the sixteen sovereign states within the Commonwealth of Nations that recognize Queen Elizabeth II as their respective monarch. Each country is an independent kingdom. Commonwealth Realm nations include Antigua and Barbuda, Australia, the Bahamas, Barbados, Belize, Canada, Grenada, Jamaica, New Zealand, Papua New Guinea, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, the Solomon Islands, Tuvalu and the United Kingdom. With the exception of Papua New Guinea and the United Kingdom, all of the Commonwealth Realm nations are former British self-governing colonies

[7] To preserve legal privilege, if it is necessary for other parties besides the client to be involved in asset protection planning-related communications (*e.g.* the client's accountant), it is generally best for the lawyer to directly engage those parties.

[8] The common law badges of fraud are as follows: (i) lack or inadequacy of consideration; (ii) family, friendship or close relationship among the parties; (iii) retention of possession, benefit or use of the property; (iv) financial condition of the defendant before and after the transfer; (v) existence or cumulative effect of a pattern of transactions or a course of conduct after the onset of financial difficulties; (vi) general chronology of events; and (vii) secrecy of the transaction.

[9] The UFTA badges of fraud are as follows: (i) was the transfer or obligation to an insider; (ii) did the debtor retain possession or control of the property after the conveyance; (iii) was the transfer or obligation disclosed or concealed; (iv) was the debtor sued or threatened with suit before the conveyance; (v) did the conveyance consist of substantially all of the debtor's assets; (vi) did the debtor abscond; (vii) did the debtor remove or conceal assets; (viii) was the value of the consideration that the debtor received reasonably equivalent to the value of the conveyance; (ix) was the debtor insolvent

at the time of the conveyance or shortly after; (x) did the conveyance occur shortly before or after the debtor incurred a substantial debt; and (xi) did the debtor convey the essential assets of the business to a lienor who transferred the assets to an insider of the debtor?

[10] *See, e.g.*, California Penal Code § 531, "Every person who is a party to any fraudulent conveyance of any lands, tenements or hereditaments, goods or chattels or any right or interest issuing out of the same or to any bond, suit, judgment or execution, contract or conveyance, had, made or contrived with intent to deceive and defraud others or to defeat, hinder or delay creditors or others of their just debts, damages or demands; or who, being a party as aforesaid, at any time wittingly and willingly puts in, uses, avows, maintains, justifies or defends the same or any of them, as true and done, had or made in good faith or upon good consideration or aliens, assigns or sells any of the lands, tenements, hereditaments, goods, chattels or other things before mentioned, to him or them conveyed as aforesaid or any part thereof, is guilty of a misdemeanor."

[11] Black's Law Dictionary 221 (Abridged 6th ed. 1991)

[12] *Id.*

[13] *See FTC v. Affordable Media, LLC*, 179 F.3d 1228 (9th Cir. 1999); *In re Coker,* 251 B.R.. 902 (Bankr. M.D. Fla. 2000); *SEC v. Bilzerian*, 112 F. Supp. 2d. (D.D.C. 2000); *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002).

[14] *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 527 U.S. 308 (1999); *Adler v. Fenton*, 65 U.S. 407 (1860) (before creditor's liens are acquired, a debtor has full dominion and control over his or her property and may convert one species of property into another and alienate to a purchaser).

[15] *See Wiseman v. Batchelor*, 864 S.W.2d 248 (Ark., 1993).

[16] *See Lazy Seven Coal Sales, Inc. v. Stone & Hinds, P.C.,* 813 S.W.2d 400, 404 (Tenn. 1991) (violation does not "define standards for civil liability of lawyers").

[17] But the violation may create a rebuttable presumption of negligent conduct on the part of the part of the attorney.

[18] *Pickard v. Maritime Holding Corp.* 161 So. 2d 239, 241 (Fla. App. 3d Dist. 1964).

[19] *McElhanon v. Hing*, 728 P.2d 256 (Ariz.App. Div. 1, 1985), *aff'd in part, rev'd in part*, 728 P.2d 273 (1986).

[20] *Id.*

[21] *Id.*

[22] *Hicks v. Bryan Medical Group, Inc.*, 287 F. Supp. 2d 795 (N.D. Ohio 2003).

[23] *Aetna Casualty and Surety Co. v. Leahey Construction Co.*, 219 F.3d 519 (6th Cir. 2000).

[24] *See Aetna Casualty; Granewich v. Harding*, 985 P.2d 788 (Or. 1999).

[25] 18 U.S.C. § 1341.

[26] 18 U.S.C. § 371.

[27] *See U.S. v Cueto*, 151 F.3d 620, 631 - 635 (7th Cir. 1998).

[28] *State v. Carrasoco*, 33 P.3d 791, 793 (Ariz. App. Div. 2001), *review denied*, (May 21, 2002) and *cert. denied*, 537 U.S. 1002, 123 S. Ct. 487 (2002).

[29] *U.S. v. Cintolo*, 818 F.2d 980 (1st Cir. 1987); *U.S. v. Cioffi*, 493 F.2d 1111, 1119 (2d Cir. 1974).

[30] *U.S. v. Faudman*, 640 F.2d 20 (6th Cir. 1981).

[31] 18 U.S.C. §§ 152 to 157.

[32] 18 U.S.C. § 2.

[33] *See U.S. v. Knoll*, 16 F.3d 1313, 1322 to 1323 (2d. Cir. 1994); *cert. denied*, *Gleave v. U.S.*, 513 U.S. 1015, *rehearing denied*, 513 U.S. 1122 (1995).

[34] 18 U.S.C. § 1032.

[35] Except as otherwise provided, all section references are to the Internal Revenue Code of 1986, as amended.

[36] *See U.S. v. Popkin*, 943 F.2d 1535, 1540 (11th Cir. 1991), *cert denied*, 503 U.S. 1004 (1992); *U.S. v Kassouf*, 144 F.3d 952 (6th Cir. 1998).

[37] 18 U.S.C. §§ 1956 and 1957

[38] Financial Accounting Standards Board, *Statement of Financial Accounting Standards No. 113, Accounting for Reinsurance of Short-Duration and Long-Duration Contracts* (December 1992).

[39] Rev. Proc. 2005-70, 2005-47 I.R.B. 979.

[40] *See, e.g.* Ohio Rev. Code § 2329.66(A)(10)(B) (payments under a pension, annuity or similar plan exempt "to the extent reasonably necessary for the support of the debtor or dependents.")

[41] Charles J. Tabb, *The Top Twenty Issues in the History of Consumer Bankruptcy*, 2007 U. Ill. L. Rev. 9.

[42] *Id.*

[43] Opt-out states include Alabama, Arizona, California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, South Carolina, South Dakota, Tennessee, Utah, Virginia, West Virginia and Wyoming.

[44] *See* 11. U.S.C. § 522(p). Controversy has already arisen as to the applicability of new Bankruptcy Code Section 522(p) in opt-out states. *Cf In re McNabb*, 326 B.R. 785 (Bankr. D. Ariz. 2005) (Section 522(p) does not apply to debtors in an opt-out exemption state because they the debtor does not elect the state law exemptions over the federal exemptions) *with In re Virissimo*, 332 B.R. 201 (Bankr. D. Nev. 2005) (Section 522(p) applies to debtors in opt-out exemption states because the debtor elects the state law exemption when he or she chooses to claim the exemption), *In re Wayrynen*, 332 B.R. 479 (Bankr. S.D. Fla. 2005), *In re Kaplan*, 331 B.R. 483, 54 (Bankr. S.D. Fla. 2005); *In re Landahl*, 338 B.R. 920 (Bankr. M.D. Fla. 2006).

[45] *See* 11. U.S.C. § 522(q).

[46] Florida, Iowa, Kansas, Oklahoma, South Dakota, Texas and Washington, D.C. have homestead exemptions that are unlimited in amount.

[47] *E.g.*, Alabama, Georgia, Kentucky, Maryland, Ohio, South Carolina, Virginia and West Virginia.

[48] *E.g.*, Delaware, New Jersey and Pennsylvania.

[49] Fla. Const. art. X, § 4; Fla. Stat. Ann. §§ 222.01, 222.02 and 222.05.

[50] *See, e.g.*, *Hillsborough Inv. Co. v. Wilcox*, 13 So. 2d 448 (Fla. 1943).

[51] ERISA § 514, 29 U.S.C. § 1144(a).

[52] *Patterson v. Shumate*, 504 U.S. 753 (1992). *See also In re Lucas*, 924 F.2d 597 (6th Cir. 1991).

[53] *See* 11 U.S.C. § 541(c)(2).

[54] *Cf In re Brucher*, 243 F.3d 242 (6th Cir. 2001), *In re Carmichael*, 100 F.3d 375 (5th Cir. 1996), *In re Dubroff*, 119 F.3d 75 (2d Cir. 1997), *In re McKown*, 203 F.3d 1188 (9th Cir. 2000) (all holding IRAs exempt) *with In re Huebner*, 986 F.2d 1222 (8th Cir. 1993) (holding IRAs not exempt where debtor can withdraw funds).

[55] *Rousey v. Jacoway*, 125 S. Ct. 1561 (2005).

[56] *See*, *e.g., In re Rousey*, 347 F.3d 689 (8th Cir. 2003) (holding IRA failed to meet requirements of Bankruptcy Code Section 522(d)(10)(E)) and *In re Barshak*, 106 F.3d 501 (3d Cir. 1997) (amounts transferred from a 401(a) plan to an IRA were subject to limitations under Pennsylvania exemption statute).

[57] 11 U.S.C. § 522(b)(3).

[58] 11 U.S.C. § 522(n).

[59] 11 U.S.C. § 541(b)(5).

[60] 11 U.S.C. § 541(b)(6).

[61] See Uniform Limited Liability Company Act §§ 503 and 504.

[62] *See* Del. Code § 15-504 (partnership interests); Del. Code § 17-703 (limited partnership interests); and Del. Code. § 18-703 (limited liability company interests).

[63] *See* Del. Code § 18-704.

[64] For limited liability companies, *see* Ohio Rev. Code § 1705.19, which provides "[i]f any judgment creditor of a member of a limited liability company applies to a court of common pleas to charge the membership interest of the member with payment of the unsatisfied amount of the judgment with interest, the court may so charge the membership interest. To the extent the membership interest is so charged, the judgment creditor has the rights of an assignee of the membership interest. Nothing in this chapter deprives a member of his statutory exemption."

[65] For limited partnerships, *see* Ohio Rev. Code § 1782.41, which provides "[o]n application to a court of common pleas by any judgment creditor of a partner, the court may charge the partnership interest of the indebted partner with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor shall have only the rights of an assignee of the partnership interest. Nothing in this chapter shall be held to deprive a partner of his statutory exemption."

[66] *In re* Albright, 291 B.R. 538 (Bankr. D. Colo. 2003)

[67] *In re Ehmann*, 319 B.R. 200 (Bankr. D. Ariz. 2005); 337 B.R. 228 (2006) (opinion vacated by court after defendant agreed to settle).

[68] *See* Minority & Majority Staff Report, Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, United States Senate, *Tax Haven Abuses: The Enablers, The Tools and Secrecy*, August 1, 2006.

[69] Delaware's liability system has been ranked first in the United States by the United States Chamber of Commerce. In contrast, Alaska's ranking was 37th.

[70] Alaska Stat. § 13.36.035.

[71] Alaska Stat. § 34.40.110.

[72] *Id.*

[73] Alaska Stat. § 13.36.310(a).

[74] Alaska Stat. § 13.36.310(c).

[75] *See* Alaska Stat. §§ 13.36.370 and 13.36.375, regarding trust protectors and advisors, respectively.

[76] Mo. Rev. Stat. § 456.080.

[77] *See In re Markmueller*, 51 F.3d 775 (8th Cir. 1995) and *In re Enfield*, 133 B.R. 515, 519 (Bankr. W.D. Mo. 1991).

[78] Mo. Rev. Stat. § 456-005.505.

[79] *See* James G. Blase, *The Missouri Asset Protection Trust*, 61 J. Mo. B. 72 (2005).

[80] Nev. Rev. Stat. § 166.010 *et seq*.

[81] Nev. Rev. Stat. § 166.015.

[82] Nev. Rev. Stat. § 166.170.

[83] While the statute is unclear, based upon conversations that I have held with Oklahoma trustees, they do not appear to believe that an entity organized in Oklahoma for the purpose of holding non-Oklahoma securities could qualify for the exemption.

[84] R.I. Gen. Laws. § 18-9.2-1, *et seq*.

[85] S.D. Codified Laws § 55-16.1 *et. seq*.

[86] S.D. Codified Laws § 55-16.3.

[87] S.D. Codified Laws § 55-16.2

[88] Utah Code § 25-6-14

[89] Utah Code § 25-6-14(2)(d).

[90] Utah Code § 25-6-10.

[91] *See* cases cited at note 14 , *infra*.

[92] *See FTC v. Affordable Media, LLC*, 179 F.3d 1228 (9th Cir. 1999) and *In re Lawrence*, 227 B.R. 907 (Bankr. S.D. Fla. 1998); 238 B.R. 498 (Bankr. S.D. Fla. 1999); 279 F.3d 1294 (11th Cir. 2002).

[93] *See* Section XIV, Compliance, *supra*.

[94] Section 2036 case law may prove helpful for an illustration of how this issue would be analyzed.

[95] For example, enhanced beneficiary disclosure and reporting obligations required of trustees under the Uniform Trust Code and the Ohio Trust Code.

[96] The six licensed trustee companies in the Cook Islands are Asiaciti Trust Pacific Ltd, Cook Islands Trust Corporation Ltd, HSBC Trustee (Cook Islands) Ltd, Portcullis TrustNet (Cook Islands) Ltd, Southpac Trust Ltd. and Zetland Trust (Cook Islands) Ltd.

[97] As a result of talks held in September 2006, a longstanding ban on flights between Gibraltar and Spain has been lifted. On March 26, 2007, Spain held its first talks in Gibraltar for the first time in more than 300 years. "Spain holds first talks in Gibraltar for 300 years," The New Zealand Herald, March 27, 2007.

[98] Gibraltar courts are made up of the Court of First Instance (dealing with civil litigation under £1,000), the Supreme Court of Gibraltar and the Court of Appeal.

[99] A Deemster is a judge in the Isle of Man High Court. Prior to 1980, the First and Second Deemsters (there are a total of three) also held seats in the Legislative Council.

[100] *In the Matter of the Esteem Settleement and the No. 52 Trust*, *Grupo Torras S.A. v. Al Sabah and Six Others*, 2002 JLR 53 (Jersey Royal Court, January 17, 2002).

[101] Treas. Reg. § 301.7701-7(c)(1).

[102] Treas. Reg. § 301.7701-7(c)(4)(D).

[103] Treas. Reg. § 301.7701-7(c)(3)(v).

[104] Treas. Reg. § 301.7701-7(d)(ii).

[105] *See* Section 677(a).

[106] Treas. Reg. § 25.2511-2(b).

[107] *See* Priv. Ltr. Rul. 9837007 (June 10, 1998).

[108] *See* Casner & Pennell, *Estate Planning* (Sixth Edition), 2005, CCH. There is also no time value of money advantage to deferring the recognition of wealth transfer tax. In fact, the greater the rate of growth on trust assets, the greater the advantage to a completed gift.

[109] The following discussion is excerpted in part from technical comments that were submitted on behalf of the American Bar Association Section of Real Property, Probate and Trust Law on December 6, 2006. The comments were prepared by members of the International Tax Planning Committee of the Probate and Trust Division of the Real Property, Probate and Trust Law Section of the American Bar Association. Principal responsibility for the comments was exercised by Leigh-Alexandra Basha, International Tax Planning Committee Chair, and Michael Spielman, principal drafter of the comments. Ellen Harrison reviewed the comments on behalf of the Section's Committee on Governmental Submissions.

[110] *See* Treas. Reg. § 25.2511-2(c); Tech. Adv. Mem. 9535008 (Sept. 1, 1995).

[111] *See* Privacy Act Notification, TD F 90-22.1 (Rev. 7/00).

[112] *See* 31 U.S.C. § 5322(a), 31 U.S.C. § 5322(b) and 18 U.S.C. § 1001.